Solo 401(k) Plans

Quick-Take: A small self-employed business owner with no employees should consider adopting a solo 401(k) plan before April 15, 2025.

Background: A solo 401(k) plan is a retirement savings vehicle for a self-employed business owner who has no employees, other than the owner's spouse. The IRS views the owner in a dual capacity: (i) the employer, and (ii)) the employee. As an employee, the owner can make elective deferrals. As the employer, the owner he/she can also make additional contributions of up to 20% of adjusted net earnings. Recall, too, that starting in 2025, individuals ages 60 to 63 have an enhanced catch-up contribution amount of $11,250 under the SECURE 2.0 Act.

Limited Amount of Contributions: There is, however, an overall limit on combined elective deferrals and employer contributions to a solo 401(k) plan. For 2024, those limits are $69,000, or $76,000 for those over the age 50.

Caution: If the individual's sole proprietorship is an on-the-side activity, and he/she is also participating in a 401(k) plan at their primary place of employment, the above limit applies to contributions across all plans, not each individual retirement plan.

Spouses: As noted above, the Tax Code allows a spouse to participate in the solo 401(k) plan if they have earnings. This could effectively double that amount a married couple could contribute, as a family, depending on the income the business generates. The owner's spouse would make elective deferrals as the owner's employee, up to the employee contribution limit (plus the 50 and older catch-up provision, if applicable.) As the employer, the owner can then make the plan's profit-sharing contribution for his/her spouse of up to 25% of compensation.

SECURE Act History: The SECURE Act's provisions initially created some confusion for solo 401(k) plans. Prior to the SECURE Act, new solo 401(k) plans had to be in place by the end of the calendar year. The SECURE Act gave businesses additional time, until the due date for the corporate tax return, including extensions, to establish a retroactive solo 401(k) plan. However, with this extended deadline, contributions were only available for employer contributions, not the employee's elective contribution deferrals. The SECURE 2.0 Act corrected this situation by allowing sole proprietors to establish retroactive solo 401(k) plans with both employer and elective employee contribution deferrals.

However, the deadline to adopt a *new* solo 401(k) plan after its first year with both types of contributions is the due date of the business's tax return, without extensions for the prior year.

Example: Sid runs a landscaping business. Sid is the sole proprietor. In March 2025 Sid learns from his CPA about solo 401(k) plans. Sid wants to set up a *new* solo 401(k) plan, retroactive to the start of 2024. If Sid's solo 401(k) plan is opened by April 15, 2025 (Sid's business's 2024 tax filing date without any extensions) Sid can fund his solo 401(k) plan with both 2024 employer contributions and employee elective deferral contributions up to $76,000 since Sid is over the age 50.

Conclusion: A married couple who runs a successful business with no other employees can contribute a substantial amount of deductible contributions, each year, to a solo 401(k) plan.

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