

# What is 401(k) business financing?

## 401(k) business financing lets new and existing business owners use their retirement funds to start or buy a business, without incurring tax penalties or taking a loan.

A big hurdle when starting a business is determining how to finance the business as it gets off the ground. In fact, more than two-thirds of both current and aspiring business owners listed lack of capital and cash flow as their No. 1 challenge.

Here's the good news: Those who have spent a substantial amount of time in the workforce likely already have the resources they need in their retirement funds. They can fund their own business through 401(k) business financing.

## How does 401(k) business financing work?

Everyone who has a 401(k) or other pre-tax retirement account has been sternly warned against tapping into these funds before retirement age because of the hefty taxes and penalties incurred — in some cases, amassing to 50 percent of the total amount withdrawn. And while borrowing against retirement funds through a 401(k) loan often carries lower interest rates than traditional business loans, it still requires monthly payments that can be hard for a new business to manage.

With 401(k) business financing (known as Rollovers for Business Start-ups or ROBS), business owners can use their retirement funds as business capital without incurring the early withdrawal or tax penalties. Since it's not a loan, there are no interest payments involved, which means a quicker path to profitability and higher chances of business success.

Setting up the 401(k) business financing structure can be complex since it requires certain steps be taken to ensure it doesn't trigger a taxable distribution, but working with an experienced provider will ensure this process runs smoothly. Briefly, here is how 401(k) business financing works:

- Create a C corporation.
- Set up a 401(k) plan for the new C corporation and select a custodian, such as Fidelity or Charles Schwab, to manage investments in the plan.
- Roll your existing 401(k) — or other pre-tax retirement assets — into the newly created 401(k) plan. Note that a rollover from one 401(k) plan to another is not a distribution and does not trigger taxes.
- The newly created and funded 401(k) plan purchases stock in your newly created C corporation.
- Use the money from the stock sale to fund and operate your business.

## Is 401(k) business financing too good to be true?

You know what they say: if it sounds too good to be true, it probably is. Not in this case; 401(k) business financing is allowed in the United States Tax Code. Beginning in 1974, employees have had — by law — much more control over the funds in private pension and health plans through the Employee Retirement Income Security Act. This act allows employees to invest their retirement funds as they see fit — whether in traditional stocks, bonds and mutual funds, or their own business.

Although it is not as well-known as other types of business funding, 401(k) business financing is gaining in popularity. ROBS ranked as the third most popular funding option (behind cash and friends & family), but among those in the baby boomer generation, it ranked even higher: almost one-third of respondents in this age group used Rollovers for Business Start-ups financing.

## What are the benefits of 401(k) business financing?

Although it is not often the first choice for funding a small business — primarily due to a lack of awareness of the option — 401(k) business financing provides debt-free funding. While that is great by itself, here are additional advantages to the ROBS structure:

- **You control your future.** Rather than investing in the stock market, you're using your retirement funds to invest in yourself and your own business. You have direct control over how your business performs.
- **No interest payments are required.** As your business earns money, you don't need to save the first part to repay a debt.
- **You do not need personal collateral to qualify.** If you have just \$50,000 in a rollable retirement account, such as a 401(k), IRA or 403(b), you qualify.
- **Your business can be profitable faster.** The ROBS structure provides a tax-free, penalty-free way to access the capital in your 401(k) without borrowing money. This lowers overhead and eliminates monthly payments to a lender, which eat into potential profits.
- **You save by deferring taxes.** With the ROBS structure, you can invest in your business using up to 100 percent of the funds in your 401(k) but without triggering the tax penalties of an early withdrawal.
- **Your employees can participate in an employer-sponsored 401(k) plan.** Because the ROBS funding structure requires the establishment of a 401(k) plan, you can offer participation to any of your employees, a competitive advantage not all small businesses offer.
- **401(k) business financing can provide a down payment on a larger loan.** If funds available in your 401(k) aren't enough to get your business started, you can use these funds to provide a down payment on a larger Small Business Administration (SBA) loan.

[continued >](#)

# What is 401(k) business financing? (continued)

## Why is 401(k) business financing better than other funding options?

Several funding options are available for funding your small business. Here we compare how 401(k) business financing stacks up against other funding options.

While 401(k) business financing can be an attractive way to fund your business, your circumstances are unique, so it's important to speak with an expert to evaluate your needs.

	Requires regular payments	Requires interest payments	Requires credit check	Requires down payment	Requires setup fees
<b>401(k) business financing</b>	No	No	No	No	Yes
<b>Business loan</b>	Yes	Yes	Yes	Yes	Yes
<b>Unsecured loan</b>	Yes	Yes	Yes	No	Yes
<b>Cash</b>	No	No	No	No	No
<b>Loan from family &amp; friends</b>	Maybe	Maybe	No	No	No
<b>Credit card</b>	Yes	Yes	Yes	No	No
<b>401(k) loan</b>	Yes	Yes	No	No	Yes

## Is 401(k) business financing right for you?

Fortunately, 401(k) business financing is easy to qualify for. If you have \$50,000 in a rollable retirement account, then you're eligible for ROBS. But before you jump in, it's always wise to look at all the business financing options available to you by pre-qualifying. It only takes a couple minutes and will give you a realistic picture of the possible funding programs that might work for you, along with the amount for which you qualify.

If you determine the ROBS structure is right for you, you'll need to find a ROBS provider to ensure you set up your business and maintain it under the law. Here are some important areas to explore with potential firms:

- **How much experience does the firm have?** The number of clients they've had and the number of years in business are facets of this. Do they have expertise in the type of business you plan to start?
- **What were the outcomes of client audits?** While a firm can't control the number of audits its clients experience, you'll want to know the outcome of the audits. Has any client ever failed an audit as a result of their ROBS setup?
- **Does the firm offer legal support for clients?** It's nice if the firm has an internal legal team, but even better if they offer access to (and pay for) an external attorney that has only the best interest of clients in mind.
- **What is the expertise of the team that would work with your business?** While the company's leadership team might be impressive, the team members who will work directly with you are the most important.

Finding funding for a small business can be challenging, but when you partner with a trusted company to set up your business, you can focus on the goals of the business itself.