The Ultimate Solo 401(k) Tax Guide: Tax Strategies and Tips to Maximize the Plan's Assets

About the Author
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Biography: With over 30 years of legal experience, Mr. Estill specializes in advising business owners with the complexities of the business and tax law issues that they may encounter. Mr. Estill is a frequent national radio and television guest lecturer, instructor, and seminar speaker at various events and colleges across the country. He is a former senior trial attorney for the IRS and former law clerk to the Honorable Lawrence Inglis of the Illinois Appellate Court. He has counseled thousands on tax techniques and is nationally recognized as one of the top tax advisors in the country. Scott's book *"Tax This! An Insider's Guide to Standing Up to the IRS"* was recognized by the Wall Street Journal as one of the five top tax books for taxpayers to own in their library. He has also written for the JK Lasser tax series with *the Real Estate Investor's Tax Edge* and is the author of the current (updated annually) *2022 Complete Tax Planning and Strategies Guide*. He is a graduate of the University of Illinois and the John Marshall Law School in Chicago.

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What's Inside

Important Information

- There is no specific investment advice in this Guide.
- It is critical that you understand any and all investments before committing to any funding.
- Always obtain professional advice before implementing any new tax plan.
- The information presented in this Guide is designed to provide accurate and authoritative information regarding the subject matter covered.
- The information is intended to be general in nature.
- None of the information in this Guide is intended to be specific tax, legal, accounting, financial, investment or other professional advice.
- Every taxpayer's tax situation is different and thus some (or all) of the information presented in this Guide may not be applicable to your unique tax situation.
- It is important to understand that tax laws change constantly and due to the complexity of the laws themselves, professional advice should be sought before implementing any tax, financial or other legal strategy.

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The purpose of this tax guide on Solo 401(k) plans is to offer potential solutions to the dilemma every business owner will face at some point: How do I earn enough money for today while also saving for tomorrow? Rather than writing a typical tax guide I have decided to put together some (ok- a lot) information concerning a Solo 401(k) account via a Question-and-Answer format.

I: Plan Basics

Q: What is a Solo 401(k) plan?
A: A Solo 401(k) plan is a retirement account designed for the self-employed, or for business owners with no full-time employees.

Q: What are the pros and cons of a Solo 401(k) plan?
A: Here are the most common:

Pros of a Solo 401(k) Plan

- High contribution limits relative to an IRA
- Contributions may be tax deductible
- Loans are permissible
- Spousal option available
- Investment earnings grow tax deferred
- Roth component permitted (tax-free growth)
- Can be self-directed

Cons of a Solo 401(k) plan

- Cannot have employees in the business
- Tax returns may be required for the plan
- Administrative fees and costs

Q: Do I need any legal documents for a Solo 401(k) plan?
A: Yes. In general, a Solo 401(k) plan can be done via a broker or self-directed. The basic plan documents will state and control the overall operations of the plan. They will state specifically what the plan can (and cannot) do. There also is a plan adoption agreement. The Plan sponsor usually provides these documents, especially if the plan is not self-directed.

Q: What are some of the plan documents needed?
A: Here are the major players as far as the legal and administrative documents are concerned (not all documents are needed for every plan). Please note that the overall complexity and state where the plan is located can also add numerous forms to this already non-exhaustive list):

- *Adoption agreement*. This covers the rules associated with establishing the plan. It will also often cover the appointment of the trustee/custodian.
- *Basic plan document*. This explains the many plan possibilities, including eligibility requirements, contributions, vesting, loan procedures and many related provisions.
- *Summary plan description*. A plain English (in theory) description of the plan.
- *Summary Annual Report*. This document explains the plan and its annual income, assets, expenses, and benefits paid via distributions.
- *Amendments to plan*.
- *Trust agreement*. This covers the responsibilities and duties of the trustee.
- *Beneficiary designations*. Primary and secondary beneficiaries need to be stated with specificity.
- *IRS determination letter*. This demonstrates that the plan complies with the current tax code.
- *Articles of Organization* (if using an LLC inside of the plan).
- *Operating agreement* (if using an LLC inside of the plan).
- *Employer Identification Number* (EIN).

Q: Who can function as the custodian of my Solo 401(k) plan?
A: In general, a custodian of a Solo 401(k) plan is a person or entity with a fiduciary responsibility over the plan assets. Often this is a bank, brokerage or a company set up specifically to manage these types of accounts.

Q: Who is a "Fiduciary" for a Solo 401(k) Plan?
A: According to the IRS, a fiduciary includes anyone who does any of the following:
- Exercises any discretionary authority or discretionary control in managing the IRA or exercises any authority or control in managing or disposing of its assets.
- Provides investment advice to the IRA for a fee or has any authority or responsibility to do so.

- Has any discretionary authority or discretionary responsibility in administering the IRA.

Q: What does a custodian of a Solo 401(k) plan do?
A: Responsibilities are typically divided between the custodian and the account holder, as the following chart demonstrates. It is important to understand that the custodian does not typically render any investment advice and thus due diligence is especially needed when an account is being self-directed.

Who is responsible?

Account owner/custodian responsibilities in the purchase of unconventional assets in an IRA

Responsibility	Account owner	Custodian
Determining the appropriateness of an asset	X	
Determining the risk associated with an asset	X	
Reviewing for potential prohibited transactions	X	
Arranging with the investment sponsor to purchase an asset	X	
Providing documentation to support the asset purchase	X	
Providing direction to disburse funds to purchase asset	X	
Verifying that funds are correctly invested	X	
Determining an asset's administrative feasibility		X
Disbursing funds from IRA to purchase asset		X
Ensuring purchased asset is titled in the name of IRA		X
Facilitating the safekeeping of certificates, notes, or deeds		X
Providing periodic statements showing account's value		X

Source: GAO analysis of available custodian information. | GAO-17-102

Q: Can I use a Self-Directed Solo 401(k) plan?
A: Yes. The ability to self-direct opens up many investment possibilities besides the typical stocks and bonds.

