SOLO 401(K)

KNOW MORE THAN YOUR ATTORNEY

IN 15 MINUTES

by Scott Royal Smith

SOLO 401K

Know More Than Your Attorney in 15 Minutes

by Scott Smith

with Cal Dunagan

TABLE OF CONTENTS

INTRODUCTION

OVERVIEW 5
- What Is It? 5
- History 6

RETIREMENT AND INVESTING 7
- Getting Started with Retirement 7
- Benefits 7
- When to Start Saving for Retirement 10

SECTION I: SOLUTIONS

TAX DEFERRAL 12
- Defer Taxes on Investments in the Face of Increased Federal Income Tax Rates 12
- Tax Deferral Vehicles 13
- The Roth Solo 401(k) 22

SECTION II: OWNERS MANUAL

HOW TO SET UP 29
- All Solo 401(k) Plans Are Not Created Equal 29
- Eligibility & Regulations 29
- The Solo 401(k) Walkthrough 35

HOW TO MANAGE 44
- Solo 401(k) Contributions 44

HOW TO HANDLE TAXES 50
- Filing 50

SECTION III: BIGGER PICTURE

WHAT TO DO WITH YOUR FUNDS 54
- Retirement Plans in Aggregate: an Overview of Contribution Plans in The US 54
- Investing with your Solo 401(k) Plan 54
- Alternative Investments 58
- Business Investments and UBTI 65
- Taking a Loan and Rolling Your Solo 401(k) Over 74
- Distributing Your Assets 81
- Protecting Your Assets 87

INTRODUCTION

OVERVIEW

Retirement. For a group of lucky, diligent, and frugal souls, this landmark comes early in life. Most of us, however, have a few years of hard work and financial management ahead of us.

Whether it's sandy beaches and daiquiris, summer days in the garage rebuilding a classic car, or the freedom to spend time with those you love, everyone has a personal vision for what life may look like at the close of their career.

But here's the cold, hard truth: retirement will more than likely be the single biggest expense of your lifetime. Planning how to fund your post-work years is a puzzle that too many people fail to solve.

Fortunately, there are a number of financial instruments to choose from to help future-minded people plan for a comfortable retirement. It is not as difficult as it might seem to be to take advantage of these tools when you finally decide to live on your own time.

The Solo 401(k) is perhaps the most flexible and effective way to manage your money when that day comes.

What Is It?

The 401(k), inadvertently created by the IRS in the early 1970s, was designed to give employers a way to help their employees save for retirement. More recently, the Solo 401(k) was established to offer the self-employed, those who generate some of their income through self-employment activities, or small business owners with no more than a few employees, the ability to grow retirement income.

The Solo 401(k) is not specifically named in Internal Revenue Code, and you may also hear it referred to as an **Individual 401(k), One-Participant 401(k), Self-Employed 401(k), a Uni 401(k), or a Self-Directed 401(k).**

The Solo 401(k) has substantial advantages over other wealth management tools. Not only is it convenient and inexpensive to administer, it gives real estate investors different ways to save.

Consequently, this retirement tool allows you to save a great deal more for your post-work years.

Most importantly, the Solo 401(k) gives you the flexibility to leverage your savings. This is especially useful for investors who want the ability to borrow tax-free money.

Speaking of tax exemption: if you have less than $250,000 in your Solo 401(k) plan, you don't have to file with the IRS.

In this book, you will find a brief history of the 401(k), how this plan compares to other wealth management tools, and a detailed outline of how to utilize the instrument to protect your wealth and prepare for retirement.

Ultimately, I hope to impart you with valuable knowledge in your quest for financial independence, as well as give you the ability to successfully implement the 401(k) into your retirement strategy.

History

By making retirement plans available, the government's stated intention was to encourage people to save and accumulate as much money as possible for retirement. One way that the IRS does this is through tax deferral. Tax deferral means that any income or gain you make (such as earnings on interest, rental income, dividends, capital gains, or royalties) accrues tax-free until you decide to withdraw the assets and take them into your possession.

The IRA and other qualified retirement plans such as the 401(k) let you avoid paying taxes until you decide to remove the funds. Obviously, this will allow you to grow your retirement funds at an accelerated pace compared to holding the money in a personal account. It is much more efficient to build for your retirement in this manner.

When you put funds into an IRA or 401(k), the money in your account is placed in a lower tax bracket. When you finally withdraw your retirement funds as a distribution, you keep more of your hard-earned cash. This makes it easier for you to keep the funds in your account while you grow your retirement as you watch your assets stockpile even faster. This lets you save for the long-term in a shorter period of time.

A huge advantage regarding the tax-deferral capabilities of the 401(k) is that by using this plan to make investments, you are able to defer taxes on returns on the investments. Again, this benefits you because any money you make on an investment grows tax-free, and any taxes that must be paid are done so at a later date.

As an investor, it is more advantageous for your investments to grow without the interruption of paying taxes. This is particularly important because investments that you make to your retirement plan typically happen when you are in your highest income-earning years and subject to a higher tax bracket.

RETIREMENT AND INVESTING

Getting Started with Retirement

401(k) plans are retirement-savings trusts that get their name from the rules laid out in section 401 of the Internal Revenue Code. As mentioned, the Solo 401(k) is an IRS-approved retirement plan for self-employed individuals.

Unlike a traditional 401(k), it is a retirement plan that covers only a single person, rather than a group of employees, making it ideal for independent contractors, sole proprietors, and small business owners. The Solo plan follows the same rules and requirements as any other section 401 retirement plan.

Benefits

More Wealth-Building Power and High Contribution Limits

The first advantage that the Solo 401(k) has over a traditional IRA is maximum contributions allowed. The amount of money you are allowed to contribute to your Solo 401(k) is dramatically higher than what is allowed in an IRA. With an IRA, you are limited to a $6000 contribution per year. If you are over 50 years old, you are allowed an additional $1,000 “catch-up” contribution for a total of $7,000. The Solo 401(k) annual contribution limit is $57,000, with an additional $6,500 “catch-up” contribution if you’re over 50.

That is nearly a 1000% increase in retirement contributions over an IRA!

Additionally, if your spouse generates income for the business, he or she can also contribute to your Solo 401(k). Under the 2020 Solo 401(k) employee contribution, or elective deferral, rules, a plan participant under the age of 50 can make a maximum employee deferral contribution of $19,500. For employees over 50, this contribution increases to $26,000. These amounts can be made either pretax or after-tax. This brings the total potential contributions for your Solo 410(k) to between $76,500 and $89,500 per year.

The Solo 401(k) also allows profit-sharing contributions if your business is considered a corporation. This allows your business to make up to a 25% profit-sharing contribution. If you operate as a sole-proprietor or partnership, this total is 20% of gross income. The total profit-sharing contributions cannot exceed $57,000, including the employee elective deferral. In other words, if someone under the age of 50 takes the maximum $19,500 in employee contributions, they are able to contribute up to an additional $37,000. And as with earlier contributions, this amount may be either made pre-tax or after-tax.

The Solo 401(k) is ideal if you intend to build your retirement account quickly. In addition to these higher limits, you can utilize the funds in your account in ways that other financial tools do not allow.

Simplicity, Flexibility and Independence

Something that is emphasized throughout this book, and that is probably the biggest advantage of the Solo 401(k), is how much control you have over retirement investing strategy. You decide when and how to make contributions to your plan.

You may want to contribute to the limit every year. Or, if you've taken a hit to your earning potential and you need to reduce or even suspend contributions in a given year, you can do so. Luckily, you will have no filing requirements as long as you keep the plan to less than $250,000.

You will never need to hire someone to look after your accounts; you are your own trustee. Additionally, you have instant access to loans for up to 50% of the account's value (up to $50,000). As we mentioned, there are no stipulations on this loan, and you can use the loan to invest in any opportunity that comes your way.

You can also use the loan to get rid of debt or take care of medical bills. You have a five-year period in which to repay and the payments can be spread out quarterly. There are no penalties for early payments and the loan is both tax and penalty-free. Finally, unlike with any other loan you will ever see, you get to decide on an interest rate that works best for you.

A World of Investment Opportunities

Another advantage the Solo 401(k) has over other instruments is that it gives you the ability to invest your account money. Provided the type of Solo 401(k) plan you adopt, you will be able to invest in virtually any investment opportunity that you come across, including mutual funds, ETFs, private businesses, and even precious metals.

Above all, the income and gains from these investments return to your Solo 401(k) plan without being taxed. As trustee of your Solo 401(k) plan, you have complete control over your retirement assets and can invest your money as you see fit, tax-free.

Loan Feature of the Solo 401(k)

We will touch on this in detail later, but you can access the funds within your Solo 401(k). Although your plan may not be the same thing as a bank account, if the Solo 401(k) plan that you adopt includes a loan option, you will be able to borrow 50% of your total account, up to $50,000, at a low interest rate. This option gives you instant access to money for absolutely any purpose. If you're ready to pay off student loans or you're looking to finance a new business, your Solo 401(k) funds are there when you need them most.

The Flexibility to Self-Direct Your Retirement Funds

As trustee of your Solo 401(k) plan, you choose where to invest your account funds. For example, if your portfolio already includes rentals, foreclosures, raw land, or tax liens, you can funnel these gains into your retirement and do so tax-free!

If your investment strategy includes expanding your current business, or if you want to branch out into a new business venture, loans from your 401(k) account can make your dreams a reality. Perhaps you trade currencies, or you invest in peer-to-peer lending, stocks, and mutual funds. With a Solo 401(k) you can leverage your expertise in these areas to build your retirement wealth.

Roth and After-Tax Type Contributions

With a Solo 401(k) you can combine the best features between similar financial instruments. One of the most common ways to take advantage of this is to build-in a Roth or after-tax subaccount. Contributions are not restricted for if you include this option into your plan, allowing you to make considerably larger contributions than with an IRA.

As discussed earlier, a traditional Solo 401(k) allows you to contribute up to 25% of your income into the account. Making after-tax contributions gives you an advantage over the normal profit-sharing contribution scheme. This means that if your Solo 401(k) includes an after-tax subaccount plan, and you're over the age of 50, you can contribute the full $63,500 to your account in 2020.

Cost-Effective Administration

If your plan does not exceed $250,000 in assets, you will have no annual filing requirement. For anything over this amount, you need to file a Form 5500-EZ with the IRS. This is a short information return that is relatively simple to complete.

You can also offset the cost of your plan with a tax deduction. For instance, because you are paying for your Solo 401(k) with funds from the business, you are eligible to deduct the cost of the plan, as well as annual maintenance fees. Any deduction for costs associated with your Solo 401(k) reduces your tax liability, which in turn offsets the costs of maintaining your plan.

Additionally, with a Solo 401(k) plan, you are under no obligation to pay tax on non-recourse leverage for real-estate acquisitions. (Non-recourse leverage is a loan usually secured by property. If the borrower defaults, the issuer of the debt can repossess the property but cannot go after the borrower for anything more.) For the real estate investor, the Solo 401(k) is a massive advantage over an IRA.

When using an IRA to purchase real estate, the acquisition is traditionally leveraged by mortgage financing. This results in the creation of Unrelated Debt-Financed Income, or UDFI, which is considered **unrelated business taxable income** (**UBTI**). This income is

taxed. A Solo 401(k) plan, on the other hand, may be leveraged outside the UDFI rules and is therefore exempt from the UBTI taxes.

Finally, the Solo 401(k) allows for retirement saving consolidation through rollovers. Although you will be unable to transfer funds from a Roth IRA, your plan can accept holdings from other retirement-savings plans, including a SEP, an IRA, or even your 401(k) plan from a previous employer. Therefore, if you're looking for a loan on an investment, you can seamlessly transfer qualified funds you already own directly into your Solo 401(k).

When to Start Saving for Retirement

How Much Have Americans Saved for Retirement?

At the end of 2011, as reported in the Wall Street Journal, the median household for persons aged 60–62 had less than a quarter saved of the average needed to maintain a basic retiree standard of living. This situation did not improve much over the next decade. According to Fidelity, by May 2019, the average 401(k) balance rose from $95,600 in 2018 to a record high of $112,300 by the end of 2019. However, this amount is still sorely inadequate for retirement purposes.

Beyond the IRA and 401(k)

By 2012, nearly 51 million households participated in some form of 401(k) plan. Three year later, in 2015, there were an estimated 50 million IRAs in the U.S. alone. Although these two financial instruments are widely popular, the limits that are placed on both accounts regarding how much money can be funded into each must be taken into account. An investor must also weigh the features against the rules, eligibility requirements, tax implications, and consequences of each plan. There are many strengths and weaknesses for both tools, but what circumstances makes a 401(k) right for you?

First, as noted above, if your goal is to save as much money as possible, in the shortest amount of time, the 401(k) allows you to save more money per year than an IRA. Additionally, if you are investment savvy, you can leverage a 401(k) in your investment strategy. If you are self-employed in any way, whether with a part-time gig, or full-time with only a few employees, the Solo 401(k) is what you need to look at.

SECTION I: SOLUTIONS

TAX DEFERRAL

Defer Taxes on Investments in the Face of Increased Federal Income Tax Rates

One of the biggest challenges you face when preparing your retirement strategy is dealing with federal income taxes. Chances are, you're a high earner, which means a larger chunk of your money goes straight to the federal government every year. You must take this into account if you want to save strategically.

In the U.S., approximately 40% of households with earners between the ages of 25 and 64 are not currently saving for retirement. Over 60% of working households aged from 55 to 64 have saved less than 100% of their total annual income for retirement. For the foreseeable future, this trend will likely get worse. For nearly a century, the American workforce has had trouble saving for retirement.

The first company in the U.S. to offer a private pension plan was the American Express Company in 1875. The company hoped to encourage employee retention by offering their employees a convenient way to plan for retirement. By the turn of the 20th century, nearly 15% of all private sector employees were covered by pension plans. This number jumped to nearly a quarter of the U.S. workforce by 1950.

Nearly 60 years after American Express decided to offer pension plans, the federal government got into the business of helping U.S. workers plan for retirement. In 1935, the U.S. government started funding the safety net known as social security using funds from the payroll tax.

At the beginning of 1956, a number of companies (primarily banks), offered a new addition to their profit-sharing plans. It was known as the **cash or deferred arrangement**, or **CODA**. This allowed employees to contribute any amount to their retirement plan as if the contribution were made by the employer, making the contribution tax deferred. Four years later, in 1960, President Kennedy sponsored a mandate that came to be known as the Self-Employed Individuals Tax Retirement Act of 1962. This bill allowed the self-employed to defer taxes on income contributed to a qualified pension plan.

A number of plans in this same vein were subsequently passed. These plans are known as the **Keogh**, or **H.R. 10**, plans. Unfortunately, these plans were severely limited and had filing requirements that were difficult to manage—a far cry from the Solo 401(k) plans of today. However, tools such as the Keogh were still effective because they encouraged people to save money for their retirement. This, in turn, had the potential to lessen the burden on the federal government to provide retirements for people who did not save.

Finally, in 1974, the **Employee Retirement Income Security Act**, or **ERISA**, was passed into law. This bill was designed to help protect American retirement assets. It ensured that the funds that working Americans placed into their retirement plans would be easier to access when they decided to retire.

Specifically, ERISA sets a number of minimum standards for private pension plans that guarantee fairness of application and adherence to the rules. Although the Act does not require every employer to establish a pension for their employees, it does require the companies that offer pension plans to meet certain industry standards.

Another important aspect of ERISA was that it established the individual retirement arrangement, or IRA. An IRA is a custodial account or private trust established for the exclusive benefit of an individual worker and the worker's beneficiaries. The IRA was created to give workers a way to supplement their retirement income, which would have the added effect of lessening the burden on social security and other social programs. Congress wanted to enable people who were not covered by a work retirement plan to save for retirement and do so using a tax-deferred account. They enlisted the help of financial institutions to accomplish this.

In 2001, as part of what are known as the Bush-era tax cuts, Congress passed the **Economic Growth and Tax Relief Reconciliation Act** (**EGTRRA**). This was a watershed moment for private retirement savings plans. First, the Act dramatically increased contribution limits. It also made it easier to consolidate retirement plans and added a number of changes to approved retirement plans that made them much more flexible.

One important addition included in the Act was the previously-mentioned catch-up provisions, which allowed older workers to save even more. The Act gave self-employed individuals, sole-proprietors and small business owners virtually identical benefits and advantages of the traditional employer-run 401(k) plan. Without EGTRRA, the self-employed would have no practical reason to establish a Solo 401(k) plan.

Tax Deferral Vehicles

The IRA

In the previous section, we covered the basics of the individual retirement arrangement (IRA). Before we go over the Solo 401(k), you must have a deeper understanding of the different types of **individual retirement accounts** (**IRAs**). The term IRA is used to describe both the individual retirement account as well as the broad category of individual retirement arrangements. Here, we'll go into a bit more detail about the individual retirement account.

The IRA gives you the ability to put aside money for retirement into what is known as a "tax-favored" personal savings account. There are different kinds of IRAs, and if you want

to set one up, you may do so at a financial institution, bank or insurance company.

The original IRA, established by ERISA, is commonly referred to as the **traditional IRA**. You are able to contribute up to $6,000 annually into your IRA account, or up to $7,000 if you're over 50 years old. Additionally, some or all of your contributions to your IRA are tax-deductible.

When you decide to distribute funds from your IRA, this money is fully or partially taxable during that year. These distributions are fully taxable if the original contributions were deductible. If you decide to distribute the funds before your 60th birthday, or when you are 59 ½ or younger, you may be subject to an additional 10% tax on the distributions.

One catch is you are not able to keep retirements in your traditional IRA account indefinitely. Generally, you must begin taking distributions from the account six months after your 70th birthday. This is known as the "**required minimum distribution**," or **RMD**, for your IRA.

As the name suggests, the RMD is only the minimum amount you must withdraw from your plan every year. You may also want to withdraw more. These withdrawals are included in your taxable income for the year, minus any portion of the amount that was taxed before or that is received tax-free, such as any gift money or qualified distributions from other retirement (Roth) accounts.

Note: A Roth IRA *does not* require you to make distributions until after your death.

For all of the different types of IRAs, the IRS has determined that contributions can only be made from *earned income*. However, this doesn't rule out the self-employed earner. You do not have to be employed by another entity to earn taxable income. Earned income also includes income you make working for yourself. This means, if you are currently employed, you can also have a side gig and contribute both sources of income into your IRA.

However, the definition given by the IRS is even more broad. Taxable earned income that you are allowed to contribute to your IRA includes salary, wages, and tips, long-term disability benefits you receive prior to the minimum retirement age (65), union strike benefits, and met earnings from self-employment. Income that is *not* considered "earned" includes any payment you receive for work while incarcerated, dividends and interest, social security, retirement income, alimony and child support, and unemployment benefits.

Let's look at the features of a traditional IRA. First, contributions are tax-deductible. Also, you may take distributions as soon as you turn 59 ½ . These distributions are mandatory when you turn 70 and a half. Any distributions which are made are subject to taxation, and if you decide to withdraw prior to the age of 59½ you may have to pay an additional 10% excise tax.

The traditional IRA is available to anyone; you are not restricted by your earned income. Moreover, you can use the funds in your IRA to purchase investments, including but not

limited to real estate, precious metals, stocks and notes. Any growth on these investments is tax-free until you decide to distribute the funds, and the income and gains from the investments are tax-deferred. However, if you use your traditional IRA funds to purchase real estate, when you take possession of the property after you reach the age of 59½ that property is subject to taxation.

The Roth IRA

Another version of the individual retirement account is known as the **Roth IRA**. This instrument was introduced by Congress through the Taxpayer Relief Act of 1997. This account is nearly identical to the traditional IRA with a few important modifications.

Although contributions to your Roth IRA are taxed, you may qualify for tax-free distributions from your account. This includes investment returns and appreciation of the account funds if these distributions meet specific requirements. There are two main requirements for tax-free distributions, which can be found in section 408A of the Internal Revenue Code:

1. **First, to avoid paying taxes, withdrawals must be taken after you turn 59 ½ .**
2. **Second, the withdrawals can only be taken after a five-year holding period.**

Once both of these conditions are met, distributions from your Roth IRA are tax-free. If you decide you want to withdraw funds before the age threshold and before the holding period you have to pay both penalties and taxes on the Roth IRA earnings.

If you are under the age of 59, Roth IRA earnings distributions may be taxed. There are situations, however, where you can avoid penalties (but not taxes). For instance, you may withdraw up to a life-time maximum of $10,000 if you are looking to purchase a first home. Also, you can make a penalty-free withdrawal of funds for qualified education expenses.

Additionally, if you become disabled or use the withdrawals to help pay for health insurance while unemployed, you are not penalized for distributions from your Roth IRA. If you have unreimbursed medical expenses or you die, your beneficiaries can withdraw earnings from your IRA without penalty. Finally, those under 59 ½ can avoid paying taxes on distributions from earnings under these same circumstances if their Roth IRA has been open for more than five years.

The Roth IRA is not designed for tax breaks; rather, it is built for future savings. Contributions to your Roth IRA are not tax-deductible because they consist of after-tax money. Essentially, you pay taxes on money you earn, then you contribute this money to your Roth IRA, and when you withdraw this money later it is tax-free because you already paid the taxes on the income.

However, if you are a low to moderate-income earner, you may qualify for a tax break

known as the **saver's credit**. This tax credit, between 10% and 50% of contributions (up to $1,000 in 2019), is available for single taxpayers who earn less than $32,000 per year, head-of-household payers who earn a maximum of $48,000 per year, or married taxpayers who file jointly and earn less than $64,000 per year.

One of the other advantages of the Roth IRA over a traditional IRA is the ability to contribute to your account for as long as you have earned income. For traditional IRAs, once you hit this 70-and-a-half age limit, you can no longer make contributions. As noted, because all Roth IRA contributions are made with post-tax funds, the amount of your contributions are treated as the basis in your account. Furthermore, any earnings and gains you make on your account funds are tax deferred and usually tax exempt.

That's a huge boost for your retirement plan because the income and gains from your investments aren't taxed. As long as the two conditions are met (age and holding period), you will never pay tax on distributions from your IRA. Unfortunately, if you are a high-income earner, or your income exceeds a certain amount, you are not able to contribute to your Roth IRA. As you will see later, this income cutoff does not apply to a Solo 401(k) Roth plan.

