

# SOLO 401(K) INVESTING GUIDE

Combine Solo 401(k) tax advantages with alternative investment opportunities.



New Direction  
TRUST COMPANY



# Solo 401(k)

## Introduction

Many self-employed persons desire a tool that will allow them to grow their retirement savings faster than a Traditional or Roth IRA. A Solo 401(k) may be the tool that they are seeking, allowing higher contribution limits and more customization than an IRA.

A Solo 401(k), which is simply a 401(k) for a self-employed person, is directed by two sources: the plan document and the trustee of the plan. The plan document dictates the rules and eligibility for the 401(k), whereas the trustee is in charge of operating the plan according to the document, and makes the decisions about the investments the plan will make.

Many don't realize that plan documents do vary and that you can choose a 401(k) that allows more than just traditional stock market investments.

The IRS allows 401(k)s to acquire a wide variety of "alternative" assets without penalty and while keeping the tax benefits associated with that account type, as long as the plan document allow them. A 401(k) can buy and sell any type of real estate, certain precious metals, equity/stock in private companies, and more. A 401(k) can even be a lender. In fact, your 401(k) can make money for your retirement in almost any way that you know how to make money outside of your 401(k).

The Plan trustee (often yourself), along with your chosen financial team (CPA, CFP, attorney, family, etc.), find the investments you want, perform due diligence, and negotiate the acquisition by the 401(k). Your New Direction Trust Company team can keep the books for your 401(k), making sure the paperwork substantiates that the asset is part of your 401(k), and therefore deserves the tax benefits associated with the plan.

This report will give you strategic information about how a 401(k) can work to your benefit and how they differ from an IRA. Once you have looked at this primary information, give our 401(k) professionals a call at (877) 742-1270 ext. 155 or email us at [info@ndtco.com](mailto:info@ndtco.com) and let us fill in the details.

## The Roles of a Solo 401(k)

With a Solo 401(k), there are typically 3 roles, all of which may be occupied by one person:

- 1. The employer** - The owner of the company decides to implement a 401(k) Plan. As the employer, you choose the plan document and the features therein as well as choose a trustee(s). You may also choose an administrator and/or bookkeeper for the plan if you desire.
- 2. The trustee** (investment maker) - It is the trustees responsibility to invest the plan. When you make an investment you are acting as trustee for the Plan and will be signing paperwork accordingly. The trustee is also responsible for the plan operating in accordance with the plan document.
- 3. The employee** - The employee decides how much yearly salary to defer into the 401(k) Plan. Remember that unlike an IRA where you send in a check to contribute funds, in a 401(k) your contribution has to come from your paycheck. The employee must sign an agreement with the plan for deferrals to occur.

Because of these roles, a Solo 401(k) is typically geared towards the self employed and has many capabilities that an IRA does not. A Solo 401(k) is available for any sole proprietorship, partnership, limited liability corporation (LLC), or incorporated business, including sub-chapter "S" Corporations.

# Solo 401(k)

## Contribution Streams

There are two streams of contributions allowed in a 401(k): employer and employee. Even though, in an Individual 401(k), the employer and the employee are the same person, the contributions come from different sources. Employer contributions are taken from the entity's revenue, while employee contributions are deferred from the employee's pay.

You may not defer from compensation that is paid to you from your corporation before the initial adoption of your Individual 401(k).

Regulations require that an election to defer compensation must be made before the compensation is currently available or paid to an employee.

Income for an unincorporated business owner (i.e. sole proprietor or partner) is treated as becoming currently available on the last day of the business' tax year.

Income for an incorporated business owner (W-2 wages) is treated as currently available when paid to the individual.

If you are an unincorporated business owner, the deadline for depositing your employee salary deferrals is your business tax return due date, including extensions.

If your business is incorporated, the deadline for depositing employee salary deferrals is the earliest date on which the deferrals can be reasonably segregated from your business' general assets, and no later than the 15th business day of the month following the month in which the deferrals are withheld.

The benefit of an Solo 401(k) can be seen come tax season, as the employee will have less taxable income for the year and the employer will have deductions for their portion of the contributions.

## Contribution Deadlines

To open a 401(k): December 31st of the effective year

Employee deferrals: December 31st of the effective year or the last paycheck of the year

Employer contribution: Extended due date of employer's return

## Contribution Limit

Contribution limits can vary for each company, depending on its revenue, so always consult with a CPA or advisor to determine your eligibility. For those over 50 years of age, there is an additional catch up contribution that can be made from the employee portion of the contributions.

