

## Solo 401(k) Plans

Self-employed folks have plenty of easy ways to save for their retirement.

- **SEP-IRA** – Easy to set-up and works great if your business is profitable.
- **Individual IRA** (Traditional or Roth) – Easy to set-up and works great even if your business is not profitable (as long as you have enough net earned income from self-employment PLUS employment).
- **Employer sponsored retirement plan** – Easy to set-up if you have an employer in addition to your self-employment and they allow you to participate in the plan.



### Can a self-employed person contribute even MORE to retirement?

Maybe. You could consider setting up your own 401(k). This is helpful when all of the following are true:

1. Your self-employment income is relatively low, so you can't contribute very much to a SEP-IRA.
2. Your other employers don't offer a plan (or don't allow you to participate because you are part-time).
3. You want to contribute MORE than the maximum you can put in a SEP-IRA + Individual IRA.

### Reasons NOT to set-up a Solo 401(k)?

- You are not a business owner (self-employed). It's OK if you have other side jobs, but you need to be self-employed to set-up a Solo 401(k) and contribute.
- Your business loses money. Businesses that regularly lose money are likely a hobby, not a business.
- You are happy with the amount you can save for retirement via other means. Don't set-up a Solo 401(k) if easier options are enough to meet your needs.
- An employer allows you to participate in their retirement plan.
- You have employees – A Solo 401(k) allows only one plan participant. If you have employees then consider the Simple IRA first (there are other options too).

### What kinds of Solo 401(k)s are offered?

- **Traditional Solo 401(k)** – Contributions are a tax deduction and qualified distributions are taxed.
- **Roth Solo 401(k)** – Contributions are not a tax deduction and qualified distributions are not taxed.

### How much more can you contribute in a Solo 401(k)?

It's complicated. It depends on what type of plan you choose (Roth vs. Traditional), your age, how profitable your business is, how much you make from other employers, and how much you are contributing to other retirement plans. Let's look at a few over-simplified examples where your only income is from self-employment.

Age	Sole Proprietorship Net Earned Income	Amount you could contribute to SEP IRA vs. Traditional Solo 401(k) for tax year 2021
40	30000	Max SEP = \$5576, Max Solo 401(k) = \$21,595
40	60000	Max SEP = \$11,152, Max Solo 401(k) = \$28,565
60	30000	Max SEP = \$5576, Max Solo 401(k) = \$26,470
60	60000	Max SEP = \$11,152, Max Solo 401(k) = \$33,440

### Drawbacks of Solo 401(k)s

- They are more complicated and always require professional tax help to understand.
- To make contributions for the current tax year you must set-up the plan before the end of the year. However, you have until April 15<sup>th</sup> of the following year to complete the funding.
- You must timely file IRS form 5500-EZ for each separate plan if the total value of your Solo 401(k) plan(s) is over \$250,000. Form 5500-EZ is also required in the final year of each Solo 401(k) plan.
- Be cautious if you are contributing to employer sponsored retirement plans in the same year that you are contributing to your Solo 401(k). Work with an expert to make sure you are not accidentally over-contributing. Similarly, try to avoid contributing to a SEP IRA and Solo 401(k) in the same year.
- Loans from a Solo 401(k) are allowed, but not wise unless absolutely necessary. Ask for help if you need to borrow from the plan.