Q: When is the deadline to set up a Solo 401(k) plan?
A: December 31, 2022, for 2022, under the traditional rules. However, the SECURE Act extended the deadline for employers to adopt a new traditional 401(k) plan from the last day of the tax year until the due date of that year's tax return (including extensions). That means the deadline for employers to adopt a new Solo 401(k) plan will depend upon the tax status of the business:

Tax Status	Filing Deadline	Extended Deadline
S Corporation (or LLC taxed as S Corporation)	March 15	September 15
Partnership (or LLC taxed as a partnership)	March 15	September 15
C Corporation (or LLC taxed as C Corporation)	April 15	October 15
Sole Proprietorship (or LLC taxed as sole proprietorship)	April 15	October 15

Unfortunately, this change does not give employees more time to make salary deferrals. It does, however, give employers more time to decide whether or not they want adopt a new 401(k) plan in order to make a year-end profit sharing contribution.

Q: When is the deadline for contributions to the plan?

A: For the employee contribution the due date is December 31 as these contributions are made via wages/W-2. However, if you are self-employed (i.e., not a corporation), you can make the contribution once you have calculated your net business income for the year, but no later than your tax filing deadline (including extensions). Employer profit-sharing contributions can also be funded up until your tax return due date (including extensions).

2022 Solo 401k Annual Contribution Deadlines Both Employee & Employer/Profit Sharing		
Entity Type	**Contribution Deadline**	**Contribute by Extended Business Tax Return Deadline**
Sole Proprietorship	April 17, 2023	October 16, 2023
Partnership	March 15, 2023	September 15, 2023
S-Corporation	March 15, 2023	September 15, 2023
C-Corporation	April 17, 2023	October 16, 2023
LLC taxed as an S-Corporation	March 15, 2023	September 15, 2023
LLC taxed as a Partnership	March 15, 2023	September 15, 2023
LLC taxed as a Sole Proprietorship	April 17, 2023	October 16, 2023

Note that for 2022 the tax deadline is currently set at April 17, 2023, for Form 1040 tax returns.

Q: What types of businesses can set up a Solo 401(k) plan?
A: A Solo 401(K) Plan can be adopted by any self-employed person/business, including a sole proprietorship, limited liability company, partnership, C Corporation or S Corporation.

Q: Can I take a loan from my Solo 401(k)?
A: Yes. A Solo 401k plan allows participants to borrow up to $50,000 or 50% of the account value, whichever is less.

New rules were put in place under the CARES Act to permit larger loans ($100,000 or $100% of the account value, whichever is less). The Solo 401k loan is tax and penalty-free and can be used for any purpose.

Q: Can I use a "Safe Harbor 401(k)" plan for my Solo 401(k) plan?

A: No. For our purposes, a Safe Harbor 401k plan is a special type of retirement plan that is flexible, cost effective and extremely popular. Like a traditional 401k, it offers flexible and fully tax-deductible employer contributions together with tax-sheltered growth of plan assets. However, these plans require employees- precisely what the Solo 401(k) does not permit.

II: Contributions and Distributions

Q: Who can make contributions?

A: There are three (3) possibilities: (1) the business owner; (2) the business owner's spouse; and (3) the business. There can be no employees.

Q: Do I need to take wages to be eligible?

A: Yes, or have earnings that are subject to self-employment taxes. It all involves "compensation." With respect to wages, this is easy as the amount is directly reported on a Form W-2.

With respect to self-employment income, the calculation involves:

Business net profit	$________
(-) ½ of self-employment tax	$________
(-) employer plan contributions	$________
= Amount of compensation for 401(k) plan purposes	$________

There is a limitation on compensation: $285,000 for 2020, $290,000 for 2021 and $305,000 for 2022. Once your income/compensation exceeds this amount, no additional contributions are permitted.

Q: What are the contribution limits of a Solo 401(k)?

A: There are possible contributions from both the business and the business owner. When contributing as the owner/employee, you are allowed up to $20,500 or 100% of compensation (whichever is less) in salary deferrals for the 2022 tax year. If you are over 50, an additional $6,500 catch-up contribution (total contribution of $27,000) is allowed for 2022. This contribution is known as the elective deferral.

Q: What about any contributions from my business?

A: Yes. The business/employer can also contribute up to 25% of your compensation from the business. When both the business and the owner/employee portions are combined the total cannot exceed $58,000 (2021) and $61,000 (2022). This contribution is known as the profit-sharing contribution.

Q: What are the spousal contribution limits of a Solo 401(k)?

A: Same rules apply for spouse as for business owner. If the spouse works in the business, he/she/they can make contributions to the plan.

Q: Can I contribute more if I am closer to retirement age?

A: Yes. If you are age 50 and older, you can make catch-up contributions. By doing so the contribution limit is increased to be $64,500 (2021) and $67,500 (2022)

Q: Do I have to make contributions every year?

A: No. You can make any size contribution, up to the maximum, in any given year. This can include making no contributions in any given year as well.

Q: How does the Solo 401(k) plan compare to other retirement plans?

A: Here is a summary of the primary players in the retirement planning realm:

2022 Contribution Limit Increases			
Contribution	**2021 Limit**	**2022 Limit**	**Change**
401(k)/403(b) Employee Contribution	$19,500	$20,500	$1,000
401(k)/403(b) Catch-up Contribution	$6,500	$6,500	$0
401(k)/403(b) Total Contribution <50	$58,000	$61,000	$3,000
401(k)/403(b) Total Contribution 50+	$64,500	$67,500	$3,000
457(b) Contribution	$19,500	$20,500	$1,000
Traditional IRA Contribution	$6,000	$6,000	$0
Traditional IRA Catch-up Contribution	$1,000	$1,000	$0
Roth IRA Contribution	$6,000	$6,000	$0
Roth IRA Catch-up Contribution	$1,000	$1,000	$0
SEP-IRA Contribution	$58,000	$61,000	$3,000
SIMPLE IRA/SIMPLE 401(k) Contribution	$13,500	$14,000	$500
H.S.A. Contribution (single)	$3,600	$3,650	$50
H.S.A. Contribution (family)	$7,200	$7,300	$100
Healthcare F.S.A. Contribution	$2,750	$2,850	$100

Note that a complete comparison of the distinctive features of each plan is the subject for an entire book and will not be covered here. But in general, the differences between the plans usually involves who is eligible, how much can be contributed in any given year and the rules concerning distributions. There are tax differences between the plans and before any decision is made concerning any specific plan it is strongly recommended that professional guidance be obtained. It is important to make sure that your plan is tailored for you and your business, as it is your retirement at issue here. There is not a one size fits all and these plans can be tailored specifically to meet your overall investing and financial needs. No matter which retirement plan you end up choosing, tax planning is imperative to make sure you maximize any potential tax deductions associated with the plan, along with making sure that any distributions are taxed as minimally as possible.

