



### **How can you build a golden nest egg if you're self-employed?**

If you own a small business with no employees (other than your spouse) and want to set up a retirement plan, consider a solo 401(k) plan. This is also an option for self-employed individuals or business owners who wish to upgrade from a SIMPLE IRA or Simplified Employee Pension (SEP) plan.

A solo 401(k), also known as an individual 401(k), may offer advantages in terms of contributions, tax savings and investment options. These accounts are geared toward self-employed individuals, including sole proprietors, owners of single-member limited liability companies, consultants and other one-person businesses.

### **How much can you contribute?**

You can make large annual tax-deductible contributions to a solo 401(k) plan. For 2024, you can make an "elective deferral contribution" of up to \$23,000 of your net self-employment (SE) income to a solo 401(k). The elective deferral contribution limit increases to \$30,500 if you'll be age 50 or older as of December 31, 2024. The larger \$30,500 figure includes an extra \$7,500 catch-up contribution that's allowed for older owners.

On top of your elective deferral contribution, an additional contribution of up to 20% of your net SE income is permitted for a solo 401(k). This is called an "employer contribution," though there's technically no employer when you're self-employed. For purposes of calculating the employer contribution, your net SE income isn't reduced by your elective deferral contribution.

For the 2024 tax year, the combined elective deferral and employer contributions can't exceed:

- \$69,000 (\$76,500 if you'll be 50 or older as of December 31, 2024), or
- 100% of your net SE income.

Net SE income equals the net profit shown on Form 1040, Schedule C, E or F for the business, minus the deduction for 50% of self-employment tax attributable to the business.

### **What are the advantages and disadvantages?**

Besides the ability to make significant deductible contributions, another solo 401(k) advantage is that contributions are discretionary. If cash is tight, you can contribute a small amount or nothing.

In addition, you can borrow from your solo 401(k) account, assuming the plan document permits it. The maximum loan amount is 50% of the account balance or \$50,000, whichever is less. Some other plan options, including SEPs, don't allow loans. This feature can be valuable if you need access to funds for business opportunities or emergencies.

The biggest downside to solo 401(k)s is their administrative complexity. Significant upfront paperwork and ongoing administrative efforts are required, including adopting a written plan document and arranging how and when elective deferral contributions will be collected and paid into the owner's account. Also, once your account balance exceeds \$250,000, you must file Form 5500-EZ with the IRS annually.

You can't have a solo 401(k) if your business has one or more employees. Instead, you must have a multi-participant 401(k) with all the resulting complications. The tax rules may require you to make contributions for those employees. However, there are a few important loopholes. You can contribute to a plan if your spouse is a part-time or full-time employee. You can also exclude employees who are under 21 and part-time employees who haven't worked at least 1,000 hours during any 12-month period.

### **Who's the best candidate for this plan?**

For a one-person business, a solo 401(k) can be a smart retirement plan choice if:

- You want to make large annual deductible contributions and have the money,
- You have substantial net SE income, and
- You're 50 or older and can take advantage of the extra catch-up contribution.

Before establishing a solo 401(k), weigh the pros and cons of other retirement plans — especially if you're 50 or older. Solo 401(k)s aren't simple, but they can allow you to make substantial and deductible contributions to a retirement nest egg. Contact us before signing up to determine what's best for your situation.