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Solo 401k Guide: The Self-Employed Retirement Account That Beats Everything Else

A self-employed person with no full-time employees has access to the most powerful retirement account in the US tax code: the Solo 401(k). In 2025 the total annual contribution limit is \$70,000 — \$77,500 with the age-50 catch-up — combining an employee deferral of up to \$23,500 with an employer profit-sharing contribution of up to 25% of W-2 wages (or 20% of net self-employment income for sole proprietors). A sole proprietor earning \$120,000 in net profit can legitimately shelter over \$45,000 from income tax in a single year. No SEP-IRA, Simple IRA, or traditional brokerage account comes close to that number. This guide covers the exact contribution calculation for sole proprietors (the 20% rule matters), the December 31 establishment deadline that catches first-timers off guard, the Form 5500-EZ filing requirement that becomes mandatory once assets cross \$250,000, the custodian comparison including which providers support Roth contributions and plan loans, and the complete decision framework for choosing between Solo 401(k) and SEP-IRA at different income levels.

1. Foundation

The Solo 401(k) works for any self-employed person who has no full-time employees other than themselves and their spouse — and the contribution limits are dramatically higher than competing options at most income levels. Eligible business types include sole proprietorships, single-member LLCs, partnerships with only the owner and their spouse, S-corporations where the owner takes a salary, and C-corporations. The disqualifying condition is having a non-owner employee who works 1,000 or more hours in a calendar year (this is the full-time test). Part-time workers under 1,000 hours per year do not disqualify the plan, though recent SECURE 2.0

provisions require long-term part-time employee eligibility tracking after 3 years at 500+ hours per year, so the rules on part-time workers are worth monitoring annually. The spouse exception allows a business owner's spouse who is also paid compensation by the business to participate in the Solo 401(k) alongside the owner, effectively doubling the household contribution capacity.

The contribution formula for sole proprietors is different from the W-2 employee rule and must be calculated precisely to avoid excess contributions.

Employee contributions: up to \$23,500 in 2025 (\$31,000 if age 50+). Employer contributions: up to 20% of net self-employment income for sole proprietors and single-member LLC members — not 25%. The 25% rate applies to W-2 wages in an S-corp or C-corp context. The sole proprietor rate is 20% because net SE income is calculated after deducting 50% of SE tax, making the effective rate on gross net profit closer to 18-19%. Total plan limit: \$70,000 in 2025 (\$77,500 with catch-up). The combined limit applies to the individual across all plans — if you also have a day-job 401(k), employee deferrals across both plans cannot exceed \$23,500 total, though the employer contribution from the self-employment income is separate. Get this calculation wrong and you face an excess contribution penalty of 10% per year until the excess is withdrawn.

The December 31 establishment deadline is the most consequential operational detail for new Solo 401(k) participants — missing it costs an entire year of contribution eligibility. To contribute to a Solo 401(k) for the 2025 tax year, the plan must be established (the plan document must be signed) by December 31, 2025. You do not need to fund the contribution by December 31 — employee deferrals can be made until the tax filing deadline including extensions (October 15 for most sole proprietors), and employer profit-sharing contributions can also wait until the filing deadline. But the plan must legally exist before December 31. Compare this to a SEP-IRA, which can be opened and funded all the way up to the tax filing deadline, including extensions. A business owner who misses the December 31 Solo 401(k) deadline loses the \$23,500 employee deferral option for the year and is essentially limited to SEP-IRA rules until the next plan year begins.

Once plan assets exceed \$250,000 at year-end, Form 5500-EZ must be filed annually with the IRS, and the penalty for missing this filing is severe. Form 5500-EZ is due July 31 following the close of the plan year (July 31, 2026 for the 2025 plan year). The penalty for late or missing 5500-EZ is \$250 per day, with a maximum of \$150,000. There is a delinquent filer program through the IRS and DOL that allows late filers to pay a reduced penalty (currently \$250 per late return, not per day), but you must apply before being discovered. Many Solo 401(k) owners are surprised by this requirement because custodians like Fidelity and Schwab do not send reminders. The solo business owner is entirely responsible for knowing the rule and filing on time. Set a

July 1 calendar reminder once your plan assets are approaching \$250,000 — you want to file well before the July 31 deadline.