Here is another summary of the contribution limits. Note that these limits change every year.

Chart of Select Limits

401k Plan Limits for Year	2021	2020	2019	2018	2017	2016	2015
401k Elective Deferrals	$19,500	$19,500	$19,000	$18,500	$18,000	$18,000	$18,000
Annual Defined Contribution Limit	$58,000	$57,000	$56,000	$55,000	$54,000	$53,000	$53,000
Annual Compensation Limit	$290,000	$285,000	$280,000	$275,000	$270,000	$265,000	$265,000
Catch-Up Contribution Limit	$6,500	$6,500	$6,000	$6,000	$6,000	$6,000	$6,000
Highly Compensated Employees	$130,000	$130,000	$125,000	$120,000	$120,000	$120,000	$120,000

Non-401k Related Limits							
403b/457 Elective Deferrals	$19,500	$19,500	$19,000	$18,500	$18,000	$18,000	$18,000
SIMPLE Employee Deferrals	$13,500	$13,500	$13,000	$12,500	$12,500	$12,500	$12,500
SIMPLE Catch-Up Deferral	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000
SEP Minimum Compensation	$650	$600	$600	$600	$600	$600	$600
SEP Annual Compensation Limit	$290,000	$285,000	$280,000	$275,000	$270,000	$265,000	$265,000
Social Security Wage Base	$142,800	$137,700	$132,900	$128,400	$127,200	$118,500	$118,500

Q: Can you provide some examples of how the maximum contribution amount is calculated?
A: Here are a few examples:

1. Jose is 42 years of age and earns an annual W-2 salary of $100,000 from his business. He can set up a Solo 401(k) plan and defer $20,500 to the account. In addition, his business can contribute $25,000 (25% of the $100,000 in compensation), for a total maximum contribution of $45,500 (less than the $61,000 maximum contribution limit).

2. Same as above, except that Jose is 52 years of age. He can set up a Solo 401(k) plan and defer $27,000 to the account. In addition, his business can contribute $25,000 (25% of the $100,000 in compensation), for a total maximum contribution of $52,000 (less than the $67,500 maximum contribution limit).

3. Dawn is 30 years of age, self-employed and has a net income from self-employment of $100,000. She can personally contribute $20,500 and her business can also contribute $20,000 (20% of $100,000), for a total maximum contribution of $39,500 (less than the $61,000 maximum contribution).

4. Same as above, except that Dawn is 60 years of age, self-employed and has a net income from self-employment of $100,000. She can personally contribute $27,000 and her business can also contribute $20,000 (20% of $100,000), for a total maximum contribution of $47,000 (less than the $61,000 maximum contribution).

The IRS also provides some examples, such as the following (from www.irs.gov):

5. "Example: Ben, age 51, earned $50,000 in W-2 wages from his S Corporation in 2020. He deferred $19,500 in regular elective deferrals plus $6,500 in catch-up contributions to the 401(k) plan. His business contributed 25% of his compensation to the plan, $12,500. Total contributions to the plan for 2020 were $38,500. This is the maximum that can be contributed to the plan for Ben for 2019."

Formula for Calculating Maximum Contribution
Under Age 50 with Wages

1. Wages in 2022	$____________	
2. Personal Maximum in 2022	$20,500	
3. Lower of line 1 or 2		$____________
4. Multiply Line 1 by .20	$____________	
5. Business Maximum in 2022	$40,500	
6. Lower of Line 4 or 5		$____________
7. Line 3 plus 6 (Maximum contribution 2022)		$____________

Formula for Calculating Maximum Contribution
Over Age 50 with Wages

1. Wages in 2022	$____________	
2. Personal Maximum in 2022	$27,000	
3. Lower of line 1 or 2		$____________
4. Multiply Line 1 by .20	$____________	
5. Business Maximum in 2022	$40,500	
6. Lower of Line 4 or 5		$____________
7. Line 3 plus 6 (Maximum contribution 2022)		$____________

Formula for Calculating Maximum Contribution
Under Age 50 with Self-Employment Income

1. Business net profit		$____________
2. ½ of self-employment tax	$_____________	
3. Employer plan contributions	$_____________	
4. Add lines 2 and 3		$____________
5. Subtract Line 4 from Line 1		$____________
6. Personal Maximum in 2022	$20,500	
7. Lower of Line 5 or 6		$____________
8. Multiply Line 1 by .20	$_____________	
9. Business Maximum in 2022	$40,500	
10. Lower of Line 8 or 9		$____________
11. Line 7 plus 10 (Maximum contribution 2022)		$____________

Formula for Calculating Maximum Contribution
Over Age 50 with Self-Employment Income

1. Business net profit		$____________
2. ½ of self-employment tax	$_____________	
3. Employer plan contributions	$_____________	
4. Add lines 2 and 3		$____________
5. Subtract Line 4 from Line 1		$____________
6. Personal Maximum in 2022	$27,000	
7. Lower of Line 5 or 6		$____________
8. Multiply Line 1 by .20	$_____________	
9. Business Maximum in 2022	$40,500	
10. Lower of Line 8 or 9		$____________
11. Line 7 plus 10 (Maximum contribution 2022)		$____________

Q: When am I required to take withdrawals/distributions?
A: As with all qualified retirement plans, there are rules to when you can and must start taking withdrawals from your Solo 401(k) plan. You must begin taking the minimum required distribution no later than age 72 (unless you turned 70 1/2 prior to January 1, 2020- then you must start taking your RMD at age 70 1/2). There is a 10% early withdrawal penalty for distributions take before age 59 1/2, but exceptions may apply.

