Retirement Savings Options for the Self-Employed

Article by Wealth Management Systems, Inc.  Courtesy of a Morgan Stanley Financial Advisor

As a self-employed individual, you have access to several types of retirement plans. As is the case for large plans, a plan-of-one allows you to put away large amounts of money on a tax-deferred basis while deducting your contributions from your income.

Among your options as a self-employed individual are IRAs, defined contribution and defined benefit plans.

**IRA OPTIONS**

The two main types of IRAs for self-employed individuals are the Simplified Employee Pension (SEP) and Savings Incentive Match Plan for Employees (SIMPLE). A key benefit of both is the ability to contribute, tax deferred, amounts greater than that of a traditional IRA.

A SEP allows you to make tax-deferred contributions of 25% of net earnings from self-employment, to a maximum contribution that is set annually by the IRS. (For 2015, the earnings limit is $265,000 and the maximum contribution is $53,000). It is up to you as to whether to contribute in a given year, allowing for fluctuations in your business’s cash flow.

A SIMPLE IRA is designed for employers with 100 or fewer employees; self-employed individuals make contributions as both employee and employer. For 2015, you may contribute 100% of compensation but not more than $12,500 through salary reduction as an employee. In addition, you may make catch-up contributions of $3,000 if you are at least age 50. As your own “employer,” you must make an employer contribution, matching (up to a maximum of 3% of compensation) or a nonelective contribution of 2% of compensation (for this purpose compensation is limited to $265,000 for 2015).

**DEFINED CONTRIBUTION OPTIONS**

Self-employed individuals may also operate a 401(k), profit sharing or money purchase plan. These are more complex to implement and maintain, even for a sole proprietor. Among the requirements is the annual filing of IRS Form 5500, Annual Return/Report of Employee Benefit Plan, or, if eligible, Form 5500-SF for small employee plans or Form 5500-EZ for sole proprietors.

Although 401(k)s are associated with larger companies, they are also available to self-employed individuals. Often referred to as a solo 401(k), it has the same rules and limits as traditional 401(k)s other than it is, by design, exempt from discrimination testing. Elective deferrals for 2015 top out at $18,000, (plus $6,000 in catch-up contributions if applicable). Additional contributions of up to 25% of net earnings from self-employment are also permitted, up to a maximum of $53,000 for combined total contributions.

A profit sharing plan allows discretionary contributions up to the smaller of 25% of compensation or the annual IRS limit ($53,000 in 2015). Money purchase plans have the same limits, yet contributions are required.

**DEFINED BENEFIT OPTION**

If you prefer a plan that will promise a monthly income at retirement, you might consider a solo defined benefit (DB) plan. The monthly benefit is determined by a formula based on salary history and years of service. Your contribution amount is not fixed--it is calculated each year by an actuary based on industry standards, and there is no upper limit. However, the annual maximum benefit you may receive at retirement is limited ($210,000 in 2015).

If you would like to learn more about retirement plans for the self-employed, including any effects should you eventually hire employees, please contact me. I can assist you with putting together a retirement plan strategy to suit your needs.

Sources:


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