

## **Allowable Contribution Amounts into Self Employed 401(k) Plans**

16 January 2017

Under the Internal Revenue Code, a self employed taxpayer can set up a 401(k) plan for himself or herself. The amount that taxpayer can contribute to the plan each calendar year is a function of the person's age and the amount of "net profit before 401(k) contribution" that the taxpayer earns. That amount appears on Line 31 of Schedule C of Form 1040. (Hereafter, "net profit.")

This discussion and the accompanying schedules display how much a taxpayer can contribute as he or she moves up the earnings ladder during a calendar year.

Initially a taxpayer over the age of 50 can contribute 92.94% of his or her "net profit" up to an amount equal to \$32,278 to his or her Self Employed 401(k) Plan. That contribution would total \$30,000.

A taxpayer over the age of 50 can contribute a maximum of \$59,000 per year to a Self Employed 401(k) Plan. To be able to contribute that amount, the taxpayer would have to realize just over \$188,300 in "net profit."

A taxpayer must first set up a Plan, typically with a brokerage house. The taxpayer can then open a Self Employed 401(k) Plan Account into which contributions may be placed. The question of how the contributions should be invested is an entirely separate matter. For many taxpayers, a combination of low cost index funds can be suitable.

The schedules that follow display the "contribution math" at various levels of "net profit."

### **Schedule**

- A** Starting with a net profit of \$15,000 and incrementing by \$5,000 per column, this schedule shows how a taxpayer can contribute \$30,505 to his or her plan, given a net profit of \$35,000. That would be a cumulative contribution rate of 87.16% of net profit.

- B** Starting with a net profit of \$30,000 and incrementing by \$10,000 per column, this schedule how a taxpayer can contribute \$37,010 to his or her plan, given a net profit of \$70,000. That would be a cume contribution rate of 52.87%.
- C** Starting with a net profit of \$80,000 and incrementing by \$20,000 per column, this schedule how a taxpayer can contribute \$53,739 to his or her plan, given a net profit of \$160,000. That would be a cume contribution rate of 35.59%.
- D** Starting with a net profit of \$120,000 and incrementing by \$20,000 per column, this schedule how a taxpayer can contribute the annual max of \$59,000 to his or her plan, given a net profit a bit over \$180,300. At \$200,000, the cume contribution rate would be 29.50% of net profit.

As with Traditional Individual Retirement Accounts (IRAs) and with Rollover Individual Retirement Accounts (Rollover IRAs), a taxpayer must begin distributions from a Self Employed 401(k) Plan in the year in which the taxpayer reaches the age of 70 1/2. (There is a small grace period for the deadline for that first distribution.) Here are the required distribution rates for the five years of the distribution period:

Age	Distribution Period	Equivalent Distribution Percentage
70 1/2	27.4	3.6496%
71 1/2	26.5	3.7736%
72 1/2	25.6	3.9063%
73 1/2	24.7	4.0486%
74 1/2	23.8	4.2017%

If a taxpayer has more than one IRA, Rollover IRA or Self Employed 401(k) Plan, the taxpayer needs to sum the market values of all such accounts as of 31 December of year one and then multiply that sum times the required distribution rate to determine the total amount of the Required Minimum Distribution (RMD) in year two. The actual amount distributed in year two can come from one or more of those accounts.

Daniel P. Doyle

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**Solo 401k Plan Pro Forma Calcs  
Deduction Worksheet for Self Employed Taxpayer**

<b>Increment</b> 5,000.00
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Net Profit, Line 31, Schedule C	15,000.00	20,000.00	25,000.00	30,000.00	35,000.00
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	<u>Rates</u>	
Employer Social Security	@	6.200%
Employer Medicare	@	1.450%
Combined Rate		<u>7.650%</u>
One minus Combined Rate		<u>92.350%</u>

Rate for Reduction of Net Profit	7.065%	1,059.72	1,412.96	1,766.19	2,119.43	2,472.67
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Net Earnings From Self Employment	13,940.28	18,587.05	23,233.81	27,880.57	32,527.33
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Contribution Rate by Employer	0.25
Adjusted Rate	0.20