Q: Do I have to take distributions if I have a Roth 401(k) plan?
A: Yes. A required minimum distribution (RMD) is required for either a Roth or Traditional 401(k) plan. The RMD rules apply to all 401(k) plans, along with traditional IRAs and IRA-based plans such as a SEP or SIMPLE. The RMD rules also apply to Roth 401(k) accounts. However, the RMD rules do not apply to Roth IRAs (while the owner is alive).

Q: When must I receive my required minimum distribution from my Solo 401(k) plan?
A: You must take your first required minimum distribution for the year in which you turn age 72. The required beginning date (RBD- see chart below) marks the official date by which a retirement plan participant must begin to receive a RMD.

Birth Month	Birth Year	Age 72 in	RBD	Use Balance From
July - Dec.	1949	2021	4/1/2022	12/31/2020
January - Dec.	1950	2022	4/1/2023	12/31/2021
January - Dec.	1951	2023	4/1/2024	12/31/2022
January - Dec.	1952	2024	4/1/2025	12/31/2023
January - Dec.	1953	2025	4/1/2026	12/31/2024

CURRENT UNIFORM LIFETIME TABLE – THROUGH 2021									
Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
70	27.4	80	18.7	90	11.4	100	6.3	110	3.1
71	26.5	81	17.9	91	10.8	101	5.9	111	2.9
72	25.6	82	17.1	92	10.2	102	5.5	112	2.6
73	24.7	83	16.3	93	9.6	103	5.2	113	2.4
74	23.8	84	15.5	94	9.1	104	4.9	114	2.1
75	22.9	85	14.8	95	8.6	105	4.5	115+	1.9
76	22.0	86	14.1	96	8.1	106	4.2		
77	21.2	87	13.4	97	7.6	107	3.9		
78	20.3	88	12.7	98	7.1	108	3.7		
79	19.5	89	12.0	99	6.7	109	3.4		

REVISED UNIFORM LIFETIME TABLE – EFFECTIVE 2022									
Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
		80	20.2	90	12.2	100	6.4	110	3.5
		81	19.4	91	11.5	101	6.0	111	3.4
72	27.4	82	18.5	92	10.8	102	5.6	112	3.3
73	26.5	83	17.7	93	10.1	103	5.2	113	3.1
74	25.5	84	16.8	94	9.5	104	4.9	114	3.0
75	24.6	85	16.0	95	8.9	105	4.6	115	2.9
76	23.7	86	15.2	96	8.4	106	4.3	116	2.8
77	22.9	87	14.4	97	7.8	107	4.1	117	2.7
78	22.0	88	13.7	98	7.3	108	3.9	118	2.5
79	21.1	89	12.9	99	6.8	109	3.7	119 120+	2.3 2.0

Q: How much time do I have left (to live presumably)?

A: The following chart summarizes the life expectancies for men and women aged 50 and up:

Age	M	F	Age	M	F	Age	M	F
50	31.43	35.17	70	14.76	17.42	90	4.36	4.91
51	30.53	34.24	71	14.04	16.61	91	4.11	4.57
52	29.63	33.31	72	13.33	15.82	92	3.89	4.27
53	28.73	32.38	73	12.64	15.03	93	3.69	3.99
54	27.84	31.45	74	11.96	14.27	94	3.51	3.75
55	26.95	30.53	75	11.31	13.51	95	3.36	3.53
56	26.08	29.61	76	10.68	12.78	96	3.22	3.33
57	25.2	28.7	77	10.07	12.05	97	3.1	3.16
58	24.34	27.79	78	9.48	11.35	98	2.99	3
59	23.48	26.89	79	8.92	10.67	99	2.9	2.86
60	22.63	26	80	8.38	10.01	100	2.81	2.74
61	21.79	25.11	81	7.86	9.37	101	2.73	2.63
62	20.96	24.23	82	7.36	8.75	102	2.66	2.54
63	20.14	23.35	83	6.89	8.17	103	2.6	2.46
64	19.34	22.48	84	6.45	7.61	104	2.54	2.38
65	18.54	21.62	85	6.03	7.08	105	2.49	2.32
66	17.76	20.76	86	5.64	6.58	106	2.44	2.26
67	16.99	19.92	87	5.27	6.11	107	2.4	2.2
68	16.24	19.08	88	4.94	5.68	108	2.35	2.15
69	15.49	18.24	89	4.63	5.28	109	2.3	2.09

Q: Who calculates the amount of the RMD?
A: You are responsible for doing so on an annual basis. However, in some cases the custodian or 401(k) plan manager may do so**.**

Q: Can I take a distribution more than my RMD?
A: Yes. If you take the minimum amount required, you are permitted to take as much as you want. Before doing so, however, make sure you understand the tax ramifications of taking a distribution more than the required minimum.

