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One-Participant 401(k) as a Tool for Farmers and Ranchers

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According to USDA, only 40% of farm households participate in some type of retirement account. For self-employed farmers and ranchers **without** full-time employees, the opportunity to invest in a One-Participant 401(k) plan is a way to (1) save money for retirement, (2) reduce taxable income, and (3) provide the potential option to borrow from the plan. This series of articles will review these features.

What is a One-Participant 401(k)?

The One-Participant 401(k)is a qualified retirement plan designed specifically for business owners with **no full-time employees** other than the business owners and their spouses. Visit with your financial planner and tax advisor if you have part-time employees and are considering establishing a 401(k) for your business to make sure you comply with 401(k) funding rules.

One-Participant 401(k)s are also called Solo 401(k)s, Self Employed 401(k), Individual 401(k), One-Participant 401(k), Solo (k), Uni-k, or One-participant k.

The plan gives self-employed individuals and their spouse an incentive to save for retirement by allowing them to contribute to a 401(k) plan and not pay federal or state income taxes on the contributions until the funds are withdrawn. Or should circumstances or accounting keep their taxable incomes low, they have an opportunity to shelter substantially more money into a Roth One-Participant 401(k) than a Roth IRA. Speak to your advisors about rolling other retirement accounts into a Roth One-Participant 401(k).

With a One-Participant 401(k), contributions are made by the owner both as the employee and as the employer. For 2023, the maximum "elective deferrals" a person can contribute as an employee is $22,500. People aged 50 and older can make an additional "catch-up" contribution of $7,500 (2023). "Elective deferrals" are limited by person, not by plan. If you have another job with a 401(k) option, make sure you are not exceeding this elective deferral limit.

As the employer, you can also contribute up to an additional 20% of self-employment income on Schedule C (Form 1040) or Schedule F. The total contributions are limited to $66,000 for 2023, not counting the "catch-up" contributions for those over age 50. Visit with a financial planner and your tax advisor to evaluate your options based on your level of income for you and your spouse. The IRS Small Business and Self-Employed Tax Center may also provide some additional insight: https://www.irs.gov/businesses/small-businesses-self-employed

One of the biggest advantages of a One-Participant 401(k) is that annual funding is not required, giving self-employed people with highly variable income the option to contribute only when times are good.

For a person to qualify for a One-Participant 401(k), owners must have at least 5% ownership share and have some self-employed income. However, it is not required that a person be self-employed full-time. A One-Participant 401(k) can be utilized by any self-employed business, including a sole proprietorship, a limited liability company, a partnership, C-Corporation, and an S-Corporation.

Contributions to a One-Participant 401(k) withdrawn from the account before age 59 ½ are subject to federal and state income tax in addition to a 10% penalty for early withdrawal. Distributions after age 59 ½ are only subject to income tax. There is no maximum age for contributing to a One-Participant 401(k). Persons who **have retired** must take the required minimum distributions from a One-Participant 401(k) at age 72 or 73. Consult your financial advisor for details. The deadlines for establishing and contributing to a One Participant 401(k) are dependent on the type of entity the business is structured as. Consult your financial advisor for details.

Traditional IRAs, SIMPLE IRAs, SEP-IRA, and other types of retirement plans may be eligible to be "rolled over" into a One-Participant 401(k). There are no limits to the amount of funds that can be rolled over. A rollover will not impact your One-Participant 401(k) contribution limits. For those high-income earners who have multiple IRAs and wish to do a "Backdoor Roth" contribution, they should certainly roll their extra IRAs into their One-Participant 401(k) to avoid the "pro-rata" rule for Backdoor Roth contributions.

For more information about saving for retirement using a One-Participant 401(k), see the article "One Participant 401(k): Saving for Retirement and Reducing Taxes."

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