



S-CORP / SOLO 401K – MATCH MADE IN HEAVEN for SOLO PRACTITIONERS

Disclaimer This is for informational purposes only. You must consult a CPA or other professional who can assess the effect of the proposed strategies presented here, and guide you according to your individual situation. The examples used will be highly simplified and for illustrative purposes only.

INTRO

Working with professionals and business owners I've learned that many don't use the tax code to their advantage. I was part of the club for years, leaving money on the table.

Here is the deal: When using the tax code in the right type of structure and vehicle, you can boost your retirement portfolio, by redirecting tax dollars otherwise destined for the IRS into your retirement account. That way the IRS becomes a co-sponsor of your future hammock somewhere in the sun on a beach - How cool is that?

S-CORP

Let's begin with the S-corp. Any current LLC can opt to be treated as an S-corporation when it comes to taxation. This is easily done by filing Form 2553 with the IRS.

The main benefit of an S-CORP is that your income will see less taxation because it is split into SALARY (W2) and DISTRIBUTION. On the Distribution, you pay no self-employment tax of 15.3%

In your "regular" LLC, everything you earn (less business deductions) is income which is subject to the 15.3% self-employment tax.

SIMPLIFIED EXAMPLE:

An LLC makes \$100,000 after ordinary business expenses. This is then considered your income from the business, and you pay self-employment taxes of 15.3% or \$15,300 on that.

S-CORP makes the same \$100,000 after business expenses, but the S-CORP splits the income into a W2 salary of 50K and distributions of 50K – since no self-employment tax is paid on the 50K distribution. You save \$7,600.

DOWNSIDE OF S-CORP: You must report payroll every quarter, detailing how much you paid yourself, and then pay the required 15.3% self-employed tax + regular income tax.

SNEAKY TIP: While you must report every quarter, your payroll doesn't have to show any salary – you can simply put zero. Then have all the salary for the year figure on just one or two payrolls, say in the 3rd or 4th quarter. Now you still want to set the funds aside, but why give them to the IRS before you have to – instead have them earn 5% in a high-yield savings account until then.

SOLO 401K (also referred to as an “individual 401k”)

The solo 401K is perhaps the most generous vehicle for deferring taxes while contributing to a retirement account. It works well with the S-CORP because the solo 401K has contributions both for you as the W2 employee **and** for the S-CORP as the “employer”

Generally speaking, you must be the only salaried person in the S-CORP, but there are exceptions if your spouse receives a W2 salary from, or is a part owner of the business. There are also exceptions allowing you to have a part-time employee, but there are certain rules pertaining to the length of employment and hours worked per year.

Going forward we will keep things simple and just assume you are the only employee.

Employee contribution limits 2023

- \$22,500 or \$30,000 if 50 or older.

Employer contribution limits 2023

- Up to 25% of compensation, not to exceed \$66,000 for the 2023 tax year.

SIMPLIFIED EXAMPLE:

PRECONDITIONS: You have changed your tax status from LLC to S-CORP as described earlier. You are 51 years old.

Next year you decide to max out your Solo 401K. You expect to make around \$100,000 after ordinary business expenses. After consulting with your CPA you decide on \$50,000 as a reasonable salary.

When the year is over here is what happened:

A. You lowered your self-employment tax significantly.

B. You lowered your taxable income by \$30,000 (max contribution 50+)

BUT wait there is more (hmm...sounds like a late-night infomercial)

C. Remember the 25% of the W2 salary that the S-CORP as an “employer” can contribute? That’s another \$12,500 you can contribute to the Solo 401K.

...Every time you hear the word contribution, you must hear the word tax deferral. In the examples, we just went through – a whopping total of \$42,500 was tax deferred **and** added to your Solo 401K.

Surely not everyone is 50 (yet) or can afford these contributions every year – but you can do something Little by little. In personal finance, it is about many small changes that compound over time.

I hope you found this piece helpful.

if you want to learn how to build wealth and start the journey toward financial independence follow me on [LinkedIn](#) and [Facebook](#) or consider buying my book “Household Finance 101” available on [Amazon](#).

I’d also invite you to a complimentary strategy session booked [here](#).