2. Step-by-Step System

1

Calculate your maximum 2025 contribution before selecting a custodian or moving any money

Step 1: Start with your estimated 2025 net profit from self-employment (Schedule C line 31 or equivalent). Step 2: Calculate SE tax on that amount: net profit \times 0.9235 \times 0.153. Step 3: Divide SE tax by 2 to get the deductible half. Step 4: Subtract the deductible SE tax from net profit to get net SE income for the employer contribution calculation. Step 5: Multiply net SE income by 0.20 to get maximum employer profit-sharing contribution. Step 6: Add employee deferral (\$23,500 or \$31,000 if 50+). Step 7: Total cannot exceed \$70,000 (\$77,500 with catch-up). Example: \$120,000 net profit. SE tax: $\$120,000 \times 0.9235 \times 0.153 = \$16,956$. Half = \$8,478. Adjusted net SE income: $\$120,000 - \$8,478 = \$111,522$. Employer contribution: $\$111,522 \times 0.20 = \$22,304$. Employee deferral: \$23,500. Total: \$45,804. Write this number down before proceeding. If your income is highly variable, calculate a conservative estimate and true up in Q4 after you have actual numbers.

2

Choose a custodian based on your priorities: Roth option, loan access, fund selection, and fees

Fidelity: no custodial fees, no minimum, excellent investment selection including zero-expense-index funds, supports plan loans, does not support Roth employee contributions. Schwab: no custodial fees, no minimum, good fund selection, does not support plan loans or Roth. Vanguard: no custodial fees, limited to Vanguard funds, no plan loans, basic plan features, best for buy-and-hold indexers using Vanguard products exclusively. E*TRADE (now part of Morgan Stanley): no custodial fees, supports Roth employee contributions and plan loans, good for those who want both features. TD Ameritrade (now merged with Schwab): similar to Schwab. If you want Roth Solo 401(k) contributions (tax-free growth, no RMDs in a Roth 401k under SECURE 2.0), choose E*TRADE. If you want the loan feature for emergency access to plan assets, choose Fidelity or E*TRADE. For pure simplicity with low-cost index fund investing, Fidelity or Schwab are the standard recommendations.

3

Open the plan and sign the adoption agreement before December 31

All major custodians allow Solo 401(k) plan establishment online. The process takes 20-30 minutes. You will need: your business EIN (not your personal SSN), your business name and address exactly as it appears on your tax filings, and a business bank account for funding. You will be asked to adopt a plan document (a prototype plan provided by the custodian), name yourself as plan trustee, and set contribution types (pre-tax, Roth if available, both). The plan establishment date on the signed adoption agreement is the legal date; make sure it is on or before December 31. Keep a copy of the signed plan document in your permanent financial records — you will need it if the IRS asks for documentation of the plan's existence and effective date. The EIN for the plan (different from your business EIN) is assigned by the custodian or can be obtained from the IRS at no cost if you need a separate plan EIN.

4

Make and document your contributions on the correct schedule

Employee deferral contributions must be made by your tax filing deadline including extensions — generally April 15, or October 15 if you file an extension. Best practice: make the employee deferral contribution in December of the tax year to stay organized and avoid confusion, but technically it is permitted until filing deadline. Employer profit-sharing contributions follow the same deadline: due by tax filing deadline including extensions. Record the date, amount, and contribution type (employee pre-tax, employee Roth, or employer profit-sharing) for each contribution. Many custodians label these separately in your account; maintain your own records as well. When you file Schedule C and complete Form 1040, the employer profit-sharing contribution gets deducted on Schedule 1 line 16 (not on Schedule C itself), and the employee deferral reduces W-2 wages if you are an S-corp owner, or is handled differently for sole proprietors — your tax software will guide the placement, but know the distinction exists.