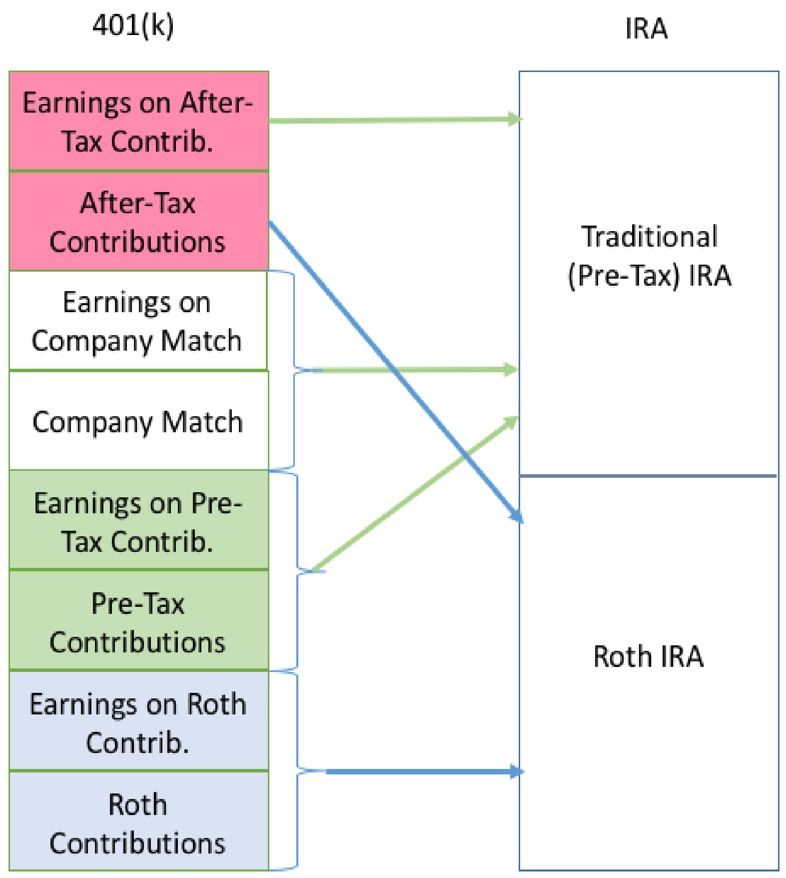
Q: What happens if a person does not take a RMD by the required deadline?
A: If an account owner fails to withdraw a RMD, fails to withdraw the full amount of the RMD, or fails to withdraw the RMD by the applicable deadline, the amount not withdrawn is taxed at 50%.

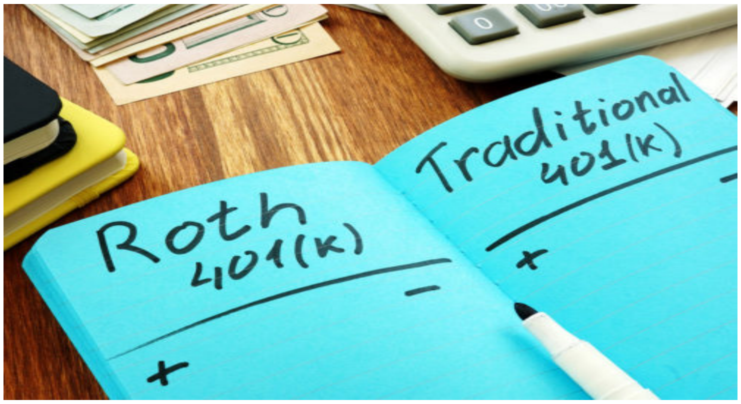
Q: Can the 50% penalty for not taking the full RMD be waived?
A: Yes. According to the IRS, the penalty may be waived if the account owner establishes that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall.

Q: Can I use a rollover and/or transfer with my solo 401(k)?
A: Yes. Here are a few possibilities:

- Distributions made due to death, disability, or plan termination (without establishment of a successor 401(k)/ profit-sharing plan) may be rolled over to an IRA.
- If Roth contributions were made to the Solo 401(k), the Roth account portion may be rolled over to a Roth IRA.
- When moving your Solo 401(k) from one custodian to another (only changing your custodian and not ending your Solo 401(k) plan entirely), the assets should be moved via a transfer and not as a distribution/rollover.
- If you do receive distribution, you are permitted up to 60 days to roll this amount over into another retirement account to avoid paying taxes on the distribution.
- The failure to perform a timely rollover could also result in the imposition of a 10% early withdrawal penalty (if done prior to age 59 ½).

- A Solo 401(k) can accept rollovers from other many retirement plans, including an IRA.
- A 401(k) or similar employer retirement plan from a former employer can also be rolled over to a Solo 401(k).
- A current employer retirement plan may not be eligible for rollover to your Solo 401(k).
- The Roth portion of a prior employer 401(k) may also be rolled.
- A Roth IRA may not be rolled into a Solo 401(k).





III: Roth vs. Traditional

Q: Are Roth plans allowed with a Solo 401(k) plan?
A: Yes.

Q: What is the difference between a Traditional and Roth Solo 401(k) plan?
A: Basically, the difference between a Roth and traditional Solo 401(k) plan concerns when you are required to pay the tax. With a traditional Solo 401(k), you make contributions with pre-tax dollars, so you get a tax deduction up front. This permits you to lower your taxable income and thus reduce the overall taxes that you owe in the year of the contribution.

With respect to a Roth Solo 401(k), the contributions are made with after-tax dollars, so there's no tax deduction in the year of the contribution. However, withdrawals of *both* contributions and earnings are tax-free at age 59½, if you've held an account for at least five years.

Thus, the question becomes: when do you want to pay the IRS- now or later? The answer usually becomes a somewhat complex math problem, with considerations involving your age, type of risk, estimated tax bracket in retirement vs. today, etc.

Here is a link to a nice calculator for a comparison between a Roth and Traditional version of the Solo 401(k) plan (courtesy of AARP):
https://www.aarp.org/work/retirement-planning/roth_vs_traditional_401k_calculator.html

IV: Types of Permitted Investments

Q: What types of investments are permitted in a Solo 401(k)?
A: There are many different types available including:

- Stocks
- Bonds
- Mutual funds
- Exchange Traded Funds (ETF)
- Options
- Private placement offerings
- Residential real estate
- Commercial real estate
- Currency/FOREX
- Mortgage notes
- Private loans
- Gold, silver
- Crypto currencies
- Oil and gas
- Mineral rights
- Tax liens
- Limited Liability Companies
- Corporations
- Partnerships
- Venture capital

Q: What investments are prohibited in a Solo 401(k)?
A: In general, very few. Here they are:

- Collectables (coins, art, wine, stamps, jewelry, etc.). Note that there is an exception for US coins- gold, silver, platinum, and palladium that re 99.5% or more pure)
- Antiques
- Life insurance
- S Corporation stock

V: Taxes

Q: What are the potential tax benefits of a Solo 401(k)?
A: There are several. Here's a list to highlight some benefits:

- You can choose when to pay the taxes: either upfront with a Roth account or when the funds are distributed with a traditional account.
- The business can get a tax deduction for the contributions made in a traditional Solo 401(k).
- The employee/owner will not have to pay current year income taxes on the amounts contributed to a traditional Solo 401(k) account.
- All investment earnings grow tax-deferred in a traditional plan and tax-free in a Roth plan.

