Owner-only 401(k) profit sharing plans

Improved 401(k) options for small business owners

A SEP IRA only allows for an employer non-elective contribution, which is what a traditional profit sharing plan offers. An owner-only 401(k) profit sharing plan offers the additional benefit of a salary deferral feature that allows the business owner to contribute in 2020 an additional $19,500, or $26,000 for an owner over age 50. In comparison, SIMPLE IRAs, with their far more modest contribution limits, don't come close to offering the savings opportunities available through an owner-only 401(k) profit sharing plan.

In addition, unlike SEP IRAs or SIMPLE IRAs, an owner-only 401(k) profit sharing plan also allows the business owner to take advantage of a Designated Roth 401(k) Account feature, along with a loan feature if they so desire.

Eligibility

The owner-only 401(k) profit sharing plan is available to any business that employs only owners and their spouses, including C corporations, S corporations, partnerships and sole proprietorships.

Higher contribution limits

- **Employer contributions —** You can contribute up to 25% of your annual income into a 401(k) profit sharing plan, based on a maximum compensation amount of $285,000 (2020 limit).
- **Salary deferral contributions —** You can defer up to $19,500 of income into your 401(k) plan in 2020 and thereafter it is indexed for inflation.
- **"Catch-up" contributions —** If you are age 50 or older, you can contribute an extra $6,500 into your 401(k) plan in 2020. This "catch-up" amount is indexed for inflation.

The sum of your employer contribution and your salary deferral contributions cannot exceed $57,000 in 2020 ($63,500 in 2020 for individuals over age 50).

Other key benefits

Apart from providing higher contribution limits, your owner-only 401(k) profit sharing plan offers you some other key benefits:

- **Contribution flexibility —** You decide each year how little or how much you want to contribute to your plan.
- **Lower costs than traditional 401(k)s —** Your plan will likely incur considerably lower fees than a traditional 401(k) plan.
- **Less administrative duties —** Unlike a traditional 401(k) plan, an owner-only profit sharing plan contains no complicated discrimination tests or detailed administrative requirements. When the plan assets are $250,000 or greater, you are required to file IRS Form 5500-EZ annually, regardless of fluctuations in the balance of the plan.
- **Wide range of investment options —** You can fund your 401(k) plan with any investment you choose: stocks, bonds, mutual funds, CDs and government securities.
- **Loan option available —** You can take out tax-free and penalty-free loans from your 401(k) plan, which you can repay at a competitive interest rate.
- **Rollovers permitted —** Your 401(k) plan generally can accept rollovers from other retirement plans.

Call your financial advisor

Your financial advisor can help you evaluate your needs to determine which retirement plan may be most appropriate. If an owner-only 401(k) profit sharing plan is right for you, then your financial advisor can help you establish the plan and offer recommendations on investment options.

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