Multiply Net Earnings by Adjusted Rate	2,788.06	3,717.41	4,646.76	5,576.11	6,505.47
Multiply Contribution Rate of 0.25 times 265,000.00	66,250.00	66,250.00	66,250.00	66,250.00	66,250.00
Enter smaller of Step 5 or Step 6	2,788.06	3,717.41	4,646.76	5,576.11	6,505.47

Contribution Dollar Limit	53,000.00	53,000.00	53,000.00	53,000.00	53,000.00
Allowable Elective Deferrals	18,000.00	18,000.00	18,000.00	18,000.00	18,000.00
Subtract Step 9 from Step 8	35,000.00	35,000.00	35,000.00	35,000.00	35,000.00

Subtract Step 9 from Step 3 if greater than 0	0.00	587.04	5,233.81	9,880.57	14,527.33
Enter one half of step 11	0.00	293.52	2,616.90	4,940.28	7,263.66
Enter the smallest of Step 7, Step 10 or Step 12	0.00	293.52	2,616.90	4,940.28	6,505.47

Subtract Step 13 from Step 3	13,940.28	18,293.52	20,616.90	22,940.28	26,021.86
Enter smaller of Step 9 or Step 14	13,940.28	18,000.00	18,000.00	18,000.00	18,000.00
Subtract Step 15 from Step 14 if greater than 0	0.00	293.52	2,616.90	4,940.28	8,021.86

Allowable Catch Up Deferrals	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00
Enter the smaller of Step 16 or Step 17	0.00	293.52	2,616.90	4,940.28	6,000.00
Add Step 13, Step 15 and Step 18	13,940.28	18,587.05	23,233.81	27,880.57	30,505.47

Enter the amount of Roth Contributions included on Step 9 and Step 17	0.00	0.00	0.00	0.00	0.00
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Subtract Step 20 from Step 19. This amount is the Maximum Deductible Contribution	13,940.28	18,587.05	23,233.81	27,880.57	30,505.47
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**Actual Contribution**

Enter the Actual Contribution, not to exceed the Maximum Deductible Contribution, on Form 1040, Line 28, as an Adjustment to Income

**Deemed Allocation of Maximum Deductible Contribution:**

To Allowable Elective Deferrals	13,940.28	18,000.00	18,000.00	18,000.00	18,000.00
To Catch Up Deferrals	0.00	293.52	2,616.90	4,940.28	6,000.00
To Contribution By Employer	0.00	293.52	2,616.90	4,940.28	6,505.47
	<u>13,940.28</u>	<u>18,587.05</u>	<u>23,233.81</u>	<u>27,880.57</u>	<u>30,505.47</u>

Increment in Maximum Deductible Contribution	4,646.76	4,646.76	4,646.76	4,646.76	2,624.90
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Incremental Contribution divided by Incremental Net Profit	92.94%	92.94%	92.94%	92.94%	52.50%
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Cumulative Contribution divided by Cumulative Net Profit	92.94%	92.94%	92.94%	92.94%	87.16%
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Cume Net Profit Before Contributions	15,000.00	20,000.00	25,000.00	30,000.00	35,000.00
Cume Max Contribution	13,940.28	18,587.05	23,233.81	27,880.57	30,505.47
	92.94%	92.94%	92.94%	92.94%	87.16%

**Solo 401k Plan Pro Forma Calcs**  
**Deduction Worksheet for Self Employed Taxpayer**

Increment 10,000.00
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Net Profit, Line 31, Schedule C	30,000.00	40,000.00	50,000.00	60,000.00	70,000.00
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	<u>Rates</u>
Employer Social Security	@ 6.200%
Employer Medicare	@ 1.450%
Combined Rate	<u>7.650%</u>
One minus Combined Rate	<u>92.350%</u>

