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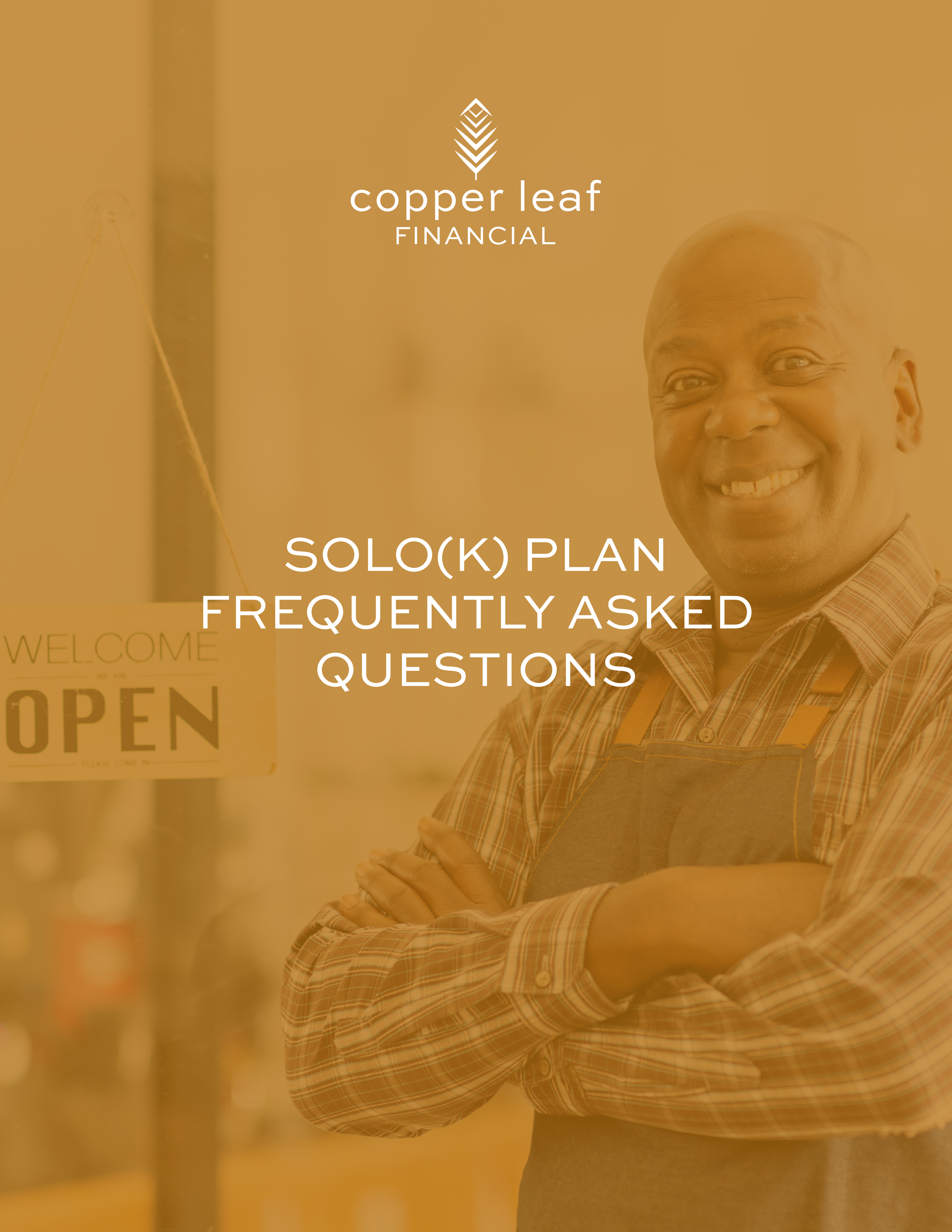
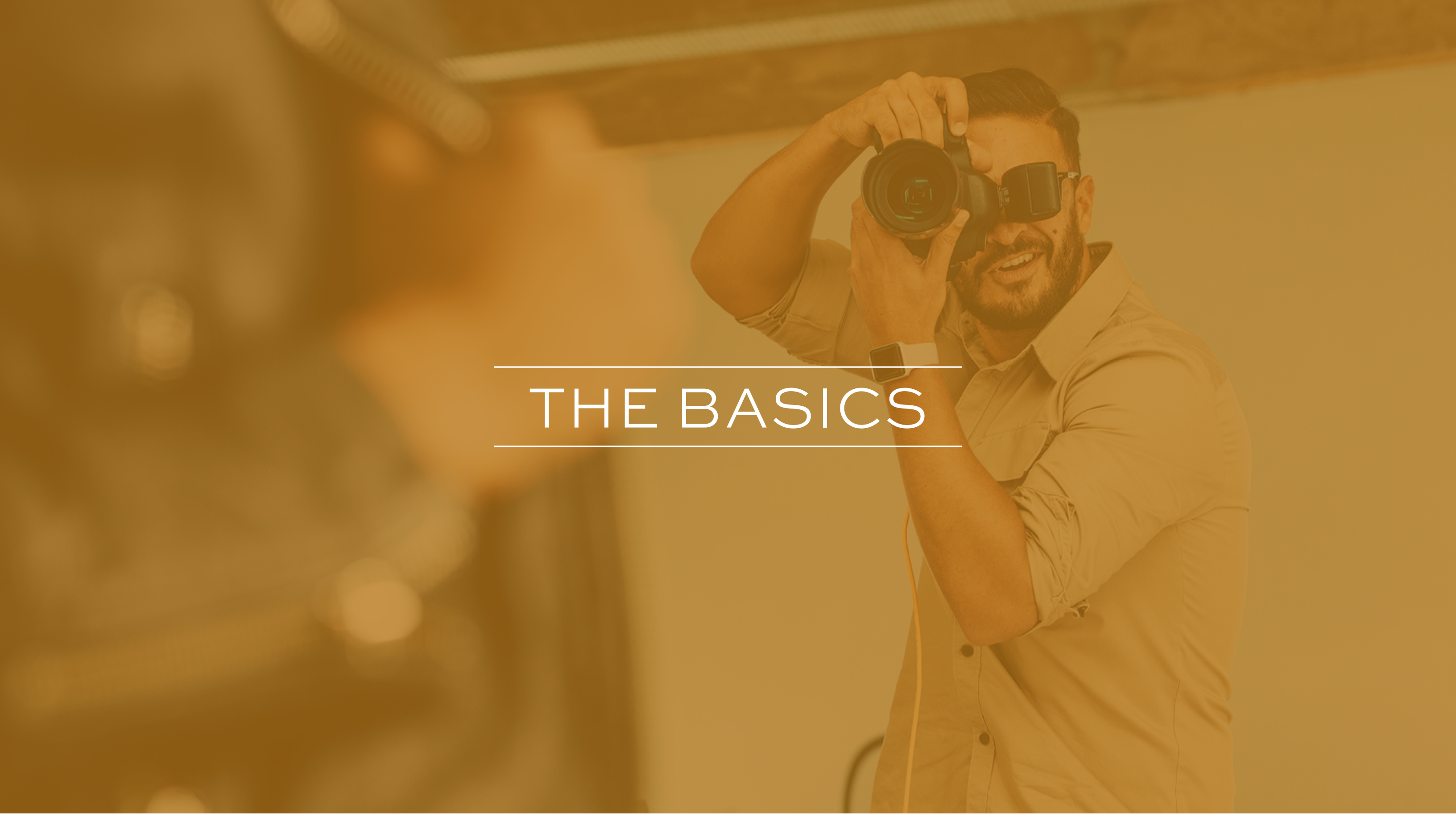
FINANCIAL