5

Track plan assets relative to the \$250,000 Form 5500-EZ threshold

Check your Solo 401(k) account balance on December 31 of each year. If the balance exceeds \$250,000, you must file Form 5500-EZ for that plan year. The form is relatively straightforward — it reports the plan year, number of participants, total assets, and contributions — and takes about 30 minutes to complete with organized records. File by July 31 following the close of the plan year. If you missed a prior year's filing, apply to the IRS Delinquent Filer Voluntary Compliance Program before you are discovered. The DFVCP penalty is \$250 per submission (not per day) for Solo 401(k) plans. File all missing years in one submission to qualify. After you cross the \$250,000 threshold, the annual 5500-EZ is a permanent obligation until the plan is terminated or falls back below \$250,000 (not typical given ongoing contributions and market growth).

6

Decide annually between Solo 401(k) and SEP-IRA for future years as your income grows

Below approximately \$70,000 of net SE income, a SEP-IRA allows a higher employer-only contribution than the combined Solo 401(k) employer contribution (because at lower income levels the 20% employer contribution does not exceed what a SEP at 25% of net SE income would allow, and a SEP has a simpler setup). Above \$70,000 of net SE income, the Solo 401(k)'s employee deferral provision becomes decisive — the ability to contribute \$23,500 in addition to the employer contribution pushes the Solo 401(k) far ahead of SEP limits at any income level. At \$120,000 net SE income: Solo 401(k) allows \$45,804 as shown above; SEP-IRA allows about \$22,000 (20% × net SE income). The gap is \$23,804 per year. At a 32% combined federal and state marginal rate, that is \$7,617 in annual tax savings available only through the Solo 401(k). Over 10 years of contributions the difference in tax-deferred compound growth is significant.

3. Key Worksheets & Checklists

Complete the contribution calculation worksheet with your actual estimated net profit before making any funding decisions. Overcounting the employer contribution by using 25% instead of 20% is one of the most common Solo 401(k) calculation errors and creates an excess contribution that must be corrected to avoid penalties.

2025 Solo 401(k) Contribution Calculator

Estimated 2025 net profit (Schedule C line 31)	\$___
SE tax (net profit $\times 0.9235 \times 0.153$)	\$___
Deductible SE tax (SE tax $\div 2$)	\$___
Adjusted net SE income (net profit – deductible SE tax)	\$___
Max employer profit-sharing (adjusted net SE income $\times 0.20$)	\$___
Max employee deferral (under 50: \$23,500 / age 50+: \$31,000)	\$___
Total contribution (employer + employee)	\$___
Plan limit check (cannot exceed \$70,000 or	<input type="checkbox"/> Under limit

\$77,500 with catch-up)	
Year-end plan balance (check vs. \$250K 5500-EZ threshold)	\$___
Form 5500-EZ required? (balance > \$250K at Dec 31)	<input type="checkbox"/> Yes <input type="checkbox"/> No

Solo 401(k) Setup and Annual Checklist

- Before December 31: open Solo 401(k) plan with chosen custodian, sign adoption agreement, and record the legal plan establishment date.
- Obtain your business EIN from irs.gov/ein if you do not already have one — required for all Solo 401(k) accounts.
- By December 31: decide 2025 contribution elections — pre-tax employee deferral, Roth employee deferral (if custodian supports it), and employer profit-sharing split.
- By April 15 (or October 15 if extended): fund employee deferral contribution from business bank account.
- By April 15 (or October 15 if extended): fund employer profit-sharing contribution and verify total does not exceed IRS limits.
- Record each contribution with date, amount, and type in your financial records.
- On Form 1040: deduct employer profit-sharing on Schedule 1 line 16 (not Schedule C).
- On December 31 each year: record plan balance; if over \$250,000 set July 31 calendar reminder for Form 5500-EZ filing.
- File Form 5500-EZ by July 31 for any plan year in which December 31 assets exceeded \$250,000.
- If income exceeds \$100,000 net SE profit: schedule a CPA consultation on S-corp election, which can reduce SE tax by \$6,000–\$10,000 annually.

