What is a Solo (k) Plan

Are you a small business owner? Are you self-employed?

The same retirement plan options available to companies with 10, 20 or 200 employees are also available for your business. Many Small Business Owners may be more familiar with a Simplified Employee Pension (SEP) IRA. With a SEP you can deduct up to 25% of your earned income. However, it may make sense to look at a one-participant 401(k) plan. This combines a traditional employee retirement savings plan with a small business profit-sharing plan. This may make for a larger overall deduction comparable to the same earned income.

Contribution limits in a one-participant 401(k) plan

The business owner wears two hats in a 401(k) plan: employee and employer. The owner can contribute:

- Elective deferrals which reduce compensation ("earned income" in the case of a self-employed individual) up to the annual contribution limit:
    - $24,500 in 2026, or $32,500 in 2026 if age 50 or over; plus
- Employer contributions up to:
    - 25% of compensation, as defined by the plan, with special calculations for sole-proprietor and partnership entities

Total contributions to a participant's account, not counting catch-up contributions for those age 50 and over, cannot exceed the lessor of: 100% of compensation, or $72,000 for 2026. In addition, the 401(k) limit on elective deferrals is an individual, calendar year limit, not a limit for each plan. If a business owner is also employed by another company and participates in its 401(k) plan, the total of all elective deferrals cannot exceed the annual contribution limit.

Contribution limits for self-employed individuals

If the business entity is a sole-proprietor or partnership, a special computation must be made to determine the maximum employer contribution. When calculating the contribution, it is a circular calculation. Compensation, or "earned income," is the net earnings from self-employment after deducting both your share of the employer allocation and one-half of your self-employment tax.

Note: *The IRS Publication 560 provides rate tables and worksheets for figuring your allowable contribution rate and tax deduction for your 401(k) plan contributions.*

Testing in a one-participant 401(k) plan

A business owner with no common-law employees doesn't need to perform nondiscrimination testing for the plan, since there are no employees who could have received benefits under the plan. The no-testing advantage vanishes if the employer hires employees. If the business hires employees, the plan must satisfy all coverage and non-discrimination requirements as any other 401(k) plan, once they become eligible.

Note: *The Plan Document should be flexible enough to protect the employer if employees are hired in the future.*

Voluntary After-Tax Contributions and a Roth Strategy

The Solo 401(k) Plan is a wonderful way for a small business to take a deduction from current income and defer the taxation until retirement age, but many small business owners are deferring the deduction to make Roth 401(k) contributions. By maximizing the Roth 401(k) deferrals, then making Voluntary, After-tax contributions up to the maximum annual additions limit ($72,000 in 2026) and immediately converting those contributions to Roth, the business can help fund a large pool of Roth money that will not be taxed upon distribution, and may be passed on to heirs without minimum distribution requirements. It is important to remember that the owner-employee must have a W-2 income equal to or greater than the current annual additions limit ($72,000 in 2026), and these voluntary, after-tax contributions must be deposited within 30 days after the end of the Plan Year to count as annual additions for that Plan Year.

Deadline for establishment of plan

The SECURE Act of 2019 allows a qualified plan to be established up until the deadline of the return for which the deduction is taken, however, it did not extend the deadline for which income may be deferred in a 401(k) plan. Thus, a Solo-k plan established after the end of the 2025 Calendar Year would only allow employer profit sharing contributions, as any 401(k) deferrals may only be deducted from income earned in 2025. Deferrals deducted from income in 2026 would be reported on the 2026 tax return. There are some limited cases with Sole-proprietorships or Partnerships that may allow deferrals after the tax year, but for the most part, deferrals must be deducted from earned income in the year the deduction is taken.

Reporting requirements (Form 5500)

If plan assets exceed $250,000 at the end of a plan year, the plan will be required to file a Form 5500-EZ, or Form 5500-SF until the plan is terminated and all assets are disbursed. A one-participant 401(k) plan with fewer assets is exempt from the annual filing requirement. When determining the $250,000 threshold, all plans of the entity are considered; if you sponsor more than one plan, the filing requirement starts when the sum of the assets combined in all plans exceeds $250,000 at year-end.

Note: *Failure to file Form 5500 when required can result in substantial penalties on audit.*

Most Small Business Owners are familiar with a SEP IRA. Planning for retirement with a 401(k) plan can offer a great degree of flexibility. The basics start with a 401(k) plan; and adding a defined benefit pension plan can greatly increase the potential tax deduction available to a successful business owner. Whether you are adopting a plan for the first time, or have one that needs cleaning up, EJReynolds is here to help.

ejr ejreynolds

WHERE IS YOUR COMFORT PLACE?
EJR CAN HELP YOU GET THERE.

9050 Pines Blvd., Suite 202, Pembroke Pines, FL 33024

Office: 954.431.1774 Fax: 954.438.7250

www.ejreynoldsinc.com