RETIREMENT PLANNING FOR THE SELF EMPLOYED

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Not everyone has a boss. In an economy upended by COVID, individuals, sometimes by choice and sometimes not, are striking out on their own and starting new businesses or becoming part of the gig economy. A critical issue for these workers is how to save for retirement. If you are self-employed, you may ask which retirement account is best for you. This question requires careful analysis because there is not one plan that is right for everyone.

Traditional or Roth IRA

For many who are new to gig work or have just started their own business, the best place to start saving for retirement may be with a traditional or Roth IRA. This is the easiest way to go. It simply requires making a contribution. However, the annual contribution limits are much lower than for other retirement savings options. For 2021, the maximum IRA contribution is $6,000 for those under age 50 and $7,000 for those over age 50. For those just starting out, the low dollar limit may not be a problem, but for higher earners it may not allow enough savings.

For those who are interested in a Roth option, a Roth IRA may be a good idea because there are no Roth options available for SEP IRA or SIMPLE IRA plans. However, Roth IRAs are subject to income limits, so this may not work for those with higher incomes. (Such individuals would need to use the “backdoor Roth IRA” strategy.)

SEP IRA Plan

One of the most common retirement plan solutions for the self-employed is a SEP

IRA plan. These plans are inexpensive to adopt and administer. However, SEP IRAs only allow employer contributions – not elective deferrals.

SEP IRA plans offer a great deal of flexibility. Contributions do not have to be made each year and the amount can vary. The plan also does not have to be established or funded until the business's tax-filing deadline, including extensions.

The SEP limit for 2021 for self-employed individuals is 20% of up to $290,000 of compensation (adjusted net earnings), limited to a maximum annual contribution of $58,000. (For a SEP for businesses not self-employed, the limit is the same, except "25%" is substituted for "20%.")

SIMPLE IRA Plan

SIMPLE IRAs can also be adopted by self-employed individuals. Generally, a business can only adopt this plan if it employed 100 or fewer people during the previous calendar year and it is the only plan sponsored by the employer.

Unlike SEP IRAs, SIMPLE IRAs allow salary deferrals. For 2021, the salary deferral limit is $13,500, but there is an additional $3,000 catch-up contribution for anyone age 50 and older. These plans also require an annual employer contribution. The annual employer contribution must be either a dollar-for-dollar matching contribution (not to exceed 3% of compensation) or a 2% non-elective contribution. (If a matching contribution is made, compensation is not limited. If a non-elective contribution is made, compensation is limited to $290,000 for 2021).

A self-employed individual stands in the shoes of both employee and employer. For 2021, the maximum SIMPLE IRA contribution available would be $33,000 ($16,500 in salary deferral + $16,500 in employer match).

Solo 401(k) Plan

A one-participant 401(k) plan is sometimes referred to as a "solo-401(k)," "individual 401(k)" or "uni-401(k)." A key point to understand is that a solo 401(k) is simply a type of 401(k) plan and is subject to many of the regular 401(k) rules. However, because there can be no employees (other than the self-employed individual and the spouse), these plans are exempt from complicated discrimination testing.

A self-employed individual can contribute both:

- Elective deferrals up to 100% of compensation, but no more than $19,500 in 2021, or $26,000 in 2021 if age 50 or over; and
- Employer nonelective contributions up to 20% of adjusted net earnings for those who are self-employed. (For a solo 401(k) for businesses not self-employed, the limit is the same, except “25%” is substituted for “20%.”)

For 2021, total contributions to a participant’s account, not counting catch-up contributions for those age 50 and over, cannot exceed $58,000 (or, if lesser, 100% of the individual’s compensation).

Making the Choice

Choosing a retirement plan can be challenging if you are self-employed. Contribution limits are not the only factors to consider. You must also think about cost, ease of administration, and accessibility of funds to consider. A knowledgeable financial advisor can help answer your questions you may have in making your decision.