How To Save For Retirement If You're An Entrepreneur or Self-Employed

Scott A. T.: Yeah. Broadcasting here from One Dallas Tower, it's the Scott Alan Turner Show, ready to help you get out of debt, save more money, and retire early, and become a financial rockstar. In the studio with me is Producer Katie, who is very excited to have the bedroom redecorated. On the show today, I'll be answering your questions about money, business, and life. This is your show, so if you have a question you like answered visit GoAskScott.com.

When Katie wasn't able to find a job because the real estate market tanked and I had left my business partners to go help Katie with her new side business, we found ourselves we no company retirement plan to contribute to. We were the business. There was no 401(k) plan. There was no Company Match. Now, starting a business is a whole new world because I hadn't had to do a profit and loss statement before. Thankfully, Katie and her dad did that part of the business, all that backend admin stuff to run the operations, which I don't particularly like to do. It's not my strength. It's not how I want to spend my time. Katie doesn't like doing it either, but sometimes she gets stuck doing the grunt work, as we call it.

Outside of that, if you start a side business that you end up moving into full time, or perhaps you're a 1099 contractor, your company retirement plan is you. It's you. One of the big mistakes contractors and entrepreneurs make is not funding or planning for their retirement. While you're out thinking about how to start a company, grow a company, sustain the business, retirement planning isn't necessarily on the radar. Just like someone who's entering the workforce for the first time, the earlier you start, the better off you're going to be in retirement, even if it's just a little, even if it's just a little that you set aside.

There are several plans out there to help small business owners save for retirement and accounts and their tax favorable. If you're self-employed, you know someone who is, you're doing side hustles that you hope that someday is going to be your full time gig, it's easy to set money aside just like if you would if you were an employer-sponsored retirement planner, 401(k), 403(b), 457, whatever. I'm going to spell out what the limits are for each of these plans, the benefits, and compare some of the differences between the different options if you're in that self-employed camp.

First question you got to figure out is how many employees do you have? If you have no employees, the primary difference between the 3 that we're going to talk about is how much you can contribute to each. The limits are not cumulative. Even though there's 3 different options, you can't do all 3. It's pick one, and that's one you're going to go with. If you do have employees, your best bet is go sit down with a tax pro, and then they're going to determine how best to stretch your retirement plans, but not only that, how to structure your company as well, what kind of corporation you're going to be. The tax difference is ... They can be pretty significant depending on the situation.

The first one is the Solo 401(k). This is for an individual or a business owner who has no employees other than maybe a spouse. With a Solo on 401(k), you're putting in pre-tax dollars, so it's going to lower your current tax bracket and it'll save you from paying taxes now. It's very similar in a regular employer-sponsored 401(k), whereas the maximum amount you can contribute is $18,000 of your salary per year if you're aged 49 and younger, and there's a catch-up provision of $6,000. You can go up to 24 grand if you're aged 50 and older. On top of that, the employer, which is actually you, but the employer side of that can make up to a 25% profit sharing contribution. That brings you up to a maximum of $53,000 a year that you can put into this plan. Again, with that, if you're over aged 50, there's another 6,000 catch-up contributions, so it's a $59,000 max on that.

That's huge, and that's per person. If you got a spouse who is also in the business that can be 53 times 2 for $106,000 you're putting away. If you're both over age 50, $59,000 a piece, $118,000 total into a 401(k). That's a lot of money. If you're doing that, well, wow, that's a lot of money. The benefits of the Solo 401(k), it's like a 401(k). You can take a loan against it. I'm telling you that's a benefit of it. I'm not saying you should do that, but it's there. 401(k) loans are terrible ideas, but if you're in a dire circumstance, you need to avoid a foreclosure or bankruptcy, you need to know that that's available to you.

Super low fees, super low annual fees. From when Katie and I set up ours, it was $250 a year in annual fees to maintain the plan. In some places, you can go Fidelity and Vanguard, they may have no setup fees as well to get started. There's also a RAF contribution option. Sometimes that depends on where you go with to get that set up, but your employee contribution, that can be made with pre-tax or after tax RAF dollars, again, up to the max of 18,000.