In conclusion, the features of your Roth IRA are somewhat different than the traditional IRA. Unlike the traditional IRA, Roth IRA contributions are not tax-deductible because they are made from after-tax dollars. Furthermore, the Roth IRA does not force you to make distributions when you turn 70½. If you decide to take a distribution, and you follow the rules described above, you will not be taxed on the distributions. This tax-free feature includes 100% of all earnings, income, gains and principal in your IRA account.

Contrasted with the traditional IRA, your Roth IRA has restrictions on earned income. However, like the traditional IRA, you may make a number of investments with your IRA funds. And most importantly, if you use the Roth IRA funds to purchase real estate and take possession of the property after 59½, you can avoid paying taxes on the investment.

The Backdoor Roth IRA Contribution

It was mentioned earlier that the Roth IRA is geared toward the lower or middle-class earner. High earners, however, can also take advantage of the saving benefits of the Roth IRA using a "backdoor" approach.

If you are a high earner, you can make "back door" contributions to your retirement by converting your traditional IRA, which is made with after-tax funds and has no income threshold, to a Roth IRA. If this conversion is made immediately after you open your traditional IRA account, the money should still be tax-free because contributions made to your traditional IRA are deposited as after-tax funds.

The sooner you convert your traditional IRA to a Roth IRA the better. For the time between when you make your initial after-tax contribution and when you convert the ac-

count to a Roth IRA, if the value of your investment increases, you are required to pay taxes on the increase.

Deciding Between a Traditional IRA and a Roth IRA

So you're ready to start putting money away for retirement. But which IRA is best for you? This question is actually easier than you think. There are few rules of thumb that you can follow to help make this decision.

To begin with, you may be ineligible to utilize tax-deductible contributions to a Traditional IRA. If, instead, you still qualify to contribute after-tax dollars to a Roth IRA, then obviously the Roth IRA is a better choice for you. Alternatively, if you are able to contribute tax-deductible dollars to a Traditional IRA and you also have the ability to contribute cash into a Roth IRA, there are a few things to consider:

- **If you anticipate your retirement tax rate to be greater than your current rate, a Roth IRA would probably be the most beneficial.**

- **If you believe your investments will bring strong returns, or if you are young and want to give your money more time to grow without having to pay taxes, the Roth IRA is probably the way to go.**

- **If your retirement tax rate will be lower than what it is currently, it might be wise to contribute your funds to a Traditional IRA account.**

The SEP IRA

If you own a business and have at least one employee, the **SEP IRA** is something you should consider. The **Simplified Employee Pension** (**SEP**) plan gives you a way to both help your employees put money away for retirement and give you an additional option to contribute toward your own retirement savings account.

Essentially, a SEP-IRA is an employee-employer profit-sharing plan set up by an employer. Both you and your employees can make contributions into either an annuity or a retirement account set up for both plan participants.

The SEP-IRA plan follows the same distribution, investment, and rollover rules discussed earlier for the Traditional IRA. When you decide to open a SEP-IRA for your business, if an employee is 21 or older, has been paid a minimum of $550 in the past year, and has worked at least three out of the past five years at your business, then they must be included in the plan. However, with a SEP-IRA you have discretion to make the eligibility process less restrictive for your employees. For instance, you may want to implement less restrictive participation rules in your SEP-IRA for family employees or hiring incentives. You may allow your employees to participate in the SEP-IRA as soon as they are hired, or after a shorter employment period.

If you do choose to use the three-of-five-year rule, any work that the employee does in the five years prior, no matter how insignificant, must be counted toward the requirement. When calculating the years, you have to use the years of your SEP-IRA plan (usually the calendar year) rather than years based on your employee's start-date.

Every year, you are allowed to make contributions toward your employee's SEP-IRA in an amount that must not exceed either 25% of their compensation, or $56,000 in 2019 and $57,000 in 2020, whichever amount is less. These contributions are subject to annual cost-of-living adjustments, which means that the limit will likely increase every year!

Finally, there are a few limitations that you must consider when deciding whether the SEP-IRA is right for your business. The SEP-IRA is a "**defined contribution**" (**DC**) plan, or a plan designed to give your employees the ability to invest pre-tax dollars in the capital market, and there are a few constraints placed both employer and employee.

First, there are restrictions for when and how your employee receives funds from the account without penalty. Furthermore, you are unable to make the catch-up contributions to your SEP-IRA that you are able to make to your Traditional IRA or 401(k) plan. Only compensation up to a maximum of $285,000 in 2020 and $280,000 in 2019 (adjusted for cost-of-living) may be considered for account contributions. You and the employee must make contributions to the account in cash, not property.

The SIMPLE IRA

Despite the name, the **Savings Incentive Match Plan for Employees** (SIMPLE IRA) has a somewhat complicated history. This instrument was made possible by the **Economic Growth and Tax Reconciliation Relief Act of 2001**, or the **EGTRRA**. This tax law, signed by President George W. Bush, made significant changes to retirement rules and tax rates. It lowered the tax brackets, placed new limits on the estate tax, and—most importantly for our purposes—allowed higher contributions into IRAs such as the SIMPLE IRA.

Prior to EGTRRA, when an employer determined an employee's maximum deduction limits, the employee's deferral along with the employer's profit-sharing and matching combinations were included in the total. After EGTRRA, the deductible profit-sharing contribution limit increased from 15% to 25% of employee compensation. The Act also reconfigured deferrals so that they would no longer be counted against the employer's maximum contributions. Additionally, it increased the employer's contribution limit to 100% of the employee's annual compensation.

EGTRRA created two savings retirement plans, the **Sidecar IRA** and the **Roth 401(k)**. These plans give employers the ability to offer Traditional and Roth contribution plans to their employees, which allows both the employer and employee to designate all of their deferrals as after-tax contributions. Through changes in the Internal Revenue Code, the EGTRRA allows unincorporated businesses to use a loan feature that had only previously applied to ERISA 401(k) plans. All of this is necessary for the SIMPLE IRA to work.

The SIMPLE IRA is a retirement savings account that small companies with fewer than 100 employees can provide. It follows basically the same investment, distribution and roll-over rules as a Traditional IRA. As long as a company does not exceed this 100-person limit and pays at least $5,000 in compensation the previous year, it may establish a SIMPLE IRA. Start-ups usually favor the SIMPLE IRA over the 401(k) because it is less complex and less costly. Also, unlike other employer-offered plans, the employer incentive to match contributions is built into the SIMPLE.

The employer may set up a SIMPLE IRA between Jan. 1 and Oct. 1, assuming the employer did not already have a previously-maintained SIMPLE IRA plan. However, any business that is formed after the first of October may establish a SIMPLE IRA right away. The SIMPLE IRA is then offered to all employees who were compensated at least $5,000 for any two (non-consecutive) years prior to the year the plan was set up. Additionally, the employee must have a reasonable expectation of at least $5,000 in compensation during the same calendar year that the SIMPLE IRA is offered.

Perhaps the biggest selling point of the SIMPLE IRA, for both employees and employers, is that the plan allows the employer to set up a Traditional IRA for employees and help contribute funds toward their retirement. With the SIMPLE IRA, the employer is required to either match contributions up to 3% of the employee's salary, or make non-elective, flat-rate contributions of between 1-2% up to an annual limit of $285,000 in 2020 and $280,000 in 2019.

The employee may choose, if the employer permits, between **matching** or **non-elective contributions**. If the employee choses non-elective contributions, the employer must contribute the flat 1–2% regardless of whether the employee decides to participate or not. If the employer makes the decision and chooses non-elective contributions, the employer must also contribute to the employee's account regardless of whether the employee makes salary-reduction contributions.

The employer can also choose to match 3% of the employee's salary. If the employer chooses this option, he or she may reduce the 3% matching-contributions. However, the employer can only do this if the limit is not reduced for more than two years out of a five-year period and the limit is not reduced below 1%. Additionally, if the employer goes with this option, it must notify employees within a reasonable time of this reduced limit and must do so before the 60-day election period during which employees have the ability to negotiate salary-reduction agreements.

The most noticeable difference between the SIMPLE-IRA and the 401(k) is the contribution limit. For 2020, the contribution limit for the SIMPLE-IRA for those under the age of 50 is $13,500. There is the usual catch-up provision that allows participants over 50 to contribute up to $3,000 more, or a total of $16,500. Also, if a business decides to adopt a SIMPLE IRA and makes contributions to the account during the calendar-year, it may not later adopt a 401(k) plan. This is due to the fact that a SIMPLE IRA has specific rules prohibiting an employer from contributing to both a 401(k) and a SIMPLE IRA during the

same year.

Aside from the fact that SIMPLE-IRAs are only permitted for companies with 100 employees or less, the two instruments are used in almost the exact same way. Like the 401(k), contributions to the SIMPLE-IRA are made with pre-tax dollars. The money in the SIMPLE-IRA also accrues tax-deferred until the employee decides to withdraw funds for retirement. Finally, both retirement tools penalize the employee if money is withdrawn before the participant turns 59 ½ .

There aren't really any benefits that the SIMPLE-IRA has over the Solo 401(k). So if you're making a decision between the two retirement plans, there is no reason to pick the SIMPLE-IRA. One of the biggest advantages the Solo 401(k) plan has over the SIMPLE-IRA is that the Solo 401(k) is not governed by Title I of ERISA. This means that the administrative rules of the Solo 401(k) are much easier to comply with than the SIMPLE-IRA.

Title I was designed to protect the interests of plan participants, as well as their beneficiaries, by giving them the ability to participate in employee-benefit plans. The ERISA rules do not apply to the Solo 401(k) because the plan does not allow the business to have full-time employees other than the owners and their spouses. If you are a sole proprietor, you are better off with the flexibility that the higher contribution limit of the Solo 401(k) affords, anyway.

The SEP IRA vs. the Solo 401(k) Plan

There are five distinct reasons that the Solo 401(k) is better for your retirement than the SEP IRA:

- **Reach your maximum contribution quicker**
- **After-tax contributions are permitted**
- **You can take out tax-free loans**
- **You have the ability to use non-recourse financing to invest in real estate**
- **Better protection from creditors**

Reach your maximum contribution quicker

First, the Solo 401(k) permits you to reach your maximum contribution amount much quicker. As stated earlier, the Solo 401(k) allows both employee and profit-sharing contributions with a high annual contribution limit. Current Solo 401(k) rules permit you to make a maximum employee deferral contribution of $19,500 if you are under 50, and you may make this amount in pre-tax, after-tax, or Roth contributions. You can then choose the profit-sharing option that allows you to make a 20-25% profit-sharing contribution.

When all is said and done, if you are over 50 with a Solo 401(k) you can save up to a total

of $89,500 per year. This is not remotely possible with a Traditional IRA. Although the SEP IRA allows both employee and profit-sharing contributions, the contribution limits are pitifully low compared to the Solo 401(k) plan.

After-tax contributions

Secondly, the SEP IRA has no Roth feature. If you remember what we discussed earlier, contributions to your Solo 401(k) plan can be made in after-tax, pre-tax, or a Roth configuration. For Traditional IRAs such as the SEP IRA, contributions to the plan are only made pre-tax. Additionally, you can contribute up to $19,000 to your Solo 401(k) Roth account.

Tax-free loans

Next, the Solo 401(k) gives you the option to take out tax-free loans. As we said, you may borrow up to 50% of your account value for a maximum of $50,000, and this loan may be used any way you see fit. If you are an IRA holder, you are not allowed to borrow a single cent from your account without triggering the dreaded "prohibited transaction." This means the account stops being an IRA, effective the first day of that year. The account then effectively distributes all of the assets to you at fair-market value, which means you are required to pay taxes on the total for that year.

The ability to take out this loan from your Solo 401(k) is one key aspect that sets it apart from a SEP IRA. This feature is even more important for the savvy investor because the loan you take from your 401(k) can be used for any purpose. The sky's the limit. With traditional IRAs, if the participant decides to remove a single penny from the account, a "prohibited transaction" is triggered.

Non-recourse financing

With a Solo 401(k), as opposed to the SEP IRA, you have the ability to use non-recourse leverage and pay no taxes while investing in this manner. You can use the funds in your Solo 401(k) plan to make real-estate investments using these "non-recourse" funds. And the great thing about it, is you can do so without triggering the Unrelated Business Taxable Income (UBTI) tax and the Unrelated Debt-Financed Income Rules.

The rules, found in IRC 514, provide an exemption for non-recourse leverage for 401(k)-type retirement plans. IRAs, on the other hand, are not included in this exemption. This means that if you decide to use non-recourse financing from your IRA to invest in real estate, this action triggers a UBTI tax. I will explain non-recourse financing in greater detail later in this book.

Protection from creditors

Finally, your ability to save for retirement can be harmed by a particularly bothersome group of people—your creditors. Generally, the Solo 401(k) gives you much better protection from creditors than a Traditional IRA. For instance, if you are forced into bankrupt-

cy, the 2005 Bankruptcy Act protects virtually all 401(k) plan assets from creditors in a bankruptcy proceeding. Furthermore, many states have their own retirement protections in place for problems beyond bankruptcy which offer greater protection from creditors to a Solo 401(k) plan than the SEP IRA.

The Roth Solo 401(k)

Let's take another look at the EGTRRA from earlier and take a deeper look at the Roth contribution option for 401(k) and 403(b) retirement plans. Essentially, rules in the EGTRRA allow you to designate as much of your employee deferral contributions as Roth funds as you wish. The Roth 401(k) is not a separate plan, rather it is only a component of a Solo 401(k) plan that you can elect to include in your plan documentation.

Roth contributions are usually designated in your plan-adoption agreement, so make sure to read the documents. When you set up your Solo 401(k), you must include the option to make Roth and pre tax contributions. It is also wise to open two separate bank accounts for the pretax and Roth contributions. These two accounts will be considered one plan under two separate sub accounts.

You will want to make certain that when you create a new bank or brokerage account for the Roth and pre tax funds, you use your Solo 401(k) plan name and employee identification number (EIN). As I stated earlier, you should establish a new bank account for your Roth contributions so your plan administrator can account for your asset values and the pretax, after-tax contributions. Additionally, this is important if you plan to make distributions or roll over your retirement accounts into a new account.

Designating Roth 401(k) elective deferral contributions is actually quite simple, as you will follow the identical rules as a pre tax 401(k) plan deferral. The difference is that your Roth employee deferral contributions are included in your gross income that same year you make the contribution, unlike the pre tax deferral. Roth employee deferrals get a similar tax treatment to Roth IRA contributions. However, with a Roth 401(k) option, you do not have the income restrictions that you have with a Roth IRA, as long as your plan offers the option.

Roth employee deferrals follow the same rules as normal employee deferrals. The Roth contribution and pre tax employee deferral contribution combined is capped at $19,500 in 2020. You must also separately account for Roth contributions and allocated earnings in your Solo 401(k) plan.

Although your Roth contributions are invested into your account in the same manner as any other pretax contributions you decide to make, your Roth funds are tracked separately and appear as a separate item on your Solo 401(k) plan statements. After you maximize your Roth 401(k) contributions, you will still be able to contribute to your Roth IRA if you follow the Roth IRA contribution rules.

For after-tax Solo 401(k) plan contributions such as the Roth 401(k) deferrals, you do not get an immediate tax deduction. However, if you meet certain age and holding requirements, your contribution amounts, income, and Roth appreciation will be disbursed from your 401(k) tax and penalty-free. This is because Roth contributions are taxed before you contribute the funds into your account, unlike Traditional IRA or pretax 401(k) contributions, which are made to your plan before federal taxes are deducted.

What this does is allow you to defer federal taxes on before-tax contributions and investment earnings to a later date when you decide to make withdrawals on your account. When you finally decide to withdraw funds, you will do so as a taxable distribution.

The chief differences between Roth and traditional contributions is the how contributions and distributions are made. For instance, when you make a pretax contribution, you are permitted a tax deduction on the amount of the contribution, yet your income and profits are subject to federal and state income tax. Also, you will be hit with a 10% early distribution penalty if you decide to distribute the funds from your retirement account before the age of 59½.

You do not receive this tax deduction with your Roth contributions. However, if your Roth account has been operable for at least five years and you are 59½ or older, when you decide to distribute funds from your account, all income, profits, and contributions are tax free. This means you will be able to live off the income and profits from your Roth 401(k) contributions and not worry about ever having to pay additional taxes on the money.

There are two specific legal requirements that you must meet to qualify to make federal tax-free withdrawals from your Roth contributions:

1 **First, you may only make your first withdrawal of your Roth contributions, including your earnings on Roth investments, after you have waited for five years after January 1st of the year you made your first contribution.**

2 **Second, you must wait until after you have reached 59½ to make withdrawals. You don't have to wait as long if you become disabled or die.**

There are also a few considerations that you must account for when deciding whether to make before-tax contributions, Roth contributions, or both to your Solo 401(k). If you are a high-income earner up until the day you retire, then chances are your tax rate in retirement will be higher than it is today. Under this circumstance, Roth contributions will make more sense for you. If you plan to slow business down by the time you decide to retire, you will more than likely have a lower tax rate in retirement than when you initially started your career. Here, you'll benefit more if you make before-tax contributions and pay taxes when you start disbursements.

If you have confidence in your investments, or you believe your investment cash flow is reasonably secure and will continue to grow, you might want to take advantage of the historically low tax-rate environment. The best way to do this is through Roth contributions.

Roth 401(k) investments work notoriously well with real estate investments perhaps because both are effective dividend-growth investments which are usually considered stable. A dividend-growth investment strategy is one where the investor focuses on investments or stocks that give payouts to the investor.

Finally, you have a much greater opportunity to grow tax free the farther out from retirement you are. If you start preparing earlier for your retirement and then give your account the time to mature in value, Roth contributions are definitely your best option.

Pre-tax Contributions

If you have only had the ability to start saving later in life, you might want to consider pre-tax rather than Roth contributions. The older you get the less attractive Roth contributions are. Also, you may need a current income tax deduction.

If you need help paying taxes, you will benefit tremendously by making pre-tax contributions. And if you anticipate your tax rates will be lower when you finally retire, you'll more than likely want to make pre-tax contributions. Additionally, a pre-tax account will be more appealing for you if your confidence is low in your 401(k) plan investment options, or if it looks like the market is headed toward recession.

After-tax (Roth) Contributions

In contrast to pre-tax contributions, Roth contributions offer you greater advantages the younger you are. Roth contributions are the way to go if you have no need for a current income tax deduction. Moreover, if you are worried about a future hike in tax rates, you should lean more toward Roth contributions.

Additionally, if you are confident in the potential future growth of your return on investments, a Roth account should be more attractive for you because any future appreciation on your investments are tax free. Surprisingly, because after-tax contribution options are elective, they are not widely known. So make sure that when you establish your Solo 401(k) plan, you adopt the after-tax option.

Solo 401(k) Plan After-tax Contributions

In this section we will discuss how to handle any after-tax contribution you make that is not a Roth contribution.

If you decide to make a non-Roth, after-tax contribution, your taxable income is not reduced. However, taxes are deferred on any earnings that your after-tax money earns. You are allowed no deductions for your after-tax contributions and any income or gain is still taxable (unlike with a Roth IRA). Fortunately, a recent IRS decision made it easier for you to convert after-tax contributions into a Roth IRA if you decide to leave your company or retire.

These new rules, laid out in IRS Notice 2014-54, allow you to rollover your pretax contributions and earnings into a traditional IRA. They also permit you to put your after-tax contribution and earnings into a separate Roth IRA, where your capital grows tax-free. In addition, the rules allow you to separate the pretax and after-tax funds, which are usually distributed from your plan on a prorated basis as soon as you decide to make a distribution.

The only way that the allocation of after-tax contributions is possible is if the entire account rolls over. The pro-rate rules still apply if only a portion of the account is rolled over. So make sure you roll everything over. A major benefit of rolling your after-tax contributions into a Roth IRA is that you do not need to notify the IRS. An IRS notice is only applicable to your after-tax contributions to employer plans.

It may seem counterintuitive to have nondeductible 401(k) plan contributions. Yet, nondeductible contributions are not a new phenomenon, and were commonplace before the new rules. The new rules, however, make after-tax contributions more appealing because you can effectively separate the pretax funds from the after-tax assets. And again, both the pretax funds and after-tax capital can be converted into either a Traditional or Roth IRA, respectively.

Sometimes the IRA is not the right choice for you. If you can remember from earlier, someone who surpasses a certain threshold of annual income cannot contribute to a Roth IRA due to the income threshold for high-income earners built into the IRA. The Solo 401(k), on the other hand does not have this limit and allows for a significantly larger contribution ($6,000 vs. $56,000) which ultimately helps you hasten your retirement savings. The Solo 401(k) allows you, as an individual business owner, to put away more tax-free retirement income by orders of magnitude.

Other new tax rules enable you to convert employer profit-sharing contributions from pretax to Roth, which gives the Roth Solo 401(k) option a staggering advantage over a Roth IRA. Make sure that your Solo 401(k) plan documents allow for this option.

Here’s how your Roth contribution is handled by your employer (or your business if you pay yourself a salary): when the Roth contribution is made, the employee designates the deferral as after-tax. The employer must then deposit the contribution into a designated Roth account and include that amount in the employee’s gross income. If the employee does not make a Roth election, the employer instead receives that amount in cash. The Roth election is subject to all applicable wage-withholding provisions.

After you adopt the Roth contribution option into your Solo 401(k) plan, you make employee deferral contributions to a designated Roth account. You simply open up a new bank account for any Roth contributions. It’s a good idea to include the designation “R” or “Roth” on your new bank account name so that it’s clear to you where your Roth contributions should be deposited.

Roth Solo 401(k) Plan Conversion Rules

If Roth contributions are something you want to take advantage of, and you have a current traditional 401(k), there is a way to convert it over to a Roth 401(k) plan. Thanks to the Small Business Act of 2010, any employee can convert their traditional 401(k) or 403(b) accounts to Roth plans as long as their employer offers this option. A downside to this, is that you have to pay income tax on the amount you convert to Roth.

For your Solo 401(k), you need to have included a Roth in-plan conversion option to convert it into a Roth Solo 401(k). So include that option if you anticipate making Roth contributions in the future. One advantage a Solo 401(k) has over the traditional 401(k) is that distributions are tax-free when made from retirement accounts of five years or older. The only real downside of making a Roth conversion is that when you convert, you must pay tax on the fair market value of the 401(k) account. This is where a traditional 401(k) differs. Instead, your traditional account gives you a tax break while you save but dings you on taxes when you withdraw.

