QUEST TRUST COMPANY

Going Solo

The Wealth Building **401k** for Entrepreneurs

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As a busy entrepreneur, are you looking for a better way to save for retirement with the ability to make large annual contributions? Do you want the ability to diversify your portfolio with a wide range of investments, including real estate and private companies? Are you looking for a plan that allows you more control to manage your investments? You’ve come to the right place. The Solo 401k has all those things and more. Intrigued? Let’s dive further into the Solo 401k to learn if this plan is right for you.

What is a Solo 401k?

A Solo 401k is one of the most powerful retirement accounts for business entrepreneurs. This plan gives you more freedom and flexibility than other retirement plans to choose your investments and respond to opportunities faster. With a Solo 401k, you can invest in almost anything. However, with this freedom and flexibility comes much more responsibility. As the administrator of your Solo 401k plan – you make the decisions, you sign your own investment documents, you fund your investments, and you are responsible for the recordkeeping and reporting. Understanding the rules and regulations are critical for managing this type of retirement account.

Who qualifies for a Solo 401k?

To qualify for a Solo 401k, you must meet the following criteria. First, you must be self-employed or a small business owner. Self-employment can be defined as carrying on a trade or business as a sole proprietor, independent contractor, freelancer, or some form of partnership. Second, you can't have any full-time employees, except for your spouse. Any employee working more than 1,000 hours per year is considered a full-time employee and would disqualify you from the plan. Third, you must receive salary or compensation from your company. Many small business owners do everything they can to save money, including not paying themselves, but for this plan, you must receive compensation. This brings us to the final requirement: your business should be profitable or at least break-even. You need to be able to pay yourself and pay the bills, so earning a profit should be your end goal.

What are the advantages of a Solo 401k?

Higher Contribution Limits

The Solo 401k allows for larger contribution limits compared to other retirement plans. With a Solo 401k, you can contribute as both the employer and the employee of your business. These higher limits can help you accelerate your savings for retirement and increase your investment options.

Tax Advantages

The Solo 401k offers tax advantages depending on what type of account you set up as the employee deferral portion.

- If you set up your account as a Traditional Solo 401k, you can reduce your taxable income by deferring a portion of your income into your Solo 401k. The money you invest and the income it earns will grow tax deferred until it is withdrawn during retirement.
- If you set up your account as a Roth Solo 401k, you can withdrawal the money tax free since you are funding the account with after-tax earnings. And for those of you that are over the income limit and are not able to contribute to a Roth IRA, you can still contribute to a Roth Solo 401k because there are no income limits.
- Small business owners may qualify for a tax credit for establishing and managing a Solo 401k, with the credit covering up to 50% of setup and administration costs, up to a maximum of $500 per year for three years.

What are the advantages of a Solo 401k?

Can Loan to Yourself

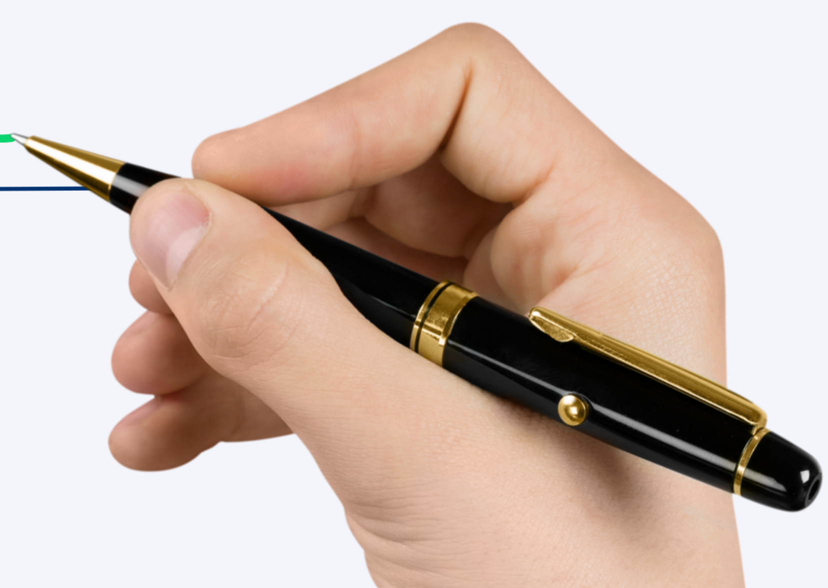
With a Solo 401k, you have the ability to make loans to yourself up to $50,000 or 50% of the account value, whichever is smaller. Then when you make payments on the loan, you pay yourself back with interest. An IRA does not have this option because loaning to yourself would be considered a prohibited transaction.

