ERSOP®.
Exit Strategies

This started it all in 1999.

C-Corporation vs. S-Corporation

C-Corp

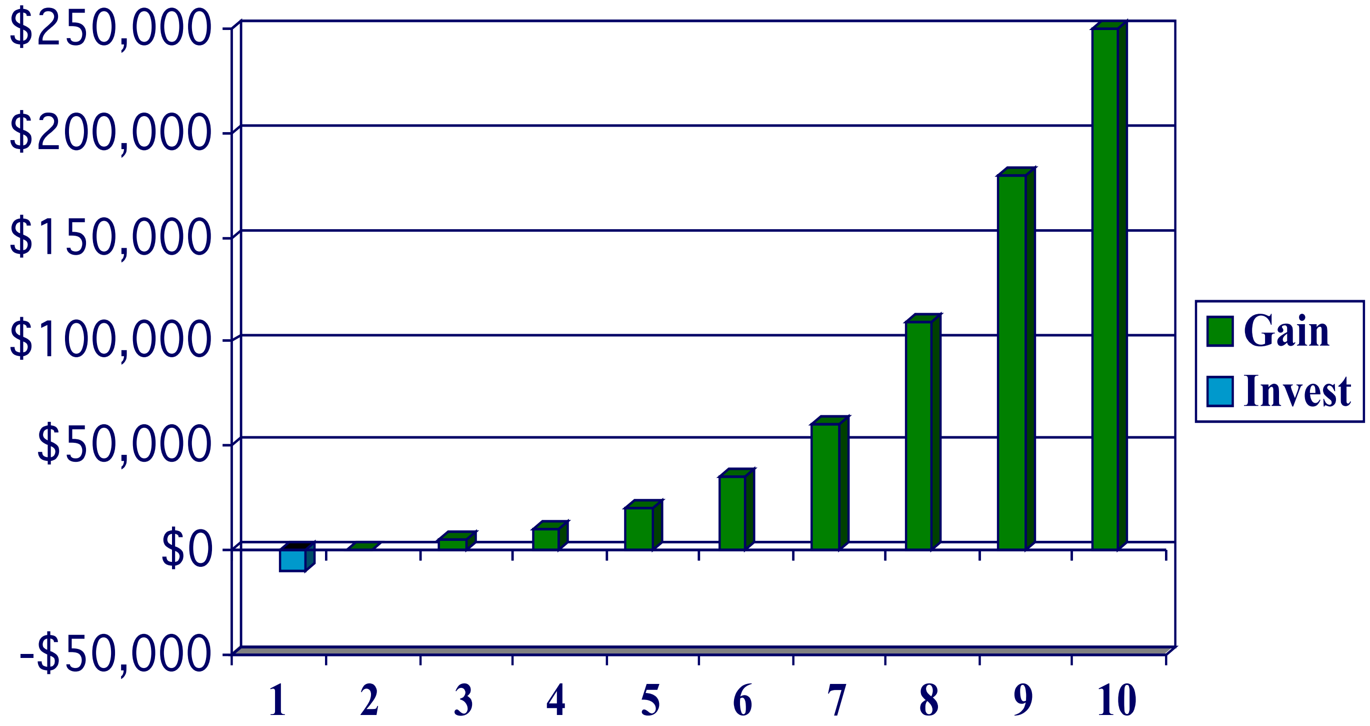
- **Makes money,**
- **Pays taxes,**
- **Distributes* money to you,**
- **You pay taxes.**
- **Taxed Twice!**

S-Corp

- **Makes money,**
- **Does not pay taxes,**
- **Distributes* money to you,**
- **You Pay Taxes.**
- **Taxed Once!**

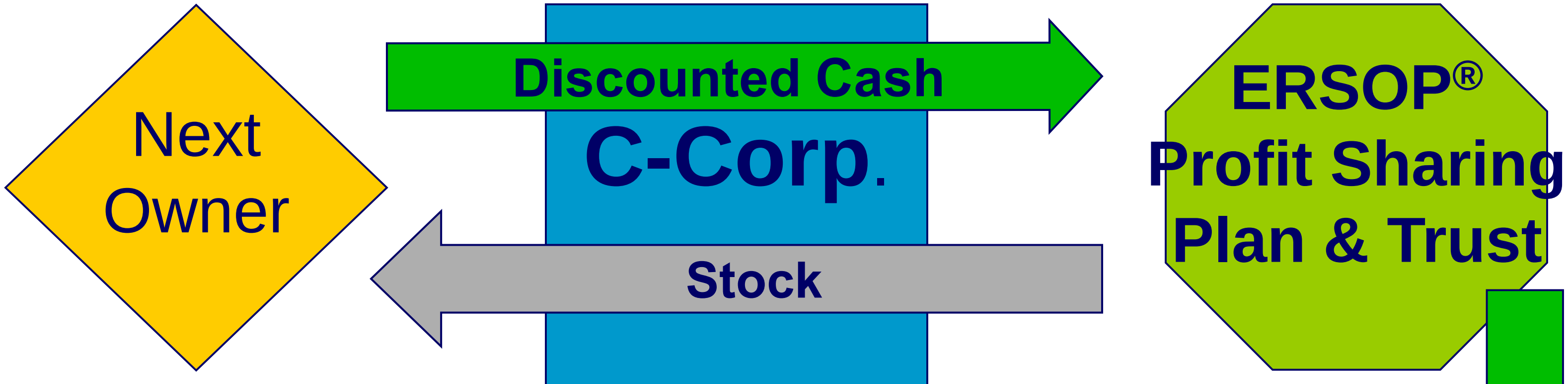
*** salary or dividends or shareholder distributions**

