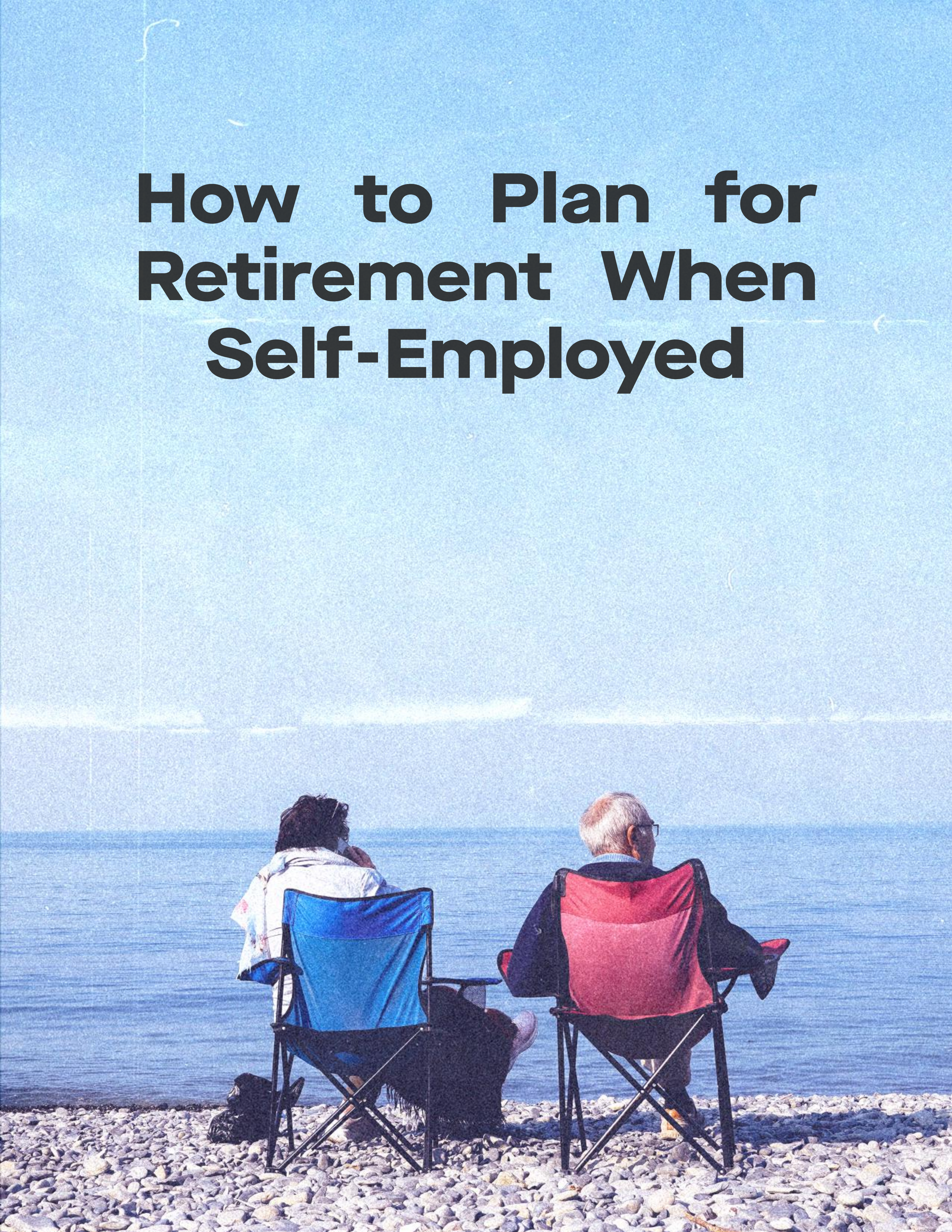
How to Plan for Retirement When Self-Employed



We hear ya. Planning for retirement when you're self-employed will have you sprouting gray hairs and wondering why the heck you set this business up in the first place.

Between picking the right account, getting it set up, and figuring out how much to contribute, it's quite the process.

However, it's still *crucial* if you want to retire comfortably. Yet, 34% of self-employed workers only save for retirement sporadically, and 20% say they *never* save for retirement. *(Don't worry, we won't let that be you.)*

If you're debating which retirement plan for self-employed workers is best, we got you. Here's what you should know.

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Why Retirement Planning is Different When Self-Employed

Planning for retirement when you're self-employed is different than when you're working a traditional role. Here are some of the key differences:

It's a DIY Project

As a freelancer, crafting a proper retirement plan is a do-it-yourself endeavor. There's no one in HR walking you through the employer-sponsored 401(k), and while you can seek guidance from a financial advisor, the majority of the responsibility falls on you.

No Employer Match

Traditional roles typically offer a compensation package, complete with benefits such as a retirement matching contribution. Essentially, employers will offer to match up to a certain percentage of your retirement contributions. So, if your employer offers a 3% match, and you contribute 3% of your paycheck toward retirement, your employer will add another 3% to your retirement account. *(Yup...free money.)*

As a freelancer, however, it's a solo performance. No matching. No free money. This means that you'll likely need to contribute *more* toward retirement than you would if you had an employer match.

It Isn't as Automatic

In a traditional role, you may have the option to automate your retirement savings. So, the amount you elect to contribute is withdrawn from your paycheck before it even hits your bank account.

As a freelancer, however, you'll need to be diligent about contributing to your retirement savings on a regular basis. While you can set up automatic withdrawals, it may be challenging to stick to contributing the same amount each month if your income fluctuates quite a bit.