SOLO(K) PLAN FREQUENTLY ASKED QUESTIONS



SOLO(K) FAQ
TABLE OF CONTENTS



THE BASICS

What is a Solo 401(k)?

A Solo 401(k) is for owner-only businesses. Self-employed businesses include sole proprietorships, closely held family businesses, LLCs, partnerships and corporations.

How does a Solo 401(k) work?

The Solo 401(k) retirement plan allows for salary deferrals found in 401(k) plans, and employer contributions found in profit-sharing plans. The business owner can make annual contributions of both salary deferral and profit-sharing contributions, empowering them to save up to the IRS maximum contribution and deduction limits.

Can a sole proprietor use their Social Security number for the Solo 401(k) EIN?

No. Form 5500 is public information. For identity safety reasons, the IRS does not allow the use of Social Security numbers as the EIN (Employer Identification Number). The sole proprietor will need to obtain an EIN from the IRS. This can be done online in a matter of minutes.

Are there any forms that must be filed with the IRS?

No annual IRS reporting is applicable until the Solo 401(k) assets plus any other qualified one- participant retirement plans (e.g., Cash Balance) sponsored by the business reaches $250,000. At that point, then an IRS Form 5500-EZ must be filed. Detailed Form 5500 instructions can be found on the IRS website.

However, a Form 1099-R must always be filed with the IRS if a distribution is taken from the Solo 401(k)'s plan assets and upon plan termination of the plan. Form 1099-R also applies to in-plan Roth Solo 401(k) conversion of both after-tax and pre-tax funds.

ELIGIBILITY

Can the business owner's spouse who works for the business participate in the Solo 401(k) plan?

If the business owner's spouse performs services and is compensated from the business, then this person can participate in the same solo 401(k) plan. The maximum amount the spouse can save also depends on his or her income, salary and age.

Can a business partner participate in a Solo(k)?

Since Solo(k) plans are for owner-only businesses, partners are eligible to participate.

What happens if the business owner's company hires an employee?

Once the business owner hires an employee, the business owner will no longer be eligible to maintain Solo 401(k) plan status once the employee meets the plan's eligibility requirements. It is critical that the business owner consult with the advisor or TPA prior to hiring any non-owner employee to discuss the options.

Can the business owner exclude part-time employees from participating in the Solo 401(k) Plan?

In short, yes if the part-time employees are credited with 500 or less hours per plan year.

However, for 2024, according to SECURE 1.0, 401(k) plans (including Solo 401(k) plans) must allow employees who have **worked more than 500 hours of service in the past three consecutive plan years** to contribute elective deferrals to the plan.

Example 1

Alex was hired in 2016, as a part-time employee. She has never been eligible to participate in the company's 401(k) plan because she did not meet the 1,000-hour requirement. In 2021, 2022, and 2023, she worked 600 hours per year. Having exceeded 500 hours and completed three consecutive 12-month periods, she can now join the plan on January 1, 2024.

✔ worked 3 plan years

✔ worked 500+ hours per year

Eligible to Participate

Example 2

Riley was hired on May 15, 2021, as a part-time employee. He worked 400 hours in 2021, 600 hours in 2022, and 600 hours in 2023. On May 15, 2024, he completed three consecutive 12-month periods; however, he did not work enough hours to be eligible.

✔ worked 3 plan years

✘ worked 500+ hours per year

Not Eligible to Participate

For 2025 and beyond, the rules change again. According to the modifications in SECURE 2.0, an employee only needs **two consecutive plan years with more than 500 hours of service** to be eligible to participate in the company's 401(k) plan.

Example 3

Ryan was hired on May 15, 2021, as a part-time employee. He worked 400 hours in 2021, 400 hours in 2022, 600 hours in 2023 and 600 hours in 2024. He has completed two consecutive plan years with more than 500 hours; he is eligible to participate in the company's 401(k) plan on the next entry date.

