Solo 401(k) vs. SEP IRA for S-Corp Owners

Choosing the Right Retirement Plan for Your Business

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Overview

For high-income business owners operating as an S-Corp with no employees (except possibly a spouse), it's important to select the right retirement plan. This fact sheet compares the Solo 401(k) and SEP IRA, highlighting key differences in contribution limits, tax efficiency, and flexibility to help you make the best choice.

What Are These Plans?

1. **Solo 401(k)**
   - A self-employed 401(k) plan designed for business owners with no employees (other than a spouse). It allows both employee salary deferrals and employer contributions, making it a tax-efficient option for maximizing retirement savings while minimizing payroll taxes.
2. **SEP IRA**
   - A Simplified Employee Pension (SEP) IRA that only allows employer contributions, calculated as a percentage of salary. It is easier to administer but may require a higher salary to maximize contributions, increasing payroll taxes.

Both plans offer tax-deferred growth, but the **Solo 401(k) generally provides higher contribution potential at lower taxable salaries.**

Contribution Limits & Tax Savings

- Solo 401(k) allows for both employee salary deferrals and employer profit-sharing contributions.
- SEP IRA only allows employer contributions, limited to 25% of W-2 wages.

Feature	Solo 401(k)	SEP IRA
Employer Contribution	Up to **25% of W-2 wages** (profit-sharing component).	Up to **25% of W-2 wages**.
Employee Salary Deferral	Up to **$23,500** (2025) + $7,500 catch-up if age 50+.	**Not available** (SEP only allows employer contributions).
Total Contribution Limit	**$70,000** (2025) or **$77,500** if age 50+.	**$70,000** (2025) but requires a **higher salary** to maximize.
Self-Employment Tax Savings	Can contribute large amounts while keeping W-2 wages low, **minimizing payroll taxes.**	Higher salary required to maximize contributions, **resulting in higher payroll taxes.**

Key Takeaway: A Solo 401(k) allows for larger contributions with lower payroll taxes, making it more tax-efficient for S-Corp owners.

Which Plan is Best for You?

Choosing between a Solo 401(k) and a SEP IRA depends on your goals, tax strategy, and administrative preferences.

- A **Solo 401(k)** is the better option if you want to **maximize retirement savings while keeping payroll taxes lower**. This plan allows both **employee salary deferrals and employer profit-sharing contributions**, meaning you can contribute more at a lower W-2 salary compared to a SEP. It also offers additional flexibility, such as **Roth contributions and loan options,** which are not available with a SEP IRA.
- A **SEP IRA** is the better option if you prefer **simplicity and minimal administration. There are no annual filing requirements** for the employer, and contributions are fully discretionary, allowing you to skip contributions in a slow year. However, because contributions are limited to **25% of W-2 wages**, you need to take a much higher salary to reach the same contribution levels as a Solo 401(k), which increases payroll tax costs.

Salary Requirements for Maximizing Contributions

The following examples illustrate how different salary levels impact contribution potential. Exact numbers may vary based on IRS limits and individual business circumstances.

Contribution Target	Solo 401(k) (Minimum W-2 Salary Needed)	SEP IRA (Minimum W-2 Salary Needed)
$35,000 Contribution	~$46,000 W-2 salary	~$140,000 W-2 salary
$69,000 Contribution	~$182,000 W-2 salary	~$276,000 W-2 salary

Example: To contribute $35,000, an S-Corp owner can pay themselves a $46,000 salary in a Solo 401(k), whereas a SEP IRA requires a $140,000 salary, significantly increasing payroll tax liability.

Flexibility & Administration

» **Solo 401(k)** provides more options such as **Roth contributions, loans, and salary deferral flexibility.**

» **SEP IRA** is simpler to administer, with no annual IRS filing requirements for the employer.

Feature	Solo 401(k)	SEP IRA
Contribution Flexibility	Employer decides each year how much to contribute.	Employer decides each year, including skipping contributions.
Plan Administration	Requires IRS Form 5500-EZ once assets exceed $250,000.	No filing requirements for the employer.
Setup Deadline	Must be established by year-end (but some businesses may have until tax-filing deadline).	Can be established up until the tax-filing deadline (including extensions).
Investment Options	Broad investment choices, including Roth deferrals.	Traditional IRA investment options.

Key Takeaway: A SEP IRA is easier to administer, but a Solo 401(k) provides greater flexibility, including Roth contributions and lower salary requirements for high contributions.