INDIVIDUAL 401(k) PLANS

An individual 401(k), also referred to as a solo 401(k) or uni 401(k), is a retirement plan designed specifically for business owners and their spouses. In many ways, individual plans work in the same way as traditional 401(k)s, but there is a key difference: individual 401(k)s are exempt from most of the Employee Retirement Income Security Act (ERISA) rules that traditional 401(k)s are subject to.

Who Can Benefit from an Individual 401(k)?

Like traditional 401(k) plans, the primary benefit of an individual 401(k) is the ability for a business owner to reduce his or her taxable income and take advantage of tax deductions by making pretax contributions. If the owner's spouse works for the business, he or she can also be included in the plan. If there are any other eligible (common-law) employees, outside of the owner and spouse, however, the business would *not* be eligible to use the individual 401(k).

Business owners with full-time employees who are older than 21 will generally be ineligible for the individual 401(k) and will need to choose another retirement plan avenue for making contributions.

How Much Can Be Contributed to an Individual 401(k) Plan?

Individual 401(k)s are subject to the same annual contribution limits as traditional 401(k)s. The 2020 annual limits are detailed in the table below:

Salary deferral contributions
Lesser of $19,500 or 100% of compensation; an additional catch-up contribution of $6,500 allowed if age 50 or older
Employer profit-sharing contributions
25% of compensation or 20% of net self-employment income if a sole proprietor*
Total combined salary deferral and employer contributions
$57,000; $63,500 if catch-up contributions apply
Maximum compensation for contribution calculations
$285,000

*If self-employed, a tax advisor should be consulted to confirm the maximum allowable profit-sharing contribution amount.

Employer contributions can be made by the employer's tax filing deadline, including extensions. Employee deferrals should be made as soon as administratively possible but no later than 15 days after the end of the month in which they were deferred.

Please note: Some plan documents may allow for after-tax and Roth employee deferrals to be made as well.

Testing

Nondiscrimination testing—a series of calculations designed to ensure that a 401(k) plan does not unfairly benefit a certain employee or group of employees—is not required because there are no common-law employees.

Distributions

Account owners are eligible to withdraw assets from the plan when they meet one of the following triggering events:

- The plan's normal retirement age (usually 59½)
- Permanent disability
- Separation of service
- Plan termination

Some individual 401(k) documents may also allow for distributions due to financial hardship and in-service distributions prior to one of the triggering events listed above.

Required minimum distributions (RMDs) must begin at age 70½. The RMD deferral option available for some participants in traditional 401(k)s is not available for individual 401(k) owners because they generally own more than 5 percent of the company.

Tax Treatment of Distributions

Any rollover-eligible distributions taken from plans that are not rolled over to another IRA or retirement plan will be subject to a 20 percent mandatory federal tax withholding. These distributions are taxed at ordinary income tax rates (unless deferrals were made on a Roth or after-tax basis), and early distributions are subject to a 10 percent penalty.

Distributions rolled over to another IRA or eligible retirement plan are done so as a direct rollover and are not subject to tax or penalty.

Vesting

Participants are always 100 percent vested in employee and employer contributions.

Loan Feature

An individual 401(k) can be designed to allow a loan feature for participants.

Administration

Plans with total assets less than $250,000 are exempt from the Form 5500 filing requirement, which is an annual reporting form for certain pension and welfare benefit plans, including 401(k)s. Once total plan assets reach $250,000 or more, the employer will be required to file Form 5500 each year. If an individual 401(k) is terminated, the employer is required to file Form 5500 for the year of termination, regardless of plan size.