Example of Company Growth

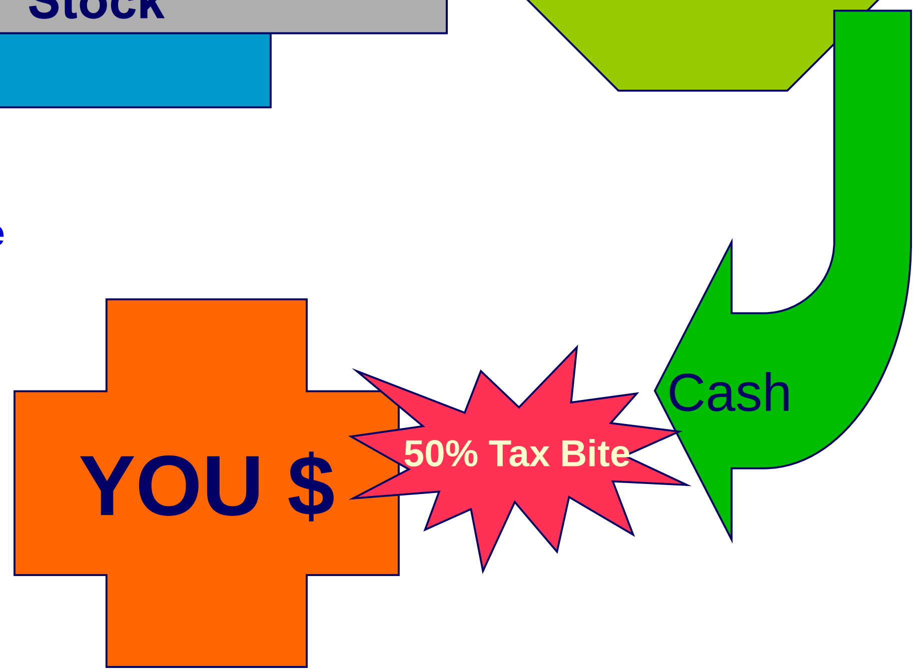


- We assume you want to start a business, build it up for ten years and sell it.
- You can be a C-Corporation for the first nine of those years without a double taxation issue; you can always take all the profits as salary and bonus.
- It is in year ten when you go to sell the business that double taxation gets really ugly.