Exemption from UDFI

UDFI or Unrelated Debt-Financed Income rules apply to tax-advantaged retirement accounts like IRAs when they use debt financing to acquire income-producing properties and are designed to prevent unfair competition with taxable entities. Generally, Solo 401ks are exempt from UDFI rules when it comes to real estate investments.

Checkbook Control

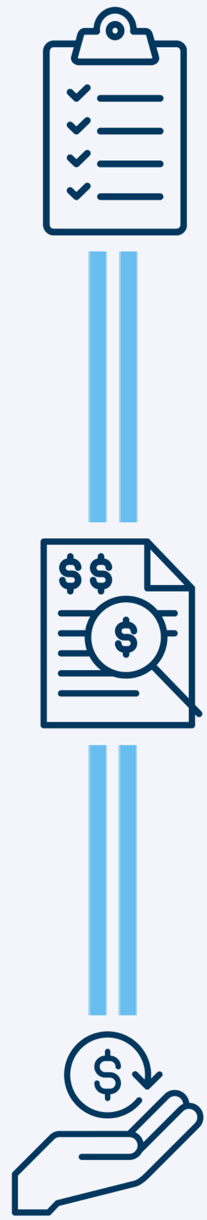
When you open a Solo 401k, you establish a bank account connected to it. This allows you to fund your own investments by writing a check directly from your account, allowing you the freedom to act quickly on investment opportunities, instead of waiting for approval from a custodian or administrator.



What are the disadvantages or dangers of a Solo 401k?

Difficult Recordkeeping

Since this is one of the most powerful accounts that is allowed by the IRS, it also requires very detailed bookkeeping. You must be able to keep your personal funds, business funds, and Solo 401k funds separate. You need to keep very accurate records of all transactions and distributions so there is no co-mingling of funds. There is no custodian overseeing your transactions so it's up to you to follow all applicable rules and regulations. Otherwise, you may incur significant tax penalties and legal issues.



