The 5 Best Retirement Accounts for the Self-Employed

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EST. MOM AND DAD MONEY 2013

There's a lot of retirement advice out there for people with traditional jobs, and therefore traditional retirement account options.

But what if you're self-employed? Or what if you're earning a little money on the side and want to put it away for the future?

What are your options then?

There's a lot less information available for people in that situation. It can be hard to even figure out what your options are, let alone which one is best for your particular goals.

So in this guide I'll break down the best retirement accounts for self-employed individuals. What are your options and why would you choose one over the other?

This is primarily meant to be for solopreneurs or people earning money on the side. It doesn't matter how much you're earning, as the advice here will work whether it's a lot or a little. But things do get complicated pretty quickly if you have employees, so if that's you I would suggest working with a professional to help you set up a retirement plan.

But if it's just you and your business, here are some great ways to save for retirement and get that much closer to financial independence.

Traditional and Roth IRA

Traditional and Roth IRAs are dedicated retirement accounts available to anyone, self-employed or otherwise. Which is part of what makes them such a great option.

Since anyone can open an IRA, just about every investment company out there offers them. Which makes it pretty easy to:

1. Find a low-cost provider
2. Open an account and start contributing
3. Choose from a long list of great investment options

When you combine all of that with the great tax breaks they offer, IRAs are typically the best way for self-employed individuals to start saving for retirement.

With that said, there are some restrictions to consider:

- Contributions are limited to $5,500 per year (for 2017).
- High-earners may not be able to contribute to a Roth IRA (though a Backdoor Roth IRA may still be an option).
- If you contribute to an employer plan, including one of the dedicated self-employed retirement plans we get into below, you may not be able to deduct your Traditional IRA contributions (more on that here).

All in all though, both Traditional and Roth IRAs are great options that are easy to start.

Health Savings Account (HSA)

Not many people know about the Health Savings Account, but the truth is that it could very well be the best retirement account out there.

The reason is simple: it's the ONLY account that offers a TRIPLE tax-break:

1. Your contributions are tax-deductible
2. Your money grows tax-free inside the account
3. Your withdrawals are tax-free when used for medical expenses

You're also able to invest the money just like you would within an IRA if you choose the right provider.

The only real catch is that you have to have a qualifying high deductible health plan in order to contribute to a health savings account. Many people don't have that.

But if you're self-employed, you may have a lot more freedom to choose your own health insurance and therefore choose an HSA-eligible plan. Of course this shouldn't be the only factor when choosing health insurance, but it could be an important one.

If you ARE eligible to contribute to a health savings account, I would highly consider doing so. That triple tax break is something you won't find anywhere else.

Solo 401(k)

Now we're getting into retirement accounts SPECIFICALLY designed for the self-employed. First up: **the Solo 401(k)**.

A Solo 401(k) - also called an Individual 401(k) or Self-Employed 401(k) - is a lot like a 401(k) you would find in a big company. It's just that when there's only one person in the company (you!), there are fewer rules to follow and it's therefore much easier to manage.

The best part about a Solo 401(k) is that you have a LOT of flexibility to contribute as much or as little as you would like. Here are annual the contribution limits for 2017:

- Up to $18,000 as an **employEE** contribution, just like with a regular 401(k).
- Up to 25% of net income as an **employER** contribution (you are the employer), on top of the employEE contribution.
- Up to $54,000 total between the two types of contributions.
- No obligation to make any contribution in any given year.

Essentially, you have the OPTION to contribute more than you can with the two other types of accounts we'll discuss below, without the OBLIGATION to contribute anything. You also have the option of opening a Roth 401(k) if you prefer those tax benefits over the Traditional 401(k).

That flexibility is the reason I tend to prefer the Solo 401(k) over other self-employed retirement accounts.

Now, there are some things to consider here, some of which might be considered drawbacks:

- There is a little more paperwork required to set up a Solo 401(k), which means they aren't quite as easy to open as the two options below (though in most cases it's still fairly simple).

- You can only operate a Solo 401(k) if you don't have employees (a spouse is not counted as an employee). If you have employees or plan on hiring some in the near future, you may want to talk to an expert.

- Sometimes Solo 401(k) providers will try to charge extra fees for these accounts, though there are plenty of free or low-cost providers out there like Vanguard, Fidelity, Schwab, and TD Ameritrade.

- You have to open it before the end of the year if you want to make contributions for that year. That's unlike the SEP IRA that we'll talk about below, where you have until April 15 of the *next* year to open it.