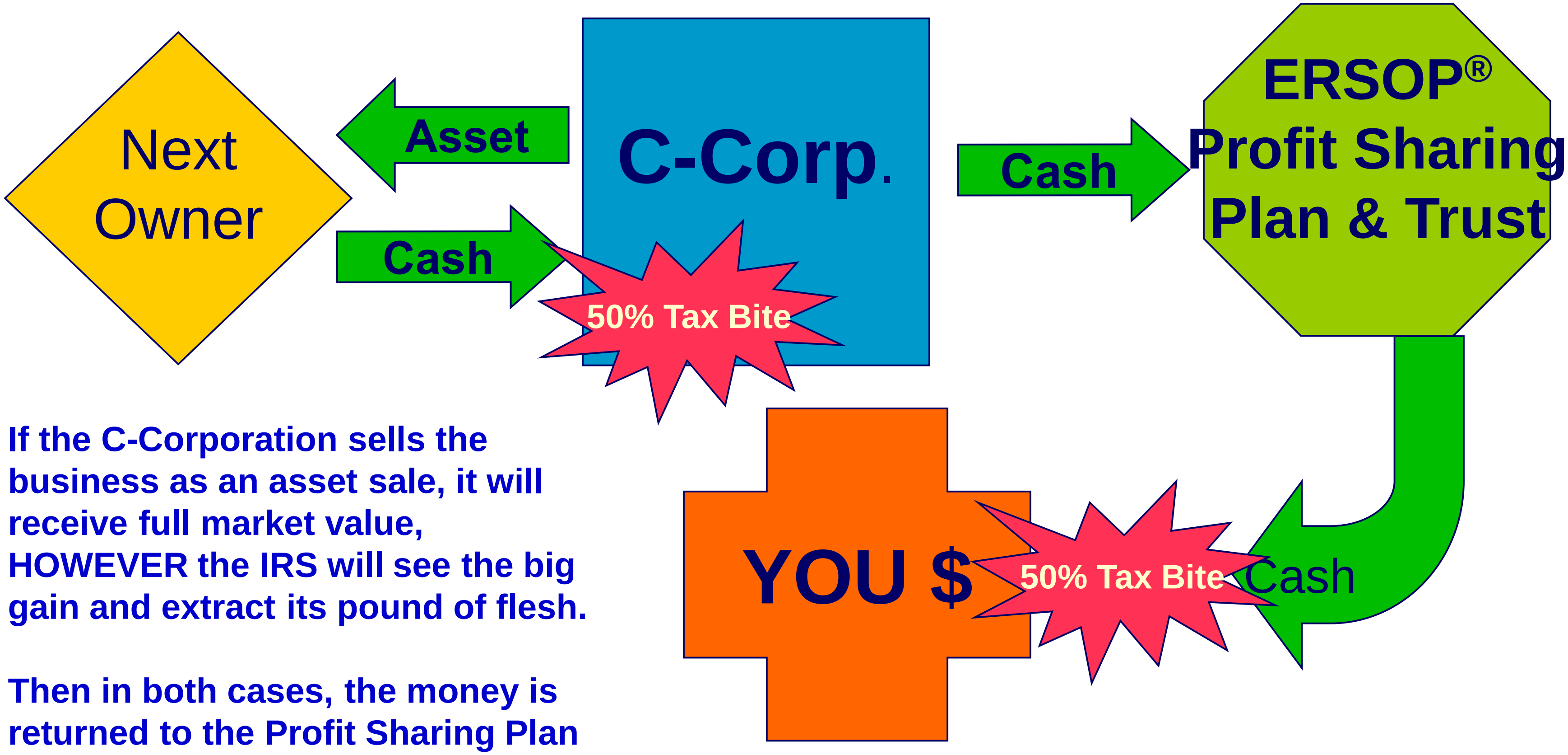
Stock Sale



You may have 99% of the stock in your Plan.
•It seems just terrific to sell the stock out of the Plan and Have the cash go into the Plan
•No taxes.
However – No one is willing to buy the Corporation's shares without a
BIG 15 to 45% discount.
Why? Because with the Corporation goes:
•Any unforeseen liabilities, such as a slip and fall you did not know, and
•Assets fully depreciated for tax purposes.
And additionally
•Your Long Term gains will become Ordinary Income.