✔ worked 2 plan years

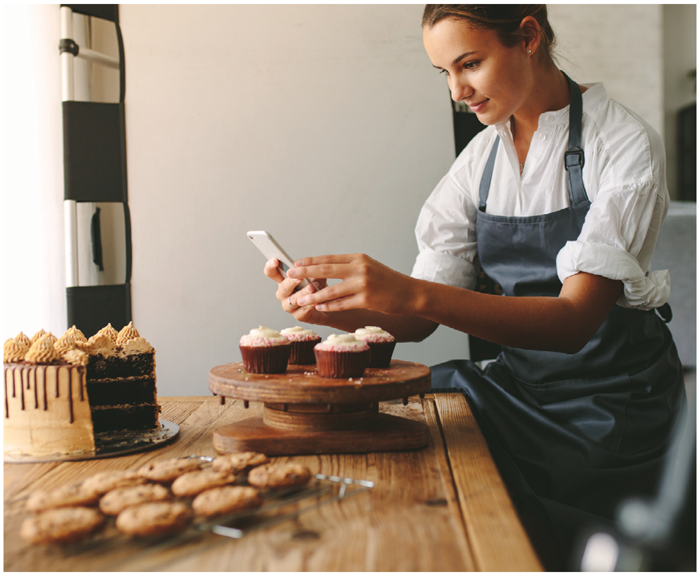
✔ worked 500+ hours per year

Eligible to Participate

CONTRIBUTIONS[i]

Can a business owner make contributions to a Solo 401(k) plan as an employee and as the employer?

Yes, the business owner can contribute both employee elective deferrals and employer profit- sharing contributions.



Is there a special contribution computation for a sole proprietor?

Yes, a special sole-proprietor contribution computation must be made to calculate the maximum amount of elective deferrals and profit-sharing contribution that can be made to the Solo 401(k) plan. When figuring the contribution, compensation is your "earned income," which is defined as net earnings from self-employment after deducting both:

- One-half of your self-employment tax, and
- Contributions for yourself.

Two helpful resources are: the rate table or worksheets in Chapter 5 of IRS Publication 560, Retirement Plans for Small Business, for figuring the allowable contribution rate and tax deduction for the Solo 401(k) plan contributions.

i https://www.irs.gov/retirement-plans/one-particpant-401k-plans.

What are voluntary after-tax contributions?

In a Solo 401(k) plan, a business owner typically makes employee deferrals into a traditional pre-tax account or a Roth account and an employer profit sharing contribution. For the mega backdoor Roth strategy, the business owner must make use of another account: the voluntary after-tax account.

After-tax contributions are undesirable on their own. Contributions are made with after-tax income, so the business owner doesn't receive any tax deductions. Unlike a Roth account, withdrawals of any gains in retirement are also taxed.

There are two purposes for the after-tax account: First, it's the only way to get additional money into the Solo 401(k). If the business owner does not make enough money to hit the yearly maximum total contribution limit, then they can use after-tax contributions to fill the gap. Second, any after-tax contributions can immediately be converted into a Roth account.

What is the maximum after-tax contribution a business owner can make to a Solo 401(k) plan?

If a Solo 401(k) provider's plan document allows for voluntary after-tax contributions, then from a tax code perspective a business owner can make a Solo 401(k) voluntary after-tax contribution up to their overall IRS §415 limit for the year; $69,000 for 2024.

Here are two examples:

1. **Maximize Employee Contributions then Contribute Rest with After-Tax Contributions**

   Let's say the business owner contributed the full amount of $23,000 in employee deferrals into a Roth Solo 401(k). Since the 2024 IRS §415 contribution limit is $69,000 that leaves $46,000 ($69,000 - $23,000) left over in contribution room.

   Remember that employer contributions for a Solo 401(k) are calculated by 25% of income (~20% if the entity type is a sole proprietorship, partnership, or LLC taxed as a sole proprietorship). If the business owner were to contribute that $46,000 amount with employer contributions, they would need an income of $184,000 (25% of $184,000 is $46,000). If the business owner uses the mega backdoor Roth strategy, they would only need $46,000 in after-tax contributions to maximize their total 2024 retirement contribution. Not only that, but the entire amount can get converted into their Roth IRS.

