

BORSA™

Business Owner's Retirement Savings Account

Designed By:



www.drdacpa.com

www.borsaplan.com

*1120 Bay Area Blvd.
Houston, TX 77058
281-954-6040
281-488-5764 fax*

*1011 Tremont Street
Galveston, TX 77550
409-765-9311
409-765-9393 fax*



BORSA™

Business Owner's Retirement Savings Account

What is a BORSA™ (Business Owner's Retirement Savings Account) Plan? Simply put, it is a self directed qualified retirement plan that allows you to purchase stock in your employer's corporation. The proceeds from the sale of this stock can be used to fund the purchase of a franchise, business start-up, or business property using your holdings in a 401(a) pension, profit sharing 401(k), 403(b), 457, or IRA rollover. Through the utilization of a BORSA™, these purchases can be accomplished without distributions, taxes, penalties, or the use of loans.

To understand how you can access your savings in a qualified plan without taxes, penalties, or interest, you must understand two bodies of law. The two bodies of law that govern the BORSA™ structure are the:

- Employee Retirement Income Security Act of 1974 (ERISA), and the
- Internal Revenue Code of 1986 (IRC).

For purposes of the BORSA™ structure, ERISA governs who is eligible and what you can or can not do in a qualified plan, while the IRC addresses what is deductible going into the plan and how money is taxed when it is taken out of the plan.

Distributions from qualified plans are generally taxed as ordinary income for both federal and state purposes. Additionally, distributions from a qualified plan prior to age 59 ½ are subject to a penalty of an additional 10%. The combination of state and federal tax and penalties can require more than 50% of your retirement savings be sent to tax authorities rather than fund your retirement years. Many baby boomers look at the money in their qualified plans and want to use these funds as equity to start or buy the business they will use to fund their second careers or retirement. Frustrated by a web of complex rules and regulations, they often postpone the beginning of this second phase of their adult life - or simply resign themselves to the fact that they will be sending more than 50% of their life savings to tax authorities in order to pursue their dream. Neither of these options is required.

Some entrepreneurs ask us or their banker if they can pledge the assets of their qualified plan as collateral for a loan for the new business. Unfortunately, ERISA prohibits the "direct or indirect...lending of money or other extension of credit between the plan and a party-in-interest". This means that any qualified plan, be it a pension,

profit sharing, ESOP, 403(b), 401(k), IRA rollover, etc., cannot be used as collateral for a loan without tax consequences. If the funds in your qualified plan are pledged, then the lesser of the amount of the pledge or the balance in your account is deemed to be a distribution and therefore subject to tax and penalties.

In order to pursue their dream some entrepreneurs have borrowed money from their retirement accounts. Some qualified plans (generally 401(k) plans) do provide for "participant loans". These loans are limited to the lesser of 50% of the participant's vested account balance or \$50,000. They must be amortized and repaid over not more than five years, with payments at least quarterly and a market interest rate. The loans may not be rolled into or allowed in an IRA account. Most plans require they be repaid upon separation from service, or else are deemed to be distributed and taxed. Since this option requires the entrepreneur to remain employed at their current job, and limits the dollar amount available, this generally does not meet the needs of the entrepreneur.

Because of the limited borrowing provisions of 401(k) plans and the perceived tax consequences of a distribution, some entrepreneurs turn to the equity in their home to fund their business purchase or start up. While equity in your home is generally accessible under favorable rates and terms, it has consequences that are not always fully thought through. When an entrepreneur borrows the equity from his home to provide equity to a business several things occur:

- The entrepreneur puts their home at risk. Often they have paid off their home and secured their place of living for the retirement years. They now have a mortgage on the home that will require a portion of their retirement savings or earnings be used to service the mortgage in order to continue living in their home.
- By borrowing additional money, they have reduced the amount of money they can borrow from a bank to start or operate their business. When a lender underwrites a loan application they must consider the amount of pre-existing debt service. In essence they understand that the borrower must first pay for the loans they already have before they can pay for the new loan that is being requested.
- They have created a requirement for the business owner to withdraw money from the new business to service the home mortgage during the crucial first months and years of their business, thereby endangering the business during its most vulnerable time.

DRDA has a solution. The solution requires an understanding of the two bodies of law discussed earlier, ERISA and the IRC. If structured properly, ERISA and the IRC provide an exemption for qualified plan funds to be invested in entrepreneurial businesses. This structure allows you to transfer money currently held in your qualified retirement accounts into a new business without a deemed distribution, taxes, penalties, or loans.

We are often asked "If you can legally transfer money from any retirement account directly into a new or established business, then why hasn't my lawyer, CPA, or financial advisor informed me of this? The reason is quite simple. Most lawyers, CPAs, and financial advisors are not knowledgeable about both bodies of law. DRDA is a CPA firm

with a more than twenty year history. The firm has been recognized as one of the 25 largest firms in the Houston market, which is the fourth largest market in the United States.

Like most firms, we were always intimately involved in the tax aspects of our clients' businesses, but we generally used outside counsel when it came to qualified plans and matters pertaining to ERISA. In 2005 we had a client with a need to access his retirement account to start a business. That client and his financial advisor brought us insight into the possibility that a tax-free and penalty-free solution might exist.