Double Taxation

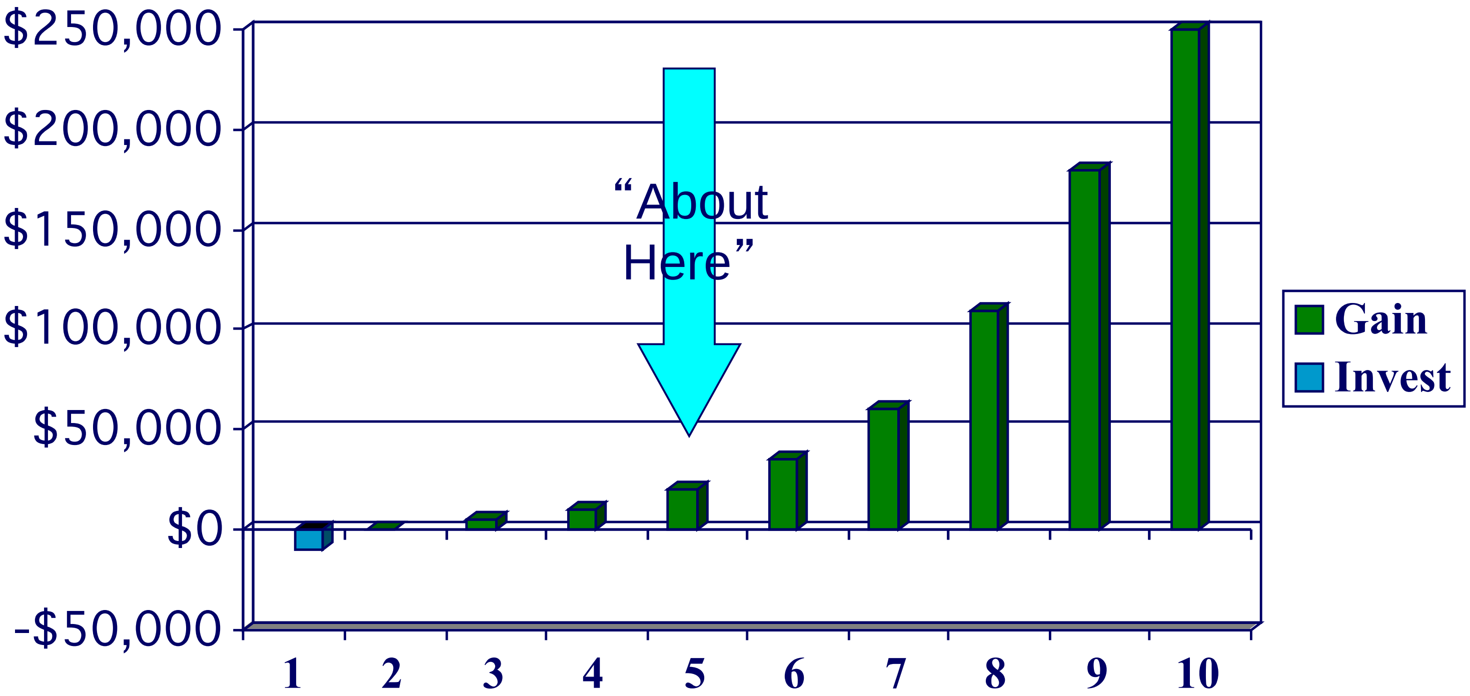


If the C-Corporation sells the business as an asset sale, it will receive full market value, HOWEVER the IRS will see the big gain and extract its pound of flesh.

Then in both cases, the money is returned to the Profit Sharing Plan Trust and it comes out at retirement fully taxable as ordinary income.

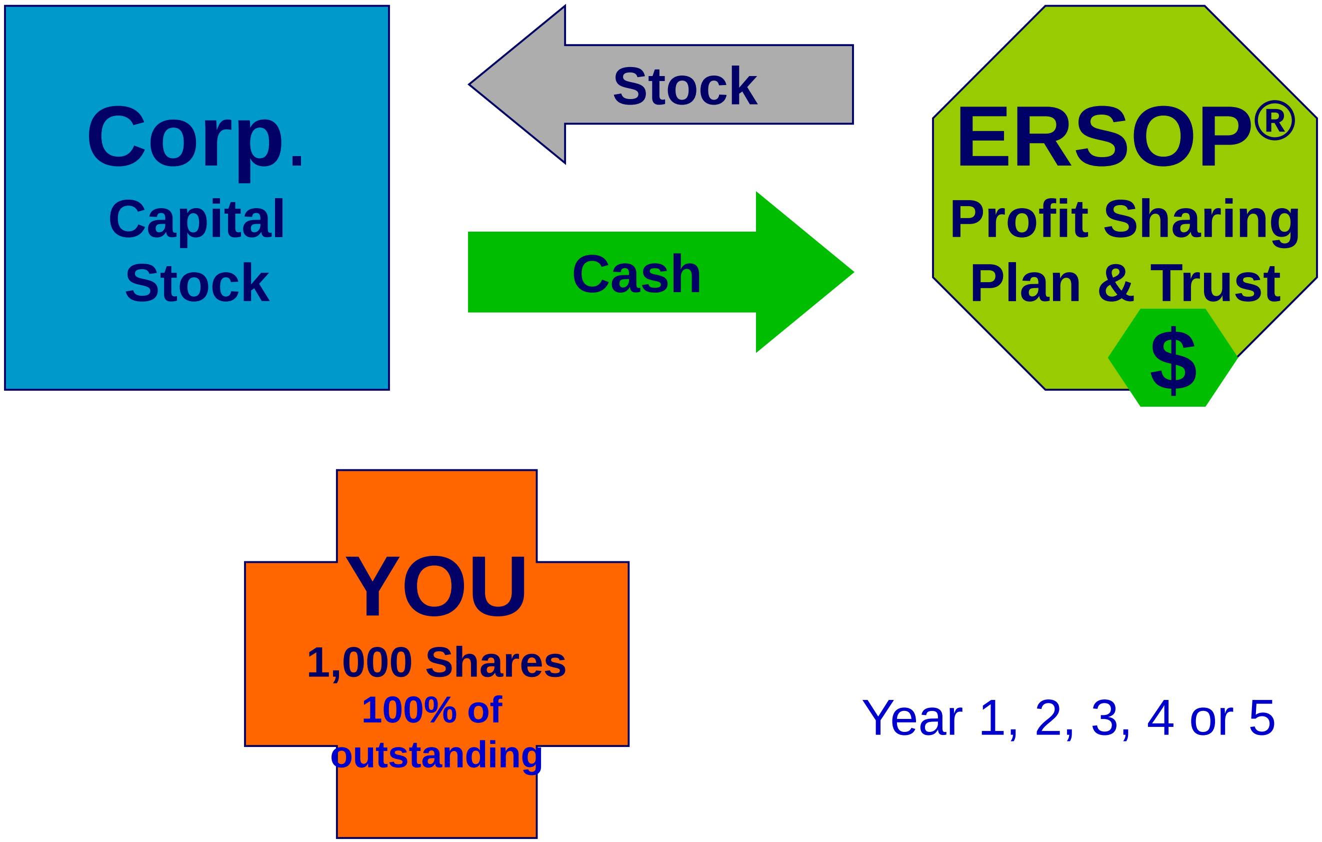
Double Taxation of the worst order!