Pay special attention to where you decide to open up your Solo 401(k). Many traditional financial institutions do not let you take advantage of an in-plan Roth conversion option due to the accounting complexities. It may be a safer option to take a look at self-directed Solo 401(k) plan document providers before you decide whether you want to convert a 401(k) into a Roth account.

If you determine that your Solo 401(k) plan institution offers the option for an in-plan Roth conversion, there are a few things to consider when making the right financial choice.

- **First, will you be able to afford paying income tax on any money you convert from pre tax to Roth?**

- **Next, does it make sense for someone in your income-tax bracket to pay the whole tax due in 2020? If you anticipate your tax rate to go down, converting probably isn't the right option. If you believe it will go down, Roth is the better choice.**

- **Also, are there any personal reasons for you to withdraw Roth Solo 401(k) plan funds within five years of the conversion? Remember, you are more than likely going to face taxes and penalties if you withdraw in this window.**

- **Finally, how confident are you in your ability to make the right investment choices? If you're a seasoned investment broker, you will invariably have a better handle on your investments.**

If you are only looking for your investments to keep a steady stream of income in your pocket, you may want to hold off on Roth contributions until you gain experience.

So you've decided that you want to do an in-plan Roth conversion and you have set up a new account in the right financial institution, what next? After you establish your Roth

account, you need to disclose the value of the cash you are converting to your plan administrator. If you decide on an in-kind Roth conversion, or a conversion of non-cash assets, you must also alert your plan administrator.

Cash is easier to convert to Roth than your in-kind assets (private stocks, real estate, etc.) because non-cash assets almost always need an independent valuation. The amount of tax due when making an in-kind conversion is based upon the value of the asset to be converted. An independent valuation is therefore necessary to come to an accurate value. The fair market value of the asset is also important for when you are doing your taxes. You are required to provide the IRS with an accurate, independent appraisal of any asset you convert to Roth.

You must complete your Roth conversion before December 31 if you want the assets to be treated as converted for that year. Since you have to pay taxes on the in-plan Roth conversion, you must report the transaction to the IRS. IRS form 1099-R is what you use to do this. A 1099-R discloses to the IRS that you have made a Roth conversion and gives them the amount. Normally, you receive a copy of the 1099-R when you make the Roth conversion.

The 1099-R form must be submitted along with Form 1096, or your "Annual Summary and Transmittal of U.S. Information Returns. In addition, you need to report the amount of the Roth conversion on IRS Form 1040, line 16 A. You also need to report all contribution amounts on your entity tax return, so you can receive a tax deduction for your pretax contributions and further notify the IRS of your after-tax Roth contributions.

SECTION II:
OWNERS MANUAL

HOW TO SET UP

All Solo 401(k) Plans Are Not Created Equal

There are a number of different styles of Solo 401(k). In this section, we'll discuss the two main categories of Solo 401(k) plans, as well as eligibility requirements.

Financial Institution-Sponsored Solo Plan

The most common way to establish a Solo 401(k) plan is through a financial institution-sponsored solo plan. The advantage of an institution-sponsored Solo 401(k) is in the pricing and simplicity of the purchase. Although this is perhaps the easiest way to establish a 401(k), the plan documents you adopt with a sponsored plan are simple, which limits a number of options.

For instance, sponsored plans do not allow for making pretax profit-sharing contributions or pre tax employee deferrals. Furthermore, your 401(k) investment options are limited to whatever financial products offered by your financial institution of choice. And even then, you are restricted from making nontraditional investments. Finally, you are not allowed to loan yourself funds from a sponsored plan, nor are you able to make Roth contributions.

Open-Architecture Self-Directed Solo 401(k) Plan

The Open-Architecture, or Self-Directed, Solo 401(k) is perhaps the most popular plan today. Probably one of the biggest selling points of this 401(k) is how easy it is to set up. To open one up, you can go to a local bank. With a Self-Directed Solo 401(k), you serve as the trustee and have complete control over investments made for retirement.

Self-directed plans are also provided by specialized plan provider companies. These organizations allow you to customize a plan based on your investment and retirement goals. The companies that offer open architecture Solo 401(k) plan documents differ from previously discussed financial institutions that offer pre-made plans in that they do not sell financial products or house your plan account. Instead, companies that offer self-directed plans merely offer advisory services and plan documents.

Specialized plan provider companies allow you to have what is called "checkbook control," or the ability to invest with your 401(k) by writing a check and through a wire transfer.

Eligibility & Regulations

In this section, we will now take a closer look at eligibility requirements for forming this

entity and which rules and regulations apply to it. Let's learn more about the finer points of Solo 401(k) rules, eligibility, how they are formed, and what regulations apply to this entity.

Who is Eligible to Use a Solo 401(k)?

Let's examine the requirements for eligibility to establish a Solo 401(k) plan in greater detail and give you a guideline to follow if you decided this plan is right for your retirement.

The 401(k) plan is by and large the most popular retirement saving plan. A 2018 report from the DOL Employee Benefits Security Administration entitled Private Pension Plan Bulletin: Abstract of 2016 Form 5500 Annual Reports found that there are 656,241 defined contribution retirement plans in the U.S. covering 100.2 million people. In a survey of major U.S. companies by the Plan Sponsor Council of America, 90% of employees are eligible for defined contribution retirement plans. Another survey reported upwards of 81 percent of companies offer defined contribution plans to new hires. A vast majority of these plans, 560,241 to be exact, are 401(k)-type plans.

The two requirements for establishing a Solo 401(k) that I mentioned previously are:

- **Any self-employment activity**
- **No full-time employees**

"Self-employment activity" is any work where you generate income outside the formal employer-employee relationship. If the work you do is for an employer, regardless of how tenuous the relationship is to your full-time job, it cannot be counted as self-employment activity. Additionally, this income does not need to be your main source of income; any amount of money counts.

Usually, the tax form that you use to report the income indicates whether that income is self-employment income or not. The forms to look out for here are 1040s (individual income), Schedule C (sole proprietorship), and self-generated W-2s for business owners.

Remember, if you are a sole-proprietor, there is no requirement that your business actually turn a profit. If your revenues do not exceed your losses due to deductions made for your business, you are usually still eligible to set up a Solo 401(k) plan for yourself.

Of course, this might mean you lack the funds to actually contribute to your account. However, this is not an obstacle, as you are usually able to adopt the plan anyway. The key factor here is the type of income received from your work. If you are actively performing services or doing something to earn self-employment income, you can count that as self-employment activity.

If you are earning passive income (such as an annuity or investments), you cannot count this income as self-employment activity. Why does the IRS make this distinction between

active and passive income? It all comes down to how your income is taxed. In other words, passive income is not subject to self-employment tax. If a majority of your income is considered "passive," it can be a big problem for your 401(k). A 401(k) plan is designed to defer self-employment taxes and since your passive income is not subject to the self-employment tax, you cannot contribute that income to your 401(k) plan.

This is a good time to get into self-employment and the self-employment tax.

Self-Employed and the Self-Employment Tax

According to the IRS, there are three circumstances that put you in the self-employment category:

- **You are a sole proprietor or independent contractor**
- **You are in some way in business for yourself**
- **You are involved in a partnership, qualified joint-venture, or a multi-member LLC that is disregarded for federal income tax purposes**

If your net earnings from self-employment are $400 or more, you are required to pay self-employment tax. To calculate your net earnings, subtract ordinary and necessary business expenses from your gross income. Typically, you are subject to tax for 92.35% of your self-employment net earnings. This tax applies to you even if you are over the age of 66 (or 67 if born 1960 or later) and you are drawing social security benefits. This self-employment tax percentage is determined by federal law.

All net earnings that you file an income tax for are considered *earned income*. This includes taxable wages and income from working as an employee and as a sole proprietor. Obviously, this amount would comprise of wages, tips and salary, as well as the net earnings you accumulate from self-employment activities. There are less common funds also included in your earned income, such as union strike benefits, long-term disability benefits that you receive before the minimum retirement age, and even some income derived from real estate holdings.

Speaking of real estate, you must consider how you acquired it and what the property is used for to determine if the earnings are considered self-employment activity rather than passive rental income. That determines which tax schedule you file on your individual federal tax return. You report your rental income as either Schedule C or Schedule E. You must report rental income so the IRS can accurately assess taxes on the amount.

Generally, rental income is derived from a number of sources, including personal property, rental property and land. If you decide to treat your rental income as business income subject to the self-employment tax, or as non-business self-employment income, you need to report the income as Schedule C. Any income you determine that is not subject to the self-employment tax should be filed as Schedule E income.

Schedule E is used when you own a single piece of real estate and then rent the property out to tenants. This schedule also includes any rental income you receive if you rent out space in the home in which you currently reside. When you file a Schedule E, you are telling the IRS that you do not treat the rental income as self-employment income.

Usually, the IRS gives you the benefit of a doubt and does not consider you self-employed. Nevertheless, when you provide services to your tenants or if managing your rental properties is your main business activity, the IRS may deem that these activities rise to the level of self-employment. You are required to fill out a Schedule C form if this is the case. If you decide to only file Schedule E income from your real estate rental dealings, you will more than likely be unable to adopt a Solo 401(k) plan.

Eligibility Requirement: No Business Earnings

Generally, you are eligible to adopt a Solo 401(k) plan if you plan to make self-employment income during the year. When determining whether you anticipate self-employment income, you must be honest with yourself about your business plan; if you're not forthright with yourself, the IRS will be there to hold you accountable!

Although the tax code states that formal self-employment activity is an eligibility requirement, the IRS does not actually care how you ultimately decide to establish your business. You can choose sole-proprietorship, a partnership or even an LLC. The entity under which you choose to conduct your business dealings is not relevant to the rules.

The entity you choose may affect your Solo 401(k), such as determining when deferral contributions must be made or your profit-sharing contribution amounts. However, your choice does not impact whether your source of income is considered self-employment activity. When determining whether your income is derived from self-employment, you have only two key questions to answer:

- **Are you, at some level, in business for yourself?**
- **Do you expect any of your earnings to come from self-employment work this year?**

Eligibility Requirement: No Full-time Employees

As discussed earlier, the next eligibility requirement is that you do not have full-time employees. If you do have a full-time employee that is not your spouse, you are not eligible to establish a Solo 401(k).

Here we must define a full-time employee. Your employees are considered full-time if they work over 1,000 hours for you during the year. Typically, someone working 40 hours a week, for 52 weeks, works a total of 2,040 hours. Notice here, that there is actually a difference between how the IRS defines a full-time employee for Solo 401(k) purposes and how it normally defines a full-time employee (i.e., 30 hours per week on average).

There are a number of other types of employees who, for our purposes here, are not considered full-time. This group of exceptions includes spouses, nonresident alien employees, union employees, and workers under the age of 21. The full-time employee requirement matters because your Solo 401(k) is not subject to the rules of ERISA. On the other hand, if you employ full-time employees, you are subject to ERISA.

As we described earlier, ERISA was designed to protect employees from unethical employers by placing certain responsibilities on employers regarding the treatment of their employees. Although this legislation has certainly created a safer environment for the employee, ERISA has created a number of problems for the employer, specifically when it comes to the cost of administering reports and record-keeping requirements. None of this is required for you if you are self-employed because it's highly unlikely you would take advantage of yourself!

On the other side of the coin, if your business is a partnership of two or more people or you are a part of a joint-enterprise, your partners are not considered employees, and ERISA, therefore, does not apply. Thus, you are able to establish a Solo 401(k) plan.

Who Exactly is Eligible?

With all of this talk about self-employment activities, what professions usually qualify to establish a Solo 401(k) plan? Ordinarily, if you work as an independent contractor, a consultant, sole practitioner, dentist, lawyer or doctor you are considered self-employed.

Additionally, if you work in one of these professions, you might also be employed full-time or part-time by schools, hospitals, or other corporations. If you offer professional services outside your normal employee hours, any work you conduct outside of your employment is considered self-employment activity. Thus, for trades people and real estate investors, the Solo 401(k) is extremely valuable in saving for retirement.

The "Controlled Group" Rules

You may be interested in setting up a Solo 401(k) even if your business has full-time employees. You may be wondering about the legal ramifications of creating a separate entity and funneling money to it from your main business to contribute money into a Solo 401(k) plan.

This is a complicated subject. Not only is it exceedingly expensive to provide retirement for your full-time employees, but there are rules you must follow if you are looking to set up multiple business entities for the purpose of creating a Solo 401(k) plan.

First, let's figure out if your business falls under the "Controlled Group" rules set forth by the Department of Labor and the IRS. These rules are specifically designed to protect employees from a business owner attempting to establish a separate 401(k) plan using an alternative business entity to avoid offering the same benefits to the employees.

The “Controlled Group” rules can be found in IRC section 414. Here, a “controlled group” of companies is defined as any two or more corporations under common control or connected through stock ownership. This applies to a number of situations:

1 When a single member of the original corporation controls 80% of the second corporation (parent-subsidiary group);

2 When at least five individuals own at least 80% of the secondary corporation (brother-sister group); or

3 Some combination of the previous groups. The IRS determines whether you are part of a “controlled group” by taking stock attribution rules into consideration.

The attribution rules details are not particularly important to our discussion, but in general these guidelines are used to keep business owners from skirting certain tax laws.

Attribution rules are ultimately important for us because they stipulate that a business owner controls what their spouse, parents, or children own. If one of these individuals owns stock in a company, you are also considered to be in control of the stock. This means you cannot avoid setting up retirement accounts for your full-time employees by setting up a subsidiary business and putting it in your spouse’s or children’s name.

What this translates to is, if you or a lineal descendant (a direct blood relationship such as a parent, grandparent, child, grandchild, etc.) own 80% of your organization and you have full-time employees, if you decide to set up a separate company, regardless of whether or not the new company provides the same services as the original company, the IRS will more than likely consider both organizations part of a one large business. You will, therefore, be required by law to offer the same retirement benefits to everyone in the company.

There are a few exceptions to the attribution laws. For instance, if your secondary business has a valid business purpose outside of the original company and you employ at least 50 people, then the IRS treats the new business as a separate line of business. Additionally, there is some flexibility when picking a retirement plan for your companies. Two or more of the businesses may adopt the same retirement plan, yet not all “controlled group” businesses must have the same plan.

Another thing you must take into consideration when choosing retirement plans for your businesses are restrictions and exemptions for your highly compensated employees. A “highly compensated employee” is an employee with a total annual compensation of at least $130,000 who customarily and regularly performs the duties and/or responsibilities of an executive, administrative or professional employee. Your business will have highly compensated ratios that determine how much your employee can contribute to their 401(k) plan. There are restrictions regarding these ratios for each of your businesses in the “controlled group,” and you must notify the IRS of any approval request, so be aware of this.

The Exclusive Plan Rules for the Solo 401(k) Plan and the Simple IRA

Another guideline you must consider when setting up your Solo 401(k) or SIMPLE IRA is what is known as the **exclusive plan** rule. This rule is designed to prevent you from "**double-dipping**" or benefitting more than once from your retirement tax deferments.

Basically, if you establish or maintain a SIMPLE IRA you will be unable to establish any other retirement plan, such as a Solo 401(k). Fortunately, there are two exceptions to this rule. First, you are allowed to maintain a second plan if you have union employees who are excluded from the first plan. Second, during a merger or acquisition, you may maintain both your current plan and the plan of the business you are acquiring for the year the transaction occurs and for an additional two years.

The exclusive plan rule applies only if you have recently established, or made contributions to, a SIMPLE IRA and you wish to create a Solo 401(k) in the same taxable year. If you make a contribution to your SIMPLE IRA during the same taxable year, you will be unable to establish a Solo 401(k). Therefore, if you want to set up a Solo 401(k) in 2021, make sure to establish your SIMPLE IRA in 2020, and do not make contributions to your SIMPLE IRA in 2021. However, you will not be able to make contributions to your SIMPLE IRA moving forward. Also, if your SIMPLE IRA has been open less than two years, your IRA contributions are ineligible to be rolled into your new 401(k) plan.

Satisfying Requirements

As I close this chapter, I would like to express again how important it is for you to satisfy all of your tax requirements when establishing a Solo 401(k). The government wants to give you the ability to save money for retirement if you're a sole proprietor with no full-time employees. The government created the 401(k) because it does not like to be burdened with the complex rules, stress of administration, and cost associated with ERISA guidelines. If you want to utilize the same advantages and benefits that a large corporation realizes, you must play by the rules. And it's the job of the IRS to catch you if you don't.

The Solo 401(k) Walkthrough

If you have made it this far, you should now have a decent grasp of retirement savings accounts and the Solo 401(k) plan basics. Here, we will focus on how to choose between the different types of Solo 401(k) plans and, when the time comes, how to set your plan up. Before deciding what type of Solo 401(k) is best for your investment plans, you should take a look at the different investment options allowed by your plan documents.

Self-directed Solo 401(k) Plan

If you have experience managing your assets, a self-directed Solo 401(k) is the best option. In fact, it's not much more work to set up than other Solo 401(k) plans. You should be able to go to almost any local bank in your area to set up a self-directed plan. You are not required to open a self-directed Solo 401(k) plan with the financial institution where you purchased the plan documents, nor do you need a custodian in another state or a trust company to manage your account.

Wherever you set up your self-directed Solo 401(k), your account will come with a checkbook. The checkbook gives you the freedom, as trustee of the Solo 401(k) plan, to make the nontraditional investments previously discussed using a check or wire transfer. If you serve as trustee for your Solo 401(k) plan, you are able to make investments more quickly and seamlessly, which is important in putting offers on investments such as real estate.

Adopting a Solo 401(k) Plan

While this book will give you a better understanding of the Solo 401(k) plan, as well as other retirement accounts, you will eventually need to consult a tax professional or tax attorney regarding which features of a Solo 401(k) plan best fit your specific retirement, investment, and tax goals. Although the Solo 401(k) is also known as an Individual 401(k) plan, it is like any other 401(k) and must be set up by an employer. Unlike a traditional or Roth IRA, your Solo 401(k) plan is adopted by your business. Such business decisions should be made with the help of an advisor.

After you sit down with your advisor, you will make a resolution for your business that allows you to establish the plan. If your business is established as a proprietorship or LLC, you will need to consult the bylaws or LLC operating agreement for the entity to find out who is required to sign the retirement plan resolution. If your organization operates as a C or S corporation, you need a board resolution to adopt the Solo 401(k) plan.

Setting Everything Up

There are generally no restrictions when establishing your 401(k) plan. You may set one up at any time during the year. The plan must, however, be established during the year that you plan to use the plan's features. After your business adopts the Solo 401(k) you benefit from the plan's features (e.g., making contributions to the plan the same year as plan adoption.)

Navigating the Solo 401(k) Plan Documents

To get a handle on the different types of Solo 401(k) plans, you need to get to know the master plan. Basic Solo 401(k) documents are offered by nearly every plan sponsor and drafted with several types of employers in mind. These plan documents require each employer to use a single plan document and all contributions to be made to a single trust

account. This type of plan is affordable, but usually not as popular as other plans because it cannot be customized to meet individual needs.

For a more customized plan, look for what is known as a “prototype” plan. This is probably the most popular Solo 401(k) that is offered to employers. A prototype allows each adopting employer to have their own trust for plan participant contributions. There are two different kinds of prototype plans. The first is known as a standardized prototype. The standardized prototype limits the plan to the most common plan features to reduce complexity. Of the two prototype plans, this is the more popular. It includes features such as a loan ability, profit sharing, employee deferrals, and Roth deferrals.

The second prototype plan is known as the non-standard prototype. The only difference between the two plans is that the non-standardized prototype allows a bit more flexibility and customization to meet an individual employer’s needs. Additionally, separate trust or custodial accounts are typically established by each employer under a prototype plan. Regardless if your plan is either a non-standard or prototype, your plan documents consist of a basic plan document, the plan summary description agreement, and the adoption agreement.

An alternative to the prototype plan is what is called an individual-designed Solo 401(k) plan. These plans are primarily drafted in such a way that it meets the specific needs of the employer or plan sponsor. However, the costs and filing fees associated with this type of plan are substantial. The approval process is also more complicated as the IRS must formally approve your plan for you to qualify for tax-exempt status.

Solo 401(k) Paperwork

Here, we will outline the rest of the paperwork you need to be aware of when establishing a Solo 401(k) plan.

Basic plan documentation

Your basic plan documentation contains all of the nonelective rules and provision that govern your plan. These rules are applicable to all employers who adopt a Solo 410(k) plan. These provisions outline the terms and conditions that the plan must follow during operation so that it complies with regulatory requirements.

The adoption agreement

The adoption agreement is a form that contains elective provisions that are generally included in your plan documents. These are the choices we discussed earlier where you decide how your plan operates regarding the vesting schedule, contributions, allocations, the loan feature, eligibility requirements, etc.

Don’t mistake this for your complete plan document. The adoption agreement is merely the paperwork that indicates certain plan features that are available for you to choose. When this document is coupled with the basic plan documents, it should provide comprehensive details regarding how your plan will operate. In addition to the adoption agree-

ment and basic plan documents, you also have a plan summary description document.

It is important for you to complete each provision in the adoption agreement, even if you have no employees or are a sole proprietor. When you, or your employer, signs the adoption agreement and other plan documents, make sure to hold on to the paperwork. You need to keep duplicates of all the documents and provide a signed copy to your plan document sponsor company, if you have one.

If, instead, your plan is a "volume submitter plan" or an individually designed plan, your documentation will likely be self-contained. When submitting your plan to the IRS, you use a three-digit plan sequence number to report to the IRS. Your business decides the plan's number, beginning with 001 for the first plan you establish.

Summary Plan Description

The last plan document that you may want to file for your Solo 401(k) plan is called the **summary plan description** (**SPD**). The SPD is usually not required for a Solo 401(k) plan as your plan will likely cover only you and your spouse. If you have more plan participants than you and your spouse, you should provide an SPD to each person contributing to the Solo 401(k) plan.

When writing the SPD, keep in mind your audience. This means the information in the SPD must be written in a manner that an "average plan participant" can understand (or as simply described as possible). If you have adopted an ERISA 401(k) plan and you have employees, you must hand out the SPD to all of your eligible employees within a 120-day period after the plan is adopted. The SPD must also be distributed to all new employees within 90 days after the employees become eligible plan participants.