Negatives on Solo on 401(k); only the business owners and the spouse can participate. No employees. If you have employees, nope, they can't participate in it. If you have a day job and you're already in a 401(k) plan, you cannot max out both. If you got a regular job and then you get a side gig, you set up Solo on 401(k), you cannot both. Remember brother, if you do your Solo thing and you're making enough money, you're probably going to have better investment options by selecting your own plan. You may end up with a better 401(k) than that provided by your employer. There's a little more paperwork to set up with this particular plan. Not a lot, just a little bit.

The next one is called a SEP IRA, Simplified Employee Pension IRA. That's a good choice if you're a 1-man or woman show. It's easy to setup and maintain, very flexible in the contributions. These are funded by employer contributions completely. There's no employee contributions. What that means is if you have employees, this type of plan is a profit sharing plan, so you as the employer can contribute up to 25% of an employee's compensation, again, up to a max of $53,000 per employee. It's flat across the board, so if you say, "We're going to give a 3% distribution or a 3% profit sharing for the company," that's everybody including you, everybody including you. There's no variance in it. It's very flexible in how it works.

Benefits of it; if you have an awesome year with lots of profits, you have the option of putting more money in it. If you have a down year, a slow year, it's a slow cycle, you don't earn as much, you can skip putting anything in it. It's at your discretion over whether you want to contribute to it or not. Contributions are tax deductible, and it works with sole proprietors, partnerships, corporations, and S corps as well, also, low admin fees.

Cons; again, the plan is employer-funded for all the employees. If you hire on additional workers, you've got to contribute equal amounts to everyone that is an employee. How is an employee defined? Well, you're at least 21 years old, and you've worked in the place at least 3 to the last 5 years. It's a flat cross the broad profit sharing.

Lastly, we have the SIMPLE IRA. SIMPLE stands for Savings Incentive Match Plan for Employees. This is also a salary deferral plan, and this is funded by part employee, part employer. It's like a traditional IRA. It follows the same investment distribution, same role of rules. As the employer, you match dollar for dollar employee contributions, up to a max of 3% of their contribution. You don't have to go any higher than that. If you don't do any matching, you can go up to 2% of nonelective contributions where the employee doesn't put in anything. That one is an either or, depending on how much money gets put in by whom. This is for

businesses with fewer than employees who earned at least $5,000 a year than the previous year.

Benefits of this SIMPLE IRA, it's just a little bit easier to administer than a fully blown qualified 401(k) plan. That's the big difference, and it's for smaller sized companies. Now, which is best? Well, hands down, it's the SOLO 401(k), if you're just you running the business or you and your spouse. Big reason is that 100% of your pay can be set aside, 100% of your pay unlike the SEP IRA. With the 401(k), it allows you to contribute a lot more, because you're not doing just profit sharing. You're doing employer contributions and employee, even though you're both employer, employee. It's kind of weird how it goes, but you're both, and because you're both, you get to contribute from both sides.

Before you decide on any of these plans, you want to check with a tax advisor, a fee-only certified financial planner. You want to make sure you're getting the maximum benefits from your choice. My CFP was the one who got us going in a Solo 401(k) early on. Allowed us to sock away a lot of money for retirement during those days when we had that plan. That wasn't particularly exciting stuff, but now you now. Learn something new every day.

I think I've probably talked about this before, but I got to bring it up again because, number 1, I can't stand it when you guys lose money and gals. Number 2, the first time I brought it up, this particular product was not endorsed by a famous celebrity and now it is, because I've heard the commercials. I'm talking about the razor blade of the month club. I cannot name it by name for legal reasons, but now there's a famous celebrity saying, "Yeah, now you can get your razors. I'm using it all the time, and it's a good deal." It's not. It's not a good deal.