Company Growth Curve



- **The left column is the initial investment from the Plan.**
- **The arrow is not pointing at year 5. It is pointing at that time when the C-Corporation is making money and has regained that initial investment plus a tidy profit.**
- **Then, cash flow permitting, it repurchases the stock from the plan. Retiring the stock to treasury stock − all in one fell swoop, or in a series of installments – say one third each in years 3, 4 and 5.**

Stock Retirement – Illustrated



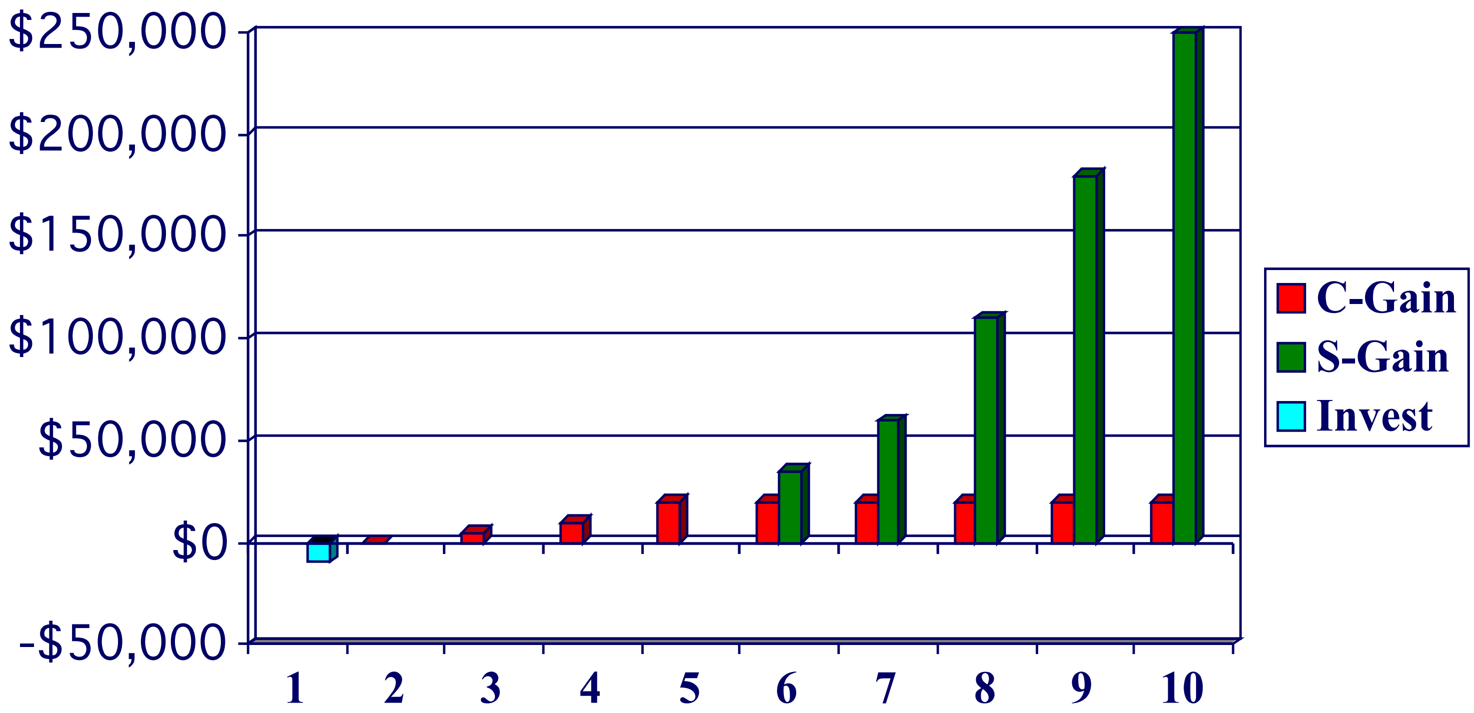
Year 1, 2, 3, 4 or 5

Then - **Elect S-Corp Status**
a good thing!