Additionally, you need to give the SPD to all beneficiaries covered by the plan within 90 days after they start receiving plan benefits. You typically do not need to let third-parties know about the SPD. For instance, you only provide your SPD to the Department of Labor if they request it.

Your SPD outlines all applicable features of the 401(k) plan you adopt. The SPD for your plan consists of a written summary of provisions, including the benefits offered and the terms of the plan. Again, the SPD must be written in plain language easily understood by a layperson, yet comprehensive enough to reasonably inform plan participants and beneficiaries of their rights and obligations associated with the plan.

In the summary, you must detail when employees can start participating in the plan. You must also include a description of the benefits that the plan provides, when these benefits become vested, and the remedies available to plan participants when a claim for benefits is denied. If you alter your plan, you must inform any participants through a revised SPD or through a document called the "summary of material modifications." Both of these documents must be provided to all plan participants without charging a fee.

The SPDs are not quite as important for a Solo 401(k) as they are for an ERISA plan be-

cause you normally know the available features of your plan because you selected them when you adopted the plan.

Solo 401(k) Plan Document Updates

The IRS considers a Solo 401(k) plan a **defined contribution plan**. Therefore, if you need to update your plan documents, the new terms must be restated by no later than April 30 of the current year. A common reason for restating your 401(k) plan documents is a change of rules made by the IRS. For instance, after 2011, plans must incorporate the language and provisions provided in the Pension Protection Act (PPA), along with a number of other amendments that recently took effect.

These update requirements apply to your new Solo 401(k) and must be included in the plan documents. Plan requirements are periodically updated by the government. The IRS requires your plan documents to be updated and submitted to the federal government approximately every six years. If your plan is set up as an individually designed plan, you have a five-year restatement cycle instead. Make sure to reach out to your tax advisor when this cycle is ending to check if the requirements have changed.

If your plan is managed by a financial institution, your document sponsor is usually the party responsible for ensuring the plan documents have not expired. If your documents are not up-to-date, your sponsor must resubmit them to the IRS for review and approval. Additionally, the party drafting the document can make any of the optional changes discussed earlier. If you do not restate the plan documents in a timely-fashion, your plan may be disqualified, or you might be hit with considerable penalties.

Naming Your Solo 401(k) Plan

Naming your Solo 401(k) plan is probably the most straight forward requirement of setting one up. There are no rules or regulations that dictate how you should name or title your Solo 401(k) account. There are, however, a few common practices that you should follow. Typically, you should use a variation of your business name with the designation "401(k) plan" or "401(k)" (e.g., Johnson Home Construction 401(k)). It might also be helpful to use the designation "Solo 401(k)," "Individual 401(k)," "IK plan," or "Self-Employed 401(k)." The IRS has recognized all of these titles for Solo 401(k) plans.

IRC Section 401 states that your 401(k) plan assets must be held in a trust. A 401(k) plan is fundamentally a trust. Therefore, a trustee is the responsible party for your plan's investments. It is also likely your plan documents will incorporate trust agreement language. Your Solo 401(k) plan might even have a separate individual trust agreement. This agreement is contained within your basic plan documents and describes the duties and responsibilities of the trustee in regard to your Solo 401(k) plan.

Serving as Trustee of the Solo 401(k) Plan

When executing your adoption agreement, you are required to appoint the person who will serve as the trustee of your Solo 401(k) plan. The IRS defines a plan trustee as someone who has exclusive authority and discretion to control and manage the plan assets. Simply put, the plan trustee accepts funds to the plan, prudently manages these funds, and timely distributes them to the named beneficiaries in the plan documents.

As the plan sponsor, you either choose an individual trustee or a single institutional trustee to manage the plan. Usually, you choose the owners, or even the officers, of your business to be individual trustees. If you chose an institutional trustee, this task can be handled by an insurance company, affiliate bank, or other financial institution.

Your Solo 401(k) plan documents allow you to choose between two types of trustees: the discretionary trustee and the directed trustee. A discretionary trustee designation provides the trustee with exclusive discretion and authority over the control and management of your assets. This power is tempered with a few responsibilities, however, the most important being that the trustee has a fiduciary responsibility and liability regarding the monitoring, selection, and replacement of your plan assets. Commonly, the business owner serves as trustee of the plan, and should, therefore, have no qualms with conducting all of the discretionary trustee responsibilities.

A directed trustee, on the other hand, is subject to the direction of a fiduciary named in the plan documents who does not act as trustee or investment manager of the account. The directed trustee has a fiduciary responsibility and liability for monitoring, selecting, and replacing your plan assets. They also have a liability and fiduciary responsibility to monitor transactions activity and accuracy, manage the timing of deposits, and ensure compliance with Department of Labor and IRS regulations.

It is exceptionally uncommon for a directed trustee to be appointed to a Solo 401(k) plan, as this would be in conflict with the one of the main benefits of your Solo 401(k) plan: control over your plan investments. In some circumstances, a financial organization is appointed trustee of a Solo plan, but usually you choose the trustee. And with a Solo 401(k) plan, you will likely prefer to be trustee of the plan. This should be the option you choose if there is more than one plan participant on your plan (e.g., your spouse).

Your Solo 401(k) plan documents presumably gives your trustee the authority to make all decisions on behalf of the trust account. This includes all of the day-to-day operations of the trust, such as: holding, investing and reinvesting funds, receiving plan contributions, maintaining accurate records of all investments, receipts earnings, contributions, withdrawals, disbursements, and other trust transactions. The trustee also has the authority to make the necessary disbursements from the proper section of your trust funds, payable to the respective beneficiary or participant.

The trustee is entrusted with certain powers to carry out their authority. These powers

are also outlined in the basic plan document and are extensive enough to allow a trustee to manage the trust efficiently.

First, the trustee has the power to purchase or subscribe for securities or any other eligible property and retain the investments in the Solo 401(k) plan trust. Additionally, the trustee may exchange or sell plan property when required to accomplish the goals of the trust. Buying and selling assets is an important task that the trustee is entrusted with. Without these two powers, you cannot invest plan funds.

The next set of powers the trustee wields deals with to how the investments in your retirement account are handled. Your plan trustee has the power to make IRS-approved investments if they are permitted in the plan documents. The plan trustee may also accept or retain securities and other property held by the plan and to place that property where appropriate.

Eventually, you may run into third-parties who are interested in your plan assets, whether for inheritance or to satisfy a debt. The trustee has a number of powers relating to managerial tasks to allow for easy transitions, if they are required. For instance, the trustee may oppose, consent, or participate in a plan consolidation, reorganization, merger, or similar plan.

A trustee is also allowed to agree to pay plan expenses, such as assessments levied against securities and other plan property deposited into, or purchased by, the plan. The trustee may extend, renew, assign, or discharge any mortgage, debt, or other lien as long as the action would be considered advisable. Furthermore, the trustee has the power to receive and collect any asset due or belonging to the plan, such as money, real property, securities, etc.

Finally, the trustee must be able to close out your account when appropriate. Thus, a trustee has the authority to use assets in your account to bargain with. Here, the trustee has the power to compromise, settle, or submit to arbitration all debts, claims, or damages owed by, or due to, the plan. Likewise, the trustee has the power to borrow money from third-parties to further the purposes set out for the plan (e.g., for plan investments). As long as the trustee deems the expense is proper, the trustee has the last say. The trustee may exercise all of these powers either personally or by using general or limited power of attorney.

The trustee handles virtually all of the day-to-day functions for your Solo 401(k) plan. To carry these tasks out, it is typical for the plan participants, whether they are spouses or co-owners, to serve as trustees. It is not a requirement that you serve as the trustee for your plan. There is, however, an advantage for both spouses to serve as trustees on the account. When both spouses act as trustees for the plan, it is easier to rollover or transfer the plan's assets into another retirement account when one of the spouses dies.

There are, nevertheless, downsides to having two trustees managing your Solo 401(k).

One common issue arises when both trustees must sign all investment-related documents. The co-trustees may also disagree regarding how best to manage your plan. However, if you choose the trustees wisely, these issues usually do not crop up. These negatives unlikely outweigh the benefits of having two people managing the account.

As previously stated, it is important for you to prepare for the eventuality that you will die before your spouse. It is necessary to designate both primary and contingent beneficiaries for your Solo 401(k) plan to ensure that your family is taken care of when you are gone The beneficiary that you choose receives all of your Solo 401(k) assets.

If you elect your spouse as the beneficiary of the plan assets, the entire account is transferred to him or her both tax and penalty free when you pass. Your Solo 401(k) funds are transferred from the plan to an IRA for your spouse. You may also elect more than one beneficiary (e.g., your children). If you do this, make sure to designate the percentages for the amount of plan proceeds each primary beneficiary is to receive so your loved-ones can avoid suing each other over who gets what.

If you are a sole proprietor and you die, the business also terminates with you. When the business dissolves, your beneficiaries can't keep your Solo 401(k) plan open. Once the plan is terminated, the plan assets are moved into a new IRA established in your beneficiary or spouse's name. If the spouse is not the beneficiary, the plan assets are transferred into what is called an "inherited IRA."

Solo 401(k) Plan Beneficiary

We've gone over the plan trustee, so let's delve a bit more into what powers and obligations the plan beneficiary has regarding your Solo 401(k).

You are required by law, as a married 401(k) plan participant, to ensure that the remaining money in your account is paid to your spouse upon death. This must be done in a specific manner. The manner of payment is usually broken down into a series of periodic payments over the life of the surviving spouse. This is commonly referred to as "qualified preretirement survivor annuity."

The amount of the periodic payments are calculated using the amount remaining in the retirement account. If your spouse needs the money now, they have the power to elect to waive the pre retirement annuity in favor of receiving the funds in a lump sum. Money received in this way is deposited into another retirement account if your plan allows this option. However, if your surviving spouse elects to waive the annuity before the age of 35, he or she is required to waive the election again after their 35th birthday.

After you select the primary beneficiary for your 401(k) plan, you have the power to also select one or more contingent beneficiaries. A contingent beneficiary is someone who receives the plan proceeds if your primary beneficiary dies before you do. You might want to elect more than one contingent beneficiary if your beneficiaries are prone to chronic ill-

ness. As mentioned above, if you elect more than a single contingent beneficiary, you have to select the appropriate percentages that each beneficiary receives upon your death.

In a few specific situations, your beneficiaries may be eligible to take out loans against their vested balances in the account, including rollover funds, before a distribution-triggering event occurs, if your plan-adoption agreement permits. Normally, using retirement funds in this manner triggers a prohibited transaction. There is, however, a limited statutory exception to the prohibited-transaction rules for Solo 401(k) plan loans.

There are two different sets of rules that you must follow when administering a 401(k), one from the Department of Labor and one from the IRS. Your Solo 401(k) plan, on the other hand, is only subject to the IRS regulations. The IRS rules focus on the amount of assets in your plan that are available for a loan as well as other situations that could potentially trigger a tax.

If your plan participant wants to take out a loan on your Solo 401(k), all of the loan documentation required to take the loan is included in the basic plan documents for your plan. This includes a loan agreement, loan application form, and a lending disclosure statement. To take a loan from your Solo 401(k), the plan participant must sign all three documents. The plan participant is also required to get a spouse's signature to consent to the loan, if one exists. To finalize the loan, you have to sign the loan application as well.

HOW TO MANAGE

Solo 401(k) Contributions

In the previous sections you were given a bird's eye view of the Solo 401(k) plan. Here, we will get more in depth. As you now know, if you choose the Solo 401(k), you're not looking to spend a ton of money and you want something that isn't difficult to administer. You're also looking for a high annual contribution limit and investment capabilities, making this plan the most flexible retirement plan option for you. So, let's take a deeper look at the Solo 401(k) plan contribution limits.

Here's a quick recap.

When you establish your Solo 401(k), you put a percentage of your self-employment or W-2 income into the retirement account. This is how you make a contribution to your Solo plan. By doing so, you avoid paying a tax on that income, with the tradeoff that you cannot use that money (without penalty) until you decide to retire. Although you are self-employed and have no full time employees, the Solo 401(k) plan allows you to contribute as both employer and employee.

Your Solo 401(k) contributions fall into two categories: employer non-elective (profit-sharing) contributions and employee salary deferral contributions. The employee salary deferral contributions are unique to the 401(k) and are not permitted under other instruments such as the SEP-IRA. Thanks to EGTRRA, as a business owner, you have an incentive to establish a 401(k) plan because you now enjoy the same tax benefits as other retirement savings plans and more.

So you've opened up your Solo 401(k). What do you do now?

First, remember that you will never be able to contribute more to your retirement savings plan than you earn annually. This is important if you participate in multiple 401(k) plans, (e.g. you have a 401(k) through your employer and are looking to set up a Solo 401(k) for your self-employment activities). Section 402(g) in the IRC is the "employee deferral limit" rule. These guidelines place a per-employee limit on the amount your business can defer. In other words, if you are self-employed, you are counted as the single employee of your business. Therefore, you may not make employee deferral to another plan if you have reached the employee deferral limit elsewhere.

Also remember that your deferrals can be made using pretax, after-tax, or Roth, and employee deferrals made pre tax are not subject to FICA and FUTA tax withholdings. However, don't forget to make sure your Solo 401(k) plan allows after-tax and Roth contributions. They are elective and do not come standard in your plan. Your after-tax and Roth

income should be placed in a separate 401(k) plan bank account so that your plan administrator can more easily manage your contributions. Just make sure the pretax and after-tax amounts do not exceed the 402(g) limit.

Distinguishable from the pre tax elective contributions, Roth contributions to your 401(k) are:

- **includible in your gross income**
- **made after-tax**
- **and mostly tax-free when distributed.**

Any other after-tax contributions that are made from your compensation must be included as income in your tax return. There are no initial deductions when you make Roth or after-tax contributions. The Roth and other after-tax contributions only differ when you decide to take a distribution. For instance, you must pay tax on any income earned from your after-tax contributions. With your Roth contributions, as long as you are at least 59½ and your Roth account has been opened for at least five years, you are not required to pay tax.

Pay close attention to the documents you are using to set up your Solo 401(k). Most plans allow pre tax employee deferral contributions; only specific plan documents allow either Roth or after-tax contributions. You are allowed a tax deduction on pretax contributions based on the amount of the contribution. However, Roth and after-tax contributions do not allow for this deduction.

There are a few things to keep in mind when making contributions. Again, IRC 404 limits employer profit-sharing contributions or non-elective employer contributions to 20% if you are a sole proprietor or a Schedule C taxpayer, and 25% if you are considered "self-employed." In other words, employer profit-sharing contributions are made by the employer, not the employee. The employee deferrals come from your salary and do not calculate into your maximum employer profit-sharing contribution. This is because employer profit-sharing contributions come from the business.

Employer profit-sharing contributions are discretionary, meaning you have the ability to decide annually whether you would like to make profit-sharing contributions. The contributions are also made pre tax, rather than after-tax or Roth. Although these contributions are 100 percent optional, the amount you are allowed to contribute is still tied to a percentage of your self-employment income. The profit-sharing contribution is not calculated using a percentage of your business profits; however, your business must have at least some profits or other capital to actually make the contribution.

Something that sets the employer profit-sharing contribution amount apart from the employee deferral limit is the fact that it is a per-plan limit, rather than a per-employee limit. A per-plan limit allows you to receive employer profit-sharing contributions from any

number of plans as long as you are pushed over your annual limit. Employee deferrals are per-individual, meaning that when you hit the deferral limit you won't be able to make any more employee deferrals.

If a Solo 401(k) plan is your only retirement account, you'll want to contribute as much as possible, or up to your overall contribution limit of $57,000 for 2020 (or $63,500 if you are 50 or older). Make sure if your spouse is a participant in your Solo 401(k) plan and earns income from the business, that you make separate, equal contributions. This increases your combined total contribution to $114,000 (or $127,000 if you are both over 50) per year.

As you may have noticed, the Solo 401(k) is incredibly flexible. The employee profit-sharing deferral and salary deferral are optional. You have the ability to change your contribution limits at any time. If your business has a good year, you may decide to contribute to your limit. If you have a downturn or are expanding, you contribute less. You can work around any situation that arises. However, it is important for you to make contributions to your Solo 401(k) plan at least once every few years. If you have more than a number of consecutive years, the IRS may consider your pan to be inactive and invalid, and you'll have to fight them in court. You don't want that kind of headache.

Your employer profit-sharing plan contributions are dependent on how your business tax is structured. You can find the rules for this in IRC section 401(a)(3). The way it works out is, if you are set up as a C or S corporation and receive a W-2, your employer contribution amount is capped at 25% of compensation paid. Therefore, you will be able to contribute to profit-sharing up to 25% of W-2 earnings as well. If you are taxed as a C or S corporation the contributions through your employer profit-sharing is based on compensation paid by your company as it is identified on your W-2 and not the overall profits of your business. Essentially, your contributions are limited by how much you decide to pay yourself as a salary on your W-2s.

If you have set up your business to be taxed as a partnership or multiple-member LLC, your employee profit-sharing deferral contributions are capped at 25% of your organization's overall self-employment earnings. This means your employer contribution will be limited on any K-1 earnings traceable to self-employment earnings. This is an important nuance to pay attention to, as any income that is attributable to investments that the IRS does not consider self-employment earnings is not included.

If you have set up your business to be taxed as a Schedule C sole proprietorship or a single-member LLC, your employer profit-sharing contribution amount is capped at 25% of your organization's income, as long as that income is considered self-employment income. To calculate the amount, you need to determine your earned income to forecast your maximum contribution.

Unfortunately, this usually has the effect of dropping the maximum contribution from 25% to 20% of your self-employment income. Note, your net earnings from self-employment

activities are considered your compensation. Your deduction for contributions to the plan and of half of your self-employment tax are included in these calculations, as well.

How to Make 401(k) Plan Contribution Limits of $100,000 or More in a Year

As we discussed in the last chapter, if you are employed with an employer-managed 401(k) plan and you have self-employment income, you can make 401(k) contributions of up to $144,000 or $127,000 in 2020 if you are 50 or older. So, if you bust your hump and can hold down a full-time job as well as a side-business that produces a significant self-employment income, you will be able to make plan contributions that exceed $100,000 by making employee deferrals and receiving employer profit-sharing contributions.

Your only limitation when contributing to your 401(k) plan is the employee deferral "per-employee" limit I mentioned earlier. When you reach this limit, don't forget that you will be unable to make employee deferrals to your other retirement plans. Your employer profit-sharing contributions are not subject to this limit so you will likely be pushed over the annual maximum limit.

Solo 401(k) Plan Contribution Deadlines

The deadline for contributing to your Solo 401(k) plan is dependent on both what type of entity your business is and the type of contribution you plan to make (e.g., the aforementioned employee deferral and employer profit-sharing contributions).

Sole Proprietorship Contribution Amounts and Deadlines

If you have set up your business as a sole proprietorship, you are allowed employee deferral contributions of up to $19,500 if you are under 50, and $26,000 if you are over 50 in 2020. You must elect to make the contribution by December 31 of that year. Nevertheless, you may make the actual contribution up until the federal tax filing deadline. You are allowed to make employee deferral contributions using pretax, after-tax, and Roth capital.

For your sole proprietorship business, you may make equal, annual employer/profit-sharing contributions for you and your spouse. This amount is capped at 25% of your organization's self-employment income. If your business is a Schedule C sole proprietorship, you have an additional step that includes the addition of earned income to calculate your maximum contribution limit. In other words, if you are Schedule C, your maximum contribution limit is capped at 20%. You must make your profit-sharing contributions by your business's federal tax filing deadline of April 15.

Single-member LLC Contribution Amounts and Deadlines

If your business is structured as a single-member LLC, you are allowed employee deferral contributions of up to $19,500 (under the age of 50) and $26,000 (over the age of 50) in

2020. You have a deadline of December 31 of the year you wish to contribute to elect to make employee deferral contributions. The actual employee-deferral contributions may be made all the way up to the federal tax-filing deadline and you may use pretax, after-tax, or Roth funds to make employee deferral contributions.

As with the sole proprietorship, you may make employer profit-sharing contributions for both your spouse and you. The employer contribution is capped at 25% of your self-employment income. Again, if you file as a Schedule C single-member LLC business, you have to do the added computation that includes your earned income to calculate your maximum contribution, which brings your maximum contributions down to 20% of earned income. Your compensation is net earnings from self-employment activities. Finally, the deadline to file your profit-sharing contributions is April 15 of the year you want to contribute.

Multiple-member LLC Amounts and Deadlines

For your Multiple-member LLC organization you are permitted to make employee deferral contributions of up to $19,500 if you are under the age of 50 and $26,000 if over 50 in 2020. As with the single-member LLC, you have until December 31 to elect to make the employee deferral contributions. The employee deferral contribution deadline is based on the federal tax-filing deadline. You can make employee deferral contributions using pretax, after-tax, and Roth capital.

The employer profit-sharing contributions to your Solo 401(k) are capped at 25% of your organization's self-employment income. You may make annual profit-sharing contributions for the business owner only (no spouse). These contributions must be made by the federal tax-filing deadline.

C Corporations/S Corporations Amounts and Deadlines

If your business is structured as a corporation, you more than likely pay yourself a salary and receive a W-2. If you decide to make employee deferral contributions, you must do so during the year. When you decide to make employee deferral contributions, it depends on how your business handles the paycheck. For instance, if your business handles employee paychecks using a payroll company, the employee deferral contribution is generally deducted from the paycheck.

If you do not use a payroll system, employee deferral contributions may be made any time during the year. As soon as you make the contribution, the Department of Labor "safe harbor" rule kicks in. What this rule means is, if your organization has fewer than 100 employees, you may make employee deferral deposits if they are placed in a plan trust within seven business days from the date the funds are withheld from your paycheck. Employee deferral contributions for corporations may be made using pretax, after-tax, and Roth capital.

Employee profit-sharing contributions for corporations are made annually. The corporation's owners and employees may make this contribution. As with the employee-contribution limits of the multiple-member LLC, a corporation is capped at 25% of the organization's self-employment income. Profit-sharing contributions must be made by the federal tax-filing deadline.

HOW TO HANDLE TAXES

Filing

Sole Proprietorship and Single-member LLC Reporting

If your business takes the form of a sole proprietorship or an LLC with only one owner, you report employer profit-sharing contributions and employee deferral contributions on IRS Form 1040, line 18. You should include the word "Roth" next to the amount for all of your Roth Solo 401(k) employee deferral contributions to indicate that the deposit is after-tax. Finally, you do not make your employer contribution on your IRS Form 1040, Schedule C. This is so you, as either a sole proprietor or the owner of a single-member LLC, don't receive double benefits from the contribution.