Solo 401(k) vs SEP-IRA Comparison

Feature	Solo 401(k)	SEP-IRA
Max contribution at \$80K net SE income	~\$37,200	~\$15,600
Max contribution at \$120K net SE income	~\$45,804	~\$22,000
Max contribution at \$200K net SE income	~\$63,500	~\$37,000
Roth option	Yes (some custodians)	No
Plan loan	Yes (some custodians)	No
Setup deadline	December 31	Tax filing deadline
Form 5500-EZ required	Yes, if assets >\$250K	No
Employee eligibility rule	No full-time non-owner employees	All employees with 3+ years service

4. Common Mistakes

Using the 25% employer contribution rate instead of the 20% rate for sole proprietors

The 25% rate is correct for W-2 employees, S-corp owners paying themselves a salary, and corporation owners. For sole proprietors and single-member LLC members, the rate is 20% of net SE income — not 25% of gross profit. The difference: on \$100,000 net SE income, 25% = \$25,000 overcalculated, 20% of adjusted net SE income = about \$19,293. The overstated contribution of \$5,707 is an excess contribution subject to 10% excise tax per year until corrected. Tax software handles this correctly if inputs are accurate, but hand calculations and online calculators frequently apply the wrong rate. Always verify the formula, not just the number.

Missing the December 31 plan establishment deadline

Many business owners plan to open a Solo 401(k) in early spring when doing taxes, unaware that the plan must have been in existence before December 31 of the tax year they want contributions credited to. Opening a Solo 401(k) in February 2026 means the first eligible contribution year is 2026 — the entire 2025 employee deferral opportunity is gone. A SEP-IRA opened in February 2026 can still receive 2025 contributions by the tax filing deadline. For this reason, every self-employed person who does not currently have a Solo 401(k) should open the account in November or December, even if the contribution itself is not funded until spring. The cost of establishment is zero.

Not knowing about the Form 5500-EZ obligation until after the penalty accrues

Custodians do not remind you about Form 5500-EZ. The IRS does not send early warnings. The obligation is triggered silently when your December 31 balance exceeds \$250,000. The penalty is \$250 per day of delinquency with a maximum of \$150,000 — among the harshest per-day penalties in the tax code. The IRS DFVCP program reduces this to \$250 per late submission for Solo 401(k) owners who self-report before discovery, but you must apply. Set a December 31 reminder each year to check your plan balance and a July 1 reminder to initiate the 5500-EZ filing before the July 31 deadline.

Choosing a SEP-IRA by default without comparing contribution limits at current income

SEP-IRAs are easier to open (no December 31 deadline, can fund until tax filing deadline) and simpler to administer (no 5500-EZ, no participation rules to track). For these reasons, many financial advisers default to recommending SEP-IRAs for self-employed clients. But at any net SE income above about \$50,000, a Solo 401(k)'s employee deferral provision allows thousands more in annual tax-deferred contributions. At \$120,000 net SE income the gap is nearly \$24,000 per year. The additional annual tax savings at a 32% combined rate is \$7,680 — every year. The Solo 401(k) is more complex to set up once; the SEP-IRA costs you that tax savings every year indefinitely. Choose the tool based on numbers, not administrative convenience.

5. Next Steps

Calculate your 2025 maximum contribution using the worksheet above before year-end. If you have not yet established a Solo 401(k) plan, open one at Fidelity or E*TRADE this week — both are free and allow same-week account opening for established businesses with an EIN. If your income is above \$100,000 net SE profit and you have not evaluated S-corp election, schedule a CPA consultation before December 31 to determine whether the election makes sense for your situation and whether it needs to be filed for the 2026 tax year. The [Side Hustle Tax Organizer](#) guide covers the SE tax deduction, QBI deduction, and quarterly estimate framework that interact with Solo 401(k) contributions in the full tax picture. For a complete retirement readiness analysis that integrates Solo

401(k) balances with your FIRE target number, Social Security benefit, and withdrawal rate, use the [FIRE Calculation Workbook](#).

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