

# DIFFERENCES BETWEEN SEP IRA AND SOLO 401(K)

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SEP IRA and Solo 401(k) are retirement plan options for business owners, independent contractors, and/or freelancers that have earned income from their business. Depending on circumstances, one plan may be preferential over the other.

Things to consider for suitability are whether you have employees or not, or whether your goal is to maximize contribution limits within your retirement plan.

For the most part, they are similar, but different in a few ways so let's take a look at the differences.

Both SEP IRA and Solo 401(k) are easy to set up and maintain, however, SEP IRA does NOT require annual filing whereas Solo 401(k) requires annual filing of the Form 5500. Although filing the Form 5500 itself is not difficult, but once employees are hired, the Solo 401(k) may need to be converted to the traditional 401(k) and this may require more administrative work and additional fees to maintain the plan.

For SEP IRA, whether they are part-time, seasonal, or full-time employees, they are eligible as long as they meet the following requirements:

- 21 years or older
- Have worked with the company for 3 years in the last 5 years
- Earned more than \$600 of income that year

If the employee is found eligible, the employer would give equal percentage of benefits as they have paid towards their own account so it may become costly to maintain if one has many eligible employees.

Here are some other notable differences between SEP IRA and Solo 401(k) beginning with the contribution limit.

### SEP IRA Contribution limit:

Two options following if within the \$55,000 contribution limit are allowed for maximum contribution amount towards SEP IRA:

- 25% of W-2 or
- 20% of Schedule C amount

For example, taking a 51-year-old named Joe who owns an S-Corporation with a W-2 totaling \$50,000 and net-profit (K1) of \$50,000; his SEP IRA contribution should be less than \$12,500 although the net-profit may support higher contributions based on the dollar limit.

### SEP IRA MAXIMUM CONTRIBUTION ALLOWED FOR \$50,000 W-2

$$\$50,000 (W-2) \times 25\% = \$12,500$$

### Solo 401(k) Contribution limit:

There are two options that allow contributions of up to \$55,000 for year 2018:

- Elective deferrals – 100% of compensation
  - \$18,500 for those under 50 years of age
  - \$24,500 for those over 50 years of age
- Nonelective deferrals
  - 25% of compensation by the company

For example, taking Joe who is 51 years old, he can elect to defer up to \$24,500 from his compensation and have the company contribute \$12,500, which is 25% of his salary totaling \$37,000 in contributions to his Solo 401(k) plan for that year unlike SEP IRA where he is limited to \$12,500 a contribution.

### SOLO 401(K) MAXIMUM CONTRIBUTION ALLOWED FOR \$50,000 W-2

$$(\$50,000 (W-2) \times 25\%) + \$24,500 (401(K)) = \$37,000$$

In summary, **Solo 401(k) in this situation allows 3 times of a greater contribution than SEP IRA at the same level of income in the case of a business owner with a \$50,000 W-2 (see Illustration below).**

SEP IRA MAXIMUM CONTRIBUTION	SOLO 401(K) MAXIMUM CONTRIBUTION
$\$50,000 (W-2) \times 25\% = \$12,500$	$(\$50,000 (W-2) \times 25\%) + \$24,500 (401(K)) = \$37,000$

Alongside, there are also many commonly held misconceptions as follows:

- SEP IRA Misconceptions
  - Catch up contribution of \$6,000 per year permitted
  - Part-time and seasonal employees can be eliminated
  - Only traditional investment options such as mutual funds, stocks, and ETFs are allowed
- Solo 401(k) Misconceptions
  - Cannot add spouse
  - Having only part-time or seasonal employees permit eligibility

In summary, both retirement plan options, prove to have solid benefits catered towards business owners. The ease of filing and maintenance make them ideal options. When deciding which option to go with, it is important to note differences between the two options as one option is better suited dependent on your situation. Please consult with a financial professional or your CPA regarding your specific situation before deciding on a retirement plan.

### SEP IRA vs. Solo 401(k) Comparison at a Glance

Here are some other factors to keep in mind and a quick chart to illustrate the differences between both retirement plans.

	FUNDING OPTIONS	EMPLOYEE MATCHING	LOAN PROVISIONS	INVESTMENT OPTIONS	CONTRIBUTION DEADLINES
<b>SEP IRA</b>	Employer contribution only	Equal percentage matching to employees	No loan provisions	Does not allow non-traditional investment options such as life insurance	Can be set up and funded just before the tax filing due date (which is as late as Sept. or Oct. of the following year if filing late)
<b>SOLO 401(K)</b>	Employer contribution only	Equal percentage matching to employees	Up to 50% of total accumulated amount or \$50,000	Allows non-traditional investment options such as life insurance.	Needs to be set up by Dec. 31st, but contribution can be funded (which is as late as Sept. or Oct. of the following year if filing late)

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