2. **Maximize Employee Contributions then Contribute Rest with After-Tax Contributions**

   Remember in the calculation above, we concluded that the business owner would need to make at least $184,000 in order to maximize the 2024 contributions ($69,000).

   $23,000 would be made with employee deferrals, and the remaining would get filled using 25% of the business owner's income.

A Solo 401(k) allows for substantially more contributions than other retirement plans due to its structure, which combines both employee and employer contribution limits. This dual contribution capability can significantly increase the total amount that can be contributed annually.

For example, a qualified individual earning $100,000 could contribute as much as $55,500 in 2024 with a Solo 401(k) plan. In comparison, the same person could only contribute a maximum of $25,000 with a SEP IRA or with a profit sharing plan and only $22,500 with a SIMPLE IRA in 2024.

Keep in mind that these amounts could potentially be doubled if your spouse is an employee of the business, further magnifying the benefits of the Solo 401(k).

But what if the business owner only made $100,000?

$23,000 would get contributed from the employee side, and 25% ($25,000) would get contributed from the employer side.

That's a total of just $48,000 and the business owner would still have $21,000 ($69,000 – $48,000) left over in contribution room.

Using the mega backdoor Roth strategy, the business owner could contribute the remainder with after-tax contributions. And then it would all be transferred into a Roth IRA account.

What is the process for a business owner to make a mega backdoor Roth contribution using a Solo 401(k) plan?

The ability for a business owner to make a voluntary after-tax contribution is largely up to the Solo 401(k) plan document provider to offer voluntary after-tax contributions as an option in the plan document.

If the Solo 401(k) plan document offers voluntary after-tax contributions and this specification is adopted then this is the process.

1. Calculate maximum voluntary after-tax contribution. (See question above.)
2. Open an account titled in the name of the Solo 401(k) plan with the words "After-Tax" in parenthesis.
3. Deposit the voluntary after-tax contribution to the After-Tax account.
4. Complete Custodian's (or Recordkeeper's) paperwork to move the funds from the voluntary after-tax Solo 401(k) account by check or wire to the Roth IRA.
5. Custodian (or Recordkeeper) will issue the Form 1099-R to report the conversion to the IRS.

How will a change in the business entity type from sole proprietor to an S-Corporation impact the Solo 401(k) plan contributions?

As a result of the business owner's self-employed business changing from being taxed as a sole proprietorship to an S-Corporation, the Solo 401(k) plan contributions will now be based on W- 2 wages under the S-Corporation instead of the IRS Form 1040 Schedule C net income. Also, the Solo 401(k) plan's annual contributions will now need to be deposited by the S-Corporation's tax-filing deadline of March 15 (or September 15 if a return extension is timely filed) instead of the IRS Form 1040 tax-filing deadline of April 15 (or October 15 if tax return extension is timely filed).

If the business owner's business is set up as an S-corporation, can the business owner contribute from their business to the Solo 401(k) plan without taking a paycheck?

The S-Corporation business owner must take a paycheck in order to make salary deferral contributions as the employee and profit-sharing contributions as the employer because both are based on W-2 earnings.