You will need a Third-Party Business Valuation

- To show the IRS "adequate consideration" was paid for the stock, but more importantly
- To freeze the C-Corporation gains at a tidy, tiny, benign level.

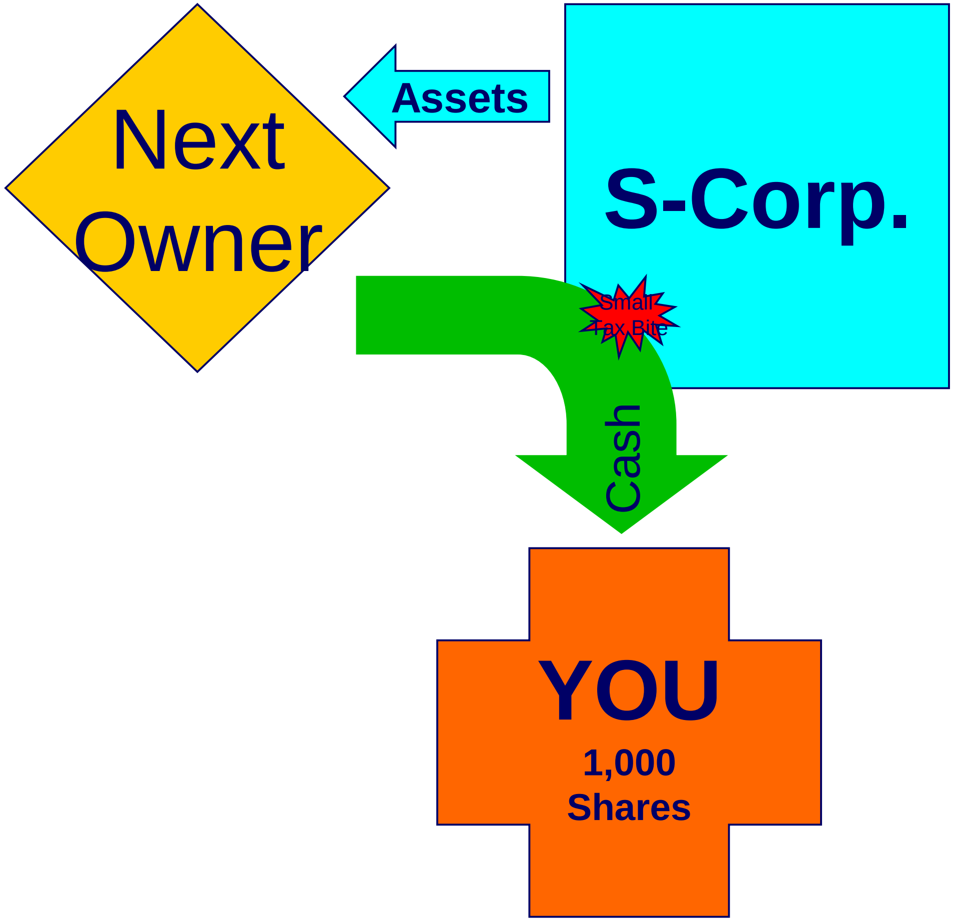
C-Corp vs. S-Corp Gain



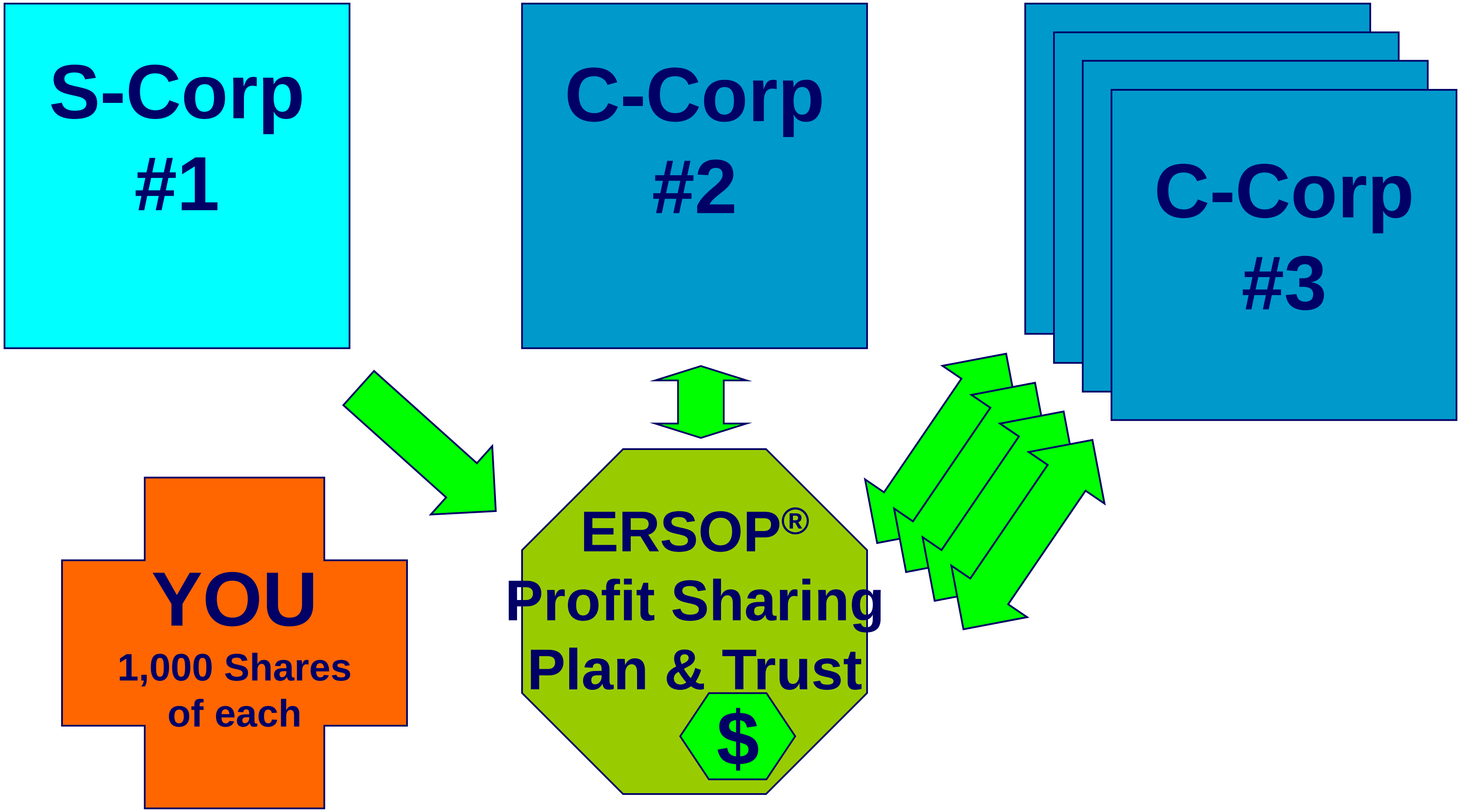
- **From then on, there will be two gains, the gain while the Corporation was a C-Corporation which is frozen, and**
- **Another much greater gain after, while the Corporation is an S-Corporation.**
- **The S-Corporation gains contains all the intangibles – the goodwill, the going concern values.**