Q: Does the business get a tax deduction for the contributions it makes to a Solo 401(k) plan?
A: Yes, unless the account is a Roth account. In a Roth 401(k), the taxes are paid upfront (i.e., no tax deduction) but taxes are not owed when the funds are withdrawn in most instances.

Q: Are tax returns required for a Solo 401(k) plan?
A: Yes, in some circumstances:
- If your Solo 401(k) plan exceeds $250,000 in assets as of December 31, an annual Form 5500 EZ is required.
- When the plan is terminated, a Form 5500 EZ is required.
- When a distribution is taken from the Solo 401(k), a Form 1099-R is required.
- When a Roth conversion is completed, a Form 1099-R is required.
- If the Solo 401(k) is operating a business or otherwise has Unrelated Business Income (UBIT) during 2022, a Form 990-T is required.

Q: If UBIT is owed who pays it?
A: The UBIT tax must be paid by the Solo 401(k) plan and not by the owner of the account personally.

Q: Do I need to pay employment taxes on my contribution to a traditional Solo 401(k) plan?

A: Yes. For 2022, the self-employment tax rate is 15.3% on the first $147,000 worth of net income (up from $142,800 in 2021). That rate is the combination of 12.4% for Social Security and 2.9% for Medicare. As a business owner you pay both portions (for employer and employee) of Social Security and Medicare, the rate breaks down as follows:

Social Security tax:

- The employee's portion of the Social Security tax, which is 6.2% of the first $147,000 of net income
- The employer's portion of the Social Security tax, which is 6.2% of the first $147,000 of net income

Medicare tax:

- The employee's portion of the Medicare tax, which is 1.45% of all net income (no cap or limit on net income)
- The employer's portion of the Medicare tax, which is 1.45% of all net income (no cap or limit on net income)

Q: Does my business need to pay employment taxes on the business contribution to a Solo 401(k) plan?

A: No.

Q: How are distributions from my Solo 401(k) Plan taxed?

A: Any distributions are taxed as ordinary income in the year received. This is not considered to be "earned income" and thus no employment taxes are due on any distributions.

Q: Are there penalties if I take out distributions before retirement?

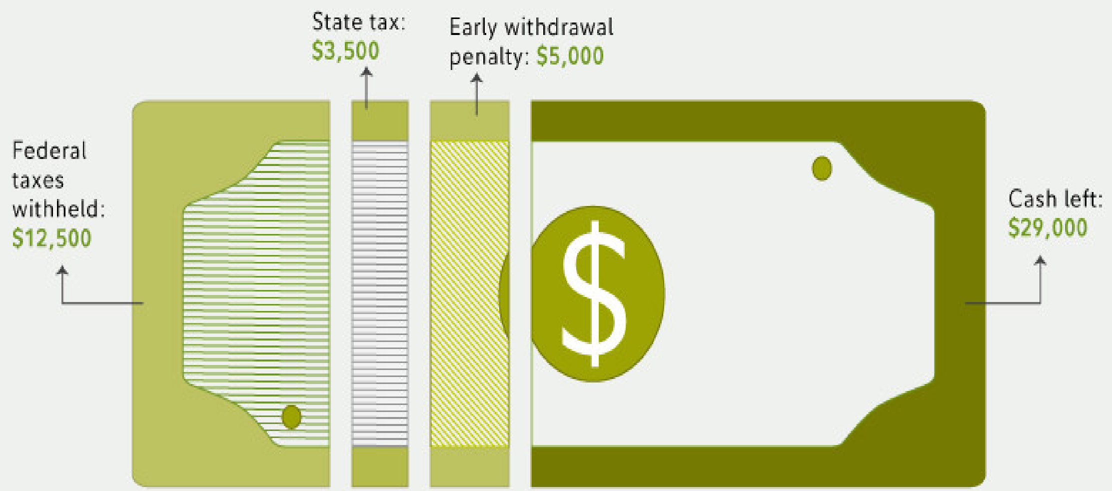
A: Yes. A 10% early withdrawal penalty may be imposed if you are under age 59 ½.

Q: Are there any exceptions to the 10% penalty?

A: Yes.

- Permanent disability
- Medical expenses that exceed 10% of your adjusted gross income
- Military service
- Withdrawal due to a divorce agreement that splits the 401(k) between ex-spouses

A $50,000 cash out prior to age 59½ could cost $21,000 in penalties and taxes.



This example assumes the following: A hypothetical 25% federal marginal income tax rate, a hypothetical 7% state income tax, and a standard 10% penalty for early withdrawal. This example is for illustrative purposes only. Please note that the 10% early withdrawal penalty does not apply to distribution made to an employee after separation from service after age 55. The withdrawal will still be subject to income taxes.

VI: Prohibited Transactions

Q: Are there any prohibited transactions with respect to a Solo 401(k)?

