

34th Annual Tax Symposium

TAX PLANNING OPPORTUNITIES WHEN BUYING A FRANCHISE

By: Gary M. Remer, Esq.

I. ROLLOVER AS BUSINESS STARTUP (ROBS)

- A. The specific “ROBS” name came from a 2007 IRS and Department of Labor review during which the process was examined, leading to the formal “Rollovers for Business Startups” designation and further guidance on its legal and operational requirements.
- B. The IRS issued a formal memorandum acknowledging that properly structured ROBS transactions were legal but directed agents to focus on specific compliance guidelines, particularly regarding potential discrimination and prohibited transactions.
- C. While the IRS acknowledged, at that time, that properly structured ROBS transactions are legal and effective, the agents examining them were directed to apply specific guidelines focusing on potential discrimination in operation and violation of the prohibited transaction rules.
- D. ROBS arrangements provide entrepreneurs and business owners funding for a business as small business financing. It is often used in the franchise industry as a funding source for franchisees.
- E. The steps to establish the ROBS:
 - 1. A new C corporation is formed. Other entities are prohibited from becoming part of the ROBS structure since they cannot issue qualified employer securities.
 - 2. A new retirement plan is created for the new corporation.

34th Annual Tax Symposium

3. The business owner becomes an employee of the C corporation and the beneficiary of the new retirement plan.
 4. Funds from the business owner's existing retirement accounts are rolled into that new retirement plan.
 5. The rolled-over funds are used to purchase company stock in the C corporation.
 6. The business owner can use the proceeds from the sale of stock to start their business.
- F. By rolling funds over directly from a retirement account, not withdrawing them, there are no taxes on the distributions.
- G. The ongoing requirements:
1. The annual filing of the Form 5500. There is an exception in the Form 5500-EZ instructions for "one-participant" plans. The exception applies when plan assets are less than a specified dollar amount (currently \$250,000) and the plan covers only an individual, or an individual and his or her spouse, who wholly own a trade or business. In a ROBS arrangement, however, the plan, through its company stock investments, rather than the individual, owns the trade or business. Therefore, this filing exception does not apply to a ROBS plan, and the annual Form 5500 is still required.
 2. Annual valuation of the stock held in the retirement plan.
 3. Follow all rules under the Code and ERISA related to the retirement plan.

34th Annual Tax Symposium

II. ALTERNATIVE FUNDING TO PURCHASE A FRANCHISE

- A. Banks and other lenders offer term loans, lines of credit, and SBA loans, which can provide substantial capital but may require good credit and collateral.
- B. If your plan allows, you can borrow up to \$50,000 from your 401(k) instead of a full rollover, which is a simpler process but can limit the amount of funds.
- C. Using after-tax accounts, a home equity line of credit (HELOC), or other personal assets is a direct way to fund your business.
- D. Bringing in an angel investor, venture capitalist, or even friends and family can provide capital, but it involves giving up equity in your company.

III. CURRENT BENEFICIAL TAX PROVISIONS FOR FRANCHISEES

- A. One Big Beautiful Bill Act (OBBBA) is poised to reshape how franchisors and franchisees operate, invest, and grow.
- B. With expanded bonus depreciation, franchises can now fully deduct the cost of qualifying property, including equipment and renovations, for qualifying property acquired and placed in service after January 19, 2025. This accelerates ROI and encourages reinvestment in infrastructure and mobility
- C. Section 179, designed for small and mid-sized businesses, allows for the immediate deduction of the cost of certain property. The maximum deduction limit has increased to \$2.5 million, with the phase-out threshold set at \$4 million. Both figures are indexed for inflation.
- D. The continuation of the 199A deduction enables LLCs and S corporations - common entity structures in franchising - to deduct a portion of their income, reducing taxable earnings and improving cash flow.
- E. Franchise employees stand to benefit directly from the bill's provisions:

34th Annual Tax Symposium

1. **Federal income tax deduction on tips and overtime pay** - This change boosts take-home pay for millions of workers in restaurants, retail, hospitality, and home services.
2. **W-2 reporting adjustments** - Enhanced treatment of overtime and tips simplifies payroll compliance and improves transparency.