Asset Sale By S-Corporation

- **The S-Corp. sells appreciated assets to the next buyer.**
- **The S-gain passes through the S-Corp. to you You pay tax only once and receives long term gains treatment – Now 20%**
- **The S-Corp. pays a small § 1374 C-tax on the C-gains.**
- **If the sale is beyond ten years after S-Corp. election, then the C-tax expires – **Poof**.**



Back at Year 5 or the Year You Retire Plan Stock:



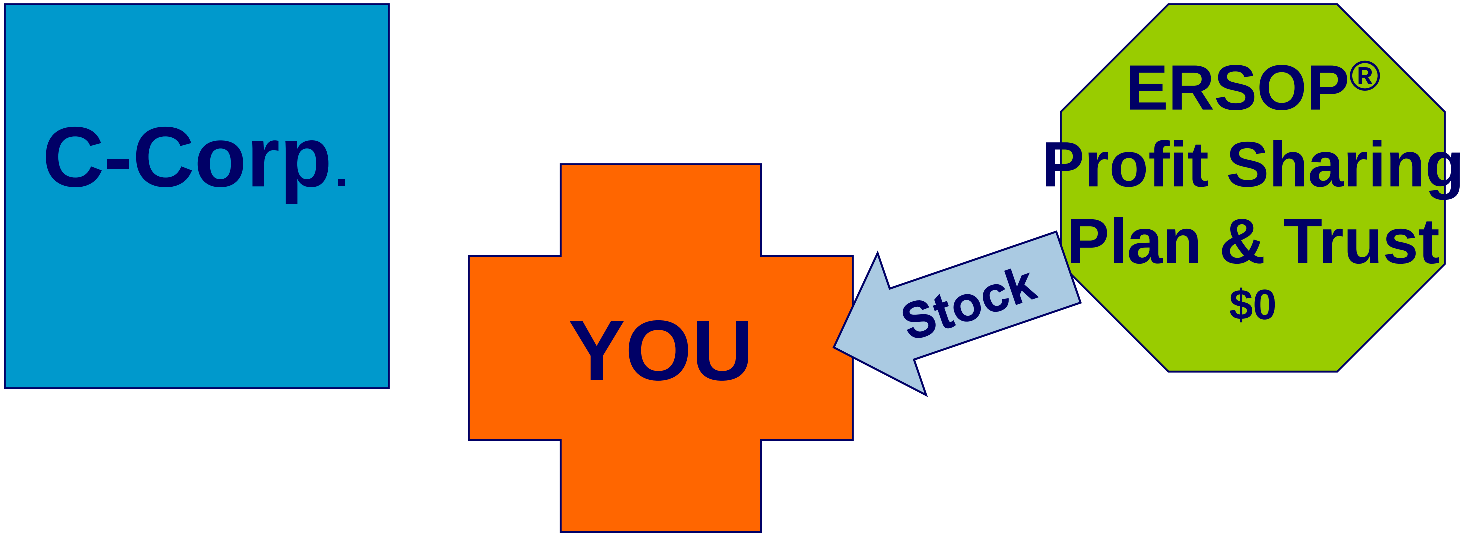
You could start a new corporation and invest in a second business or franchise unit, then a third . . . all with the same plan.