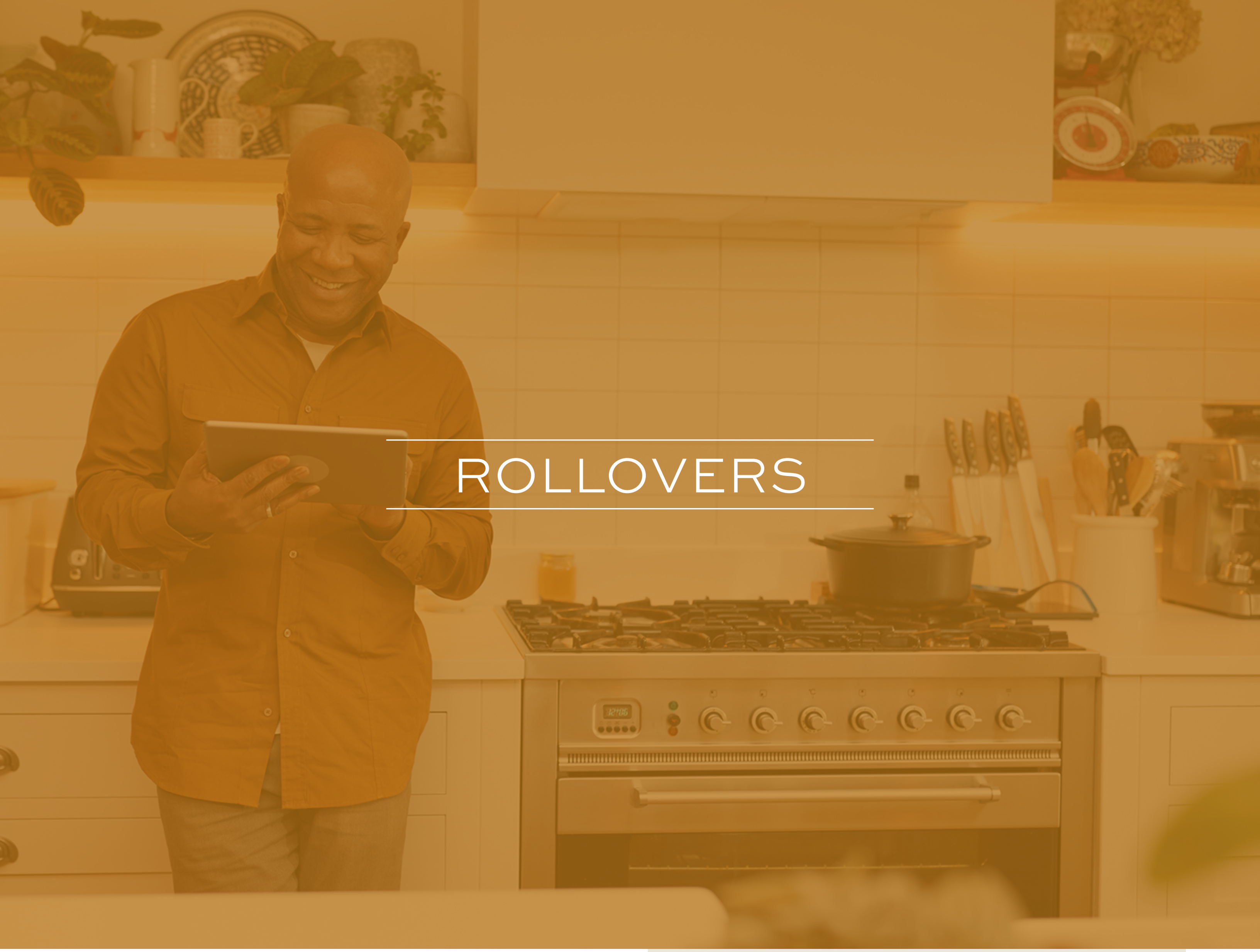
Is there a deadline to fund a Solo 401(k) plan?

For Sole Proprietors:

Employee and profit-sharing contributions must be funded by the Form 1040 tax-filing deadline of April 15 (or October 15 if tax return extension is timely filed).

For Other Entity Types:

Employee and profit-sharing contributions must be funded by the business' tax-filing deadline.



ROLLOVERS

Can a business owner roll over other retirement assets to the Solo 401(k) plan?

Yes. The business owner can transfer other qualified plans such as a former employer 401(k) plan account balance and pretax IRAs to the Solo 401(k) Plan.

All of the following types of tax-qualified retirement savings can be rolled or transferred into a Solo 401(k) plan.