Multiple-member LLC or Partnership Reporting

Perhaps your company is managed by a number of different owners or partners. For this type of type of business, your employee deferrals are reported on IRS Form 1040, line 18. As with previous retirement accounts, you should include the word "Roth" next to the amount of Roth Solo 401(k) employee deferral contribution. This also indicates that the contribution is after-tax.

For your employer profit-sharing contributions, your LLC or partnership must include the total amount of profit-sharing 401(k) contributions on IRS Form 1065, line 18. This form is also known as the U.S. Return of Partnership Income. You must also indicate your partner's partnership-sharing contributions on IRS Form 1065, K-1, line 13, Code R. If your business is a partnership, it is considered a pass-through entity for tax purposes. This means that a partnership does not pay taxes on the corporate level. Instead, corporate income is passed on to owners and income tax is levied at the individual partner level. Therefore, each individual partner must include the amount allocated to them on line 18 of IRS Form 1040.

C Corporation Reporting

The tax rules for the C Corporation are similar to multi-member LLCs or partnerships except for a few key distinctions. Like other entities, if you structure your organization as a C Corporation, you report employee deferrals on IRS form 1040, line 18. You should also include the word "Roth" next to the amount of any Roth Solo 401(k) deferral contributions you make to alert your account manager (or yourself) that the contributions are after-tax.

The first difference for C corporations, is you have a new form to fill out for your employer profit-sharing contributions. You indicate any amount of your partner's profit-sharing con-

tribution, if any, on line 23 of your U.S. Corporation Income Tax Return (IRS Form 1120). Another difference between the C Corporation and other entities is that the C Corp. is not a pass-through entity, and therefore, you do not report the employer profit sharing contribution on your IRS Form 1040.

S Corporation Reporting

For those of you who file as an S corporation, your employee deferrals must be reported on IRS Form 1040, line 18. Again, you should include the word "Roth" next to the amount of the contribution on any Roth Solo 401(k) employee deferral contributions, as it shows your account manager the contribution is after-tax.

Your S corporation has new paperwork for you as well. For your employer profit-sharing contributions, you need to mark the amount of your partner's profit-sharing contribution on IRS Form 1120S, line 17. However, if you are an individual, you are not required to report your employer contribution amounts on Form 1040, line 18.

Filing Requirement and Exemptions

There is one more rule you need to consider when setting up your Solo 401(k). If your plan does not exceed $250,000 in assets as of the 31st if December during the previous tax year, you are not required to file annually. There are two ways to exceed this $250,000 amount in assets:

1 **Either your assets meet the requirement alone, or**

2 **Your assets are combined with your other qualified retirement plans that you (or your spouse) own more than 80% of.**

It is not a big deal, however, if the assets in your Solo 401(k) do exceed $250,000. You are only required to file a short information return (Form 5500-EZ) with the IRS. The 5500-EZ form is due July 31, must be filed by paper, not electronically, and must be filled out by both you and your spouse.

Solo 401(k) Plan EIN

Your Solo 401(k) plan comes with an **employer identification number** (**EIN**), also known as a Federal Tax Identification Number. The IRS gives every business an EIN so it can more easily identify if the organization is a business or a trust (such as your Solo 401(k) plan). The IRS sends you an EIN after you establish your plan and files the proper paperwork with the federal government.

At this point, you may then use that EIN to open up a bank account in the name of the plan. However, the IRS does not require that you actually acquire an EIN for your Solo 401(k) plan, as it is an owner-only plan. Having an EIN is important, though, because most Solo 401(k) plan sponsors use the business EIN as the tax id number for the account. The only

other alternative is your social security number. If the institution you use to manage your Solo 401(k) includes a separate trust agreement during the formation of your plan, they will likely suggest that you obtain a separate EIN.

IRS Letter of Determination

Along with your basic plan documents, you should include an IRS **determination letter** that states your Solo 401(k) is a prototype plan that fulfills all requirements of a qualified plan. Your plan document sponsor will likely request an IRS review for the plan documents. The sponsor will look for the IRS to issue a favorable determination letter to ensure that your plan complies with the IRC. Although you are not required by law to request a determination letter from the IRS, it is just more assurance for your plan sponsor. If you utilize a document sponsor company, the company is actually the party responsible for requesting your plan IRS determination letter. When you adopt a standardized master or prototype plan, you may rely on the favorable IRS opinion letter for either plan.

A favorable opinion letter lets you know that the plan documents are pre-approved by the IRS. This assures that, as long as you lawfully operate your plan, any subsequent tax disqualification of your plan is not applied retroactively. When the IRS gives the assurance that your plan will not be retroactively disqualified it is usually referred to as "**guaranteed reliance**." When it comes to a Solo 401(k) plan, most businesses adopt prototype or standardized master plans. This allows employers to avoid engaging in additional plan-approval procedures. Typically, you may rely on an IRS determination letter that is granted to your document sponsor. You do not, however, have to give notice to interested parties, such as beneficiaries, for an owner-only plan.

Solo 401(k) Plan IRS Audit Risk

The beautiful thing about the Solo 401(k) plan is that it is relatively safe from audit. As long as you are not engaged in what the IRS deems as a prohibited transaction and you follow the plan rules, you really have no reason to worry even if the IRS audits your plan. If you obtain an IRS letter of determination it is a major safety net. The truth is the IRS does not actively audit Solo 401(k) plans. So make sure to keep everything above board and you should be safe from audits.

SECTION III: BIGGER PICTURE

WHAT TO DO WITH YOUR FUNDS

In this section of the book, we're going to go over what to do with all of that hard earned cash you've saved up. What can you do to grow your wealth and have peace of mind?

Retirement Plans in Aggregate: an Overview of Contribution Plans in The US

Although a large portion of the aging population does not save for retirement, the amount of money held in retirement plans in the U.S. is staggering. A study conducted by the Investment Company Institute found that 401(k) plans and other contribution plans accounted for an estimated $6.8 trillion in assets by December 31, 2014. This retirement asset total represented nearly 28% of the entire U.S. retirement market, which held a total of $24.7 trillion in assets. The plans included in the study were unit investment trusts (UITs), closed-end funds, mutual funds, and exchange-traded funds (ETFs).

As of September 30, 2019, 55 million American workers participated in 401(k) plans, holding $5.9 trillion in assets. The vast majority of IRAs and 401(k) plans are usually managed by traditional financial institutions. Therefore, millions of retirement account holders only have investment opportunities that include equity-based investments such as ETFs, mutual funds, and stocks.

Traditional financial institutions only invest in these areas because they are considered safe investments. These organizations usually see no financial incentive to allow 401(k) or IRA account holders the ability to invest in non-traditional investments such as real estate, hedge funds, private equity, etc. The risk is too high. So if you have a successful history in investing in non-traditional instruments, make sure to find the right financial institution to take out your retirement account.

Investing with your Solo 401(k) Plan

Here, we will discuss a few tips for making Solo 401(k) plan investments, as well as how to use your plan funds to invest in real estate. The first step in this process is making sure you perform adequate due diligence on the property you are looking to purchase. If someone brings property to your attention, it is important, no matter their trustworthiness, to not take the property at face value. This is especially so if the investment is in a state you do not currently reside.

Make sure to go directly to where the property is being held, especially if the property is

real estate or used consumer goods, to check the quality of the investment. If you are unfamiliar with the type of property you are investing in, bring someone you trust to do the evaluation.

The next tip for making investments with your plan funds is to only use retirement funds when investing. If you use personal funds, or you obtain funds from a disqualified person, the IRS will consider the investment a prohibited transaction. This applies to whether you are looking to buy real estate or merely purchasing stock. Do not forget the prohibited-transaction rules!

After you make your 401(k)-plan investment, there are a number of things to keep in mind.

First, any expenses, taxes, expenditures, repairs, or other related fees must be paid using your retirement funds. As when you purchased the investment, no personal funds should be used. If you require additional funds to make improvements to your investment, or you need money due to other matters involving your 401(k) investments, the funds should come either from a non-disqualified person or your retirement account.

Next, if there are any services that are required regarding your investment, such as an evaluation of the value of gold bullion, these services must be performed by an entity that is neither you nor a disqualified person. Some people may look to cut corners if they have expertise in servicing the investment. This will inevitably trigger the prohibited-transaction rules. However, you are allowed to take care of any necessary and required tasks in regard to the maintenance of your retirement account. In other words, disqualified persons and plan participants are not allowed to provide active services with respect to the plan transaction.

In addition to expenses and services, you should allocate all gains, losses, or income from your 401(k) plan investments to the plan. Additionally, any purchased assets or title to real estate managed by your plan should use the plan trustee's name in the name of the asset. If you need financing, say for a real-estate transaction, you should only use non-recourse financing. This is so the lender cannot hold you (the borrower) liable as the non-recourse loan is not personally guaranteed.

Finally, you need to take into account the UBTI tax rules we detailed earlier. Remember, these rules can be triggered if you use plan margins to buy stock or if you purchase a trade or business that is operated using a flow-through entity, such as an S Corporation or an LLC. As we detailed earlier, the UBTI tax rates may run you as high as 40%, so do not overlook how this may potentially negatively impact your 401(k) investments. Additionally, don't forget the exemption you receive for using a non-recourse loan to make real-estate purchases with your 401(k) plan. This type of transaction is not permitted for your IRA funds and offers a number of promising tax planning opportunities.

You should be safe if you want to invest with third-party promoters or would like to purchase assets in another state as long as you perform your due diligence when investing your retirement-account funds.

Real Estate Investment Using Solo 401(k) Funds

I hope now you have a better understanding of how to use your Solo 401(k) funds to make investments. The different types of property you can invest in have their own ins and outs. We specialize in real estate, so let's go over how to use your retirement funds to invest in real estate.

Using Solo 401(k) funds to invest in real estate is a relatively straightforward procedure. Again, it is important to keep the IRC rules discussed in this book in the back of your mind, as specific rules apply to different types of real estate. Additionally, certain rules change depending on the real estate method you incorporate into your investing strategy. The following steps and methods will help you navigate this process.

The first step, obviously, is to establish a Solo 401(k) plan. Your offer to purchase real estate must be made under the name of your 401(k) plan. Since you will use the Solo 401(k) to purchase the property, you must comply with regulations, which means all purchasing fees must be paid with your 401(k) funds.

For your next step, you must fund the Solo 401(k) plan. As soon as you sign your plan documents, you may make a purchase offer on the property in the name of your 401(k) as long as the plan is being funded. You fund the plan by making annual contributions, transferring funds from other qualified plans, and through direct rollovers from SIMPLE IRAs, SEP IRAs, or Traditional IRAs. When you fund your Solo 401(k), the operation may take between five and 10 business days due to the various processing times followed by financial institutions, particularly how these establishments process out-going transfers.

Next, you must determine which purchasing method you will use to make the investment. Generally speaking, there are four methods you can use to invest your Solo 401(k) funds in real estate. There are a different set of rules for each method:

- **All cash purchase**
- **Non-recourse loan**
- **LLC purchase**
- **Co-investing funds**

All cash purchase method

The "**all cash purchase**" method is perhaps the simplest way to use Solo 401(k) funds to invest in real estate. Here, you directly use Solo 401(k) funds to purchase the property. If you use this method, your 401(k) owns the property outright, free and clear of any encumbrances.

Non-recourse loan method

The "**non-recourse loan**" method of investing Solo 401(k) funds entails using the 401(k) plan to take out a private loan to purchase the property. The non-recourse loan is the most popular method of investing retirement funds because it allows you to have more funds to purchase real estate, which leads to far larger gains to your Solo 401(k). The plan must be non-recourse, which means that the mortgage company can only go after the property, not the borrower. This protects you personally from liability. Additionally, the lender will not review your credit, just your plan balance. Finally, you have to jump through a number of hoops to qualify with a bank for a non-recourse loan. This process, however, is beyond the scope of this book.

LLC purchase method

The next method for investing in real estate using Solo 401(k) funds is using an LLC to purchase the property. After you establish your Solo 401(k) you will set-up and fund an LLC. This entails registering the LLC with your state and drafting an LLC operating agreement. You need a specialized operating agreement that includes language referring to 401(k) regulations and investing. After this, you will obtain an EIN for the LLC. Do not use the EIN for your Solo 401(k)! Then, open up a bank account with the new EIN and fund the LLC.

The funds contributed to the LLC are used to purchase real estate. This LLC method is an extremely flexible way to purchase real estate. You can invest more 401(k) funds into the LLC later. Additionally, both Roth and pre-tax funds may be invested. All of the income and expenses from the property flow through the LLC bank account. Also, you won't need to file an LLC federal tax return if the Solo 401(k) plan is the only member of the LLC.

Co-investing method

The final method for using your Solo 401(k) plan to make real estate investments involves co-investing funds through a **tenants in common** (**TIC**) transaction. Co-investing is a complicated transaction because there are different rules depending on whether the co-investor is you or third-party. That's right: this is a way to invest with both your non-retirement funds and your Solo 401(k) funds together in the same property.

If you are the other investor, the investment must be an all cash purchase; no debt-financing is allowed. It must also be a simultaneous purchase and you cannot purchase property from yourself or another disqualified person. The IRS may challenge you here, but as long as you can prove the transaction could have taken place without using 401(k) funds, you are permitted to make the investment.

If the co-investor is a third party, you are allowed to use debt-financing to purchase real estate. Again, you are forbidden to purchase your own property or the property of another disqualified person. Then all you have to do to complete the TIC transaction is put an offer together, make an earnest deposit, and purchase the property with this money.

Making the Purchase

Once you have decided which method to purchase the property, you put a contract together. Make sure when you put an offer together to list the Solo 401(k) as the buyer. Because the Solo 401(k) is legally a separate entity, the plan will be listed on all of the purchase documents. For example, you will take title of the property as "John Doe, Trustee of Solo 401k Trust." Then you will make an earnest deposit to your Solo 401(k) with which you purchase the real estate. An earnest deposit merely means you are using 401(k) funds and not personal funds.

The last step for using Solo 401(k) funds to invest in real estate is closing on the property. Here, you approve and sign all of the purchase documents as trustee for the Solo 401(k) plan. Then you submit these documents to the closing agent along with the purchasing amount (check or wire) from your 401(k) account. The closing agent then asks you for your Solo 401(k) agreement.

After you close on the property purchase, you must hold all the closing documents for safe-keeping. You are also responsible for any ongoing expenses that pop up. These must be paid with 401(k) funds. Finally, any rental income generated by the real estate must be deposited into your Solo 401(k) bank account.

Alternative Investments

Making Alternative Investments With a Solo 401(k) Plan

One of the most important aspects of the Solo 401(k) that we discussed briefly is the fact that the Solo 401(k) plan allows you to invest in non-traditional, alternative investments. Traditional investments are those that are considered historically safe and relatively non-complicated; these include bonds, cash, and stocks. Alternative investments include real estate, hedge funds, commodities, and tangible assets such as machinery and inventory. Some alternative investments have always been allowed for your retirement accounts. A Solo 401(k) retirement account gives you a greater variety of alternative investments to make.

You must first make sure that your 401(k) plan documents allow for you to make alternative investments. Although the IRS permits you to invest 401(k) plan funds in assets such as real estate, your Solo 401(k) plan documents are not required to give you that privilege. You are more than likely interested in a Solo 401(k) because it gives you the ability to use retirement funds to make alternative-asset investments, which offers a number of important advantages over other options. A Solo 401(k) allows you to invest in the areas that you have experience in and understand. Additionally, the Solo 401(k) gives you a much more diverse investment portfolio for your retirement funds, as well as the ability to hedge against inflation or a failing dollar.

The more control you have over your retirement funds the better. So, it is likely more beneficial for you to open up a self-directed Solo 401(k), rather than relying on a financial institution to properly manage your funds. Most self-directed Solo 401(k) plan documents permit you to invest in:

- **Raw land**
- **Residential or commercial real estate**
- **Mortgages and mortgage pools**
- **Foreclosure property**
- **Deeds**
- **Tax liens**
- **Private loans and private businesses**
- **Limited liability companies and partnerships**
- **Precious metals and certain coins**
- **Private placements, stocks, bonds, mutual funds, and foreign currencies**

An overwhelming majority of all retirement assets (around 90%) are invested in financial markets. The ability to invest in non-traditional assets such as residential and commercial real estate allows you diversification beyond equity markets. It is more important than ever to have a diversified portfolio in a changing global financial landscape. The more diverse your retirement portfolio is, the greater the chance that your assets have a lower correlation. This means your assets have a lower chance to move in the same direction. So, if one investment starts to trend negatively, your other investments are less likely to do so.

Unfortunately, diversification does not ensure that you will profit, nor will it protect your assets against loss. However, if you invest in non-traditional assets, this helps shield your retirement portfolio if the market trends downward. You will also lose less than the market in the aggregate.

The important thing here is to focus on investing in something you know. If you grew up exposed to real estate, real estate may be a comfortable investment for you. On the other hand, if you have experience with Wall Street and other securities, invest in these assets. Both of these asset classes offer substantial returns if managed properly, and they also come with risk. If you feel more comfortable working within the real estate market and buying and selling real estate than stocks, don't feel obligated to invest in stocks unless you can take the time to become more familiar with them.

Another important aspect of diversification is inflation protection. A dollar today more than likely will not be worth the same a year from now. For instance, a dollar from 1860

has the buying power of $31.17 as of 2020. The dollar has experienced an average inflation rate of 2.17% over the past 180 years. You should expect this trend to continue. Inflation can spell disaster for your retirement portfolio and if your portfolio does not keep up with the inflation rate, you are losing money.

Additionally, inflation also increases the cost of living and recreation expenses. The decrease in the value of money makes it so that the costs of goods and services increase as well. One way to protect your portfolio from inflation is investing in hard assets. For example, rent tends to increase as prices inflate.

This phenomenon is the reason many investors invest in commercial real estate as a hedge against inflation. A hard asset is one that you can see and touch. Other hard assets include:

- **Precious metals**
- **Vehicles**
- **Office furniture**
- **Overstocked goods**

With today's volatile global market and political climate, it is important to have at least a few tangible hard assets in your portfolio. One of the most popular hard assets is real estate.

Real estate investment is perhaps the most consistent avenue for portfolio growth that you have. Diversification in real estate gives you the ability to protect your assets from Wall Street and should be used for both personal and retirement fund growth. It has been more than a decade since the 2008 housing recession, and real estate is slowly reemerging as an asset that you can have confidence and comfort in investing in.

Real estate can bring both exceptional returns and help protect you from the threat of currency inflation. One of the biggest advantages to having real estate in your retirement account is that income and gains from the real estate owned in your Solo 401(k) plan are not taxed. This is a massive advantage over using personal funds to purchase real estate property, as any gain from this type of purchase would be subject to federal, and in certain circumstances, state income tax. Be aware, however, that the IRS only allows you to use your Solo 401(k) funds to purchase commercial and residential real estate or raw land if your plan documents allow you to do so.

As I pointed out earlier in this chapter, most financial institution-run plans do not let you invest in real estate. So, make sure to establish an open-architecture self-directed Solo 401(k) plan that includes the real estate investment option in the plan documents. Once you set up your self-directed plan, it is actually quite simple to make a real estate investment. All you have to do is write a check from your 401(k)-plan bank account.

You are not required to establish a separate LLC to invest in real estate using your plan

assets. This is because, technically, your Solo 401(k) plan is a trust. Therefore you do not have title to the real estate, but rather the trustee takes title to the real estate asset on behalf of the trust. However, you are not penalized for using an LLC to make investments with your 401(k) plan assets. In fact, it might be advantageous to establish a new LLC that is wholly owned by your Solo 401(k) plan. According to recent case law regarding IRAs, you are able to serve as manager for a recently established LLC.

If you want to make an investment using the LLC, you use the local LLC bank account. As manager of the LLC, you cut a check and make the investment on behalf of the entity. You should also title the investment in the name of the LLC. The biggest advantage to using the LLC in this manner is that it offers limited liability protection for your 401(k) assets that are held outside the LLC.

Tax Liens And Deeds

Believe it or not, you can use the people's financial mistakes to help you save for retirement. Tax deed and tax lien investments have recently become popular as Solo 401(k) plan investments.

This is how it works:

1 First, a delinquent property owner fails to pay their property taxes.

2 Next, the tax collectors wait for a certain time period to pass, an interval based on state law. The time period can be from a few months to several years, depending on the jurisdiction.

3 When this period is up, the tax collector then puts the unpaid property taxes up for auction.

Like any other auction, the bidder willing to pay the most for the tax lien wins the auction. A few states, however, have what is called a bid-down process, where bidders specify how much interest they are willing to pay on their investment. For this type of auction, the lowest bid wins. Regardless of which method is used, the purchaser takes the lien on the property from the tax collector in exchange for the amount from the winning bid. The winning bid is used to pay the tax collector for the overdue taxes. The winning bidder gets their return on investment either by the interest payments on the bid amount or ownership of the property.

The IRS allows you to purchase both tax liens and tax deeds with your Solo 401(k) funds. If you decide to use your account funds to invest in a tax deed, you actually own the property outright where the owner has neglected to pay property taxes. When the former property owner is delinquent in paying property taxes, either the court or another taxing authority will sell the tax deed to investors to recover the back taxes and whatever penalties are associated.

The primary advantage of investing in tax deeds or tax liens with your Solo 401(k) funds is that profit taxes are deferred back into your plan account until you decide to take out a distribution. If you have a Roth Solo 401(k) plan, then all your gains are tax-free.

Loans and Notes

You may have experience with leveraging debt, or perhaps you are looking to help an acquaintance start a new business. The IRS allows you to use your Solo 401(k) funds to purchase notes from third-parties or make private loans. If you use your 401(k) account to make loans or purchase notes, all interest payments that you receive are not taxed until you decide to take a distribution. If your Solo 401(k) plan is a Roth account, then all of the gains are taken tax free.

When you decide to use 401(k) funds to give out private loans or purchase notes, you need to pay attention to IRS Section 4975, which outlines the **disqualified person** and **IRS-prohibited transaction rules**. Prohibited transactions are any improper uses of retirement account funds. In addition to the prohibited transactions, the IRS doesn't permit you to use retirement funds to purchase collectables such as artwork.