It should be noted that the employee portion of the contributions can equal out to 100% of income, but the employer can only contribute up to 25% of the revenue that the company receives.

# Solo 401(k)

## 401(k) Capabilities

A 401(k) can differ from an IRA in many ways. It has the ability to lend to a participant of the plan, have both pre and post tax funds, purchase stock from the employing company, hold life insurance, and lease out 401(k) owned property to the employer.

## Participant Loans

Loans can be made to participants up to \$50,000 or one half of the total assets, whichever is less, if the loan option is selected to be built into the plan document.

Loans must be repaid on a fully amortized basis within 5 years with the only exception being if it is a first time home loan, then it is extended to 30 years.

Interest accrues and must be paid regularly (at least quarterly), not as one big balloon payment at the end. Loan defaults may result in the loan being treated as a taxable distribution.

Note: The plan defines the interest rate.

## Roth Deferrals

A 401(k) is normally a pre-tax status, much like a Traditional IRA. It also has the capability of having a portion of the employee deferrals be in a post tax, or Roth, status. The employer can make contributions to the Roth component, but they will be pre-tax contributions instead of post-tax.

If the Roth Deferral option has been selected, the Trustee/Administrator is responsible for keeping track of the funds in the plan that have the Roth tax designation, including deferrals and earnings.

One thing to note about Roth deferrals in a 401(k) is that the Roth portion is subject to Required Minimum Distributions (RMD), which differs from a Roth IRA. The RMD's must be satisfied annually from the 401(k) after obtaining the age of 72. 401(k) distributions do not count toward IRA RMDs and vice versa.

## Purchasing Stock from Your Company

With an IRA, you cannot invest into your own company according to IRC 4975, which outlines prohibited transactions. One 401(k) exception is that the plan can invest into the company that qualifies the plan. The stock being purchased by your plan may be either "C" Corporation stock or "S" Corporation stock.

## Holding Life Insurance

Life insurance is an investment deemed a "statutorily disallowed asset" for IRAs to invest in, according to the IRS. This rule does not fully apply to 401(k)s though, meaning that your plan could invest in life insurance.

If your plan is purchasing term life insurance, your plan may use up to 25% of your annual contributions for the premiums. If the plan is purchasing whole life insurance, it may use up to 50% of your annual contributions for the premiums.

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## Leasing 401(k) Real Estate

Your plan may purchase real estate as a plan asset. Your company may, in turn, lease up to 25% of the property for your business with rent being paid to your 401(k) as investment earnings.

## Unrelated Debt Financed Income (UDFI)

One great feature of 401(k)s is that the account is not subject to UDFI when it holds real estate that is leveraged. All IRAs would need to file annually for this specific tax, but 401(k)s are exempt from the tax.

## Reporting & Disclosure Requirements

No IRS reporting is required until your plan's assets exceed \$250,000. When your plan's assets reach this amount, the plan needs to file a form 5500 annually.

No common-law employees is a requirement for a Solo 401(k) so no nondiscrimination testing is required. Sole Proprietorships are not subject to ERISA.

Generally, under federal law, you are permitted to exclude the following types of employees from coverage under a 401(k) plan:

- Employees under age 21
- Employees with less than one year of service
- Employees who work less than 1000 hours per year
- Certain union employees
- Certain nonresident aliens employees

## New Direction Trust Company (NDTCO) 401(k) Offerings

**The Plan** only (no assets held at NDTCO) - This is for individual business owners who are looking to adopt a prototype (pre-approved by the IRS) Solo 401k Plan for themselves and want the plan administration to occur completely without NDTCO. The plan is only allowed to cover the business owner. Spouses can be added to the plan if they work for the company covered by the plan. As the trustee of the plan, you could open a bank account under the name of the 401(k) and operate without custodial oversight.

**The Bookkeeping** only (already have a 401(k) plan document outside of NDTCO. NDTCO holds asset(s) and provides recordkeeping.) - The 401(k) bookkeeping option is for those who already have a 401(k) Plan under which they are a participant. The plan document must have a provision that allows the plan participants to hold assets with another book keeper. NDTCO will provide the bookkeeping for the assets held in the account. Statements reflecting the asset/account value will be available to the participant and the participant will need to provide the statements to their plan administrator.

**Plan & Bookkeeping** (NDTCO 401(k) Plan Adoption and 401(k) book keeping)- The Full Service Plan is for business owners looking to adopt a prototype Solo 401k Plan for themselves and plans to hold their assets at NDTCO.

Please call us for additional questions and appropriate fees!