

# The Reasons for a Roth Solo 401(k)

*Here is a way for a solopreneur to save much more for retirement.*

Provided by Benedict A. Mitchell Jr.

**Self-employed? Seeking to ramp up your retirement savings?** You should look at the potential of the Roth Solo 401(k). If you are a high-earning solopreneur, this savings vehicle may be a great choice, because it allows you to make both employee and employer contributions to a 401(k) account in the same year.<sup>1</sup>

**How does a Roth Solo 401(k) work?** This is a Roth variation of the standard Solo 401(k). In the standard or “traditional” Solo 401(k), employer and employee account contributions are made with pre-tax dollars. In the Roth version, the employer still contributes pre-tax dollars but the employee contribution is made with *after-tax* dollars.<sup>2</sup>

There is a very nice tradeoff for doing this. If you abide by IRS rules, the Roth contributions you make, and the earnings they generate, can be eventually be withdrawn tax-free.<sup>2,4</sup>

**You can make an employee contribution of up to \$18,000 to a Roth Solo 401(k) in 2015.** This amount will rise in future years, as it is indexed for inflation. Yearly catch-up contributions of up to \$6,000 are currently allowed for those 50 and over.<sup>1</sup>

**Your business may also contribute 20-25% of your yearly net earnings to the plan.** If you have incorporated your company, this profit-sharing contribution limit is set at 25%; if you have not, the limit is 20%. Total employer & employee contributions to a Roth Solo 401(k) are capped at \$53,000 for 2015, \$59,000 if you are old enough to make the \$6,000 catch-up contribution. (The maximum amount of employee elective deferrals and employer non-elective contributions should be calculated via the methods detailed in IRS Publication 560.)<sup>1,3</sup>

**How can you invest the Solo Roth 401(k) assets?** You can invest them in myriad ways. This is truly a self-directed retirement plan, and that means you aren’t limited to a dozen or two dozen investment options as you might be with a 401(k) sponsored by a large employer.<sup>4</sup>

**What are the restrictions on a Roth Solo 401(k)?** As the name implies, this is truly a retirement plan for the smallest businesses. To have any kind of Solo 401(k), you must work for yourself and have a maximum of only one other full-time employee (and that other FTE needs to be your spouse). If you foresee hiring people as your business evolves, then this is not the retirement account for you.<sup>1</sup>

Once the Roth Solo 401(k) contains more than \$250,000 in assets at the end of a year, you must file Form 5500 annually with the IRS. The plan is also subject to non-discrimination testing if you have common-law employees. (If you have an employee and you can control what will be done

by that worker and how it will be done, that is a common-law employee under the IRS definition.)<sup>1,5</sup>

If by chance you also contribute to a 401(k) at another employer, your total Roth and traditional employee contributions to all 401(k)s will be capped at the common employee limit – \$18,000 in 2015, \$24,000 if you are 50 or older. Participation in another 401(k) plan does not limit employer profit-sharing contributions to a Roth Solo 401(k).<sup>2</sup>

As you can't deduct after-tax dollars, you can't deduct your employee contributions to a Roth Solo 401(k). Your business, however, can still make traditional, tax-deductible contributions.<sup>2</sup>

**December 31 is the annual deadline.** If you want to contribute to a Solo 401(k) for the current tax year, you must create the account by that date or earlier. Many self-employed people need to establish a retirement plan, and through a Solo Roth 401(k), you could go a long way toward fixing a retirement savings shortfall.<sup>6</sup>

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#### **Citations.**

- 1 - [irs.gov/Retirement-Plans/One-Participant-401%28k%29-Plans](http://irs.gov/Retirement-Plans/One-Participant-401%28k%29-Plans) [6/18/15]
- 2 - [kiplinger.com/article/retirement/T001-C001-S003-self-employed-tax-free-retirement-roth-solo-401-k.html](http://kiplinger.com/article/retirement/T001-C001-S003-self-employed-tax-free-retirement-roth-solo-401-k.html) [7/24/15]
- 3 - [forbes.com/sites/ashleaebeling/2013/11/01/retirement-savings-for-the-self-employed/](http://forbes.com/sites/ashleaebeling/2013/11/01/retirement-savings-for-the-self-employed/) [11/1/13]
- 4 - [nerdwallet.com/blog/finance/advisorvoices/self-directed-retirement-plan-can-be-for-anyone/](http://nerdwallet.com/blog/finance/advisorvoices/self-directed-retirement-plan-can-be-for-anyone/) [7/27/15]
- 5 - [irs.gov/Businesses/Small-Businesses-&Self-Employed/Employee-Common-Law-Employee](http://irs.gov/Businesses/Small-Businesses-&Self-Employed/Employee-Common-Law-Employee) [6/30/15]
- 6 - [quickbooks.intuit.com/r/healthcare-and-benefits/solo-401k-savings-small-business-owners](http://quickbooks.intuit.com/r/healthcare-and-benefits/solo-401k-savings-small-business-owners) [6/30/15]