Furthermore, your retirement funds cannot be used for or transferred to a disqualified person. Disqualified persons include:

- **the retirement account owner (you)**
- **your spouse**
- **your lineal ascendants/descendants (children, grandchildren, parents, grandparents, etc.) and their spouses**
- **any beneficiary of the retirement account**
- **plan service providers and fiduciaries (e.g., advisors, custodians, and administrators)**
- **any entity in which you are an owner with at least 50% of the voting stock**
- **a director, officer, share-holder or partner with at least 10% interest in your business.**

In addition to investing in private loans and notes, you may also use Solo 401(k) funds to purchase interest in a privately held business of your choice, so long as the entity is engaged in some sort of business activity.

Private Business Investment

If you're reading this book, there's a good chance a significant portion of your income comes from your own business activities. And as I have already stated, it is always good to invest in what you know. So, consider using your Solo 401(k) fund if you're looking to start up another business.

The IRS allows you to invest in any legally established entity other than an S corporation. The IRC rules do not allow a retirement account to be a shareholder in an S corporation. Also, when you use 401(k) funds to invest in private business ventures, you must comply with the "**unrelated business taxable income**" (**UBTI**), "prohibited transaction" rules described in the previous section. You also need to comply with the "disqualified person" rules mentioned.

Precious Metals and Coins

You cannot normally use retirement account funds to invest in coins or metals such as steel, copper, etc. The IRS, however, allows you to invest Solo 401(k) plan assets into precious metals (gold, silver, platinum, etc.) or federally-approved coins mentioned earlier. Precious metal such as gold or silver has been widely traded and has held value for thousands of years. This is because, historically, these metals have kept up with or exceeded inflation rates.

One of the best ways to protect against inflation is to use Solo 401(k) plan funds to purchase precious metals and coins. Remember, any metals or coins that you purchase for your Solo 401(k) plan should be held in the name of your plan.

Holding IRS-approved Metals and Coins

Oddly enough, although you can't normally use your Solo 401(k) plan funds to purchase metals or gems, the IRC does allow investing into certain approved metals and coins. The types of coins and precious metals that are permitted investments for plan funds can be found in IRC Section 408(m). Unlike many regulations, where the list of approved actions is not exhaustive, the list of approved metal investments is set in stone.

It should be obvious why gold is an IRS-approved metal, given its history. Investment metal comes in bullion (bars, ingots, or coins).You are permitted to use 401(k) funds to purchase one-tenth, one-quarter, one-half, and one-ounce U.S. gold coins. You may also invest in non-U.S. issued gold coins as long as they are at least 99% pure and are able to be used as legal tender.

The next on the list is silver, gold's ancient counterpart. You may invest in one-ounce U.S. Treasury silver coins. Additionally, the IRS allows you to invest in platinum, as described in 31 U.S.C § 5112(k), as well as any coin issued by a state in the union.

Lastly, you are permitted to invest in palladium, silver, gold, or platinum bullion of specific fineness in the trustee's physical possession as long as the bullion meets plan trustee requirements laid out in Section 408(a).

Apparently, the "physical possession" requirement applies only to bullion, and not coins. The trustee referred to here, as defined in IRC Section 408(a), is any bank or person who demonstrates to the Secretary of the Treasury that trust will be administered according to the requirements of Section 408. So basically, this means the Secretary will approve any

entity with a record of accomplishment in managing assets.

A bank in this section refers to any U.S. bank or insured credit union. The IRC also implies that precious metal investments cannot be held by a foreign bank. Essentially, the institution that holds your investment must be subject to supervision and examination by the Commissioner of Banking or other such state agency.

Life Insurance Contracts

In keeping with the theme of protecting your wealth in your golden years, let's talk about life insurance. If you have a Solo 401(k) plan, you can use plan funds to purchase life insurance. This is not the case with your IRA thanks to IRC Section 408. Before you go out to buy life insurance with plan funds, though, make sure your plan documents allow for it; not all plan documents allow this. Before setting up your Solo 401(k), you must indicate permission in the plan-adoption agreement.

Using 401(k) funds to invest in life insurance comes with a few stipulations. For instance, the policy must be owned by your 401(k) plan and the death-benefit must be payable to the plan. You must also pay income tax on the total amount of the value of the insurance protection every year. This amount roughly comes out to the term insurance cost. Lastly, all excess death benefits of the insurance policy's case value must be distributed tax-free to beneficiaries upon your death. Any cash amount due from the death benefit may be rolled into an IRA tax-free.

Usually, when someone uses 401(k) plan funds to invest in life insurance, they do it to take advantage of paying premiums with pretax funds rather than after-tax funds, primarily if they bought the policy with personal funds.

Foreign Currencies

As a high-earner, you may frequently travel abroad, operate an international business, or have some expertise in foreign trade. If your plan documents allow it, Solo 401(k) funds may be used to purchase foreign currencies. One advantage of investing in foreign currencies is the liquidity of hard cash. All gains you see on your foreign currency investments are not taxed until you take a distribution. If you have a Roth 401(k) plan, the gains are tax-free.

Stocks, Bonds, Mutual Funds and CDs

If you have a background in investing stocks and similar wealth generation products, perhaps the most obvious investment for your Solo 401(k) plan is in this area. Your advantage here is that you have checkbook control over the retirement account funds, and therefore, have nearly unlimited investment flexibility in opening a stock trading account to invest your retirement funds.

Business Investments and UBTI

In the previous section, we briefly touched on using your retirement funds to invest in a business. If you recall, there are a few tax rules that you must abide by to do this properly. Here, we will discuss these rules in more depth so that you may have clarity on how to apply them.

The easiest rule to remember is that the IRS does not allow you to invest your Solo 401(k) plan funds into your own business, as it would violate the IRC rules. However, you are permitted to use your 401(k) plan funds to invest in a friend's business venture as well as any other non-disqualified person's business.

Note: disqualified persons are listed in the prior section.

If the business you want to invest in is conducted as a flow-through entity such as an LLC, the **unrelated business taxable income** (UBTI) rules apply and up to a 40% tax could be imposed on any business income that you put towards retirement. A flow-through entity is a business that passes the income to the owners/investors of the business, which limits taxation by avoiding double taxation. More precisely, the owners or investors, rather than the entity itself, are taxed on revenues.

UBTI Rules

Normally, when you make passive investments with your 401(k) plan funds, such as mutual funds, CDs, stocks, etc., any income generated from these investments are not subject to taxation. Additionally, if you use your retirement account funds to invest in an active business, such as a restaurant or retail shop, as long as the organization is not a pass-through entity the retirement gains are not subject to UBTI.

The vast majority of American retirement investors never have to worry about UBTI because most types of retirement income and gains are exempt from UBTI rules. For instance, any retirement funds that come from interest, capital gains, dividends, rental income, and royalties are not subject to the UBTI-tax rules.

When you use your Solo 401(k) funds, the UBTI tax is triggered because you are either investing in a business that exists as a pass-through entity or you are using margin to buy stock. Buying margin to purchase stock means that you borrow money from a broker to purchase the stock. Furthermore, the UBTI rules are also triggered when you take out a non-recourse loan from a self-directed IRA to buy real estate. The income generated from activities that trigger the UTBI rules are usually subject to between 35 to 37% tax.

Retirement funds that are invested into a C corporation do not trigger UTBI rules. This is because a C corporation is not a pass-through entity. Instead, this type of business "blocks" the income from the shareholder, which keeps the business or active trade income from making it to your retirement account.

IRC 512(a)(1) defines UBTI as "the gross income derived by any organization from any unrelated trade or business…regularly carried on by it, less the deductions." The UBTI-tax rules apply solely to exempt organizations such as 401(k) plans, IRAs, and charities. So, for 401(k) plans and self-directed IRAs, a transaction that is not considered a trade or business regularly carried on by your business will trigger the UBTI rules.

The IRS taxes "unrelated business taxable income" at rates appropriate for trusts or corporations. These rates are based on the entity's legal characteristics. Because IRAs and 401(k) plans are considered trusts, they are subject to a trust tax rate. Retirement account funds subject to UBTI taxes are capped at 37% in 2020.

When the UBTI tax is imposed on your retirement account investments it, in effect, creates a double-tax regime. This happens because the UBTI tax applies both when you take a distribution (i.e., when you are forced to take a distribution after the age of 70½) and the year in which the income or gain is realized.

There is no exact law or rule for how much business activity you must engage in during the year to trigger a UBTI tax. The IRS uses a number of factors in determining whether you have a high enough volume of transactions to meet the threshold:

1 First, the frequency of your transactions are examined.

2 Next, the IRS looks to your intent in making these transactions.

3 After this, your retirement account transactions are scrutinized to determine if the activity in question is an investment or part of your business activities.

4 Finally, the IRS takes note of your personal business activities and makes a determination on whether the retirement investment is integrated into your overall business model.

The IRS makes a decision on whether the UBTI taxes apply only after weighing each of these factors.

In addition to the factors the IRS imposes on your transaction, there are a six factors you must take into consideration if you want to determine whether the activity you are planning is a hobby or a business:

1 First, the time and effort you put into an activity may indicate your intentions. If you plan to work long, hard hours chances are you would not do so without a profit motive.

2 Second, are you dependent on income from the activity? If so, it's likely you are participating in a business activity.

3 Next, have you accumulated any losses, and are they due to circumstances beyond your control? Or rather did they occur during the start-up phases of your business? If the losses are out of your hands and did not arise due to starting the business, the activi-

ty is probably not a business one.

4 Following this, ask yourself if you have changed any method of operation to improve profitability of the act. If you have, then it is likely you are participating in a business activity.

5 After that, figure out if you or your advisors have the knowledge required to carry on the activity as a profitable business. Have you made a profit using similar activities in the past, or is the activity profitable in some years and not others? It is likely that if the activity is profitable throughout the years then it is business related.

6 Finally, do you expect to make gains in the future due to the appreciation of the assets you used in the activity? If so, it is more than likely a business activity.

There is little federal guidance on UBTI implications for Solo 401(k) real estate investing. What we do know can be gleaned from the teachings of retirement investment professionals who have decades of experience working with IRAs and 401(k)s. In this regard, there is an abundance of reliable advice on how UBTI affects real-estate transactions made by tax-exempt entities.

This is important for us because your retirement account is a tax-exempt entity, and you can invest in real estate if you have the right retirement savings plan (SD IRA or Solo 401(k)). More often than not, UBTI tax is not triggered when you purchase real estate. As long as your retirement-funded real estate investments are not excessive, the IRS does not consider the transaction the act of a trade or business.

A majority of investors lack the retirement resources to be able to purchase or sell multiple real estate properties in a single year or invest in land development for business activities. However, there are a number of tax court rulings that can be helpful if you are worried that the real estate transactions you plan to make using your retirement funds rise to the level of trade or business.

Tax Court Rulings

Something you may not know is many of the rules governing how taxes are done are decided by the tax court in tax proceedings, rather than tax rules or laws. Tax courts consider these tax findings when they determine whether you are investing as a business or trade. The IRS first looks to the intent of the investor. More specifically, they ask if your real estate investment is meant to be a one-time investment, or a series of ongoing and related investments that could be reasonably perceived as business activity.

Next, the court looks at the frequency, continuity, and size of the real estate transactions. As common sense would indicate, the more real estate transactions you make in a given year, the more likely the IRS considers that these real estate transactions were made as a single real estate business venture. The larger the size of the investments and how often you make similar transactions also signals to the IRS that you are conducting a business.

When weighing these first two factors, the IRS has the power to consider all of your retirement activities beyond real estate investments, as well as your activity in years prior, when determining whether there are any business activities.

When these two factors have been thoroughly examined, the IRS then looks at the extent of improvement you have made to the property. The more work done, and improvements made, to your property, the more likely the IRS will determine it is part of a business. This is particularly true of improvements you make to raw land. However, the gains and losses you take on dispositions of real estate are excluded from UBTI regulation if the property is not held primarily for sale in the ordinary course of business or as inventory.

Finally, the IRS considers the proximity of sale to purchase. If it appears that you purchased the land just to turn around and sell it, then the transaction will more likely be considered a business transaction. Therefore, the longer the period between when you purchase the real estate and when it is sold, the more likely that the IRS will exclude the sale from UBTI regulation.

Not all real estate is treated equally when determining UBTI tax. Certain purchases, such as investing in a storage facility, hotel, or retail store normally trigger the UBTI. If you are looking to invest in commercial real estate that generates rental income, whether the purchase falls under the UBTI tax is determined by the nature of rent payments.

More specifically, the IRS looks at whether the rent is based on real property or rental property. Additionally, the IRS determines if the rent is dependent on the income or profits made by a person on the property. If services other than occupancy are rendered to your tenants, it is good indication that the rent is derived from the profits of the tenants. If other services are rendered to your tenants, such as with a boarding house, hotel, storage garage, or parking lot, then the rental income is considered rent from a rental property rather than from real property. Therefore, this income is subject to UBTI tax. On the other hand, if your tenants take the form of private residences or offices, then the rental income is considered rent from real property and does not trigger the UBTI tax.

The key to avoiding the UBTI tax is to make passive investments with your Solo 401(k) plan. If you use a pass-through entity such as an LLC, or an organization that involves margins or leverage not used in real estate acquisition, your Solo 401(k) investments will likely trigger the UBTI tax. However, C Corporations are an alternative to the pass-through organization that you can use to avoid the UBTI tax.

Direct or Indirect Prohibited Transaction

You are now familiar with who is considered a disqualified person, so let's turn now to the transactions you're not allowed to make with your retirement account funds. Prohibited transactions are broken down into two categories: direct or indirect prohibited transactions. Basically, the IRS does not allow any transaction using Solo 401(k) plan funds between you and a disqualified person that directly or indirectly benefits the disqualified person.

The most obvious type of prohibited transaction that you can make is the direct prohibited transaction. This deals with circumstances that involve your retirement account funds being transferred directly to a disqualified person or using said funds to directly assist the disqualified person accomplish some financial goal.

On the other hand, an indirect prohibited transaction is harder to detect because it is a transaction that does not always appear to benefit a disqualified person. A common example of an indirect transaction is when an owner of a retirement plan guarantees a loan to their plan. The IRS considers this guarantee as an indirect extension or credit.

The IRS gives us a list of instances where you cannot use your Solo 401(k) plan funds with a disqualified person. The first two circumstances are probably the most common directly prohibited transactions, followed by situations that are somewhat rare. The last few rules deal with your fiduciary responsibility regarding your Solo 401(k). We will go deeper into your responsibilities as a fiduciary of your account in a later section, but this should act as a primer. You can find these rules in IRC Section 4975(c)(1).

- **First, you are not allowed to use funds to directly or indirectly sell, lease or exchange property with a disqualified person.**

- **Second, you cannot lend money or extend credit to a disqualified person. There is, however, a special circumstance where a disqualified person may take out a loan on a qualified retirement account if they are a beneficiary of the account that we will discuss in greater detail later.**

- **Next, you cannot use your retirement funds to furnish services, goods, or facilities to a disqualified person. So, if you need to help someone out who is disqualified, make sure to use personal funds. This rule is often broken because it is difficult for some people to turn down helping out family members.**

- **Furthermore, you cannot transfer income or assets from your retirement account to a disqualified person. You are only allowed to transfer income or assets to yourself or to make for qualified investments.**

- **Additionally, any direct or indirect "act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account." This is what is known as the self-dealing restriction.**

- **Finally, you are prohibited "receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan." In other words, a disqualified person cannot receive funds or property as a consideration for the purchase of assets for your retirement plan.**

Statutory Exemptions

As you may recall, I mentioned that there are special circumstances where a disqualified person can avoid the prohibited-transaction rule when accepting loans from your Solo 401(k). This is done through what is called a prohibited-transaction exemption. The most popular way to satisfy this exemption is using the statutory exemption. All you have to do is comply with the terms of the statute.

The most widely used prohibited-transaction exemption involves loans you make from your 401(k) plan to plan participants. A plan participant loan is one you make either to yourself or one of the beneficiaries named in you Solo 401(k) plan. You can find the rules for loaning money to your beneficiaries in IRC Section 4975(d)(1).

Another favored prohibited-transaction exemption comes from IRC Section 4975(d)(13). This section deals with the taxpayer's ability to use 401(k) plan assets to buy corporation stock (more specifically qualifying employer securities). The ability to use your plan funds to invest in a corporation's stock is a somewhat complicated area but it is necessary when considering a **rollover business start-up solution** (ROBS). We will delve deeper into ROBS later in the book.

The majority of the rest of Section 4975(d) is not commonly applied and only pertains to specific, obscure investment circumstances, such as plan participant's ability to invest plan assets in a company's life insurance products where that company is also the participant's employer, or the ability to invest retirement assets into bank accounts where the bank is also the participant's employer.

If you plan to use your 401(k) funds to invest in company stock, you are subject to the **plan-asset** rules, also known as the "**look-through**" rules. These rules regulate circumstances that may cause assets owned by an organization to be considered assets of the Solo 401(k) Plan (unless an exemption is applied).

You may trigger the prohibited-transaction rules if you don't follow these rules. Put simply, if your Solo 401(k) owns at least 25% of the membership interest of a business that is involved in passive investments, such as a hedge fund, real-estate fund, or private equity fund, the assets of the company are considered assets of your Solo 401(k). If the plan-asset rules say that the assets of the company are also considered assets of the 401(k), the IRS considers any transaction between the company and a disqualified person to be a prohibited transaction.

There are three areas concerning statutory exemptions for Solo 401(k) plan assets:

1 **First, the rules allow you to contract with a disqualified person for office space, as well as accounting, legal, or other services as long as this action is necessary for the proper management of your Solo 401(k) plan, and if the act is deemed reasonable.**

2 **Additionally, if a bank acts as the trustee of your retirement account, they are allowed to provide auxiliary services to your retirement plan.**

3 Finally, a disqualified person is able to receive the benefits that they are entitled to as a plan participant or beneficiary of your Solo 401(k) plan. However, the disqualified person can only receive benefits that are consistent with how the plan pays benefits to the other beneficiaries and participants. For example, your plan beneficiary, as a disqualified person, may take out a loan from your Solo 401(k) if absolutely necessary. More on that later.

Policing the Prohibited-Transaction Rules

The **Department of Labor** (**DOL**) is responsible for determining the prohibited-transaction exemptions and whether the transactions you make with your retirement funds fall under the prohibited-transaction rules. Nevertheless, the IRS is the government organization that actually monitors your transactions.

If the IRS discovers you are using retirement funds improperly, they will report the transaction to the Department of Labor so a determination can be made. When the Department of Labor makes its determination, it alerts the IRS, who in turn responds to you (the taxpayer). It is up to you to apply for a prohibited-transaction exemption with the DOL.

Prohibited-Transaction Penalties

If you have experience with nontraditional investments and you intend to use that expertise when investing your Solo 401(k) plan funds, you must have a good understanding of the prohibited-transaction rules and the harsh penalties that can be incurred.

Under IRC regulations, when a disqualified person uses retirement plan funds incorrectly and violates the IRS prohibited-transaction rules, they are assessed a penalty tax equal to 15% of the total funds used in the prohibited transaction. This amount is compounded if you make this transaction successive years.

Further, the IRS is able to assess this penalty annually. Any other disqualified person involved in the prohibited transaction will also be assessed and fined annually. Once the Department of Labor identifies the prohibited transaction, you must correct it immediately. This means the correction has to take place within the taxable year. You are charged an additional penalty tax of 100% of the transaction amount if you do not correct the prohibited transaction during the taxable year.

The IRS applies the 15% and 100% penalty to both you and the disqualified person who engages in the prohibited transaction so that the penalty is harsher and thus more of a deterrent against similar actions in the future. However, any fiduciary to your plan who is only acting in their fiduciary capacity and not directly involved in the transaction does not face a penalty.

Surprisingly, the penalty for partaking in a prohibited transaction is more severe for IRA funds than funds from a 401(k) plan. For example, if an IRA participant or beneficiary breaks the rules in IRC Section 4875 and makes prohibited transactions, the IRA no lon-

ger maintains its tax-exempt status. This IRA status changes either immediately or on the first day of the year that the prohibited transaction took place. If a 401(k) plan is hit with a prohibited-transaction penalty, only the prohibited transaction is penalized, while the rest of the plan is safe from losing its tax-exempt status.

Other Prohibited Assets

There are a number of other investments you are not permitted to make with Solo 401(k) plan funds in addition to the prohibited transaction rules. These assets are not covered by IRC section 4975, but rather are outlined in IRC section 408. You cannot use your retirement account funds to invest in:

- **Art**
- **Gems and most metals (except the metals discussed earlier)**
- **Alcoholic beverages**
- **Rugs or antiques**
- **Stamp collections**
- **Most coins**

The justification the IRS gives for prohibiting purchase of these assets is that they are generally difficult to accurately value and, therefore, hard to sell. One caveat to the prohibited assets, as we went over previously, are official coin money or coins that contain precious metals, including platinum bullion, silver, 99% pure gold, and coins that are commonly used as tender such as state-minted coins.

The Non-Recourse Leverage UDFI Exception

If you have a history of using debt-financed properties to generate income and plan to utilize this same strategy with your retirement accounts, you need to be cognizant of the **UDFI**, or *unrelated debt-financed income tax*.

Unrelated debt-financed income is generated when you borrow funds from your retirement account to purchase real estate. If you use an IRA to take out the loan, any portion of the real estate investment purchased using an IRA loan is considered "acquisition indebtedness."

What does this mean? When your IRA acquires debt to make a real estate purchase, taxable income is determined by taking the value of the property and comparing it with the percentage of debt used to make the purchase. For example, if you use your IRA to take out a $100,000 loan to purchase a $200,000 single-family home, 50% of the total net income from the property is considered acquisition indebtedness and will be subject to tax.

Sometimes, a commercial lending entity offers what is known as **non-recourse financing**

for real estate loans. Non-recourse financing is an agreement between lender and borrower that the lender may only be repaid from the profits of the project the loan funds. Simply put, a non-recourse loan is a debt secured by collateral only. The most common example of a non-recourse loan is a home mortgage. Contrary to IRA loan investments, if you use non-recourse financing to purchase real estate, any income derived from the investment is not considered UDFI.

