4 Ways to Save for Retirement Without a 401(k)



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This is the second in a series of original columns for Entrepreneur.com by Laura D. Adams that will publish two Mondays a month. And don't forget to purchase a copy of Adams' latest book for Entrepreneur Press, Money-Smart Solopreneur: A Personal Finance System for Freelancers, Entrepreneurs, and Side-Hustlers, *via* Amazon | Barnes & Noble | Bookshop | IndieBound.

Being self-employed gives you a certain amount of freedom, but it doesn't give you a pass on saving for retirement. No matter how busy you get, planning for a secure future is entirely up to you when you're the boss.

While you may not have a regular job with benefits and a 401(k), several retirement accounts are designed specifically for solopreneurs and small business owners. These accounts offer tax advantages, but you own them privately, similar to taxable investment accounts.

Contributing regularly to one or more retirement accounts could make the difference between enjoying a comfortable life down the road or just scraping by. Here are four to consider when you have part- or full-time self-employment income.

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1. Traditional IRA

An IRA (Individual Retirement Account) is for individuals (and non-working spouses) with earned income from their own business or a W-2 job. Contributions to "traditional" accounts are tax-deductible, even if you don't itemize deductions on your tax return. You manage every aspect of the account, such as choosing investments and your contribution amount.

For example, if you earn $60,000 and contribute $6,000 to a traditional IRA, you only pay tax on $54,000 of income. Additionally, investment earnings are not taxed until you withdraw them. You can open a traditional IRA at many financial institutions (e.g. banks, investment firms and insurance companies) by transferring funds or rolling over a traditional retirement account with a previous employer.

Main pro: You can use a traditional IRA to defer tax on both contributions and account earnings.
Main con: If you or a spouse participate in a workplace retirement plan, such as a 401(k) or 403(b), some or all of your contributions to a traditional IRA may not be tax-deductible, depending on your income.
Rule to know: For 2020 and 2021, you can contribute up to

$6,000 or $7,000 if you're over age 50.

2. Roth IRA

A Roth IRA has many of the same rules that apply to a traditional IRA, except for taxes. Contributions to a Roth IRA are not tax-deductible, which means they don't give you an upfront tax break. However, if your tax rate is lower now than you believe it will be in retirement, you can come out ahead.

For example, if you earn $60,000 and contribute $6,000 to a Roth IRA, you must pay tax on $60,000 of income. You reap the benefits in retirement when withdrawals of contributions and earnings are entirely tax-free.

Like a traditional IRA, you can open a Roth at various financial institutions. You can't roll over funds from a traditional workplace retirement plan into a Roth IRA without triggering taxes. But you can do a tax-free rollover from an old Roth 401(k) or Roth 403(b).

Main pro: Avoiding tax on decades of account growth in a Roth IRA can add up to massive savings. You get the full tax benefit even if you (or a spouse) participate in a retirement plan at work.
Main cons: There is an annual income limit based on your tax filing status to qualify for Roth IRA contributions.
Rule to know: For 2020 and 2021, you can contribute up to $6,000 or $7,000 if you're over age 50.

3. Solo 401(k)

A solo 401(k) is similar to a regular 401(k) offered by many companies, but it's only available when you're self-employed without employees other than a spouse. You can make contributions as both an employee of your business and as

the owner.

Solo 401(k)s are available as a traditional or Roth account, offering pre- or post-tax contributions. Like a Roth IRA, withdrawals of contributions and earnings in retirement are completely tax-free. But unlike a Roth IRA, you can contribute to a Roth solo 401(k) no matter how much you earn.

There are many places to open a traditional or Roth solo 401(k), such as banks, investment firms and insurance companies.

Main pro: A solo 401(k) offers a high contribution limit, so it's an excellent option when you have a high self-employment income and no employees.
Main con: If you plan to hire employees, you'll have to complete IRS paperwork to convert a solo 401(k) into a regular 401(k), which comes with more administrative hassles and restrictions.
Rule to know: For 2020, you can contribute up to $57,000, or $63,500 if you're over age 50, to a solo 401(k). The limit increases to $58,000 or $64,500 for 2021.

4. SEP-IRA

If you're self-employed and have employees or plan to hire staff someday, consider using a SEP-IRA, which stands for Simplified Employee Pension. It's an option for any size business or those who are self-employed with or without employees.

Like a traditional IRA, contributions to a SEP-IRA are tax-deductible, and there isn't a Roth option. You defer tax on contributions and earnings until you take distributions in retirement.

With a SEP-IRA, contributions can only come from you as the employer. Your employees can never contribute their own money.

As the business owner, you choose the amount to contribute each year. However, you must give all employees the same percentage of retirement contributions that you give yourself.

For example, say you have a web design business with one employee named Terri. If you contribute 15% of your pay to your own SEP-IRA, you'd also have to contribute 15% of Susan's wages to her SEP-IRA (in addition to paying her full wages). But if you have a bad year with little profit, you can choose not to make contributions.

You can open a SEP-IRA at many financial institutions by completing Form 5305-SEP, a simple IRS form.

Main pro: A SEP-IRA gives you the flexibility to make contributions in years when your business cash flow allows it and opt-out when money is tight. Like the solo 401(k), a SEP-IRA gives you high contribution limits.
Main con: If you have employees, you must fund their SEP-IRAs in an equal percentage of income as you do for your account.
Rule to know: For 2020, you can make SEP-IRA contributions for each of your employees (including yourself) up to 25% of each employee's compensation for a maximum amount of $57,000. The limit goes up to $58,000 in 2021.

Taking Early Withdrawals from a Retirement Account

Most retirement accounts impose a 10% early withdrawal penalty if you tap them for any reason before reaching the official retirement age of 59.5. However, under the CARES Act, if you have a Covid-19-related hardship, the penalty is waived for withdrawals up to $100,000 in 2020.

For instance, if you, a spouse, or a child are diagnosed with COVID-19, or you have financial challenges due to being laid off, quarantined, having reduced work hours or closing

a business, you qualify for the penalty exemption. While income taxes would still be due on any retirement hardship withdrawal that wasn't previously taxed, the good news is that you can delay or avoid tax with the following options:

- Repay the hardship distribution to your account within three years and avoid tax.
- Pay taxes on the hardship distribution by paying one-third of your liability for three consecutive years.

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Since you make contributions to a Roth on an after-tax basis, so you can always withdraw them penalty-free. That was the case even before the CARES Act. However, the account's earnings would be subject to income tax if you withdraw that portion of your balance. So, if you have both a traditional and a Roth retirement account and experience financial hardship, you're better off tapping your Roth first.

Good luck, and good future fortune.

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