C-Corporation Required for a FranPlan®

Q: A very common question people ask when considering the use of a FranPlan® is "Can I use an S-Corp or an LLC instead of a C-Corp?"
A: Unfortunately, the answer is simply, "no". The ROBS (Rollover for Business Start-up) Program is a *non-prohibited* transaction because the necessary exemption, IRC § 4975(d) (13), is not available with an S-Corp or LLC structure due to IRC § 4975(f) (6) (C).

Q: What does that mean?
A: The investment of a retirement plan fund, in stock of the corporation that sponsors the plan, is possible only because of a special exemption from the "*prohibited transaction"* rules of the IRS Code and ERISA. Under the law, this special exemption <u>does not apply</u> to plans established by LLCs, S-Corporations, Partnerships of any kind, or any "pass through" type of business entity.

Q: Is there any way to change the operating structure in the future?
A: As long as the 401(k) Profit Sharing Plan (the FranPlan®) owns stock in the sponsoring corporation, the entity must remain a C-Corp. If in the future you decide to repurchase the stock, and the FranPlan® no longer owns stock, then the entity may be converted from a C-Corp to an S-Corp or LLC. Executing this strategy would require a Third Party Valuation of the C-Corp to determine the current value of the stock. Once the value is determined, the stock may be purchased. At that point your CPA or accountant could convert the bookkeeping and associated activities.

Q: What kind of business can establish a FranPlan®?
A: Almost any type of active business that provides a product or service and operates as a "C-Corporation" can adopt a FranPlan®. The primary restriction is that the business must not be a "passive" investment –only business. The business must be an "operating company", which is defined as an entity that is primarily engaged, directly or through a majority-owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital.

Q: I've heard there is "double taxation" if you use a C-Corporation. Is that true and can it be managed?
A: Double taxation occurs when (or if) dividends are paid. This means that the company's profits are initially taxed at the corporate level, and then taxed again when distributions are made to the shareholders. However, there are no laws that require a corporation to declare a dividend. Salary and bonuses are not considered a dividend. For a smaller business, this issue may be mitigated by the corporation's ability to deduct salaries, bonuses and ordinary/necessary business expenses. Your CPA or accountant will be an excellent resource for determining potential deduction opportunities.

Q: Are there any benefits of being a C-Corporation?
A: The profits from a C-Corporation are not reported on the owner's taxes (unlike an S-Corp or an LLC). This means that the income from the business will not increase the individual's tax bracket or taxable income. Paper losses in a C-Corp structure may be carried over to offset a future year's earnings. A C-Corp can elect the parameters of its fiscal year to complement its business cycle. Your CPA or accountant can elaborate on the various deductions available for a C-Corp.