Rate for Reduction of  
Net Profit

	7.065%	2,119.43	2,825.91	3,532.39	4,238.87	4,945.34
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Net Earnings From Self Employment	27,880.57	37,174.09	46,467.61	55,761.14	65,054.66
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Contribution Rate by Employer 0.25  
Adjusted Rate 0.20

Multiply Net Earnings by Adjusted Rate	5,576.11	7,434.82	9,293.52	11,152.23	13,010.93
Multiply Contribution Rate of 0.25 times 265,000.00	66,250.00	66,250.00	66,250.00	66,250.00	66,250.00
Enter smaller of Step 5 or Step 6	5,576.11	7,434.82	9,293.52	11,152.23	13,010.93

Contribution Dollar Limit	53,000.00	53,000.00	53,000.00	53,000.00	53,000.00
Allowable Elective Deferrals	18,000.00	18,000.00	18,000.00	18,000.00	18,000.00
Subtract Step 9 from Step 8	35,000.00	35,000.00	35,000.00	35,000.00	35,000.00

Subtract Step 9 from Step 3 if greater than 0	9,880.57	19,174.09	28,467.61	37,761.14	47,054.66
Enter one half of step 11	4,940.28	9,587.05	14,233.81	18,880.57	23,527.33
Enter the smallest of Step 7, Step 10 or Step 12	4,940.28	7,434.82	9,293.52	11,152.23	13,010.93

Subtract Step 13 from Step 3	22,940.28	29,739.27	37,174.09	44,608.91	52,043.73
Enter smaller of Step 9 or Step 14	18,000.00	18,000.00	18,000.00	18,000.00	18,000.00
Subtract Step 15 from Step 14 if greater than 0	4,940.28	11,739.27	19,174.09	26,608.91	34,043.73

Allowable Catch Up Deferrals	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00
Enter the smaller of Step 16 or Step 17	4,940.28	6,000.00	6,000.00	6,000.00	6,000.00
Add Step 13, Step 15 and Step 18	27,880.57	31,434.82	33,293.52	35,152.23	37,010.93

Enter the amount of Roth Contributions included on Step 9 and Step 17	0.00	0.00	0.00	0.00	0.00
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Subtract Step 20 from Step 19. This amount is the Maximum Deductible Contribution	27,880.57	31,434.82	33,293.52	35,152.23	37,010.93
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**Actual Contribution**

Enter the Actual Contribution, not to exceed the Maximum Deductible Contribution, on Form 1040, Line 28, as an Adjustment to Income

**Deemed Allocation of Maximum Deductible Contribution:**

To Allowable Elective Deferrals	18,000.00	18,000.00	18,000.00	18,000.00	18,000.00
To Catch Up Deferrals	4,940.28	6,000.00	6,000.00	6,000.00	6,000.00
To Contribution By Employer	4,940.28	7,434.82	9,293.52	11,152.23	13,010.93
	27,880.57	31,434.82	33,293.52	35,152.23	37,010.93

Increment in Maximum Deductible Contribution		3,554.25	1,858.70	1,858.70	1,858.70
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Incremental Contribution divided by Incremental Net Profit		35.54%	18.59%	18.59%	18.59%
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Cumulative Contribution divided by Cumulative Net Profit	92.94%	78.59%	66.59%	58.59%	52.87%
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Cume Net Profit Before Contributions	30,000.00	40,000.00	50,000.00	60,000.00	70,000.00
Cume Max Contribution	27,880.57	31,434.82	33,293.52	35,152.23	37,010.93

	92.94%	78.59%	66.59%	58.59%	52.87%
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**Solo 401k Plan Pro Forma Calcs  
Deduction Worksheet for Self Employed Taxpayer**

<b>Increment</b> 20,000.00
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Net Profit, Line 31, Schedule C 80,000.00 100,000.00 120,000.00 140,000.00 160,000.00

	<u>Rates</u>				
Employer Social Security	@	6.200%			
Employer Medicare	@	1.450%			
Combined Rate		<u>7.650%</u>			
One minus Combined Rate		<u>92.350%</u>			