- Traditional IRAs
- SEP IRAs
- Rollover / Conduit IRAs
- SIMPLE IRAs
- SIMPLE 401(k) Plans
- 401(k) Plans
- Profit Sharing Plans
- Money Purchase Pension Plans
- Defined Benefit Plans
- Government 457(b) Plans
- 403(b) Plans
- Thrift Savings Plans (TSP)

BENEFICIARY DESIGNATIONS

Is it important to complete a Solo 401(k) plan beneficiary designation form?

A court case from 2012 titled, Herring v. Campbell, Administrator of Marathon Oil Company Thrift Plan, U.S. Court of Appeals for the Fifth Circuit, 8/17/12, confirms the importance of making sure a beneficiary election form has been completed and kept up to date when opening a qualified plan such as a Solo 401(k). In addition to electing a primary beneficiary, as this court case demonstrates, it is just as important to name a contingent beneficiary.

In the above court case, the qualified plan participant named his wife as the beneficiary, who later passed away, but did not name a contingent beneficiary. As a result, instead of his stepchildren receiving the $300,000 payout, his six siblings received the money.

In sum, this court case highlights the importance of making sure Solo 401(k) plan beneficiary designation forms are kept up to date by reviewing them periodically.

How many beneficiary designation forms need to be completed?

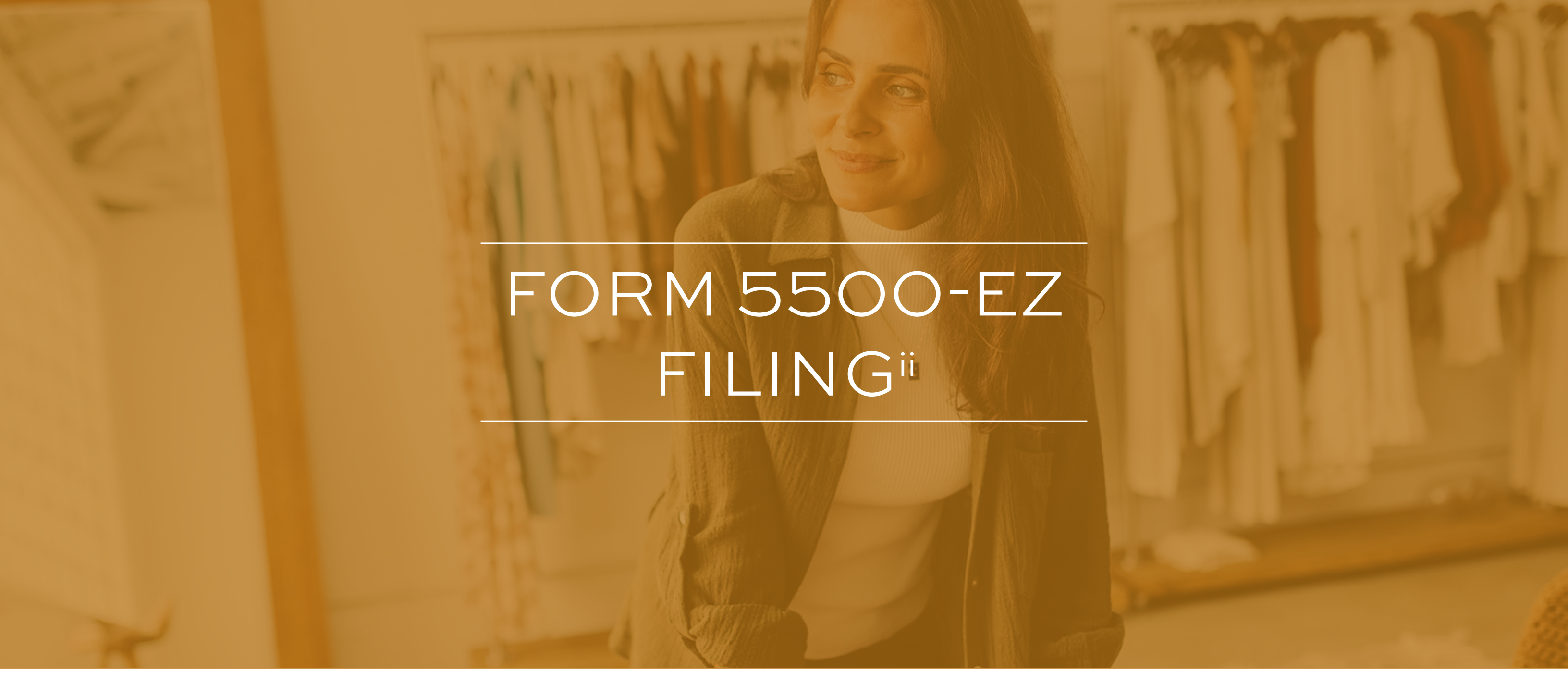
A beneficiary designation form should be completed by **each participant** in the Solo 401(k) plan that has an account balance.