4 Main Retirement Plans for Self-Employed

There are a variety of ways you can save for retirement as a freelancer. However, here are four retirement account options that self-employed people tend to love:

Roth IRA

A Roth IRA allows you to contribute post-tax income toward retirement. This means that while the money you contribute today is taxed, any future withdrawals will not be.

Contribution Limit: $6,000 per year; $7,000 per year if age 50+ (as of 2022)

Pros:

• It's easily accessible. Almost all brokerage firms, banks, and investment companies offer a Roth IRA.
• Your contributions will grow tax-free.
• You won't have to pay taxes on any withdrawals.

Cons:

• The contribution limit changes from time to time, so you'll need to pay close attention to any changes.
• You can't contribute to a Roth IRA if you make over $144,000 per year and are a single filer on your taxes. If you file jointly, you cannot contribute if you make more than $214,000 combined.

TLDR

PROS:

Accessible at most brokerage firms, tax-free growth, no taxes on withdrawals

CONS:

Contribution limit of $144,000 per year (for single filers), guidelines for contribution change, so you'll need to pay close attention to changes

Solo 401(k)

A solo 401(k), or a one-participant 401(k) as the IRS calls it, is intended for sole proprietors with no employees (a spouse working for the business being the one exception). It operates similarly to an employer-sponsored 401(k), except you get to be both the employer and the employee in terms of contributions.

With a company-sponsored 401(k), you contribute a portion of your pre-tax income with each paycheck. Because the contribution is pre-tax, it'll score you a bit of a tax break later on. Likewise, if your employer matches your contributions, they'll score a tax break, too.

With a solo 401(k), you get to take advantage of both sides of the equation. You can contribute as an employee (an elective deferral) and as the business owner (an employee non-elective contribution). The total contribution limit, between the two contribution types, if $61,000 per year, or $67,500 if age 50+.

There are two types of solo 401(k)s: traditional 401(k) and Roth 401(k). The main difference between the two is how contributions are taxed. While traditional 401(k) contributions are made with pre-tax income, Roth 401(k) contributions are made with post-tax income. If you'd prefer to pay taxes later, a traditional 401(k) may make more sense for you. If you'd prefer to have your investments grow tax-free, a Roth 401(k) might be your best bet.

(Note: Solo 401(k)s are also called Self-Employed 401(k), Individual 401(k), Solo-k, and Uni-k. I know...they could've made it a bit simpler, right?!)

Contribution Limit:
Elective deferrals: $20,500 per year, or $27,00 if age 50+
Total contribution: $61,000 per year, $67,500 if age 50+

Pros:
- Solo 401(k)s have a higher contribution limit than some other retirement accounts.
- You can take a tax deduction on your contributions if you opt for a traditional 401(k).
- Your contributions will grow tax-free if you opt for a Roth 401(k).

Cons:
- You can't contribute if you have an employee other than your spouse.

TLDR

PROS:
Higher contribution limit than other retirement accounts, tax deductions on traditional 401(k) contributions, tax-free growth in Roth 401(k)

CONS:
Not available for those with employees

SEP IRA

A SEP IRA, or simplified employee pension, is a great option for sole proprietors and those with one or more employees. Unlike a solo 401(k), SEP IRA contributions are made as the employer only. As a result, you're able to contribute up to 25% of your net earnings, with a maximum of $61,000, as of 2022.

If you have employees, however, be aware of the fine print. If you set up a SEP IRA, you will need to include all employees on the plan. While you don't have to contribute to the account each year, when you do, you'll have to do so for all employees that are eligible.

Contribution Limit: 25% of your net earnings, with a maximum of $61,000, as of 2022

Pros:

- Depending on your earnings, the contribution limit may be higher than other options.
- You can withdraw contributions at any time, although there are a few limitations.
- You can take a tax deduction on payments made to employee SEP IRAs.

Cons:

- Contributions are pre-tax, meaning you'll pay taxes on the money in retirement. Unlike a solo 401(k), there is no option to make SEP IRA contributions post-tax.
- Distributions before age 59 ½ are taxed as income.

TLDR

PROS:

Contribution limit may be higher than other options, can withdraw contributions at any time, tax deduction on payments made to employee SEP IRAs

CONS:

You'll pay takes on the contributions in retirement, distributions before 59 ½ are taxed as income

SIMPLE IRA

A SIMPLE IRA, or Savings Incentive Match Plan for Employees (a mouthful, huh?), is a great option for business owners with 100 or fewer employees. As the employer, you're able to make tax-deductible contributions to employees' accounts. However, there are matching requirements you should be aware of.

As the employer, you must match either 3% of each participating employee's income or make a fixed contribution equal to 2% of the employee's income, regardless of whether they contribute to the plan or not.

Contribution Limit: With a SIMPLE IRA, employees can contribute up to $14,000 per year toward retirement, or $17,000 per year if age 50+.

Pros:
• You can get a tax deduction for contributions you make for employees.
• SIMPLE IRAs have lower operating costs in comparison to other retirement plans for self-employed people.

Cons:
• The employee contribution limits are lower than other retirement plans.
• Early withdrawal fees are high.

TLDR

PROS:
Tax deduction for contributions made to employees, lower operating costs compared to other options

CONS:
Contribution limits are lower than other plans, early withdrawal fees are high

Bottom Line

While planning for retirement as a self-employed person can be complicated *(and full of funky terms)*, it's important to understand *why* you're selecting the account you are. Each option will offer you something different, so take the time to understand the ins and outs of each one before opening an account.

Want a better way to visualize your income so you know how much you can contribute to retirement? Go to tryboost.com and get early access!