A: Yes. In general, the Solo 401(k) is prohibited from using any assets of the retirement account with a "Disqualified Person." Examples of a disqualified person include:

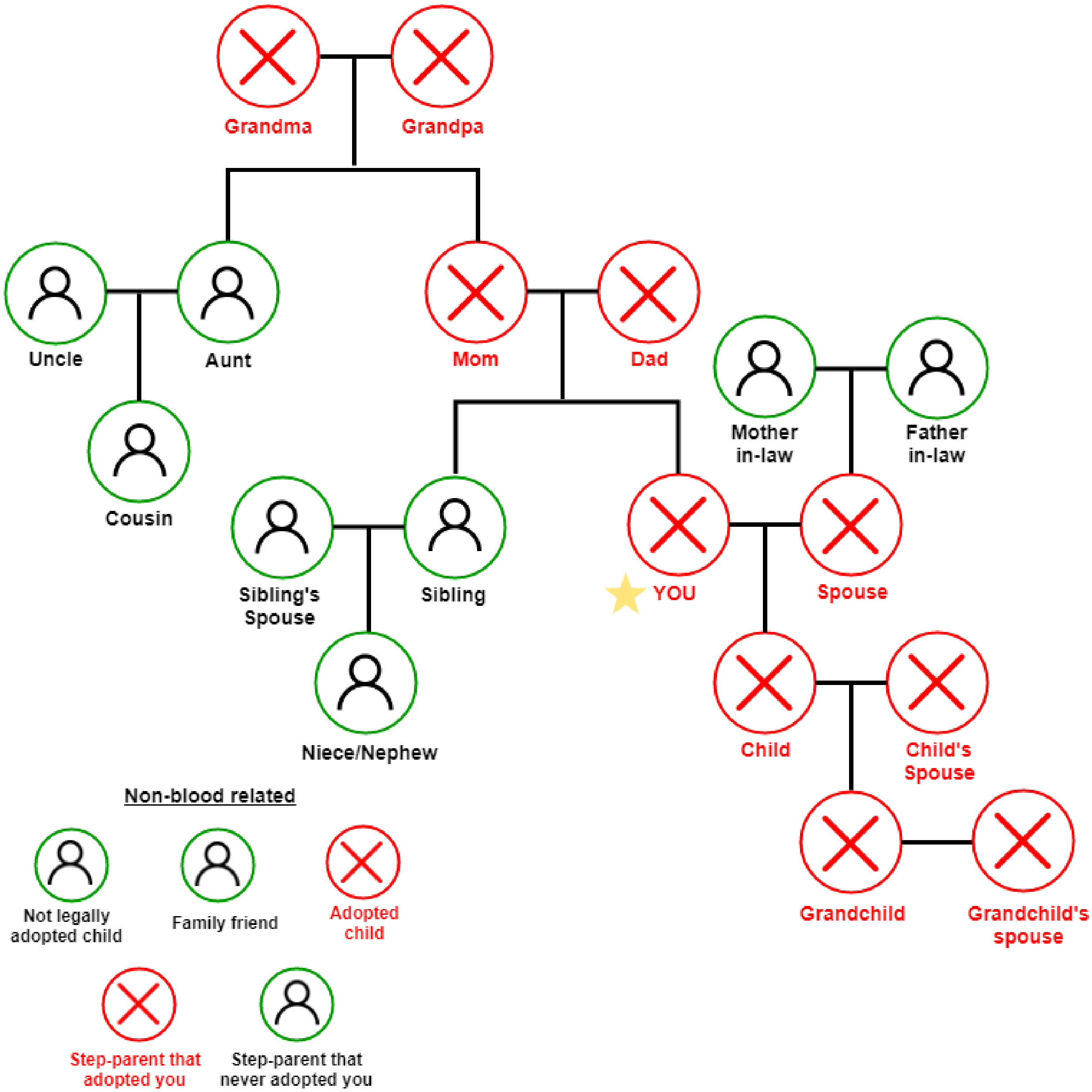
- The Solo 401k owner and his/her/their spouse
- The owner's mother, father, and grandparents
- The owner's children and grandchildren (and spouses)
- The fiduciary of the Solo 401k
- Anyone that provides services to the account (i.e., attorney, accountant, financial advisor, real estate advisor, etc.)
- Any entity (e.g., corporation, partnership, LLC, etc.) that is owned 50% or more, singularly or collectively, by any disqualified persons
- Once an entity becomes disqualified, then all its officers, directors, highly compensated employees, and other owners (owning 10% or more) become Disqualified Persons as well.

Although the list is lengthy, there are several categories who are not considered to be a "disqualified person." These include:

- Friends
- Brother and sister
- Uncles and Aunts

- Nieces and nephews
- Cousins

With respect to the chart below, the people with the red “x” are disqualified persons, while the green individuals are not.



Q: What does the IRS say about "prohibited transactions?

A: The IRS provides some nice guidance here, stating: "Prohibited transactions generally include the following transactions:

1. A disqualified person's transfer of plan income or assets to or use of them by or for his or her benefit.
2. A fiduciary's act by which he or she deals with plan income or assets in his or her own interest.
3. A fiduciary's receipt of consideration for his or her own account in a transaction that involves plan income or assets from any party dealing with the plan.
4. Any of the following acts between the plan and a disqualified person:
   - Selling, exchanging, or leasing property
   - Lending money or extending credit
   - Furnishing goods, services or facilities."

Q: What are some examples of a "Prohibited Transaction?

A: Here you go (*these are all prohibited*!):