Rate for Reduction of Net Profit 7.065% 5,651.82 7,064.78 8,477.73 9,890.69 11,303.64

Net Earnings From Self Employment 74,348.18 92,935.23 111,522.27 130,109.32 148,696.36

Contribution Rate by Employer 0.25  
Adjusted Rate 0.20

Multiply Net Earnings by Adjusted Rate 14,869.64 18,587.05 22,304.45 26,021.86 29,739.27  
 Multiply Contribution Rate of 0.25 times 265,000.00 66,250.00 66,250.00 66,250.00 66,250.00 66,250.00  
 Enter smaller of Step 5 or Step 6 14,869.64 18,587.05 22,304.45 26,021.86 29,739.27

Contribution Dollar Limit 53,000.00 53,000.00 53,000.00 53,000.00 53,000.00  
 Allowable Elective Deferrals 18,000.00 18,000.00 18,000.00 18,000.00 18,000.00  
 Subtract Step 9 from Step 8 35,000.00 35,000.00 35,000.00 35,000.00 35,000.00

Subtract Step 9 from Step 3 if greater than 0 56,348.18 74,935.23 93,522.27 112,109.32 130,696.36  
 Enter one half of step 11 28,174.09 37,467.61 46,761.14 56,054.66 65,348.18  
 Enter the smallest of Step 7, Step 10 or Step 12 14,869.64 18,587.05 22,304.45 26,021.86 29,739.27

Subtract Step 13 from Step 3 59,478.54 74,348.18 89,217.82 104,087.45 118,957.09  
 Enter smaller of Step 9 or Step 14 18,000.00 18,000.00 18,000.00 18,000.00 18,000.00  
 Subtract Step 15 from Step 14 if greater than 0 41,478.54 56,348.18 71,217.82 86,087.45 100,957.09

Allowable Catch Up Deferrals 6,000.00 6,000.00 6,000.00 6,000.00 6,000.00  
 Enter the smaller of Step 16 or Step 17 6,000.00 6,000.00 6,000.00 6,000.00 6,000.00  
 Add Step 13, Step 15 and Step 18 38,869.64 42,587.05 46,304.45 50,021.86 53,739.27

Enter the amount of Roth Contributions included on Step 9 and Step 17 0.00 0.00 0.00 0.00 0.00

Subtract Step 20 from Step 19. This amount is the Maximum Deductible Contribution 38,869.64 42,587.05 46,304.45 50,021.86 53,739.27

**Actual Contribution**

Enter the Actual Contribution, not to exceed the Maximum Deductible Contribution, on Form 1040, Line 28, as an Adjustment to Income

**Deemed Allocation of Maximum Deductible Contribution:**

To Allowable Elective Deferrals	18,000.00	18,000.00	18,000.00	18,000.00	18,000.00
To Catch Up Deferrals	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00
To Contribution By Employer	<u>14,869.64</u>	<u>18,587.05</u>	<u>22,304.45</u>	<u>26,021.86</u>	<u>29,739.27</u>
	38,869.64	42,587.05	46,304.45	50,021.86	53,739.27

Increment in Maximum Deductible Contribution 3,717.41 3,717.41 3,717.41 3,717.41

Incremental Contribution divided by Incremental Net Profit 18.59% 18.59% 18.59% 18.59%

Cumulative Contribution divided by Cumulative Net Profit 48.59% 42.59% 38.59% 35.73% 33.59%

Cume Net Profit Before Contributions 80,000.00 100,000.00 120,000.00 140,000.00 160,000.00  
 Cume Max Contribution 38,869.64 42,587.05 46,304.45 50,021.86 53,739.27

48.59% 42.59% 38.59% 35.73% 33.59%

**Solo 401k Plan Pro Forma Calcs  
Deduction Worksheet for Self Employed Taxpayer**

<b>Increment</b> 20,000.00
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Net Profit, Line 31, Schedule C 120,000.00 140,000.00 160,000.00 180,000.00 200,000.00