I can mathematically prove it that it's not a good deal because I'm looking at the website right now, what they're charging for razor blades to ship them to you each month, and then I can go on Costco and Amazon and find that Gillette MACH3, which is what I use. Those blades are in fact cheaper. If they are in fact cheaper, the Gillette MACH3, then the other product cannot also be cheaper too. It can't. One has to be the better deal. I'm looking at 2 websites right now. I can see which one is the better deal. That's a fact. That's a mathematical fact.

The opinion comes in, is which one provides better shave. Well, Katie bought me the razor blade of the month club, last year, the year before. I don't know what it was. I started out with the base package, which is the cheapest package, which was just abysmal, abysmal. I could not even get a clean shave with that, so I had to upgrade to the middle tier package, which is more expensive, of course. I tried that, didn't like the shave compared to the Gillette MACH3. I wasn't going to go to the even more expensive one, A, because it's more expensive. They give you a new razor every week, and I don't need to change razors every week. I shave every day, and I don't need to switch out my razor blade once a week. I can make one last 3 weeks before I swap it out. For me to pay for a razor every single week is also mathematically not a good deal.

Okay, I'm probably getting a little angry, but I'm angry for you. I'm angry for you. I dislike it when celebrities, people, athletes, whoever, whatever, retired movie stars who need to make some extra money in there on the late night infomercials. People are selling stuff when it's not good for you. I don't like it. I don't like it. If you're looking at the razor of the month club, if you're buying the razor of the month club, if you're thinking of giving the razor of the month club a try or as a gift, mathematically, it is not as good of a deal as buying individual razors from Amazon or even Costco. It's not. Whether it's a better shave, that is a matter of personal opinion.

Back to your questions, Donald in Wichita Falls, Texas wonders if he is saving too much. That's a good problem to have. He says,

Donald: "My wife and I currently have IRAs totaling about $375,000, an investment portfolio right around $210,000. We have 3 529 plans with a combined amounts of 84,000 and growing, emergency fund, a vacation fund. We have no debt, and our house is paid off. I'm investing in the company 401(k) to get the match. All totaled, we are investing about $1450 a month. We don't eat out much. We don't spend any money on ourselves. No new clothes, fancy electronics, and live a very happy but modest lifestyle. Should we continue with the save, save, save lifestyle, or do you think we're doing okay and can live a little? We definitely continue or going to continue to max out our Roth IRAs. A little about us, we are in our early 40s. We have a 20 year term policy in place. My policy is for 750,000. My wife's policy is for half a Mil. She stays at home with our 3 little ones. Have we saved enough and should we continue saving at the same rate?"

Scott A. T.: There was a study awhile back by The Pew Charitable Trusts. They found that Generation X, which you guys are members off, haven't saved enough and fill face a declining standard of living in retirement. Don't get worried though. Gen X are people born between 1966 and 1975. If you're in that age group, which you guys are, how do you know if you have saved enough? Well, Fidelity Investments, they've got some quick rules of thumb, so let's just go over those. By 35, you should have saved 1 times your gross annual salary. By age 40, 2 times your gross salary. By age 45, 3 times, 50, 4 times, by 55, 5 times, and by age 60, 6 times your gross annual salary. By age 67, 8 times your gross annual salary.

You're a 46 Joe. You have $500,000 in investments. If your salary is $166,000 or less, you could say you're doing well. Now, that is back of the envelope math though. I would never risk the last 30 years of my life on something that simple. Let's say you have your immediate goals funded. We're going to ignore those. You got your emergency fund, vacation fund, your mortgage is done, 529s with 85 grand in them. That's going to grow in another 13 to 15 years, which as you mentioned, you continue to add to. You're saving roughly 17 grand each ear between your 401(k), your non-qualified investment accounts, and you've got $500,000 saved up so far.

Let's assume for a second you're going to retire when the last kid is out of college. That's going to be about 18 years. That puts you at around age 62. Maybe you like what you do and you want to work that long, so that appeals to you. I've got this new handy investment calculator now on my website. Link will be in the show notes. The more I plug in some numbers, $500,000 to start. You're putting 1450 a month for 18 more years. We're going to do 8% interest. Why are we doing 8%? Because as you're approaching the retirement age, you're going to ease off on the stocks. You're going to get into more bonds. That's not going to give you 10% return. You're going to be a little bit more conservative. I plug in those numbers. You end up with 2.8 million dollars at age 62. Well, 2.8 million. That sounds pretty darn good doesn't it?