Other Exits . . .

Yes, you can remain a C-Corp —

- Especially if you are not making money hand-over-fist, or
- If there is no real aftermarket, i.e. YOU are the business, or
- If you may have planned to sell the business as a stock sale all along −
  - You were going "public,"
  - You have the stock in the Roth feature,
  - You are leaving it to the kids,
  - You are NOT leaving it to the kids.

Other Exits . . . Stock Distribution



- If the value gets away from you, was $1 now $5,
- Distribute Stock from Plan to YOU, all at once.
- Immediate ordinary income tax on the "basis"($1),
- Elect S-Corporation status.
- Deferred capital gain tax on unrealized appreciation ($4),
- Until"realization" — then pay Long Term Capital Gains.

Other Exits [cont.]

- IRC Sec. 338(h)(10) — [Cinderella's pumpkin]
  - You sell stock today that becomes "assets" for the buyer at midnight.
- Tax deferral through third-party annuity.
- Retirement – Yes!
- Death or Disability . . . Messy.
- Divorce [QDRO] . . . Very messy!
- Use the ERSOP . . . My personal favorite!
  - Find someone with retirement funds.
  - Have them roll it in, exchange it for your stock.
  - You roll your funds out to an IRA

The Three Rules of ERISA Section 408(e)

1. **If such acquisition, sale, or lease is for adequate consideration (fair market value),**
2. **If no commission is charged with respect thereto" . . . "to or from a disqualified person,"**

   [Also see Title 18 USC Section 1954]
3. **If the plan is an *"eligible individual account plan"* as defined in section 407(d)(3)-**
   - **Profit Sharing**
   - **Pre-1974 Money Purchase Pension,**
   - **Stock Bonus, Thrift & Savings, or ESOP**

This is why you cannot use a self-directed IRA as the "Plan"

- **ERISA 407(d)(3) excludes IRAs from the definition of *"eligible individual account plans."***
- **IRC Sec. 4975(e)(2)(H) . . . Officer, director or having any of the powers or duties of an officer or director . . . is a "disqualified person."**
- **Our clients are Entrepreneurs.**
- **The money in most any IRA may be rolled over into an ERSOP® or ROBs Plan.**

This is why you cannot use a self-directed IRA? – cont.

- **James H. Swanson, et ux. v. Commissioner, 106 TC 76 (1996)**

- **Lawrence F. Peek, et ux., et al. v. Commissioner, 140 T.C. No. 12 (2013).**
- **Terry Ellis, et ux., v. Commissioner, TC Memo 2013-245 (2013, 2015)**

Magic Words

Call whomever (whoever?) is the custodian of your retirement funds [former employer benefits department, HR, broker, mutual fund house] and tell them:

- **"I wish to do a 'direct rollover' to my new employer's plan."**

Then ask them:

- **"Will you bank wire the funds?"**

If they say yes tell them you will get back to them with the bank wire instructions. If they say no, move on.

Magic Words, cont.

Then ask them:

- **"Do you have a form you wish me to complete?"**

  or

- **"Can we do this over the phone?"**

  or

- **"Do you wish my new employer's plan to generate a form?"**

If they have a form, we will assist you in its completion. If they want our from, it is the first form we send to you via email.

Ask someone who has recently terminated, just how long it took them to receive their rollover.

Still, it generally takes just 2 weeks to get the money to move!

We tell the client everything they need to know before they commit.

Your Assignment:

Go forth and find that business for which you cannot wait to get up in the morning to go do – even if it is only for the #!@^%*& money.