How a Solo 401(k) Plan Works

INDIVIDUAL AS EMPLOYER

- Makes contributions up to allowable limits.[1]
- Contributions are tax deductible to the business.[2]
- Plan may provide for participant loans.
- Nondiscrimination rules may apply if other employees are hired.[3]

INDIVIDUAL AS EMPLOYEE

- Elects to defer a portion of salary or bonus.
- Employee's elective contributions are limited to $19,500[4] per year (2020).
- Amounts deferred are subject to FICA and FUTA taxes but not current income tax.

SOLO 401(k) PLAN

- Employer contributions are not currently taxable to employee and earnings accumulate tax deferred.
- Most plans are self-directed (employee controls investments).
- Investment risk remains on employee.

EARLY WITHDRAWAL

- A 10% penalty generally applies if withdrawals are made before age 59½.
- Some exceptions to the 10% penalty are available.
- Employee elective contributions can be withdrawn for financial hardship.[5]

RETIREMENT

- Distributions must begin by specified date.
- Funds may be distributed as a lump sum or as periodic payments.
- Earnings + deductible contributions are taxed as ordinary income in the year received.

DEATH

- Value of account is included in owner's gross estate.
- Proceeds can pass to beneficiaries with payments over their lifetimes.
- Income and estate taxes can severely reduce funds left to nonspousal beneficiaries.

[1] For 2020, the allocation total of employer contributions, forfeitures and employee deferrals to a participant's account may not exceed the lesser of 100% of compensation or $57,000.
[2] The total deduction is limited to 25% of covered payroll.
[3] Plans covering only the business owner (or the owner and spouse) effectively sidestep the nondiscrimination issue.
[4] In 2020, for those age 50 and older, additional "catch-up" contributions of $6,500 may be made.
[5] If provided for by the plan; specific requirements may apply.

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