A 401(k) plan does not trigger the UDFI tax unless leverage is used to purchase real estate property. For a Solo 401(k) plan, UDFI does not fall under UBTI rules. IRC Section 514(c)(9) exempts 401(k) qualified retirement plans, and not IRAs, from the UDFI tax so long as non-recourse leverage is used to purchase the property. However, the funds must be used to purchase real property and not loans, notes or liens.

ROBS

If you customarily use a flow-through entity such as an LLC to make purchases for your business, you might also look into using your retirement funds to invest in C corporation stock. If you take advantage of the exception in IRC Section 4975(d), a ROBS (*rollover as business start-up* solution) allows you to use 401(k) funds to buy stock in a C corporation, also known as "**qualifying employer securities.**" A qualifying employer security is a security which is either a stock or a bond, debenture (an unsecured loan certificate issued by a company and backed by general credit instead of specified assets), note, certificate, or other evidence of indebtedness.

To qualify for the exception, you must use the 401(k) plan to buy these qualifying employer securities. This is the primary reason you're not allowed to use your Solo 401(k) plan or self-directed IRA to invest in a business venture that you or another disqualified person is involved in. It is also why you cannot use 401(k) plan funds to invest in an LLC that either you or another disqualified person is involved in unless you are looking to be hit by the prohibited-transaction rules. If you want to use retirement funds to invest in an organization that involves a disqualified person, then use a C corporation to operate the business and adopt the 401(k) plan.

To take advantage of ROB, you roll over a prior 401(k) plan or IRA account into a freshly established 401(k) plan. The best practice here is the new 401(k) plan should be sponsored by either an existing or newly established C corporation. After you roll over the accounts into the new 401(k) plan, you invest the rollover funds into the stock of the C corporation. Finally, these funds are deposited into the bank account for the C Corporation, which are available for immediate use for the business.

Counterintuitively, you are not subject to the same rules when you use a self-directed IRA, LLC or 401(k) plan funds to purchase stock in a C Corporation. Nevertheless, if you use 401(k) plan funds instead of IRA funds, it falls under the prohibited-transaction exemption via IRC Section 4975(d)(13) that we discussed earlier that applies to any qualifying employer securities.

If you use a self-directed IRA or Solo 401(k) to buy a business, as the individual retirement-account business owner, you are not allowed to take an active role in the business, nor are you permitted to personally guarantee a business loan or even earn a salary. If instead, you take advantage of a ROBS strategy, you are authorized to take an active role in the day-to-day operations of the business or earn a salary without being hit by the prohibited transaction rules.

The only downsides to using the ROBS strategy are the fees, the two levels of taxation (double-taxation), and IRS compliance.

Taking a Loan and Rolling Your Solo 401(k) Over

The Solo 401(k) Plan Loan Feature

We mentioned a number of advantages that the Solo 401(k) has over other retirement accounts earlier. No advantage is more important, perhaps, than the fact that the Solo 401(k) plan allows you to take out loans on the account. Let's go into more detail about this.

First off, not all Solo 401(k) plans offer you the ability to take out a loan, so make sure that yours does if you plan to take advantage of this. Either you as the business owner, your employer, or your document sponsor determines whether a loan feature is included in your Solo 401(k) plan. When you set up your Solo 401(k), you elect to include the loan feature into your plan in the plan adoption agreement document.

Although a loan feature on your Solo 401(k) is highly advantageous, many traditional financial institutions do not offer this option. This is because it is more complicated and labor-intensive for an account manager to administer the account if you are taking out loans and making investments with the loan money. Many financial institutions simply don't want to keep track of it.

If you want to include the loan feature, you should look for a self-directed plan document sponsor to help you set up your Solo 401(k). A plan document sponsor company does not have to spend time managing the account for you, and therefore most self-directed Solo 401(k) plans offer a loan feature.

When you include a loan feature in your Solo 401(k), you are able to borrow 50% of your account value or up to 50,000, whichever is less. As I indicated earlier, you may use this money for absolutely anything your need, including making an investment, paying for an emergency, paying credit card bills, making mortgage payments, etc. You must pay the loan back over a five-year period, and the payments must be made quarterly at a minimum prime interest rate. Currently, (2020) the prime interest rate is 3.25%.

If you are using the loan to purchase your first, principal place of residence, you are exempt from the five-year payback rule. If you take the option to extend your repayment

period longer than five years, you must make a sworn statement certifying that your loan will be used to purchase your first home. You either give this statement to your employer or file it yourself with the IRS.

The Solo 401(k) plan loan is fairly straightforward. The loan gives you access to your retirement funds as a loan using the accumulated balance of the account as collateral. The loan gives you the ability to withdraw funds without tax or penalty and you can borrow 50% of the amount up to $100,000. If your 401(k) account contains more than $100,000, the maximum you are allowed to loan yourself is $50,000.

Remember, this loan feature is unique to the 401(k); you do not have this feature with any type of IRA, including a SIMPLE IRA or SEP-IRA. If you are a sole proprietor or small business owner, this makes the Solo 401(k) even more appealing.

Typically, you are prohibited from taking out a loan against your retirement accounts. It is legal for you to take out loans from your Solo 401(k) because of the exception to the prohibited-transaction rules laid out in IRC Section 4975(d)(1). In addition to this section, IRC 72(p) and EGTRRA rules further dictate your ability to borrow money from your Solo 401(k) without penalty or tax. As long as you make your loan payments on-time you won't face taxes or penalties.

You may need multiple loans throughout the year. Fortunately, you are able to take out more than one loan. However, the loans combined cannot exceed 50% of your account value or the $50,000 cap, whichever amount is less. To be more specific, the total amount of money you can borrow is $50,000 minus the highest loan outstanding balance (HLOB) of any loan you take out from your account, or up to half of your vested current plan outstanding balance (POB) or $10,000. Although you have five years on an amortization schedule to repay the loan, you may also choose to pay the loan off earlier, as long as you make at least quarterly payments.

As with any other loan, you must pay interest on your Solo 401(k) plan loan. The interests that you pay must be set at a reasonable rate. A reasonable rate is usually understood to mean the prime interest rate set by the Wall Street Journal. If your Solo 401(k) is managed at a financial institution, most administrators set your interest rate at the prime interest plus 1%, or 4.25% in 2020.

However, it may be a good thing to charge yourself a higher interest rate for the 401(k) loan. For instance, you are able to ultimately defer more money for your retirement, which allows you to pay less tax when you decide to make withdrawals. If your Solo 401(k) plan is managed at a financial institution you will probably not be allowed to make balloon payments to repay your loan. A balloon payment is a lump sum payment at the end of a loan period that is larger than all payments made before. This option allows borrowers to lower monthly repayment costs associated with their loans in the early stages of paying on a loan. If you decide to manage your own Solo 401(k), however, most customizable loan documents allow you to make any loan repayment amount without penalty.

To make sure you can take out a Solo 401(k) loan, you must first ensure that your plan documents allow for you to do so. After determining that your plan allows for the loan to be taken, you determine the amount you are allowed to borrow. To calculate this amount, you must first confirm the fair market value of the assets in your account, taking into consideration the 50%/$50,000 limit.

If your plan account is all cash, the fair market value of your account is already established. If, instead, your assets consist of non-traditional assets such as investments, notes, or real estate, then you need an independent third-party to give you an assessment of the value. You are not required to bring in the third-party assessor if it is obvious that your assets are over $100,000 because you are only allowed to borrow up to the $50,000 maximum.

Once you determine the amount you can borrow, all you need to do is contact the financial institution that administers your 401(k) plan and apply for the loan. You only need to fill out a few necessary loan documents and the loan will be deposited into the appropriate bank account. With a Solo 401(k) plan, you are usually your own plan administrator, so the only thing stopping approval is yourself or your spouse!

The loan paperwork involves filling out a loan agreement and a "Truth and Lending Disclosure Statement" that provides a detailed overview of the loan terms. These terms include the payment schedule, the payment amount, and the applicable percentage of interest, among other things. Additionally, you must get a signature from your spouse on the loan agreement.

You probably do not need to obtain a notary's signature because most loan documents do not require you to do so. Technically, when you take out a Solo 401(k) plan loan, it is a private loan between you (plan participant) and your plan. Since your loan documents are not filed with the federal government or IRS, if you are the plan administrator then you are responsible for the administration of the loan.

If you do not have a financial institution running your Solo 401(k), which will likely be the case, you act as both the plan administrator and the plan participant. It is your duty as administrator to administer the loan. If you are not the plan administrator it is important to both you (plan participant) and your plan administrator each keep a copy of the plan documents. Fortunately for you and your administrator, administering a Solo 401(k) plan loan is not overly work-intensive. The only thing the administrator must do is make sure the loan payments are made in-full and paid out in a punctual manner.

If the Solo 401(k) plan loan payments are not made in a timely manner or paid in-full, then they are considered delinquent. Keep in mind, a delinquent loan is not synonymous with a defaulted loan. The main difference is that loan delinquency can usually be remedied by catching up on the payments. More specifically, a delinquent loan becomes a defaulted loan if payments stop after the delinquency period.

A 401(k) plan, according to the IRS, is only considered in default if:

1 **An event stipulated by the 401(k) plan takes place;**

2 **The 401(k)-plan loan exceeds the maximum allowable account;**

3 **The 401(k)-plan loan is not paid in accordance with the amortization schedule, where loan payments are made at least quarterly (including any interest or penalties accrued); and**

4 **The 401(k)-plan loan is not paid within a permissible loan term, which usually comes out to be about five years.**

Life is uncertain and to be successful at planning ahead you must prepare for the worst. Therefore, it is important you take into consideration that you may default on your 401(k) loan due to an unforeseen circumstance. If you plan ahead properly, you can include a cure period in your 401(k) plan documents. To do this, you must include a clause in your plan documents that gives you a certain period of time to make up missed payments. However, the cure period you designate must not extend past the end of the quarter in which your payment was missed.

If you default on your plan loan, the cash amount is considered a "deemed taxable distribution," which means the amount is taxed as if it were an actual distribution from your account. The amount is still considered an outstanding loan and, therefore, still accrues interest until paid back. In other words, the entire loan balance is considered a taxable distribution for the taxable year the amount is considered distributed.

If your maximum loan amount has been exceeded, the loan amount above that allowable limit is considered a taxable distribution. If you are under the age of 59½ the year you default, this deemed distribution is subject to a 10% early distribution penalty. Unfortunately, you will still be required to pay the loan even if you are in default and the IRS considers your money to be distributed.

The loan repayments you make are treated as if they were after-tax contributions to your retirement account. After a deemed distribution occurs, your account funds are no longer considered retirement assets, but rather become personal assets. However, even if you never pay off your defaulted loan, the amount of the loan is still considered outstanding when you calculate the amount available for future loans.

Pay attention when drafting your Solo 401(k); some plan documents do not allow for a plan participant to roll an outstanding loan into another 401(k) plan. There are two different types of plan documents when it comes to outstanding loans. Some plans do not allow permit rolling funds out of the plan until you repay the loan or take the loan as a distribution. Other plan documents allow you to roll an outstanding loan into another 401(k) account as long as that plan offers a loan program. Make sure you adopt the documents that work best for your situation.

If you get into a situation where you cannot roll your loan over into a new retirement plan, focus on paying the loan off. If this is not possible, take the hit and consider the outstanding balance as a taxable distribution.

In the next section, we'll get into how to roll over your retirement accounts into your Solo 401(k). You can either fund your Solo 401(k) plan through income earned from your business or from rollovers from other retirement accounts you may own. Your Solo plan has the ability to accept rollover funds from most other retirement-savings accounts, including an IRA, SEP, or a 401(k) plan from a previous employer. This means you can take funds from your IRA, along with other qualified plans that do not allow investing and use those funds for investing and loan purposes. The only funds that cannot be rolled into your Solo 401(k) plan are Roth IRA funds.

Solo 401(k) Plan Rollover Rules

It will help your retirement efforts to have the ability to roll funds from other retirement accounts into your Solo 401(k) plan. If you set up your plan with the proper plan documents, all after-tax, Roth 401(k) funds, pretax IRA funds, 401(k), and other qualified retirement plan funds may be rolled into your Solo 401(k) without taxation.

It is standard for plan documents you receive from a self-directed plan document sponsor company to include a direct rollover form to help you transfer funds from your former trustee to the new plan. This form notifies the financial institution where your retirement account is kept that you wish to transfer (rollover) the retirement funds into your new Solo 401(k) account. It also alerts your retirement-account custodian that you would like to rollover these retirement funds.

It is important for your custodian, if you have one, to be informed so that when you rollover the funds to the 401(k) plan the funds are treated as tax-free rather than a taxable distribution. Doing this is tax-free because the funds are merely being transferred from one retirement account to another. The direct rollover request form also lets your custodian know the funds are to be rolled over penalty-free to your Solo 401(k) plan. Additionally, the form provides the name of the institution that now receives these funds.

A rollover of cash is just considered a cash rollover. Your plans may also allow you to rollover assets such as stocks, bonds, and real estate. A rollover that involves assets such as real estate and stocks is known as an in-kind rollover. As with the 401(k)-loan option, when you rollover your non-cash assets, you must obtain a third-party assessment for the current fair market value of the asset you wish to roll over. You also have to re-title any hard asset with the name of your new Solo 401(k) plan. Both asset and cash rollover are made tax-free.

If you want to roll over your eligible IRA or employer retirement plan to your new Solo 401(k) plan, you must begin the rollover process with whichever financial institution that holds your retirement funds. To do this, you usually submit your direct rollover request

form in writing. When your current retirement-account custodian receives the request, they will issue you a check in the name of the new Solo 401(k) plan for your benefit. Because the rollover is not considered a taxable distribution, you have no withholding. Also, the 60-day rollover rule does not apply.

When you decide to make a direct rollover of retirement assets from a 401(k) to your Solo 401(k), it must be reported on IRS Form 1099-R, distribution Code G, box 7. Fortunately for you, the financial institutions that handle your retirement account must file the transaction with the federal government. For rollovers, only the financial institution that transfers the account must file Form 1099-R with the IRS. The financial institution that receives the account does not have to file the rollover.

Rollovers for retirement funds from most other retirement accounts into your Solo 401(k) are treated pretty much the same. Here too, it is not necessary for a receiving financial institution (new custodian) to report the rollover when retirement funds rollover is received. Again, this is because the retirement-account custodian who transfers the retirement funds into a different 401(k) plan files a 1099-R, which notifies the IRS that the assets were transferred into a new retirement account.

If you plan to transfer your retirement funds into an IRA, the IRA custodian who receives the rollover or transfer of assets must report the receipt of funds to the federal government using IRS Form 5498. The purpose of this form is to alert the IRA of the value of your new IRA account. The IRS uses this information to match your Form 5498 with the 1099-R form, which allows them to get a birds-eye-view of how your funds are moving.

It is likely that if you are rolling funds over into a new 401(k), the funds have had time to mature. If your solo 401(k) account assets exceed $250,000, you need to file IRS Form 5500-EZ. This form is used in the same manner as Form 5498 for IRAs. It alerts the IRS of your annual Solo 401(k) plan account value, and gives the IRS the ability to track funds you rolled over which were identified in the 1099-R.

For most retirement accounts, if you have less than $250,000 in plan assets, you rely solely on Form 1099-R, code G, box 7 to disclose the amount of funds that were rolled into the new retirement account to the IRS. However, if you have a Solo 401(k) plan, then you always have the option to file a 5500-EZ form, even if your account assets do not amount to $250,000.

When you choose to file the 5500-EZ form you are disclosing the value of your account assets to the IRS, which will match up with the rollover amount that was entered on the 1099-R. Usually, you can rely on your 1099-R as the only method of showing the IRS which funds were directly rolled over into your new Solo 401(k) account. However, if you are worried that there is a chance the IRS might get confused about where your funds are coming from/deposited, make sure to file a 5500-EZ.

In the case that you are an IRA holder, you are generally allowed to initiate what is known

as an indirect rollover by requesting a distribution from your IRA account. An indirect rollover means that you cash out on your old retirement plan and reinvest that money into a new plan, rather than directly rolling over the funds from one account into another. In other words, the retirement funds in your old account are distributed directly to your bank account and then you decide whether to put that money into a new IRS or other qualified retirement plan.

You must complete the transfer of funds into a new retirement account within 60 days of cashing out. An indirect rollover may only be done once every 12 calendar months. The IRS checks if you have made an indirect rollover by using the name of the IRA holder (your name). The IRS then alerts you if you haven't made the transfer and you have the 60 days from that point to deposit the funds into a qualified retirement plan (IRA, Solo 401(k), etc.) to avoid a tax penalty.

The indirect rollover is usually more complicated than a direct rollover and is, therefore, an uncommon way to fund a new retirement account. Distributions that are intended to be rolled over into a new retirement plan are treated like an IRA distribution and must be reported to the IRS on Form 1099-R, using either code 1 or code 7. Which code you use here depends on your age. Again, you have 60 days to roll the funds into your new Solo 401(k) account.

If you decide to indirectly roll funds over to your Solo 401(k), use precaution. Indirect rollovers often lead to IRS inquiries into where your rolled-over retirement funds are actually located. When you rollover funds into an IRA, you or your IRA custodian must report the value of the funds received to the IRS (Form 5498). This reporting is not required for your rollovers into a Solo 401(k) plan. For these reasons, I would not usually recommend using indirect rollovers when transferring funds to your IRA.

Although a Solo 401(k) plan custodian is not required to report any activities regarding the plan, you are required to report the value of your Solo 401(k) plan if your funds exceed $250,000. If you are looking to indirectly roll retirement funds from one account into your Solo 401(k), you must usually make a withholding election. However, this election may also be waived.

Solo 401(k) Plan Rollover Process

So we've outlined the rules you must follow when you rollover 401(k) plan funds into another retirement account. Now, we will focus on what that process actually looks like. If you take a look at your plan documents, you will find a "direct rollover form." This form instructs how to transfer funds from your current custodian or trustee to a new Solo 401(k) plan.

This direct rollover request form notifies the financial institution where you currently keep your retirement funds that you are rolling your retirement funds over to a new plan account. In addition, the form alerts your retirement-account custodian that the funds

need to be removed from the account and placed into the new account. Again, because the funds are going from one retirement account to another retirement account, the rollover is a tax-free, not a taxable distribution.

Distributing Your Assets

How Do You Take a Distribution?

So you have finally made it and you're ready to retire. What do you do next? How exactly do you take money out of your Solo 401(k) plan?

First, take a look at the terms of your plan. The rules for taking a distribution are found there. Depending on how you set your plan documents, you should be able to take distribution in a number of different ways, such as periodic distributions (annuity or installment payments) or non-periodic lump-sum distributions.

For example, when you take a distribution of excess of $1,000 and either you or your beneficiary has waived the "qualified joint and survivor annuity" option, you have effectively opted for a non-periodic lump sum distribution. You can either take a partial payment or a lump-sum payment. Any installment payments you receive cannot exceed your life expectancy or the last surviving beneficiary's life expectancy.

One major benefit to establishing a Solo 401(k) plan is that a Solo plan does not require plan distributions to take the form of an annuity, which is a requirement of most retirement plans under the Retirement Equity Act of 1984. However, you always have the option to apply the distribution to a purchase of an annuity contract.

Consider the following when deciding how to take a distribution. The lump-sum payment is largely the most popular way to take a distribution. It shouldn't come as a surprise that most people want all of their money as soon as possible. A lump-sum distribution of your Solo 401(k) assets is also less complicated to handle, as it makes it easier to determine the value of your vested account balance.

A lump-sum distribution is taxable as ordinary income for the year it is received, less any Roth contributions you have made to your plan. This distribution option is also subject to a 20% federal income withholding tax.

On the other hand, you may choose to take periodic payments if you are satisfied with your 401(k) plan investments and wouldn't benefit from switching investments or using a new bank. Also, it might hurt your current investments if you roll the funds over into a new IRA investment. Periodic payments act more like a regular stream of income from your Solo 401(k) plan. If you have this option built into your 401(k), the plan will likely allow you to select a monthly or quarterly amount. You may also elect to receive the amount once a year.

Finally, you can choose to take installment payments. Here, you decide on a specified period of time to make the periodic payments to yourself. With this option, the payments are not guaranteed for your lifetime. Instead, your plan funds are distributed in periodic payments. Once the entire account balance is distributed and the installment payments are complete, no more payments are made.

Solo 401(k) Plan Distribution Rules

With an IRA, you're allowed to take distributions from your IRA any time you choose after the five-year wait period. When you withdraw IRA funds from your retirement account, the distribution is taxed according to what type of IRA you have. For instance, if you have a traditional IRA, you are taxed on the money you have put in and the earnings. If you have a Roth IRA, you have already paid taxes on the deposits and you do not need to pay taxes on the earnings. Additionally, your tax burden is determined by your age, and, if you have a Roth IRA, how long it has been since you established the account.

When you decide to take distributions from your 401(k), however, there are a set of rules and requirements that you must satisfy before you can withdraw the funds.

The first thing you need to do when deciding to withdraw funds from your Solo 401(k) plan is look at your 401(k) "Basic Plan Document," which is the document that dictates how your plan is run (if you are managing the plan yourself). If a financial institution is managing your account, you must speak with your plan administrator.

If you have retirement funds that you rolled into your Solo 401(k) plan from another IRA or 401(k) plan, the funds may typically be rolled out of your Solo 401(k) at any time without triggering a tax event. Technically, the IRS does not treat a rollover as a contribution made to your plan. Rather, this money is treated as retirement funds that you have merely transferred from one retirement account into another. Your Solo 401(k) documents more than likely include a provision that permits rollover funds to be taken from one plan and placed into another account without plan service rules or age requirements. Double check to make sure.

Recall from earlier, an elective employee deferral is the amount that an employer contributes to a plan at the employee's election that is excluded from an employee's gross income (as long as they are not designated as Roth contributions). Your Solo 401(k) plan documents likely do not allow you to access the employee deferrals unless you can satisfy "**hardship distribution**" criteria or a plan-triggering event occurs.

Hardship distribution is a withdrawal of retirement funds when you find yourself on hard times. The hardship distribution rules dictate that a hardship distribution amount is limited to the amount necessary to meet the need. To satisfy this rule, you must be unable to reasonably obtain funds from an alternative source. If you meet this criteria, you may make a distribution, but only up to the amount needed to cover the immediate financial need.