Responsible for IRS Reporting

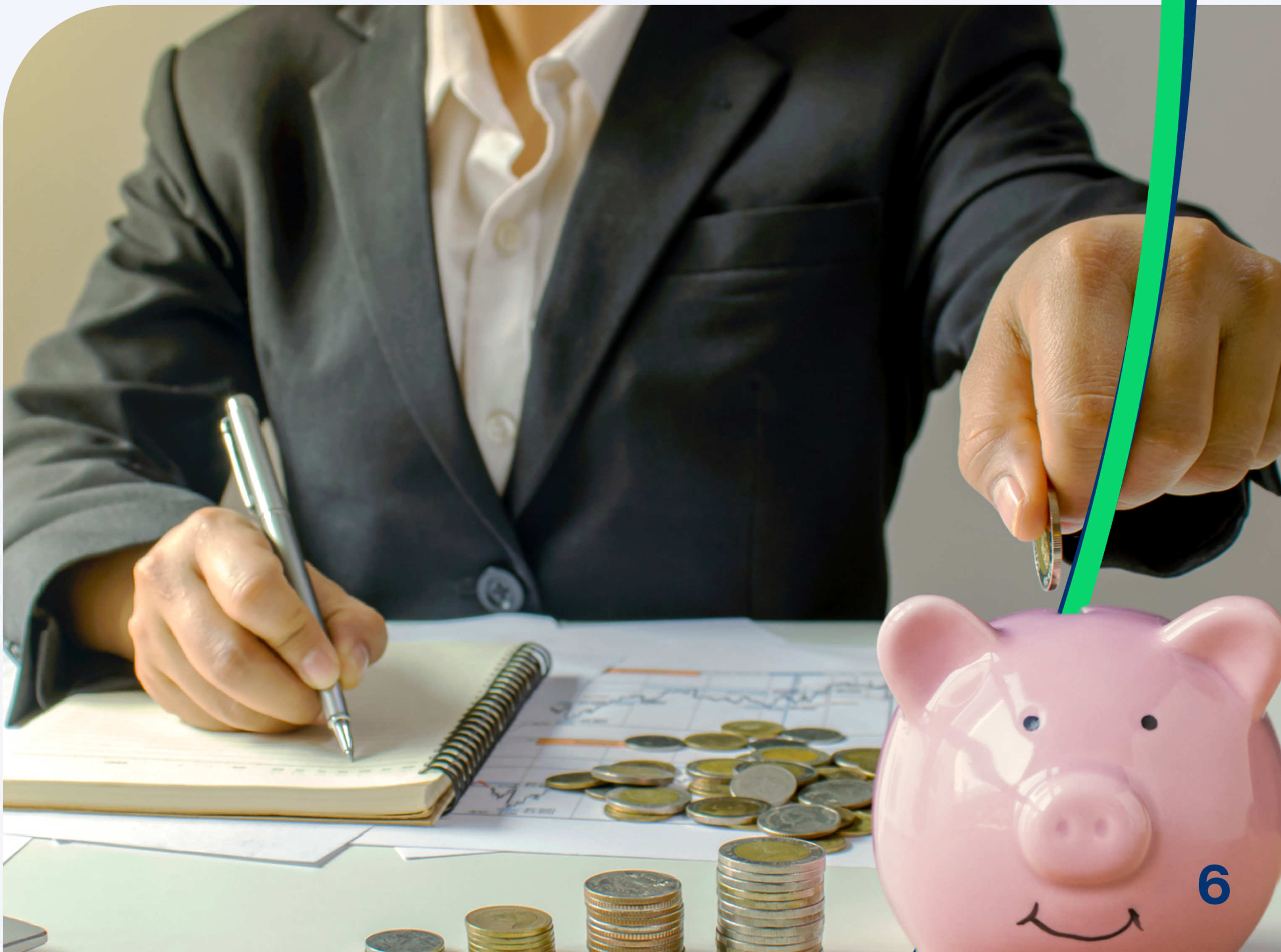
While you need a custodian to set up the plan documents, the custodian does not administer this type of account – you do. This means that you will be responsible for filing IRS forms, such as that 5500-EZ and 1099-R and making sure you are compliant with any IRS regulations.

Legitimizing

When you open a Solo 401k, you are required to legitimize the account by making a contribution satisfying the minimum funding requirement for the tax year in which the account was established. According to IRS Pub. 560 – Minimum Funding Requirement, "Determining the amount needed to satisfy the minimum funding standard for a defined benefit plan is complicated, and you should seek professional help in order to meet these contribution requirements."

What are the contribution limits?

SOLO 401k Contribution Limits	2022	2023
Employee Salary Deferral Maximum	$20,500	$22,500
Employer Contributions Profit Sharing	25% of W-2 wages or 20% net self-employment income up to the maximum combined limit	
Combined Total Maximum	$61,000	$66,000
Catch-up Contribution Age 50+	$6,500	$7,500



What are the contribution limits?

For a Solo 401k, you have the advantage of making contributions up to the combined total maximum as both an "employee" and "employer." As an "employee," you can contribute up to 100% of your earned income up to the salary deferral maximum allowed for that tax year. As an "employer," you can contribute up to 25% of W-2 wages or 20% of your net self-employment income minus the plan contributions you made as the "employee" and half your self-employment tax. If you are age 50 or older, you can also make a catch-up contribution on top of the combined total maximum.