For my money, a Solo 401(k) with the right, low-cost investment company is often the best option if you're self-employed without employees. The ability to make bigger contributions than you can with the other accounts below outweighs the fact that there's slightly more paperwork.

For more on the Solo 401(k), you can refer to this overview from the IRS.

SEP IRA

For the most part, a SEP IRA works just like a Solo 401(k). You can open it with all the same providers, and the contribution limits are similar as well:

- Up to 25% of net income as an **employER** contribution.

- Up to $54,000 total.

- No obligation to make any contribution in any given year.

The BIG difference is that you AREN'T allowed to make the $18,000 employEE contribution that you can with a Solo 401(k). Which for many people means that you simply can't contribute as much with a SEP IRA as you can with a Solo 401(k).

So why would you ever choose a SEP IRA? There are a few reasons to consider it:

- They're incredibly easy to open. You can be up and running with a SEP IRA very quickly.

- You have until April 15 of the *next* year to open a SEP IRA and make contributions for the *prior* year.

- You CAN have a SEP IRA with employees (though there are more rules you have to follow), which might make that transition a little easier.

- If your business' net income is $216,000 or more, you could contribute the same amount to a SEP IRA as to a Solo 401(k), since the 25% employer contribution would reach the $54,000 total allowed contribution.

Also, keep in mind that you CAN have a SEP IRA in addition to a Traditional or Roth IRA. They are considered separate accounts with separate contribution limits, so there's nothing to worry about there.

For more on the SEP IRA, you can refer to this FAQ from the IRS.

SIMPLE IRA

The fifth option is a SIMPLE IRA, which is kind of like a mix between the Solo 401(k) and SEP IRA.

It's easy to open, just like a SEP IRA, but the contribution limits work more like a Solo 401(k):

- Up to $12,500 as an **employEE** contribution.

- Either a 3% **employER** match on your employEE contribution, or an automatic **employER** contribution of 2% of net income.

Essentially, it's an employee contribution with an employer match, but you are BOTH employee and employer. You can also run this kind of plan with up to 100 employees and it works pretty much the same way.

So if it's just you and your business without employees, when would you choose a SIMPLE IRA? I would consider it under the following conditions:

1. You want to avoid the slightly higher amount of paperwork that's required to open a Solo 401(k).

2. You want the ability to make an employEE contribution that isn't limited to a percent your business income (as opposed to a SEP IRA).

For more on the SIMPLE IRA, you can refer to this FAQ from the IRS.

Just get started!

There are a lot of numbers and rules here and I know that it can feel a little overwhelming. You might be looking at all of this and thinking "Hey! I just want to run my business and save some money. Just tell me which one is best!"

I hear you. So here are two parting thoughts to help you out.

First, remember that BY FAR the most important part of your investment plan is your savings rate. All of these plans are great, and the worst case scenario is that you end up switching later on. So just get started without worrying about it too much.

Second, while there are no golden rules, here's a quick order of operations to help you decide:

1. Start with a Traditional or Roth IRA.

2. Use a health savings account if you can.

3. If you're okay with a minimal amount of paperwork and you won't be hiring employees in the next year or so, go with a Solo 401(k).

4. If avoiding that paperwork is important to you, go with a SEP IRA if 25% of your net business income is all you'll want to contribute.

5. Otherwise, go with a SIMPLE IRA if you like the ability to make a contribution that isn't limited to a percent of your business income.

Good luck!

Want More Guidance?

I know how hard it can be to balance all the financial responsibilities that come with starting a family. From paying your bills, to saving for the future, to trying to enjoy yourself in the meantime, it's not easy figuring out what to prioritize and how to find room for everything.

As a fee-only CERTIFIED FINANCIAL PLANNER™ who specializes in working with new parents, I work every day with other parents who want to make the right financial decisions for their families. And as a dad with two young boys myself, my wife and I are going through many of the same things you are.

It's not easy. And that's why I offer a range of options for you to get more guidance.

If you'd like more help with your financial questions, here are a few different ways you can get it:

- The **Jump Start Session** allows us to work together to craft a personalized financial plan for your specific goals and situation. And it's pay-what-you-can so that you can get the advice you need at a price you can afford.

- If you're more of a DIYer, I offer a variety of **financial guides** designed to walk you step-by-step through the most important parts of your financial plan..

- Please feel free to email me any time with any questions that are on your mind. I'd love to hear from you and I'm always happy to help. My email address is matt@momanddadmoney.com.