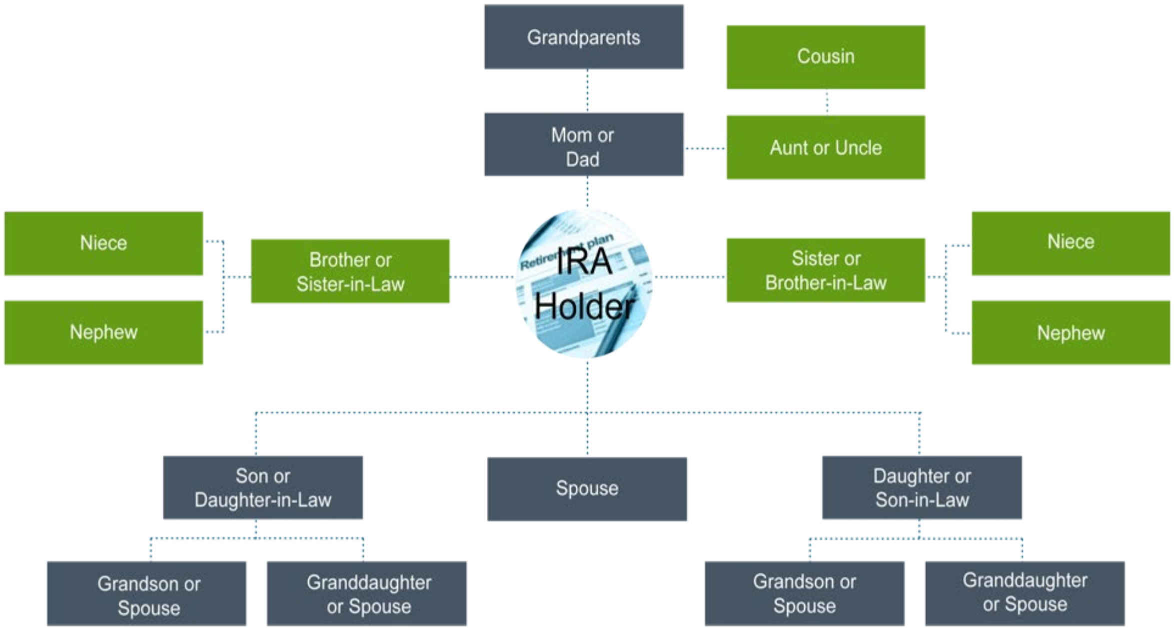
- Son rents condo in 401(k) plan to mother (even if at fair market value).
- Daughter sells real estate owned by Solo 401(k) Plan to Grandfather for fair market value.
- Dad invests funds in daughters LLC.
- Plan owner uses personal finances to pay for expenses that are related to the Solo 401(k), such as hiring a painter to paint your rental property owned by your account.
- Plan owner personally uses vacation condo owned by Solo 401(k) Plan.
- Plan owner hires grandson to perform work at rental property owned by Solo 401(k) plan.
- Son lends money in 401(k) plan to mother at fair market interest rate.
- Son lends money in 401(k) plan to father's business at a fair market interest rate.
- Plan owner personally guarantee a loan on behalf of the Solo 401(k) Plan.
- Plan owner buys asset from themselves in the Solo 401(k) plan.
- Daughter is hired to manage rental properties in Solo 401(k) plan.
- Daughter is hired to perform maintenance at property owned by 401(k) plan.
- Plan owner loans funds to business she owns 50% of.

- Mom is real estate agent and receives a commission upon sale of son's real estate inside 401(k) plan.

Q: What happens if I engage in a Prohibited Transaction in my Solo 401(k)?
A: If you have a Solo 401(k) Plan and engage in a prohibited transaction, the penalty is 15% of the amount involved. The IRS allows for some time to pay this tax and fix the transaction. Failure to do so will lead to an additional 100% penalty of the amount involved.

Q: How do I correct a Prohibited Transaction?
A: Once you have identified a prohibited transaction, you must correct it as soon as reasonably possible. In reality, this means that you must undo the transaction and put the Solo 401(k) plan back in the position it would have been in but for the prohibited transaction. I would strongly advise that professional counsel be engaged at any time a potential prohibited transaction may have occurred.

Here is another chart to help you distinguish between family members, with the green family members good from a prohibited transaction standpoint:



VII: Concluding Thoughts and Further information

IRS

Department of the Treasury
Internal Revenue Service

Q: Does the IRS offer any assistance here?
A: Yes. I strongly recommend that you obtain a copy of IRS Publications 560, 590-A and 590-B (free at www.irs.gov)

Education is Critical

Register for my next no-cost tax planning and strategies webinar here:
https://shrtlnk.co/fFano

Tax Tips for A Solo 401(k) Plan

1. Do your due diligence on the custodian of the account.
2. Do your due diligence on any investment and other professional/tax/legal advice.
3. Consider the pros and cons of a Roth 401(k) plan.
4. Never personally guarantee any loan/leverage in your Solo 401(k).
5. All loans which the Solo 401(k) plan receives must be non-recourse in nature (only recourse is to satisfy the debt with the underlying asset itself).
6. For any physical gold/silver metals or coins, make sure that these are held in the United States. They cannot be held outside of the U.S.
7. Do not make a loan or receive loan proceeds from a disqualified person.
8. Any loans should be in writing, formally recorded (secured) and have a current fair market interest rate (often Prime rate).
9. Beware of the “too good to be true” financial promoters.
10. Beware of flipping properties with real estate as while permitted it would trigger the application of the Unrelated Business Income Tax (UBIT).
11. Records concerning any rental income and expenses must be kept when the real estate is leveraged due to UBIT.
12. UBIT may also occur if you are operating a business within the Solo 401(k) plan.

13. Business records concerning income and expenses must be kept if a business is being operated within a Solo 401(k) plan.
14. All transactions must be done in the plan's name.
15. Do not combine any plan assets with personal assets.
16. Do not earn any current income from any assets in the Solo 401(k) plan.
17. Do not use personal credit cards to purchase anything on behalf of the plan.
18. Do not use any personal checks to pay for any Plan expenses.
19. It is permissible to use "checkbook control" and write the checks from the Plan's account. However, this is not always recommended.
20. All investment gains and losses must be allocated to the Plan.
21. Get IRS Publications 560, 590-A and 590-B to understand the rules.
22. If there is a current personal benefit to you or any other "disqualified person" from your Solo 401(k) Plan, it is probably a prohibited transaction.
23. Get professional advice before you buy or sell any investment within the 401(k) plan to avoid any unpleasant tax surprises.

Further Information

Tax Code Sections:

IRC § 401:   Retirement Plans
IRC § 4975: Prohibited Transactions

IRS Publications:

Publication 560	Small Business Retirement Plans
Publication 575	Pensions and annuities
Publication 590-A	Contributions to an IRA
Publication 590-B	Distributions from an IRA
Publication 598	UBIT

LinkedIn

https://www.linkedin.com/in/scottestill/