Many of us are affected by financial hardships in life. When something comes up that requires you to fork out money you don't have on-hand, you need to look at your Solo 401(k) plan documents to see if your plan allows for hardship distributions. If you satisfy the hardship-distribution rules, you have immediate access to the plan funds, and you are exempt from paying the 10% early-distribution penalty. However, you are not permitted to bypass paying taxes on the amount of your hardship distribution. For reference, check your plan documents for the specific criteria you must meet in a hardship determination.

Your plan applies objective and nondiscriminatory standards to determine the existence of a valid need, along with the amount of funds required to meet this need. The most common hardship distribution criteria that you find in Solo 401(k) plan documents are:

- **Medical expenses for you or your immediate family (spouse and dependents) as well as expenses associated with obtaining medical care.**
- **The purchase of a principal place of residence (maximum $10,000).**
- **Payment for tuition and other related educational fees for you and your immediate family.**
- **The prevention of mortgage foreclosure of, or eviction from, your principal residence.**
- **Payment for funeral expenses such as burial for your extended family (parent, child, spouse or dependents).**
- **Repair expenses of damage to your principal residence, as long as the expenses qualify for casualty deduction (Section 165).**

In general, Solo 401(k) distributions cannot be taken until a triggering event occurs. As discussed earlier, a distribution is triggered if:

- **You reach the retirement age designated by your plan (ordinarily the age of 59 ½).**
- **You die (your beneficiary receives the distributions).**
- **You become disabled.**
- **You separate from service.**
- **You terminate the plan and do not replace it with another defined contribution plan.**

Chances are your Solo 401(k) plan documents also allow for employer profit-sharing contributions discussed earlier in this book, which are determined by a percentage of your income amount. These profit-sharing contribution distributions are handled differently than the employee deferrals. Your plan documents allow you to access employer profit-sharing contributions after a specific period of time. This is known as the vesting period. Here, your plan documents designate the number of years you must wait.

The most common vesting period allows you to access all profit-sharing contributions after a maturation of five years. If you have chosen the appropriate plan documents, you may have access to some of these funds after two years, and the rest after five years. When you take a distribution from employer profit-sharing contributions the withdrawal is subject to both penalty and taxation.

Remember, after-tax contributions are made to your Solo 401(k), or any other retirement account for that matter, after taxes are deducted from your income. Your Solo 401(k) plan documents dictate whether or not after-tax contributions are allowed to be made to the plan. It is highly unlikely that your plan documents will impose rules or restrictions on access to these after-tax funds. This means you are allowed to distribute or rollover these funds without penalty, and the after-tax funds are available anytime you need them.

Required Minimum Distributions

This section is for those who are getting later in years and who are ready for retirement. When you reach 70½ years of age, your retirement funds are subject to the **required minimum distributions** (RMD) rules. After you pass this age threshold, the IRS demands that you withdraw a minimum amount from your retirement plans each year. You must pay any ordinary income tax on these withdrawals unless the contributions were made after-tax. Conversely, you are not required to make a minimum withdrawal on your Roth IRAs.

The required minimum distribution rules do not kick in until six months after your birthday. Instead, you can wait until the April following the year you reach 70½. So, if you're born after April, you'll have more time before you have to begin making disbursements. Also, you must no longer be employed. The employment stipulation does not apply to if you are a business owner and own more than 10% of the stock of the business.

Any time you're late taking the required distributions, you are taxed at a rate of 50%. If you take the distribution on time, you may opt for the tax-withholding rate instead. The IRS considers RMDs as partial annual payments. This is to ensure that you actually disburse the funds from your retirement counts. Before this rule was in place, people would just leave the money in the account and use it as a vehicle to pass tax-free or tax-reduced money to their heirs.

Your RMD amount is determined by the preceding December 31 value of your retirement account balance and life-expectancy tables provided by the IRS every year. When your retirement account triggers the RMD, any distribution from the account made during the year counts toward the total RMD value for the year.

Obviously, you're allowed to take more distributions than what is required by the RMD during the year. Unfortunately, any amount that you withdraw in excess of your RMD does not carry over to your RMD requirements for the following years. This is because the IRS calculates each RMD by taking the fair market value of your account from the previous

year. When time comes to take your RMD, you will likely have the option to have state and federal taxes withheld or wait until you file your taxes at the beginning of next year.

The RMD funds are ineligible for rollover into other retirement accounts, and thus not subject to a 20% withholding tax. If you want to rollover funds from one retirement account into another, and an RMD is due at the same time, the IRS requires that you satisfy the RMD before you roll money over into a new retirement account. In this case, the taxable portion of your RMD is subject to a 10% federal income tax and any applicable state taxes.

You are personally responsible for satisfying the RMD, so don't expect your account custodian to remind you when the time comes. Additionally, you're not permitted to satisfy your RMD using the funds from other plans of the same type. Technically, you're supposed to satisfy your RMDs from each individual plan subject to the RMD rules alone.

You calculate the RMD amount by dividing the adjusted market value of your account on December 31 of the previous year by what is known as the "**applicable life-expectancy factor**." You can find this factor on the life-expectancy table provided by the IRS. To find the table, search for the "**Uniform Lifetime Table**" on the IRS website or your favorite search engine. Make sure you use the correct table for the year you are making your RMD. If you are 10 years older or younger than your spouse, and your spouse is the sole designated beneficiary on the retirement account, you use the "**Joint Life and Last Survivor Expectancy Table**."

At first glance, the table might be a bit confusing. To navigate your RMD calculation, first find your age in the Uniform Lifetime Table. Next, go to the corresponding life-expectancy factor. Finally, divide your entire retirement account balance by this life-expectancy factor. Again, you can't use the funds from other retirement accounts to make your RMD, so make sure to calculate the RMD for each plan separately. You can, however, add the RMD amounts of all of your accounts together and withdraw the RMD amount from a combination of any of the retirement accounts.

Spouse Beneficiary and the RMD Rules

You must plan for the eventuality that you may die before you can take advantage of your retirement accounts. This involves determining how the RMD rules work for your spouse if they are the primary beneficiary on the account. If your spouse is the sole designated beneficiary, they will have the power to:

- **Treat the retirement account as their own.**
- **Base the plan's RMD on their current age**
- **Base the RMD on your age at death, which reduces the distribution period by one each year**

- **Withdraw all of the funds from the account balance at the end of the 5th year following your death, if you died before the RMD rules kicked in.**

Non-spouse Beneficiaries and the RMD Rules

Perhaps the beneficiary on your retirement account is not your spouse, but rather a child, parent, or other entity. The IRS gives a few options that your non-spousal beneficiary can utilize to determine the RMD amounts.

The first option is called the "**five-year rule,**" which is identical to one of the spousal powers. This allows your non-spousal beneficiary to withdraw all of the funds from the account balance at the end of the fifth year following your death if you died before the RMD rules kick in. The other option the IRS gives your non-spousal beneficiary is called "**life expectancy payments.**" Here, to calculate the RMD, your beneficiary must use the single life expectancy of the oldest designated beneficiary on your account the year following your death.

If you die after the RMD rules kick in, then the life expectancy payments revert to the longer of either your remaining life expectancy at death minus one for each subsequent year, or your beneficiary's remaining life expectancy for the year following the year of your death minus one for each subsequent year. If you die before the RMD rules kick in, then the RMD is determined by your non-spousal beneficiary's age at the end of the year following your death, which reduces the distribution period by one for each successive year.

10% Taxation

One last thing you should be mindful of is a possible 10% tax on any distribution made before you reach the age of 59½. You may need to take an early distribution for any various reasons we have detailed in this book. There are, however, certain circumstances where your distributions are exempt from the tax.

For instance, there are no guarantees to life, and you may die before getting a chance to enjoy your retirement benefits. If that happens, your money will go to the beneficiary you designated during the creation of your plan. This transfer of funds is exempt from the 10% early-distribution tax.

Or perhaps you're being forced to retire due to a work injury. In that case, you are exempt from the tax for the allowable amount of medical care that is permitted as a medical expense by the IRS, or if you have a qualifying disability.

This may not be obvious, but you are free to close your retirement account at any time. The 10% tax does not apply to distributions from your retirement account taken as substantially equal periodic payments starting the date you stop service. Furthermore, your retirement account can be closed out to pay for a divorce proceeding. You are not subject to the tax if a distribution is given to an alternative payee under a **qualified domestic relations order** (QDRO), a judicial order given to split retirement funds in a divorce proceeding.

This final group of exemptions revolve around the correction you make to your taxes when the IRS tells you something is wrong with your tax liability. Let's say you accidentally put too much money into your retirement account. You can avoid the 10% early-distribution tax if you make a distribution to reduce these excess contributions. This applies to any excess employee matching employer contributions, and elective deferrals, as well. Lastly, if you fall into a tax hole, the IRS can levy your Solo 401(k) plan funds. The money from this tax levy is not subject to the 10% tax.

Protecting Your Assets

Asset and Credit Protection

We briefly mentioned asset protection in an earlier section. Here, we'll go into a bit more detail.

One of the most important aspects of saving for retirement is finding a way to protect your money from creditors. The credit or asset protection methods available to you are dependent on the type of retirement plan you establish, whether the assets are inherited or not, and the state you reside in. The main credit protection that a traditional 401(k) affords is a protection from bankruptcy.

After ERISA, rules were put into place to give protection to a debtor's retirement funds during bankruptcy, effective for bankruptcies filed after October 17, 2005. Basically, the rules exempt all 401(k) assets from the bankruptcy estate. This general exemption can be found in Section 522 of the bankruptcy code. This section allows unlimited exemption for retirement assets as long as that asset is exempt from taxation according to Section 401(a). This includes profit-sharing, tax qualified retirement plans (pensions), and section 401(k) plans.

However, these protections may not apply to a Solo 401(k), as the Department of Labor regulations and case law suggest that this type of plan benefits only the owner or their spouse. There's a bit of confusion here, but the court decisions indicate that the Solo 401(k) plan, and other plans that benefit only a single person, are not ERISA plans. Therefore, the anti-alienation protections afforded by ERISA do not apply to your Solo 401(k) federally.

What this means for Solo 401(k) plan participants is the federal government has delegated credit protection decisions to state governments. Each state handles retirement asset protection differently. Fortunately, most states offer full protection of assets outside of bankruptcy to Solo 401(k) plans. Only a few states, such as Michigan and California, do not allow a full exemption. Other states, such as Virginia and Nevada, allow protection. However, the exemption is only partial.

Solo 401(k) Plan and Estate Taxes

We have gone over the tax status of your Solo 401(k) funds in a number of earlier sections of this book. What we have not discussed is how estate taxes are assessed for your retirement account when you die. If you choose your spouse as the beneficiary of the retirement account, the plan proceeds will be transferred to that spouse when you pass. When this happens, your spouse will generally not have to pay an estate tax on the transfer because of what is known as the marital deduction.

After your death, your estate executor totals the value of every single one of your assets. This total is called the "gross estate." For the marital deduction, the executor then subtracts the value of the property left to your surviving spouse from this sum. A marital deduction is perhaps one of the most important deductions used to determine your taxable estate when you die.

A major benefit of this deduction is that there is no limit to the amount you deduct. As previously stated, when you die, your spouse has an option to either roll the inherited Solo 401(k) funds into their own IRA without paying taxes as the funds rollover, or they can begin annual distributions based on their life expectancy, ignoring age. The only tax that your spouse pays is applicable income tax on the distributions.

Non-spouses are not afforded the same tax protections as your spouse. If you leave your 401(k) plan proceeds to a non-spouse, the plan funds transferred may be subject to estate taxes. Additionally, as stated earlier, a non-spouse beneficiary does not have the ability to roll funds from a 401(k) plan into a different IRA.

The funds are instead deposited into an inherited IRA in the name of the beneficiary, allowing the plan assets to grow tax-deferred until the beneficiary retires. If the beneficiary does not want to wait until retirement, they are allowed to take a distribution from the IRA if they pay tax on the amount. Furthermore, the non-spousal beneficiary is not forced to take an early withdrawal penalty if a distribution is made from the plan of the deceased. The funds that rollover into the inherited IRA are no longer governed by the 401(k) plan rules. Instead, they are subject to normal IRA rules.

Protecting Your Solo 401(k) Plan From Fraud

It should be your goal to save as much money as possible for retirement. If you do things right, the amount should be substantial. It should come as no surprise, then, that you may be a target of fraud, specifically when it comes to investing retirement funds.

In 2018, the **Securities and Exchange Commission** issued an "investor alert." Investor alerts are an easy way for the SEC to give non-legal or policy-based advice to investors. This particular alert was issued to warn investors of a potential risk of fraud affiliated with certain retirement accounts. Over the past few years, the SEC has received an uptick in reports or complaints for investment fraud schemes that utilize Solo 401(k) or Self-Directed IRA plans.

So how can you protect yourself from investing fraud? First, you should always undertake a personal evaluation of the credibility of every investment proposal that comes across your desk. In addition, you should check with your local regulators regarding the history and background of a potential investment and its promoters before you decide to invest. Never rely on the custodian of your self-directed account, as they generally have limited duties to investors. This means that a trustee or custodian likely will not evaluate the legitimacy or quality of a certain investment or the promoters of the investment.

Fraud Protection Resources

If you do get into trouble with a fraudulent investment, or you are just looking to get more information about how to protect yourself from fraud, take a look at each of the following entities:

- **Securities and Exchange Commission**: The SEC is a federal agency with a goal to protect investors. Their mission statement purports that it is their responsibility to maintain fair, orderly, and efficient markets, while simultaneously facilitating capital formation. They promote a market environment that does not violate the public's trust. The SEC is an excellent source for information on a number of different retirement products, including info for specific assets, allocations, and risk. You will want to always be wary of their Investor Alert.

- **FINRA**: FINRA is a non-profit organization that works to ensure the integrity of American financial system. FINRA is supervised by the SEC to write and enforce rules which govern ethical actions of financial institutions in the US, such as federally registered brokers and broker-dealer firms. FINRA monitors these firms to make sure rules are complied with. Additionally, FINRA actively educates investors. It also has an online service called Broker Check that allows investors to check a broker's background.

- **NASAA**: No, the North American Securities Administrators Association is not the unwanted step-child of NASA. It is, however, a helpful resource for information in certain states. Founded in 1919, this storied group is the oldest international organization involved with investor protection. It is a voluntary association with a membership of 67 territorial, provincial, and state securities administrators in all 50 states plus the District of Columbia, the U.S. Virgin Islands, Canada, Puerto Rico and Mexico. This organization is known to be proactive regarding retirement and regularly provides resources for senior investors.

- **The Federal Trade Commission**: The FTC was established in 1914 after the passage of the Federal Trade Commission Act. It is the FTC's responsibility to protect the American consumer from fraudulent, deceptive and unfair business practices. They can also help you discover whether or not you are being defrauded, how to stop the scam, and how to avoid fraud in the future.

- **Better Business Bureau**: The BBB is a private nonprofit with the stated mission of

improving market trust. There are 106 independent, incorporated local BBB organizations throughout the U.S. and Canada. If a business has been reported for fraudulent or deceptive practices, you will find the cases, and even reports from the defrauded consumer, here.

- **AARP**: Formerly known as the American Association of Retired Persons, this organization was founded in 1958. It started as a magazine and bulletin and claims a membership of more than 38 million people. Today, the organization is involved in a number of charitable works, such as disseminating retirement advice to the public, lobbying state, and federal government for retirement rights, and launching a website to help people learn about retirement investing. They have also devoted funding for a number of research projects that helped uncover scams directed toward senior citizens.

Other Helpful Tips to Avoid Fraud and Prevent Financial Crime

There are also a few habits that might be helpful for you to start adopting.

First, always shred financial documents and paperwork that contains your personal information. Do not just throw whole documents into the trash. Next, do everything in your power to not give out your SSN. Ask if you can use another identifier. Additionally, never give out your personal information over the phone or through email unless you are certain about who you're communicating with. You should also not divulge your account passwords to anyone, nor should you give your credit card numbers to a stranger.

Even if you think the contact is legitimate, double check the person or entity's identity. If you must send any information, go directly to the entity's website using the address bar in your browser, or use a page you bookmarked. Never click on a link provided in an email. This is the most common way for a hacker to get into your accounts.

If you end up in a phone conversation with someone you are not familiar with, always be aware of how long you're being kept on the phone. It is usually easier to spot fraud than you think. For instance, watch out for promises of profits or an offer to share insider information. Also, avoid anyone who tries to pressure you to invest before giving you the opportunity to do an investigation.

If you are hiring someone to help look after your money, be wary of any financial advisor you can't find through FINRA's broker search. Make sure to educate yourself on the investment before you decide to invest. Talk about all important financial decisions with a family member, friend, or advisor that you trust. If you decide to take the investment, never make the check out to the financial adviser.

You will want to avoid any pressure to trade the plan assets in a manner that is wholly inconsistent with your stated investment goals and the risk you are willing to take. Generally, identifying and researching the entity offering services is the best fraud prevention technique.

Keeping Your Solo 401(k) Plan In Good Standing

With your Solo 401(k) plan set up, your only obligation will be the occasional requirement to update your written plan in compliance with PPA amendments. The next PPA amendments are likely to occur sometime in the next few years, by 2022. Stay connected with the company or person who drafted your plan documents. They are responsible for ensuring you remain in compliance. It is not rare for the IRS to pass interim amendments that you must include in your plan documents to stay updated and avoid penalties. As long as you work with a competent Solo 401(k) plan document provider firm or tax professional, they will be familiar with how to manage your plan documents.

The Cares Act and Your Retirement Plan

I want to leave you with one last piece of information that may be pertinent to you if you have been impacted by the COVID-19 pandemic of 2020. On March 27, 2020, Congress passed The **Coronavirus Aid, Relief, and Economic Security** (**CARES**) Act to provide funds to the businesses and people who have experienced financial hardship from the global pandemic. The CARES Act adds a number of provisions to the tax code regarding pandemic-related distributions and participant loans.

If you own a Solo 401(k), you can utilize these expanded provisions if you qualify. The IRS considers you a "**qualified person**" if:

1. **You have been diagnosed with COVID-19 using a CDC-approved test.**

2. **Your spouse or one of your dependents have been diagnosed with COVID-19 using a CDC-approved test.**

3. **You experience adverse financial consequences from being furloughed or laid off by your employer, or from being quarantined.**

4. **You are unable to work due to the unavailability of childcare due to the pandemic.**

5. **For any other reason determined to be related to the pandemic by the Secretary of the Treasury.**

You may also rely on what is known as "self-certification" if you own a 401(k) or IRA and you meet any one of the above qualifications. A self-certification, in this context, is merely an official statement you will make about yourself to the IRS that you are being truthful in your request for aid. To make a self-certification, you need to complete a self-certification form and submit it to the IRS. A number of banks offer free pdf templates of this form online.

The CARES Act also includes a number of coronavirus-related distribution provisions. First, you are now permitted to take up to $100,000 as a distribution from the plan, so long as your employer or your business is a member of a controlled group. This $100,000 distribution maximum applies to an aggregated limit for all plans under the controlled

group. The total may increase or decrease in the future.

In addition, the 10% early withdrawal penalty you would normally have to pay is officially waived. However, if you take a distribution of traditional or pre tax funds, normal taxation applies. One change from the normal is you are able to pay the tax on this distribution over a three year period, starting with your 2020 filing.

You also have an option to repay the distribution. If you chose to do this, you may repay the entire distribution over a three-year period beginning with the day after you have received the distribution. You can repay with a lump sum or using multiple payments as long as the total is paid by the end of the three years. If you can pay the entire distribution back into your account within this timeframe, your distribution will avoid taxation. These provisions apply to any qualified distribution you take between January 1, 2020 and December 31, 2020.

A number of pandemic-related loan provisions are also included in the CARES Act. These provisions apply to how you determine your maximum loan amount. Additionally, they act to delay any repayments for new and existing Solo 401(k) participant plan loans.

The first step in determining your maximum retirement-plan loan amount is to find out the date you took out the new loan. These provisions only apply to loans taken between March 27, 2020 and September 23, 2020. Subject to change, you may take 100% of your vested account balance as a loan, or up to $100,000, whichever amount is less.

The provisions allow you to delay the repayment of new and existing retirement plan loans. If you have loan payments that come due between March 27, 2020 and December 31, 2020, you are allowed to delay those payments up to a year. However, your loan payments must resume on or after January 1, 2021, and the interest on the loan will continue to accrue within the normal repayment periods.

Any repayments you make on the loan must continue to be level payments and you cannot make a lump sum repayment at the conclusion of your loan repayment period. Additionally, if you skip a payment, you must repay the total payment skipped, plus interest, beginning exactly one year after the skipped payment occurred. Your maximum repayment period may be extended for up to one year, depending on the time-period in which your loan payments were skipped.

So to summarize, determine if you are a qualified person as defined in the CARES Act. Complete the self-certification form and make sure to keep it on file. Track any pandemic-related distributions as aggregate amounts if you belong to a controlled group. You don't want to exceed your maximum distributions. Track and document any delayed repayments on the loan if you decide to take out a pandemic-related retirement account loan. Do the same for any pandemic-related distributions.

FROM LITIGATION TO ASSET PROTECTION

Success! I had just graduated from law school with no debt. Those two years spent rehabbing my first commercial property had finally paid off, and I was in love with real estate. Well...not real estate exactly, but the financial freedom it helped me create.

If you don't know me, my name is Scott Royal Smith and I've been investing in real estate for years. These days I'm a tax and asset protection attorney, but I actually started my career playing for the bad guys. That's right, I was a litigator and good at my job. I used to sue insurance companies when they refused to pay legitimate claims (which happens all the time).

How did I come to start fighting for the honest working man? It all started with that first property, watching my money start working for me and realizing I was onto something. I actually got pretty obsessed and spent every spare moment studying real estate investing. I literally read every book I could find and talked to the authors, collecting a mountain of tips, tricks, and secret techniques. Before I knew it, I was making more money from my investments than from my attorney work. I was finally experiencing the freedom I had dreamed of for so long.

One day I was at a local real estate group and I started sharing some of this information with fellow investors. It became clear almost immediately that we were all struggling with the same problems:

- What is the best asset protection strategy?

- How can I avoid paying so much on taxes?

- Who do I need on my team to help me scale?

In the preceding pages, I've shared what all of my research and investing experience has taught me about real estate. It's my blueprint for creating the wealth and freedom we all want. I hope you enjoy!

SCOTT ROYAL SMITH
Royal Legal Solutions