SUMMIT FINANCIAL RESOURCES, INC.

Planning Alert

Retirement Plan Selection for Small Business Owners

Self-employed business owners wear many hats and juggle multiple responsibilities. One aspect that should not be neglected is saving for retirement through tax efficient vehicles, such as the SEP IRA, Solo 401(k), SIMPLE IRA or a defined benefit (pension) plan (the subject of a future alert). Which plan you should choose depends on several factors, including your age, income, liquidity needs, tax benefits, employee incentives and administrative costs.

A Solo 401(k) provides a larger contribution than a SEP IRA for someone with say, $200,000 of income, since the plan allows both employee contributions and employer profit sharing. In 2018, the maximum contribution to a Solo 401(k) is $55,000 or $61,000 if age 50 or older (see chart below). By comparison, the SEP IRA has similar annual limitations but does not allow for employee or catch-up contributions. At higher income levels, the Solo 401(k) and SEP IRA may be comparable, again depending on your age. The SIMPLE IRA imposes additional requirements on the employer and would not likely be used unless you have employees, steady profits and a reasonable payroll. Finally, employer contributions to all such plans reduce taxable income and *may* enable the pass-thru business owner to take advantage of the 20% qualified business income deduction[1].

	Solo 401(k)	**SEP IRA**	**SIMPLE IRA**
Who can contribute?	Both employee and employer	Employer only	Both employee and employer
2018 limits: **Employee** contributions	*Lesser of* $18,500 ***or*** 100% of compensation *Plus* $6,000 (age 50 or older)	N/A	*Lesser of* $12,500 ***or*** 100% of compensation *Plus* $3,000 (age 50 or older) if plan permits
Tax deductible **employer** contributions	25% of compensation ***or*** 20% of earned income	25% of compensation ***or*** 20% of earned income	Required 100% match up to 3% of employee comp. ***or*** Non-elective contribution of 2% of all eligible employees comp.

Both the Solo 401(k) and the SEP IRA can be *funded* by the time the tax return plus extensions must be filed. However, the Solo 401(k) must be established before the end of the year for which the contribution is being made. Clients should consult with their tax and financial advisors before taking any action.

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[1] Availability of the 20% QBI deduction depends on the type of business, owner's taxable income, total wages, etc.