For example, John Smith receives $100,000 in W-2 income from his business. He was able to make the maximum "employee" salary deferral of $22,500 and an "employer" profit sharing contribution of $19,375 for a total contribution of $41,875.

$100,000 - $22,500 = $77,500 x 25% = $19,375

It's important to note that 401k contribution limits are per person, not per plan, so if you have a 401k through your employer and a Solo 401k for your freelance business, the total you can contribute to both accounts is the combined total maximum allowed.

What can I invest in with my Solo 401k?

Real Estate

Rentals
Foreign Property
Vacation Rentals
REITs
Tax Liens

Entities

Crowdfunding
Fintech
Angel Investing
Syndications

Traditional Investments

Mutual Funds
Stocks
EFTs
Annuities
Life Insurance

Promissory Notes

Convertible Notes
Secured Notes

Other

Precious Metals

What are the distribution rules?

Distribution rules for the Solo 401k are subject to specific guidelines set by the IRS and can be complex and vary based on plan specifics, your age, and other factors. Generally, you can start taking penalty-free distributions from your Solo 401k once you reach age 59½.

- Distributions taken before age 59½ may be subject to a 10% early withdrawal penalty, in addition to regular income taxes, unless an exception applies.

- Roth contributions, if allowed by the plan, can be withdrawn tax-free at any time, as long as the account has been open for at least five years.

- If a full-time employee is hired, the plan can be terminated and funds inside the Solo 401k can be rolled over into another retirement plan.

What are the steps to establish a Solo 401k?

1. Choose your custodian. Not all custodians are the same. While some just help you establish the account and create the plan documents and amendments, other custodians have platforms that can help you manage the account, simplifying the complex recordkeeping, IRS reporting, and compliance.

2. Label the 401k as **"[Business Name], 401k Plan"** and vesting would be **"[401k Plan Name], [Trustee's Name], Trustee"**

3. Apply for an Employer Identification Number (EIN) for your Solo 401k, which is different than your business EIN. To apply for an EIN, click on this [link for IRS website] (hold Control while you click link). Select "Begin Application," and then select "View Additional Types…" and then you will have the option to select 401k plans.

4. Complete the new account paperwork.

5. Establish a bank account. Any bank will work since the account is just a depository to hold your funds.

6. Legitimize account by making a contribution. You can fund your account by profit-sharing, Traditional or Roth 401k contributions, and rollovers from other employer accounts.

If you would like to make a contribution for the current tax year, you must establish your account and make an employee contribution by <u>Dec. 31st of the tax year</u>. Profit-sharing contributions can be made until your tax-filing deadline.

Quest's New **Solo 401k** Platform

Quest's new Solo 401k platform provides an all-in-one solution to address the common areas of concern with administering this plan. This platform will help you with:

REDUCING MANUAL WORK

Our platform allows for simplicity in managing various buckets of money.

EASY TO USE

User-friendly platform with intuitive features offers a simple solution to manage your retirement plan.

IRS REPORTING

Our platform prepares IRS Forms such as 5500-EZ and 1099-R, as well as stores everything you need in case of an IRA audit.

AUTOMATIC BANK ACCOUNT

Our platform automatically opens an FDIC insured account which is connected to your Solo 401k plan.

COMPLIANCE

Keep current with regulatory changes and compliance requirements.

RECORDKEEPING

Our recordkeeping system is simple to use and will guide you through the process of setting up your plan as well as managing it and keeping track of your money in separate "buckets".

If you would like to learn more about Quest's new platform or have questions about any retirement accounts, give us a call or schedule a consultation with one of our IRA Specialists.

Click here to learn more about our Solo 401k Platform

At Quest, we pride ourselves on the educational resources we provide, which are available to both clients and non-clients. If you have any questions or are unsure of which type of retirement account would best meet your financial needs, give us a call or schedule a consultation with one of our IRA Specialists, and we would be happy to help.

Contact us!

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