Again, like those Fidelity rule of thumb numbers, it is meaningless. You could save 5 million, 1 million, 10 million. It doesn't really tell us anything, especially if you're running out and buying $800,000 yacht. Let's use a different calculator, a one that's a little more in depth. I found this one online. Again, the link will be on the show notes. It's called, FourPercentRule.com, Four, spelled out, F-O-U-RPercentRule.com. The 4% Rule is a general benchmark people have used in the past that allows you to figure out if you're going to run out of money in retirement. It's the safe withdrawal rate. You can withdraw 4% a rate based on what you put away for your retirement and you won't run out of money. Again, that's a back of the envelope math. I wouldn't rely on it.

This calculator online, it's a little more in depth. It's got a lot more variables that you can mess around with and see how you're doing. That's a better place to start. You can plug that in for your particular situation and mess around with those numbers, and then it gives you a probability of you running out of money, which is nice. Now, let's say you're a little baffled by that calculator. Again, there's a lot of variables in it, and you want to know with 80% certainty that you won't run out of money or 53% certainty that you will. You can get that granular by working with an expert. They'll run some calculations. They're called Monte Carlo simulations. It's one of those higher math terms.

A new resource I have no mentioned on the show before, I want you to check out. It's called the XY Planning Network. That is a website which will connect you with fee-only certified financial planners. They have no commissions, no sales. There's no minimums. They're all certified financial professionals, which is cream of the crop. They are sworn fiduciaries, which means they are legally bound to do what is in your best interest, and they're virtual as well. You can find one locally if you want to, but a lot of them work online. They're not out to sell you junk that you don't need and make a fat commission on it. They have people that work by flat fees, hourly rates, quarterly rates. You can work on retainer. You can just find somebody that works for you for your particular situation.

They don't pay me to refer people to them. I do it because I think it's a good service. My friend Katie Brewer is in the network. She lives here in Dallas. Katie is a riot if you want to work with her. Pick someone you feel comfortable working with. Katie, she doesn't pay me either, but if she wants to buy me a diet coke for the referrals, I will not turn it down. At the end of the days, it's going to figure out what you want. Do you want to retire at 50? Do you want to retire at 62, 65? Do you want to travel the world? Then you're going to need a travel the world fund.

You sound like you got it together, but what happens is people who live a certain lifestyle, they continue that type of lifestyle in retirement. Since you're living low key, kind of frugally, that will probably continue through your retirement, which gives you a better chance of not running out of money. It doesn't mean you can't step it up a notch right now. It becomes easier to gauge how long the money will lasts when you work with one of these experts. If you're living frugal now, that's going to continue, but man, you got a paid off mortgage, 529s, half a Mil in the bank. Those are great numbers as long as your salary isn't something like $250,000 and your yearly budget is $150,000. That would be a different situation.

That's not your case because you're living frugally. Go out to Five Guys Burgers and Fries this weekend. You can probably go out to Five Guys Burgers and Fries every weekend until you retire after you check those calculators and meet with somebody. I think you'll find that you can loosen the purse strings and you guys will be just fine. Thanks so much for the question, and keep up the great saving.

Back in 43.2568 seconds. You're listening to Scott Alan Turner.

Hey nation, Scott Alan Turner here. For those of you that are my long time listeners, you know I'm not one of those guys in the radio who promotes every product that shows up on their desk. You're never going to hear me trying to get you to buy an expensive name brand memory foam mattress, because Novaform from Costco is best, or recommending to buy New York style pizza when Chicago style is clearly the best, Lou Malnati's.

No, I have a name uphold to you, my rock star listeners, but if I were, if I were to recommend something to you, I would tell you about the Dancing Pony Steakhouse. I can't get enough of that flowering onion appetizer,

and what about that honey wheat bread? So delicious. Forget paleo, and that chocolate volcano for dessert is to die for. The steaks are okay too. The next time you're hungry and looking for a place to celebrate, visit the Dancing Pony. It's not only a great place to eat, each location has a tiny inn above if you get stuffed and you want to spend the night, give them a ring, tell them Scott Alan Turner sent you.