Example: The business owner has a business partner. Both the business owner and business partner own a 50% stake in the company, and both will be trustees for the plan. If the business owner is the only one who is participating in the plan, then only the business owner will need to complete a beneficiary designation.

Is it possible to name separate beneficiaries for each source of the Solo 401(k) plan's funds?

Yes, it is possible to name separate beneficiaries for each account type held under the Solo 401(k) plan. In other words, the beneficiary named for the Solo 401(k) pretax account type can be different than the beneficiary named for the Roth account type. The participant will be required to fill out a separate beneficiary form for each account type (e.g., Pre-tax, Roth, after- tax) associated with the Solo 401(k) plan.

Such designation of separate beneficiaries for each Solo 401(k) plan account type is possible because each account type has to be separately tracked using separate bank or brokerage accounts titled with the name of the Solo 401(k) plan for benefit of the participant. Upon the participant's passing the Solo 401(k) plan benefits will be distributed based on the separate beneficiary form completed for each Solo 401(k) account type.



FORM 5500-EZ FILING[ii]

What is the purpose for filing Form 5500-EZ?

Form 5500-EZ is used by owner-only plans such as a Solo(k) plan that are not subject to the requirements of Internal Revenue Code section 104(a) of the Employee Retirement Income Security Act of 1974 (ERISA) to report the fair market value of the plan as of the end of the plan year.

Does the business owner have to file a Form 5500-EZ for the Solo 401(k) plan?

Yes, if the total value of the Solo 401(k) plan's assets exceeds $250,000 as of the end of the plan year (either alone or in combination with one or more one-participant plans maintained by the business owner) or the plan is terminating.

How does the business owner determine the Form 5500-EZ's $250,000 filing threshold?

If the business owner participates in multiple solo plans (e.g., 401(k) and cash balance), all the plans' assets, for all participants (e.g., husband and wife), and all the multiple sub-accounts (e.g., pre-tax, Roth, etc.) must be aggregated to determine if the $250,000 threshold has been met. Once the aggregate $250,000 threshold is met, Form 5500-EZ must be filed for each of the one-participant plans including those with less than $250,000 in assets for the plan year.

If the business owner borrowed from the Solo 401(k) plan (e.g., took a Solo(k) plan participant loan), the balance of the loan as of the plan's year-end (e.g., December 31), then it is treated as an asset, not a liability, so it must be included in the calculation to determine if the $250,000 threshold filing requirement has been met.

What is the due date for filing Form 5500-EZ?

The Form 5500-EZ is due to the government seven months following the plan's year-end (e.g., July 31 for a December 31 plan year-end). If the plan properly files an extension, then the plan has an additional 2½ months (e.g., October 15 for a December 31 plan year-end).

Is a final Form 5500-EZ required at the time the business owner closes their Solo 401(k) if the plan has never had to file Form 5500-EZ in the past?

Yes, a final Form 5500-EZ has to be filed when a solo 401(k) plan is closed regardless of if the value was under $250,000 in prior plan years or in the year it was terminated.

ii https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/plan-administration-and-compliance/reporting-and- filing/form-5500/2023-ez-instructions.pdf.

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