Upon learning of the possibility of the solution, we undertook extensive research to determine if the possibility was a reality. We researched the provisions of the IRC and then pulled and read the provisions and regulations of ERISA, current and past professional publications, and court cases that we felt were pertinent. After reading both bodies of law and related materials we believed we understood the solution. However, we did not stop there. We sought a second opinion from a nationally recognized ERISA attorney that our firm had worked with in the past on various client matters. We called the ERISA attorney, explained what we wanted to do and asked him to review our research and perform his own so he could tell us one of two things:

- No, it does not work - and specifically cite the sections and provisions that would prohibit such a use of funds, or
- Yes, it does work - and that if he believed it did work, would he be willing to write a legal opinion indicating his understanding and agreement?

Within two weeks the attorney called us and reported that he had reviewed our research, had also done his own, that he concurred with our findings, and that he was willing to write the legal opinion. After receipt of the legal opinion we found four test cases and prepared the transactions and structures in accordance with what our research had told us was appropriate. We then filed these four cases with the Internal Revenue Service and asked them to provide the taxpayers with a letter favorably determining that investment by these qualified plans in the stock of their company was an allowable investment. All four cases received a favorable determination letter from the IRS in the matter.

The structure and path to the solution are as follows:

Steps to the Solution

First: The Corporation

- You will need to form a C-Corporation. To engage us to create your C-Corporation:
 - 1) Complete the Incorporation Questionnaire.
 - 2) Complete, sign, and date the Incorporation Engagement Agreement.
 - 3) Pay the fee of \$1,100 via credit card over the phone or via a check.
 - 4) Email, fax, or overnight the completed and executed documents to us.
- We will incorporate your new company with the Secretary of State in the state where you plan to do business.

- We will obtain a Federal Taxpayer Identification Number (EIN) for your new C-Corporation.
- We will prepare your corporate book and stock certificates and forward them to you.
- With your new corporate charter, authorizing resolution, and corporate EIN, your bank will open a corporate checking account for you.
- We can complete all of the above steps within two business days if your state of incorporation offers electronic filing.

Second: BORSA™

- We will prepare the adoption documents for your new 401(k) Plan & Trust. This can be completed within three business days. To engage us to create your BORSA™
 - 1) Complete the BORSA™ Questionnaire.
 - 2) Complete, sign, and date the BORSA™ Engagement Agreement.
 - 3) Pay the fee of \$3,895 via credit card over the phone or via a check.
 - 4) Email, fax, or overnight the completed and executed documents to us.
 - 5) Include a copy of the Articles of Incorporation (Corporate Charter) if you already have a C-Corporation.
- We will draft your BORSA™ documents.
- We will send the BORSA™ documents to you and schedule a conference to review them.
- After the review conference we will overnight the C-Corporation and the 401(k) Plan & Trust signature pages to you for your signature. We will include a return overnight envelope.
- Upon receipt of the return overnight envelope containing the executed signature pages, we will assemble the documents and overnight them back to you in your new plan records binder.
- We obtain an EIN for your new 401(k) Plan & Trust.
- With your new plan documents, corporate resolutions, and 401(k) Plan and Trust EIN, your bank will open a trust checking account. Typically this takes no more than five business days.

Third: Corporate Valuation

- The Internal Revenue Code provides an exemption from prohibited transaction penalties for purchases of qualifying securities provided such purchases meet the criteria of ERISA section 408(e). One of the criteria of Section 408(e) is that purchases or sale of employer securities must be for adequate consideration. Adequate consideration for assets other than securities for which there is a generally recognized market is fair market value as determined by a professional appraiser. The initial appraisal will generally run \$300 and be paid directly to the appraiser.

Fourth: The Rollover

- In order to be eligible for a rollover from an employer's qualified plan, you usually must have terminated employment with your former employer. Generally, employers make rollovers available within 30 days. If you are still employed, you should inquire now about your employer's distribution policy with its human resources/benefits department.
- We will help you in the preparation of any forms to secure the "direct rollover" of your retirement assets into your new trust checking account.
- You, as trustee, will transfer money from the trust checking account to the corporate checking account. Your new C-Corporation will then issue shares of its stock to the new 401(k) Plan & Trust.
- The corporation will now have cash in the bank and no debt. Your debt-free, cash-rich corporation will be very attractive to perspective lenders should you need additional financing.

Annually:

- The plan will require administration, trust accounting, and federal reporting every year. Our annual fee for this service is \$800 (plus \$40 per participant in excess of five).
- Additionally, a valuation of the company stock will be required each year the retirement plan holds non-marketable stock. The valuation at the end of the first year of operations will generally run \$1,500. Valuation for subsequent years will generally run 50% of the first year valuation or about \$750.
- Each corporate/plan year end, we will estimate the tax deductible contributions that you can make to your BORSA™.
- We are also available to assist you with questions you may have throughout the year as it pertains to employees coming and going, eligibility, vesting and other operational issues that may arise from time to time.
- We can also assist you with year-end tax planning and options available to you as a result of this structure.

In conclusion, we thank you for choosing DRDA, PLLC as your trusted advisor. We value your business, and we will work diligently to provide you with insightful advice that will help you manage and grow your company in the years ahead. We look forward to a long and prosperous business relationship.

Sincerely,



Douglas A. Dickey, CPA
Principal
DRDA, PLLC