Two Tax-Friendly Retirement Plans for the Self-Employed

As a business owner, you may devote most of your time, energy, and profits to running and growing your business. But working for yourself means that saving money for retirement is entirely up to you.

This is not the only reason it may be worthwhile to divert a sizable portion of your earnings to one of these tax-deferred retirement accounts. Doing so could significantly reduce your taxable income.

Solo 401(k)

A solo 401(k) is a one-participant plan for business owners who have no employees (other than a spouse). As the employee, you can contribute as much as 100% of your annual compensation on a pre-tax basis, up to the $23,000 annual maximum in 2024 ($30,500 if you are age 50 or older). As the employer, you can also contribute an additional 20% of your earnings (25% if the business is incorporated) and deduct it as a business expense. Total contributions are capped at $69,000 in 2024 ($76,500 if age 50 or older).

A solo 401(k) plan may also allow plan loans and/or hardship withdrawals.

The deadline to establish a solo 401(k) and formally elect salary deferrals is December 31 of the year in which you want to receive the tax deduction (or before fiscal year-end for corporations). For businesses taxed as sole proprietors and partnerships, salary deferrals and profit-sharing contributions for 2024 must be deposited into the account by the April 15, 2025, tax filing deadline* (October 15 if an extension is filed).

SEP IRA

If you are self-employed, you can contribute 20% of net earnings, up to $69,000 in 2024, to a Simplified Employee Pension (SEP) plan. A SEP IRA may also be an appropriate choice for business owners with a small number of employees for whom they would like to provide retirement benefits. All employees age 21 and older who have worked for the employer for at least three of the last five years must be included. The plan may exclude employees earning less than $750 in the current year.

The same percentage of salary (up to 25% of compensation or $69,000) must be contributed to each eligible employee's SEP IRA, including the owner's. However, the business is not required to contribute every year. You have until the due date of your business's federal income tax return (including extensions) to set up a SEP IRA and make contributions.

Distributions from 401(k) plans and SEP IRAs are taxed as ordinary income. Early withdrawals (prior to age 59½) may be subject to a 10% federal income tax penalty.

*In Maine and Massachusetts, the tax filing deadline is April 17, 2025, due to state holidays.