LD CO
LOREN D. STARK COMPANY

Eligible Individual Account Plans Guide

An eligible individual account plan (EIAP) can be a boon to those who wish to fund an investment into their own new or existing business. The plan itself is simply a 401(k) with ERISA-tailored provisions explicitly permitting concentrated plan investment in employer stock. However, the steps necessary for an entrepreneur to benefit from these plans can sometimes be confounding, even to those with experience in financial and retirement planning experience.

Because the law regarding the utilization of such plans is largely unknown to most financial professionals, we hope to outline the steps which must be taken to fund a business through an eligible individual account plan.

STEP 1: Forming a C corporation.

The first task in setting up your EIAP rollover is to form a C corporation. You have several options at your disposal to accomplish this essential foundation. You may draft and file the Articles of Incorporation and all other relevant documentation by yourself or through legal counsel. There are several online services that specialize in business formation and filing. If you choose to set up the corporation on your own, we recommend that you thoroughly research the incorporation process by examining the most up-to-date materials available at your local library or bookstore. Be aware that incorporation requirements vary from state to state. Our legal staff can walk you through the incorporation process if you intend to form your corporation within the State of Texas.

Please remember that you cannot make a subchapter S election when forming your corporation. S corporations, partnerships and limited liability companies do not qualify for the specific sale of stock necessary to fund your business.

We recommend that your corporation authorize at least 2 million shares of common stock, and that the par value of the stock be set at $1.00 per share. You may subsequently issue as many shares as necessary in order to complete the rollover procedure explained below. Your corporation is required to file an IRS Form SS-4 to apply for a Federal Taxpayer Employer Identification Number. You may do so by calling the IRS EIN Hotline at (800) 829-4933 or via the internet at https://sa.www4.irs.gov/sa_vign/newFormSS4.do.

Once the corporation is completed and filed with the appropriate Secretary of State of your jurisdiction, you should open the corporation's operating account at the bank of your choice.

STEP 2: Creating the plan.

After you form the corporation, LDSCO will create your plan document customized to your requirements and will secure your plan's EIN number. You must complete and submit the sponsor and census forms found on this website. LDSCO will identify you or the person of your choice as plan trustee and will supply you with all of the information necessary to open a retirement trust account for your plan. Please be aware that the plan trustee cannot be paid to serve as trustee.

STEP 3: Posting a bond.

You as the plan's trustee will need to be bonded against non investment loss. ERISA regulations require all plans to maintain a fidelity bond equal to 10% of the lesser of all plan assets or $500,000.00. You may be required to post an additional bond if you wish to avoid the audit requirements for a plan with less than 100 participants. The amount of this bond will be 100% of all non-qualified plan assets. Keep in mind that the stock of your C corporation is considered a non-qualified asset. However, plans covering only business owners and their spouses are exempt from the audit requirements and are therefore only required to maintain the aforementioned 10% fidelity bond. These bonds can be obtained at Colonial Surety Company by calling (888) 383-3313 or applying online at http://www.colonialsurety.com or by clicking on the logo under the Strategic Alliances section of this website.

STEP 4: Opening the plan's account.

Your next step is to open a retirement trust account for your new EIAP retirement plan. While you can open a retirement plan and trust account with any financial institution, it may be less troublesome to open a simple cash account with a brokerage firm. Be careful, however – many financial institutions are unaware of the law controlling this type of EIAP rollover transaction and may attempt to open a different type of account or even set up another retirement plan altogether. You should inform the bank or brokerage firm that you intend to make a direct rollover of funds from your pre-existing IRA or other retirement account to your new EIAP trust account.

STEP 5: Transferring funds to your corporation.

Once your new EIAP retirement plan account has received the rolled-over funds, you are now free to transfer money from the plan's trust checking account to the corporate checking account. Be forewarned that this is the step that may require a thorough explanation to the financial institution holding your plan's retirement trust account. You must clarify that the transfer of funds to your corporate checking account is not a distribution of plan funds and that an IRS 1099 form should not be filed. You will need to explain that you as plan trustee are making a sale of corporation stock to your plan in consideration of plan assets and that your EIAP 401(k) retirement plan specifically allows for investment in your company's stock.

Your corporation must issue shares of stock to the plan as consideration for the monies held by your plan's trust. If you had previously set a par value of $1.00 per share, you could sell shares to the plan at the rate of $1.00 per share from the amount rolled into the plan's trust account. You should issue the stock certificates, draft a stock purchase agreement and post the transaction to the stock transfer ledger to memorialize the sale of stock certificates to the plan. The agreement should then be placed in your corporation's minute book.

While the actual amount of funds to be removed to your plan's trust is at your discretion, we recommend that you withdraw the entire amount needed to finance your enterprise in a single transaction to avoid the requirement that the stock value be independently appraised upon any subsequent transactions (something that would be unnecessary upon the initial funding of a new corporation).

STEP 6: Operating your business.

One point that should be discussed is how the funds now in your corporation's account are to be used. Basically, any legitimate business expense is allowed, but care should be taken to maintain the corporation. You may not use the corporation to simply pay a salary and not use the corporation as a legitimate business. Doing so could cause the transfer of funds to your corporate account to be classified as a distribution, with a levy of penalties and excise taxes in addition to the income tax. Accordingly, make sure that you keep your corporation's minute book up to date and demonstrate genuine business activity.