Self-Employed? Take These 3 Steps to Get Your Retirement Savings on Track

BY **MARTHA C. WHITE** APRIL 1, 2020

Kiersten Essenpreis for Money

Working for yourself means your retirement savings plan falls entirely on your shoulders. With the day-to-day operations of running your own business, it can be easy to let investing for the future fall by the wayside.

The ranks of independent workers are growing by the day, as millions of Americans lose their jobs due to the coronavirus outbreak and accompanying economic slowdown. Whether you're a long-time freelancer by choice, or temporarily freelancing to make ends meet, here are three tips you can use to get started on the path to retirement planning. If you don't have the cash flow to begin right away, keep these moves in mind for when your financial situation improves.

Figure out your "salary" and pay yourself first

It's surprising how few self-employed people actually budget for retirement savings, says Marty Reid, president of Reid Financial Consulting in Charlotte, N.C.

"They need to make sure they have a really good understanding of their expenses and cash flow, and they need to include a retirement plan contribution as part of their budget," he says.

"Most people are shocked at how much it really costs them to run their business," says Danielle L. Schultz, principal financial planner at Chicago-area Haven Financial Solutions. "The first thing I tell people is, all the money that you get isn't yours. Look at your tax return to see what it costs you to run a business."

As a rule of thumb, your expenses shouldn't be more than 30% of your total earnings, and another 20% of your gross should be earmarked for taxes, Schultz says. "For every $100 you earn, you only have $50 of spendable money."

It's up to you whether you want to allocate your retirement funds from your "business expenses" or "spending money" bucket, Schultz says — just make sure you stay within that 30% if you're counting it as an expense.

Fund a Roth IRA to keep some contributions accessible

Schultz says a Roth IRA is a good retirement vehicle for self-employed professionals because it offers more flexibility than traditional accounts that can't be tapped without penalty before you reach the minimum distribution age of 59½.

"It can be a backup emergency fund, because you can take out your own contributions," Schultz says. There are a few things to keep in mind with a Roth: she adds. First, you can only withdraw contributions without penalty before age 59½., not any earnings your investment made in the stock market. There are some situations where you can avoid paying a penalty on earnings withdrawals — although you'll still have to pay income tax on them — such as if you're putting the money towards your first house or unreimbursed medical expenses, or you become disabled.

"I really urge people to contribute to the Roth until they've reached the maximum," she says. The annual contribution limit is $6,000 for 2020 for people under the age of 50. (Those 50 and over are allowed an additional $1,000 a year in "catch-up contributions.")

Roth eligibility also depends on your income. Single filers can contribute the full amount up to an adjusted gross income of $124,000; for married couples filing jointly, that threshold is $196,000. Single filers earning up to $139,000 and married couples earning up to $206,000 can contribute a partial amount.

Look into a 401(k) made just for you

"My favorite savings vehicles are self-employed 401(k) plans. They allow for the most potential savings," says Dana Levit, owner of Boston-area Paragon Financial Advisors.

Also referred to as solo or individual 401(k)s and intended for sole proprietors — that is, business owners who don't have any non-spouse employees on their payroll — these plans allow for greater savings. They let you contribute the regular maximum contribution you would be able to for an employer-sponsored 401(k) plan — that's $19,500 for 2020 for workers under 50 — plus a share designated as the employer's share, which is equivalent to 25% of W-2 income or 20% of Schedule C or K-1 income.

It might sound a little complicated, since sole proprietors like independent contractors and freelancers technically wear both "employer" and "employee" hats, but the upshot is it lets you sock away a lot more money than other retirement plans.

"The one rule about a self-employed 401(k) is you have to establish it by December 31," Levit says, so if you're just getting on board the retirement-planning train, you missed your chance to set one up for the 2019 tax year.

If you're in this situation, Levit advises setting up a SEP-IRA, which only has to be set up by the time you file your taxes, even if you take an extension. The one drawback is that the amount you can contribute is lower — roughly 20% of your net income — but you won't have to put off retirement planning for another year. "It's a bit of a last-minute planning tool," Levit says. And what busy entrepreneurial type doesn't appreciate being able to make last-minute plans?

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