

Tax-Advantaged Retirement Accounts for the Self-Employed

by Gene Curry, Realtor, Certified Financial Planner

As being self-employed, you can set up your own tax-advantaged retirement program and likely set aside more retirement money each year than you could if you work for an employer.

The following details on the best self-employed retirement plan options out there based on the 2008 tax rules. (See table below.)

Simplified Employee Pensions – SEPs

Simplified employee pensions - referred to as SEPs or SEP-IRAs - are generic retirement plans that allow you to contribute and deduct up to 20% of self-employment income or up to 25% of salary if you're an employee of your own corporation. However, the percentage can be voluntarily varied each year, so lower amounts (or nothing at all) could be contributed in lean years when revenue is down. The maximum dollar contribution in 2008 is \$46,000.

For those who procrastinate, SEPs are great because they can be opened up as late as the date of your income tax return, including extensions. Moreover, SEPs are very easy to establish and administer compared to other business pension retirement plans. It takes only minutes to get one started and usually at no charge with a bank, brokerage firm, insurance company or self-directed IRA administrator. There are no annual government reports required or ongoing administrative expenses to pay. Essentially, SEPs are easy deductible traditional IRAs for the self-employed that allow much bigger contributions.

Retirement Plan Options*

Plan	Contribution Limits	Phaseout Limits	Comments
SEP	20%*/\$46,000	None	Simple to establish and administer
Keogh	20%*/\$46,000 (or more)	None	Can be designated a profit-sharing plan, or a defined benefit plan. Generally requires a professional to set up, especially if you want a defined benefit plan.
Solo 401(k)	\$46,000/\$51,000 if age 50 or older at year end	None	High contribution limits mean you can lower your tax bills and generate more tax-deferred earnings for your retirement stash.
Roth IRAs	\$5,000 for singles, \$10,000 for couples	\$101,000-116,000 for singles, \$159,000-169,000 for joint filers	Contributions are nondeductible, but earnings grow tax-free. You can contribute an extra \$1,000 if you will be 50 or older as of Dec. 31, 2008.
Spousal Deductible IRA	\$5,000	\$159,000 to \$169,000	If your spouse participates in a retirement plan at work but you do not, the joint AGI limits on a spousal IRA (for you) are \$159,000 to \$169,000. If you yourself

already have another type of smText business retirement plan set up, such as a SEP or a 401(k), then your joint AGI phaseout is \$85,000 to \$105,000. An extra \$1,000 can be added to the account annually if you will be age 50 or older at year end.

Based on 2008 limits.

** 20% of self-employment income or 25% of compensation for employees.*

Keogh Plans

Keogh plans are the self-employed equivalent of corporate retirement programs. They come in two basic flavors: profit-sharing plans and defined benefit pension plans. To get a deduction for the current tax year, the plan must be established before year's end. Once that's done, actual contributions can be deferred until the extended due date for that year's tax return.

Annual contributions to Keogh profit-sharing plans are based on a percentage of self-employment income or compensation and are subject to a \$46,000 ceiling in 2008. A plan document must be drafted in Year One, which is an added cost and the IRS requires an annual report, which unfortunately is another added cost.

Keogh defined benefit pension plans are designed to deliver a "targeted" annual retirement benefit, which can be as high as \$185,000. Each year's contribution must be calculated by an actuary (another cost) and the exact amount depends on your income, the target benefit, years until retirement and anticipated investment returns. Annual actuarial fees and the required IRS report can mount up. Yet there is another negative - You're locked into making the actuarially determined contribution each year. On the plus side, if you making decent money and are over 50, a defined benefit plan may be worth all the trouble (and cost) because it permits much bigger contributions than any other type of program. If you're younger than 50 and revenue is lean, a SEP, profit-sharing Keogh or Solo 401(k) is likely a better choice.

Solo 401(k)

The Solo 41(k), also known as a Self Employed 401(k), Individual(k) or Personal 401(k) self employed retirement plan, got a hefty makeover thanks to tax-law changes a few years ago and is expected to revolutionize the way successful self employed business owners save for their retirement.

The Solo 401k is available to self-employed individuals and business owners with no full time W-2 employees other than themselves or a spouse. Businesses employing independent contractors (1099 employees) would not disqualify you from a Solo 401(k). Sole proprietorships, partnerships, LLCs and corporations (including both subchapter S and C corporations) would qualify.

With a Solo 401(k) you can contribute up to 100% of the first \$15,500 of your 2008 compensation or self-employment income (\$20,500 if you'll be 50 or older at year-end). On top of that, you can contribute and deduct an additional amount of up to 25% of your compensation income, or 20% of your self-employment income. So, for those who are looking to max out their contributions to a deductible retirement account, it's a major improvement. The reason: With a solo 401(k), annual contributions consist of two parts. And in this case, two is definitely better than one.

So, the biggest improvement - Much larger deductible annual contributions. This means you can quickly build up a substantial tax-deferred retirement account balance — while cutting your annual income tax bills, to boot.

Another important distinction between the Solo 401(k) versus other self employed retirement plans is the ability to receive a Solo 401(k) loan. Loans are permitted up to 1/2 of the total value of the Solo 401k up to a maximum of \$50,000. Solo 401(k) loans generally have a 5 year term. Principal and interest is repaid back to yourself into your Solo 401(k). A Solo 401(k) loan can be provided tax free, penalty free and without credit checks or income qualifications and the money can be used for any purpose. A Solo 401(k) loan is a key benefit and may be considered a valuable feature for many self employed business owners.

Bottom line - For those who hate to leave any tax break on the table, the solo 401(k) is a great deal. You won't be forced to contribute more than you can comfortably afford in years when cash is tight and you can always pay in less than the tax-law maximum or even nothing at all. In other words, the solo 401(k) lets you rack up major tax savings in the good years, while leaving you the option to contribute less (or zero) in the lean years, when conserving cash is your highest priority.

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