

## **Solo 401(k): A Retirement Plan for Your Businesses**

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**Tags: Investing | Retirement | Tax Benefits | Employer-Sponsored Plan**

### **Introduction to the Solo 401(k)**

The Solo 401(k) was introduced by the Economic Growth and Tax Relief Reconciliation Act of 2001 as a way for sole proprietors, independent contractors, and small business owners (with no employees other than a spouse) to take advantage of the high contribution limits offered by other retirement plans. This plan type offers tax-deferred growth, the possibility of Roth contributions, and the option for loans, making it a flexible and powerful retirement savings tool. This type of account is only available to self-employed individuals.

### **Why Should I Consider a Solo 401(k) Retirement Plan?**

There are many reasons you should consider a Solo 401(k) retirement plan as a self-employed individual. Depending on your financial objectives, the Solo 401(k) may be the most beneficial retirement account for you.

#### ***Tax-Deferred Investment Growth***

Like other retirement account types, the Solo 401(k) allows assets invested in the account to grow on a **tax-deferred** basis. This means account owners won't incur any tax liability until withdrawing the assets in retirement, at which point the withdrawals are taxed as ordinary income. If the Solo 401(k) is a designated Roth account, the growth of the assets in the account could be **tax-free**. Either way, the impact of tax-advantaged growth is massive in the long-term.

#### ***Tax Deductibility of Contributions for Your Business and Yourself***

Contributions to a Solo 401(k) are **tax deductible** for both you and your business. Your own contributions are deductible on your personal tax return, and contributions from your business are deductible to your business.

#### ***Relatively High Contribution Limits***

Solo 401(k)s offer relatively high annual contribution limits for self-employed individuals. These individuals can contribute a total of \$70,000 per year to their Solo 401(k). This type of plan gives highly-compensated employees a way to maximize contributions to tax-advantaged accounts.

### **Who Can Own a Solo 401(k)?**

Only self-employed individuals can open and own a Solo 401(k) account. Solo 401(k) plans are not available to businesses with employees other than the business owner. For businesses with employees, or employees looking to invest directly, other retirement account options exist.

There are no age limits for contributing to a Solo 401(k)—people of all ages can contribute—and no income restrictions either.

### **How Much Can Be Contributed to a Solo 401(k)?**

In 2025, the maximum contribution you as an employee can make to your Solo 401(k) is \$23,500. When combined with contributions from your business (the employer in this case), the maximum contribution to any one Solo 401(k) account in a given year is \$70,000 (the split between employee and employer contributions does not matter).

Those who are at least 50 years old are eligible for a bonus contribution amount of \$7,500, and those who are between 60 and 63 years old can contribute a bonus amount of \$11,250. These “catch-up” contribution amounts increase the maximum contribution for both the employee and combined limits, alike. The employee limit, combined limit, and catch-up contribution amount are occasionally revised in order to adjust for cost of living and inflation.

### **How Can My Business Deduct Contributions to Solo 401(k) Accounts?**

The deadline for taking a tax deduction on Solo 401(k) contributions is the federal income tax return due date for your business, including any extensions. The tax document on which contributions can be deducted depends on how your business is legally organized.

### **What are the Employer Requirements for Solo 401(k) Plans?**

Solo 401(k) plans are exempt from annual nondiscrimination testing, since only the self-employed individual is covered by the plan. Solo 401(k) plans are required to file Form 5500-EZ with the IRS for all years in which your account balance exceeds \$250,000.

### **What are the Withdrawal Rules of a Solo 401(k)?**

Solo 401(k) plans are subject to specific withdrawal rules that, when not followed, could result in a substantial penalty. Starting at age 59½, you may take distributions from your Solo 401(k) at any time and in any amount without incurring a penalty. These distributions are included in your taxable income for the year in which you take them.

Those who withdraw funds before age 59½ are subject to penalty in an amount of 10% of the distribution, unless the distribution qualifies for an exception. The most common exceptions include distributions related to birth or adoption expenses (up to \$5,000 per child), emergency personal expenses (up to \$1,000 per year), federally declared disasters (up to \$22,000), certain unreimbursed medical expenses, death or disability of the Solo 401(k) account owner and separation from service for those aged 55 and older.

Separately, Solo 401(k) account owners must abide by **required minimum distribution (RMD)** rules. Starting at age 73, account owners are required to withdraw a certain amount from their account each year to avoid a penalty (up to 25% of the value) on the missed RMD. The amount of the RMD is calculated based on life expectancy and account balance.

### **Can Account Owners Borrow Against the Balance of Their Solo 401(k)?**

Yes, if the plan allows loans. If loans are permitted, a Solo 401(k) account owner can typically borrow up to 50% of their vested account balance, with a maximum limit of \$50,000. Loans must generally be repaid within five years, unless the loan is used to purchase a primary residence, in which case the repayment period may be longer.

### **What Types of Assets Can Be Invested in with a Solo 401(k)?**

A Solo 401(k) allows its account owner to invest in a fairly broad spectrum of assets. Stocks, exchange-traded funds (ETFs), mutual funds, bonds, money market funds, and certificates of deposit (CDs) are all permitted assets in a Solo 401(k). Examples of investments that are prohibited in a Solo 401(k) include life insurance, artwork and collectibles, S corporation stock, and real estate for personal use, among others.

### **What Other Forms of Retirement Plans Exist for Businesses Like Mine?**

There are many other forms of retirement plans that may be a fit for your business, including:

- 401(k) / Roth 401(k) – A tax-deferred retirement plan commonly offered to the employees of large, private employers.
- Safe Harbor 401(k) – A 401(k) that avoids the regulation requirements and expenses of Traditional 401(k)s and specifies that all employer contributions are immediately vested.
- SIMPLE 401(k) – A 401(k) plan with more flexibility and less administrative burden for self-employed individuals or small business owners.
- SEP IRA – An IRA with special perks for self-employed individuals or small business owners.
- SIMPLE IRA – Another IRA with special perks for self-employed individuals or small business owners.
- Payroll Deduction IRA – The easiest retirement plan to establish with the least financial and legal requirements for the sponsoring business.

### **How Can I Start a Solo 401(k) for my Business?**

To get started with a Solo 401(k) retirement plan for your business, reach out to us at **FreeMind Financial Advisory** and we would be happy to provide a **free strategy session** personalized for your business. We can help determine if a Solo 401(k) is the best retirement plan for your business, and if it is, we can assist in setting up accounts and onboarding employees.

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