Solo 401k FAQs

What is a Solo 401k?

The Solo 401k is an exciting new retirement plan option for the self employed created by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Businesses employing only the owner or owner and spouse can now benefit from extremely beneficial retirement planning and tax saving options via a Solo 401k. Businesses qualifying for this favorable treatment in the tax code include Sole Proprietors, C and S Corporations, Partnerships and LLCs.

What is special about the Solo 401k?

High 2012 contribution limits of $50,000 ($55,500 if age 50+) as well as the ability to borrow retirement plan assets tax free and penalty free before retirement age using a Solo 401k loan are features that make this self employed retirement plan unique.

Each year the funding of the Solo 401k plan is completely discretionary and flexible. Funding can be increased, decreased, or skipped entirely if necessary. The contribution flexibility of a Solo 401k eliminates potential funding worries if there is a bad business year.

For those age 50+ there is a generous $5,500 "catch up" salary deferral contribution and a maximum Solo 401k contribution limit of $55,500.

How much can be contributed to a Solo 401k?

In 2012 the maximum Solo 401k contribution limit is $50,000 or $55,500 if age 50 or older. If the spouse is employed by the business and provided there is adequate income, the contribution limits can potentially be doubled.

How is the Solo 401k contribution calculated?

A Solo 401k contribution consists of two parts, an employee salary deferral contribution and an employer profit sharing contribution. In 2012 the maximum allowable salary deferral contribution is $17,000 and $22,500 if age 50+ (not to exceed 100% of pay). In addition, a profit sharing contribution is permitted equal to 20% of net self employment income for unincorporated businesses or 25% of W-2 income for incorporated businesses. In 2012 the maximum Solo 401k contribution limit is $50,000 or $55,500 if age 50 or older.

Solo 401k contribution calculation for an S or C corporation or an LLC taxed as a corporation.

- Employee Salary Deferral Contribution: In 2012, 100% of compensation up to the maximum of $17,000 or $22,500 if age 50 or older can be contributed to a Solo 401k.
- Employer Profit Sharing Contribution: A profit sharing contribution up to 25% of compensation can be contributed into a Solo 401k.

View examples of solo 401k contribution limits for an S or C corporation or an LLC taxed as a corporation.

Solo 401k contribution calculation for a sole proprietorship, partnership or an LLC taxed as a sole proprietorship.

- Employee Salary Deferral Contribution: These business organizations do not provide a W-2 salary to the business owner. The employee salary deferral contribution is calculated by taking gross self-employment income and then subtracting business expenses and then subtracting 1/2 of the self-employment tax (this is termed net adjusted business profit). In 2012, 100% of net adjusted business profits income up to the maximum of $17,000 (or $22,500 if age 50 or older) can be contributed as employee salary deferrals into a Solo 401k.
- Employer Profit Sharing Contribution: An employer profit sharing contribution can be made up to 20% of net adjusted businesses profit. Net adjusted business profit is calculated by taking gross self-employment income and then subtracting business expenses and then subtracting 1/2 of the self-employment tax

View examples of solo 401k contribution limits for a sole proprietorship, partnership or an LLC taxed as a sole proprietorship.

How much can I contribute to a Solo 401k based on my income?

To determine the annual retirement contribution you could make based on your income use the solo 401k calculator.

Are Roth 401k contributions permitted in a Solo 401k?

Yes, provided the plan document permits Roth contributions. Participants in a Solo 401k can elect to make after-tax or Roth contributions with the salary deferral portion of the Solo 401k. The 2012 salary deferral contribution limit is $17,000 or $22,500 if age 50 or older. Roth contributions are not permitted with the profit sharing portion of a Solo 401k.

Learn more about a solo roth 401k.

Who is eligible for a Solo 401k?

Businesses whose only full time employees are the owner or the owner and spouse, whether incorporated or unincorporated including partnerships and LLCs are eligible. A business is eligible if the business has employees who each work less than 1000 hours per calendar year or utilizes independent contractors or if all employees are age 21 or less.

Are Solo 401k contributions 100% tax deductible?

Yes, salary deferral and profit sharing contributions are generally 100% tax deductible. Roth 401k contributions made with the salary deferral portion of a Solo 401k are not tax deductible.

Subchapter S and C corporations or LLCs electing to be taxed as a corporation can generally deduct the salary deferral contribution from personal W-2 earnings and the profit sharing contribution as a business expense.

A sole proprietorship, partnership or a LLC taxed as a sole proprietorship can generally deduct salary deferral and profit sharing contributions from personal income.

How can I take a loan from a Solo 401k before retirement age?

The Solo 401k is unique because it permits the small business owner to borrow 1/2 of the funds in the 401k ($50,000 maximum) for any reason at any time, tax free and penalty free. The loan must generally be repaid within 5 years according to an amortization table set up before taking the loan, although a 10-15 year payback is allowable for the purchase of a home. The plan must also specifically allow loans. There are no tax consequences if loans are repaid on schedule.

Questions and answers about a solo 401k loan.

Can my spouse contribute to the Solo 401k?

If a spouse is on the payroll and receives a W-2 then they are eligible to contribute to a Solo 401k. Owner and spouse businesses are one of the biggest beneficiaries of the Solo 401k because with sufficient income they can potentially contribute $100,000 total or $111,000 if both are age 50+ in 2012.

What happens if my business grows and I need to hire full time employees?

If you anticipate hiring W-2 employees with more than 1000 hours of service in a calendar year this year, then a Solo 401k may not be the appropriate retirement plan for you. If all employees are under age 21 or if the business employs independent contractors the business is eligible. Contact a BCM advisor to discuss your retirement options.

What is the deadline for establishing a Solo 401k?

The deadline for establishing a Solo 401k is December 31st of the year in which you would like to receive the tax deduction or fiscal year end for corporations.

What is the deadline for making salary deferral contributions?

For unincorporated businesses the deadline is the tax filing date of April 15 of the next year plus extensions. For incorporated businesses the deadline is 15 days after the close of the fiscal year. For instance if December 31 ends the fiscal year, make contributions by January 15 of the next year.

What is the deadline for making profit sharing contributions?

For unincorporated businesses the deadline is the tax filing date of April 15 (or October 15 if an extension was filed). For incorporated businesses the deadline is corporate tax filing deadline March 15, plus extensions.

What are the responsibilities of the plan administrator?

The plan administrator (usually the business owner) must make contributions prior to the deadlines, make timely payments according to the loan amortization schedule if a loan has been taken, and file Form 5500 if plan assets exceed $250,000.

Can other retirement plans be rolled over into a Solo 401k?

Yes. This includes IRA, Rollover IRA, 401k, SEP IRA, Keogh Plans (including Profit Sharing and Money Purchase), Defined Benefit Plans and 403b Plans. By consolidating multiple retirement plans retirement assets can be easily monitored and a greater selection of investment choices may be gained. Another advantage of rolling over retirement accounts into a Solo 401k is these assets become eligible for a loan.

Rollovers are a fast way to build assets in the Solo 401k, assets which then become loan eligible, up to a limit of $50,000 or half of plan assets, whichever is less.