

INTRODUCTION

Thanks to the Economic Growth and Tax Relief Reconciliation Act of 2001, small businesses - whose only employee is the owner or the owner and spouse - can open and contribute to a Self-employed 401K plan. Finally. A great tax break strictly geared to benefit the smallest business owners. On top of the tax break, the Self-employed 401K offers other benefits for cash-strapped small business owners.

Who can Establish this type of plan ?

Any single business owner, an independent contractor with 1099 income, freelancer, sole proprietor, or in a partnership, Limited Liability Company (LLC) or corporation, can tap into the full benefits of the Self-employed 401K.

History

Prior to 2002, the employer Profit Sharing Plan contribution deduction limit was 15% of eligible compensation, the individual plan contribution allocation limit was the lesser of 25% of compensation or \$35,000 and the compensation limit considered in determining the employer maximum deduction and the individual contribution allocation was \$170,000. Spouses working for family owned businesses were oftentimes not compensated due to the 15.3% cost associated with the Social Security and Medicare taxes (FICA), and a previously repealed pension law that limited plan contributions if a spouse was included in the plan.

The Present and The Future

Starting in 2002, the revised pension law provides the following:

An employer has the discretion to contribute and deduct from 0-25% of eligible employee compensation to a Profit Sharing Plan.

The individual compensation limit increases to \$200,000.

The individual contribution allocation limit increases to the lesser of 100% of



compensation or \$40,000.

The 100% of compensation or \$12,000 individual 401(k) contribution limit is not considered in determining the employer 25% deduction limit.

The \$1,000 401(k) "Catch-up" contribution for individual over 50. deduction limit.

OVERVIEW

General Features:

Plan Establishment

Sole proprietors with no additional employees other than the spouse of the proprietor or Partnerships whose only employees are self-employed partners and their spouses. Trustee and Plan Administrator Business Owner, Spouse or Partner or any combination, or any other designated third party.

Salary Deferral

Contributions Up to \$12,000 (not to exceed 100% of pay. No more than \$200,000 of pay can be taken into account.). Total salary deferral and employer maximum of \$40,000.

Catch-up

Contributions Individuals age 50 or older may contribute an additional \$2,000 in salary deferrals beyond the \$12,000 which does not count towards the maximum total contribution limit of \$40,000.

Employer Contributions

Up to 25% of pay, (20% for self-employed), maximum \$40,000. Salary deferral contributions are also counted towards the \$40,000 limit.)

Rollovers

Rollovers and transfers allowed from traditional IRA, SEP, Qualified Plans or Keoghs (Profit Sharing, Money Purchase Pension, Defined Benefit), 401(k), 403(b) and governmental 457 plans. SIMPLE IRAs are eligible for rollover after two year holding period is met.

Loans

Available to all participants, including unincorporated business owners.

Government Reporting

IRS 5500-EZ.

CASE STUDIES

Name: *Bill Smith*
Occupation: *Lawyer*
Earnings: *\$167,000*
Age: *48*
Business Type: *Sole Proprietor*

Bill wants to contribute the maximum allowable to his retirement plan.

Plan Type	Maximum Contribution
SEP	\$31,873.95
SIMPLE IRA	\$12,641.84
Profit Sharing Plan	\$31,873.95
One Man 401(k)	\$40,000.00