



## Oppenheimer & Co. Inc.

Spencer Nurse  
Managing Director - Investments  
500 108th Ave. NE  
Suite 2100  
Bellevue, WA 98004  
425-709-0540  
800-531-3110  
spencer.nurse@opco.com  
<https://www.oppenheimer.com/spencernurse/>



# The Individual 401(k)



If you're self-employed or own a small business, you've probably considered establishing a retirement plan. If you've done your homework, you likely know about simplified employee pensions (SEPs) and savings incentive match plans for employees (SIMPLE) IRA plans. These plans typically appeal to small business owners because they're relatively straightforward and inexpensive to administer. What you may not know is that in many cases an individual 401(k) plan [which is also known by other names such as a solo 401(k) plan, an employer-only 401(k) plan, a single participant 401(k) plan, or a mini 401(k) plan] may offer a better combination of benefits.

## What is an individual 401(k) plan?

An individual 401(k) plan is a regular 401(k) plan combined with a profit-sharing plan. However, unlike a regular 401(k) plan, an individual 401(k) plan can be implemented only by self-employed individuals or small business owners who have no other full-time employees (an exception applies if your full-time employee is your spouse). If you have full-time employees age 21 or older (other than your spouse) or part-time employees who work either 1,000 hours a year for one year or 500 hours a year for three consecutive years, you will typically have to include them in any plan you set up; in this case, adopting an individual 401(k) plan will not be a viable option.

## What makes an individual 401(k) plan attractive?

One feature that makes an individual 401(k) plan an attractive retirement savings vehicle is that in most cases your allowable contribution to an individual 401(k) plan will be as large as or larger than you could make under most other types of retirement plans.

With an individual 401(k) plan you can elect to defer up to \$19,500 of your compensation to the plan for 2021 (plus catch-up contributions of up to \$6,500 if you're age 50 or older; unchanged from 2020), just as you could with any 401(k) plan. In addition, as with a

traditional profit-sharing plan, your business can make a maximum tax-deductible contribution to the plan of up to 25% of your compensation (up to \$290,000 in 2021, an increase from \$285,000 in 2020).

Because your 401(k) elective deferrals don't count toward the 25% limit, you, as an owner-employee, can defer the maximum amount of compensation under the 401(k) plan, and still contribute up to 25% of total compensation to the profit-sharing plan on your own behalf. Total plan contributions for 2021 cannot exceed the lesser of \$58,000 (plus any catch-up contributions) or 100% of your compensation (up from \$57,000 in 2020).

For example, Dan is 35 years old and the sole owner of an incorporated business. His compensation in 2021 is \$100,000. Dan sets up an individual 401(k) plan for his retirement. Under current tax law, Dan's plan account can accept a tax-deductible business contribution of \$25,000 (25% of \$100,000), plus a 401(k) elective deferral of \$19,500. As a result, total plan contributions on Dan's behalf can reach \$44,500, which falls within Dan's contribution limit of \$58,000 (the lesser of \$58,000 or 100% of his compensation).

These contribution possibilities aren't unique to individual 401(k) plans; any business establishing a regular 401(k) plan and a profit-sharing plan could make similar contributions. But individual 401(k) plans are simpler to administer than other types of retirement plans. Since they cover only a self-employed individual or business owner and his or her spouse, individual 401(k) plans aren't subject to the often burdensome and complicated administrative rules and discrimination testing that are generally required for regular 401(k) and profit-sharing plans.

## Other advantages of an individual 401(k) plan

Individual 401(k) plans also have advantages that are shared by many other types of retirement plans:

- An individual 401(k) is a tax-deferred retirement



**Taxable distributions from a traditional 401(k) taken prior to age 59½ may be subject to an additional 10% federal income tax penalty, with certain exceptions.**

**Generally, tax-advantaged retirement plans, including Roth 401(k) accounts, require that minimum distributions (RMDs) must begin after you reach age 72. However, Roth IRA owners are not required to take annual minimum distributions, although beneficiaries must take them.**

plan, so you pay no income tax on plan contributions or earnings (if any) until you withdraw money from the plan. And, your business's contribution to the plan is tax deductible.

- You can, if your plan document permits, designate all or part of your elective deferrals as after-tax Roth 401(k) contributions. While Roth contributions don't provide an immediate tax savings, qualified distributions from your Roth account are entirely free from federal income tax.
- Contributions to an individual 401(k) plan are completely discretionary. You should always try to contribute as much as possible, but you have the option of reducing or even suspending plan contributions if necessary.
- An individual 401(k) plan can allow loans and may allow hardship withdrawals if necessary.
- An individual 401(k) plan can accept rollovers of funds from another retirement savings vehicle, such as an IRA, a SEP plan, or a previous employer's 401(k) plan.

### Disadvantages

Despite its attractive features, an individual 401(k) plan is not the right option for everyone. Here are a few potential drawbacks:

An individual 401(k) plan, like a regular 401(k) plan, must follow certain requirements under the Internal Revenue Code. Although these requirements are much simpler than they would be for a regular 401(k) plan with multiple participants, there is still a cost associated with establishing and administering an individual 401(k) plan.

Your individual 401(k) plan assets are fully protected from your creditors under federal law if you declare bankruptcy. However, since an individual 401(k) plan generally isn't subject to ERISA, whether your plan's assets will be protected from your creditors outside of bankruptcy will be determined by the laws of your particular state.

Self-employed individuals\* and small business owners with significant compensation can already contribute a maximum \$58,000 in 2021 (up from \$57,000 in 2020) by using a traditional profit-sharing plan or SEP plan. An individual 401(k) plan will not allow contributions to be made

above this limit (an exception exists for catch-up contributions that can be made by individuals age 50 or older).

An individual 401(k) may not meet your future needs. If your business grows and you hire a full-time employee who is not your spouse, that employee will generally need to be included in your plan. If that happens, you no longer have an individual 401(k) plan; you have a regular 401(k) plan and profit-sharing plan, and you lose the benefit of the individual 401(k) plan's simplified administration rules.

### Profit-Sharing Contribution

Tax-deductible contribution of up to 25% of total eligible compensation\* (up to \$290,000 in 2021)



### 401k Elective Deferral

Elective deferrals (pre-tax and/or Roth) of up to \$19,500 in 2021 (plus catch-up contributions up to \$6,500 if 50 years of age or older)



### Maximum Total Contribution

Up to the lesser of: (1) \$58,000 in 2021 (plus catch-up contributions up to \$6,500 if 50 years of age or older), or (2) 100% of compensation\*

\*If your business is unincorporated, your plan compensation is based on your net income. This means that you must deduct one-half of your self-employment tax as well as any plan contributions to determine your compensation base. Effectively, this means that an unincorporated business with one owner-employee can deduct profit-sharing contributions of up to 20% of the owner-employee's earnings after the deduction for one-half of self-employment tax. Similarly, special rules apply in calculating the annual additions limit.

This newsletter should not be construed as an offer to sell or the solicitation of an offer to buy any security. The information enclosed herewith has been obtained from outside sources and is not the product of Oppenheimer & Co. Inc. ("Oppenheimer") or its affiliates. Oppenheimer has not verified the information and does not guarantee its accuracy or completeness. Additional information is available upon request. Oppenheimer, nor any of its employees or affiliates, does not provide legal or tax advice. However, your Oppenheimer Financial Advisor will work with clients, their attorneys and their tax professionals to help ensure all of their needs are met and properly executed. Oppenheimer & Co. Inc. is a member of all principal exchanges and SIPC.