NEWS Tax

# Advisors recommend solo 401(k) to sole-proprietor clients

Some business owners are able to accumulate more retirement savings in the vehicles than in a SEP IRA, and such funds can also become part of a Roth IRA rollover strategy.

February 28, 2023 By Mark Schoeff Jr.



Financial advisors are telling their clients who are sole proprietors to consider managing their retirement savings in a solo 401(k), a vehicle that will gain more flexibility next year.

Joanne Burke's advisory firm is located in suburban Virginia, where some of her clients are retired federal workers. A portion of them have set up consulting practices after concluding their government service.

They have a government pension coming in as well as the revenue from their businesses, and that's a profile that lends itself to a solo 401(k), Burke said.

The contribution limit for a solo 401(k) is $66,000 in 2023, or $73,500 for people over 50, who can also make a catch-up contribution of $7,500. It can be ***a better savings vehicle*** than a simplified employee pension plan — known as a SEP — which has the ***same contributions limits*** as a traditional individual retirement account.

"Typically, you can put more into the solo 401(k) than you can into a SEP IRA," said Burke, owner of Birch Street Financial Advisors in Vienna, Virginia.

In a solo 401(k), a business owner can contribute to the plan both as the owner and an employee. In part, that's what can make it a better savings vehicle than a SEP for business owners below a certain income level.

Such owners may not be thinking about ***optimizing retirement plan tactics,*** and that's where an advisor can help. Jon Ekoniak, managing partner at Bordeaux Wealth Advisors, said he tends to start that discussion.

"We are more frequently proactive," Ekoniak said.

Funds allocated to a solo 401(k) also can become part of a ***Roth IRA rollover strategy,*** Burke said.

If a client who's over 50 allocates $30,000 tax-deferred into a solo 401(k) — the limit for that kind of contribution this year — the remaining $43,500 contribution can be made in after-tax money. Those funds can be withdrawn and put into a Roth IRA, if that's allowed by the solo 401(k) sponsor. It's a form of a back-door Roth.

"This is a way to accumulate tax-free growth assets," Burke said. "It all boils down to cash flow."

Thanks to the sweeping SECURE 2.0 retirement savings legislation Congress approved in December, sole proprietors will have more time to decide whether establish a solo 401(k). Beginning in 2024, they will have until the tax-filing deadline to make contributions that affect their prior-year taxes.

“It’s putting [solo 401(k)s] on a similar schedule to the SEP and Simple IRAs, which can be opened after the beginning of the year,” said Jonathan Duggan, director of financial planning at Procyon Partners.

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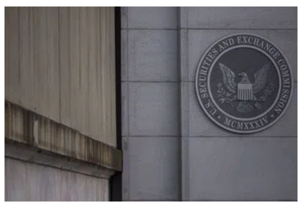

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