	<u>Rates</u>				
Employer Social Security	@	6.200%			
Employer Medicare	@	1.450%			
Combined Rate		<u>7.650%</u>			
One minus Combined Rate		<u>92.350%</u>			

Rate for Reduction of Net Profit 7.065% 8,477.73 9,890.69 11,303.64 12,716.60 14,129.55

Net Earnings From Self Employment 111,522.27 130,109.32 148,696.36 167,283.41 185,870.45

Contribution Rate by Employer 0.25  
Adjusted Rate 0.20

Multiply Net Earnings by Adjusted Rate 22,304.45 26,021.86 29,739.27 33,456.68 37,174.09  
 Multiply Contribution Rate of 0.25 times 265,000.00 66,250.00 66,250.00 66,250.00 66,250.00 66,250.00  
 Enter smaller of Step 5 or Step 6 22,304.45 26,021.86 29,739.27 33,456.68 37,174.09

Contribution Dollar Limit 53,000.00 53,000.00 53,000.00 53,000.00 53,000.00  
 Allowable Elective Deferrals 18,000.00 18,000.00 18,000.00 18,000.00 18,000.00  
 Subtract Step 9 from Step 8 35,000.00 35,000.00 35,000.00 35,000.00 35,000.00

Subtract Step 9 from Step 3 if greater than 0 93,522.27 112,109.32 130,696.36 149,283.41 167,870.45  
 Enter one half of step 11 46,761.14 56,054.66 65,348.18 74,641.70 83,935.23  
 Enter the smallest of Step 7, Step 10 or Step 12 22,304.45 26,021.86 29,739.27 33,456.68 35,000.00

Subtract Step 13 from Step 3 89,217.82 104,087.45 118,957.09 133,826.72 150,870.45  
 Enter smaller of Step 9 or Step 14 18,000.00 18,000.00 18,000.00 18,000.00 18,000.00  
 Subtract Step 15 from Step 14 if greater than 0 71,217.82 86,087.45 100,957.09 115,826.72 132,870.45

Allowable Catch Up Deferrals 6,000.00 6,000.00 6,000.00 6,000.00 6,000.00  
 Enter the smaller of Step 16 or Step 17 6,000.00 6,000.00 6,000.00 6,000.00 6,000.00  
 Add Step 13, Step 15 and Step 18 46,304.45 50,021.86 53,739.27 57,456.68 59,000.00

Enter the amount of Roth Contributions included on Step 9 and Step 17 0.00 0.00 0.00 0.00 0.00

Subtract Step 20 from Step 19. This amount is the Maximum Deductible Contribution 46,304.45 50,021.86 53,739.27 57,456.68 59,000.00

**Actual Contribution**

Enter the Actual Contribution, not to exceed the Maximum Deductible Contribution, on Form 1040, Line 28, as an Adjustment to Income

**Deemed Allocation of Maximum Deductible Contribution:**

To Allowable Elective Deferrals	18,000.00	18,000.00	18,000.00	18,000.00	18,000.00
To Catch Up Deferrals	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00
To Contribution By Employer	<u>22,304.45</u>	<u>26,021.86</u>	<u>29,739.27</u>	<u>33,456.68</u>	<u>35,000.00</u>
	46,304.45	50,021.86	53,739.27	57,456.68	59,000.00

Increment in Maximum Deductible Contribution 3,717.41 3,717.41 3,717.41 1,543.32

Incremental Contribution divided by Incremental Net Profit 18.59% 18.59% 18.59% 7.72%

Cumulative Contribution divided by Cumulative Net Profit 38.59% 35.73% 33.59% 31.92% 29.50%

Cume Net Profit Before Contributions 120,000.00 140,000.00 160,000.00 180,000.00 200,000.00  
 Cume Max Contribution 46,304.45 50,021.86 53,739.27 57,456.68 59,000.00  
38.59% 35.73% 33.59% 31.92% 29.50%