Sue is concerned about hackers breaking into her bank account. Sue is over on the YouTube channel commenting on one of my investment videos. She says,

Sue: "I noticed that you put your log-in and password for your bank into the software, the investment software. Won't this void any protection you get from your bank if this information falls into the wrong hands and money is stolen? I think that is stated in the contract you signed when opening up an account at the investment brokerage."

Scott A. T.: Katie, if you recall, or maybe you don't, that her credit card is stolen 3 times in the past 6 months, and one of those times, the thieves charged $8,000-plus to American Airlines for some airline tickets. All she had to do is call the credit card company and say, "That's a fraud, fraud charge. Take it off," and they took it off. She also had to call American Airlines so that they took that charge off as well and voided those airline tickets. Easy peasy if you got a credit card and there's a fraudulent charge on it. You don't actually lose any of the money. Nothing comes out of your account, the way that works. You get a debit card and someone had stolen that, that $8,000 would've been taken out of our bank account at the time, and then we would've had to argue to get that money it. It would've taken a couple of days if we hadn't noticed that quickly.

What about if you're using an auto-draft or an auto-pay service? What if you go your auto insurance pulling from your bank account to pay your bill every month, or you're using an investment brokerage to do the auto-withdrawals each month to automate your savings and pull that money out or any of those other types of services that connect to your bank account? Are you protected? Well, you're probably correct Sue that in the terms of service, in the mice type, they void the protection provided by the bank. However, and that's going to vary place to place. I don't go through and read the terms of service for everybody that I sign up for these place, but I bet you're right that it's in there, but hoops a hacker would need to go through to make this happen make the possibility pretty small, pretty small.

Not like the hackers who broke into Target and Home Depot and got all the credit card numbers. First, they have to hack into the brokerage account. We used that as an example, or the auto insurance company, whosoever collecting their bills. First they have to hack into that server and get that information. They've got to figure out how to decrypt the data, figure out the bank account, your log-in, your password. They've got to decrypt all that stuff because that's encrypted on the servers. Then they need to go to the individual bank accounts and drain those accounts.

I would speculate, having an IT background, that there are some security measures in there, there is a ton of security measures beyond the scope of my knowledge, but just guessing as to ... Because I've worked on some of these stuff in the past, there is probably something in there going on behind the scenes that say, "Okay, you are an investment brokerage. You can talk to the bank servers over the network," but that's it. The bank is only going to allow the investment service to talk to the service and get the data, pull out the money that way.

For me to be a hacker sitting here at my house and try to break into the bank, it's going to say, "No, who are

you? I don't recognize who you are." It's not say that a hacker can spoof that information. Spoofing is the technical term for it where they fool the servers into thinking that somebody else ... All right, we're going off in a tangent here. I'm not saying it's not impossible. I'm saying, I don't worry about it. I know there's a lot of security going on behind the scenes. Those guys, they're on the hook. Their business is toast if anything happens.

If you are concerned, hey, let's give you a work around. What could you do? Set up a separate bank account. Not at the place that currently bank, so completely separate and different name, different account, it can be an online bank, if you want to use that. Then you automate. Connect that bank account to your primary bank account. Have that automate the transfer once a month. Say you're putting out 100 bucks a month into an investment account. You have this intermediary bank account that's setup to auto-withdraw from your primary account, and then the investment brokerage to hook that up to this secondary account. You get a little middle man there who's doing the transaction for you. The only amount of money that is ever in that middle man account is at most the $100 in that case. That's your risk if your brokerage account gets hacked and somebody tries breaking into your middle man bank account in that example.

Now, what happens if somebody breaks into the middle man bank account and steals all that information? Well, the bank is FDIC insured up to $250,000 per individual, $500,000 per couple. I think you're going to be good in that case. If the bank gets hacked and people start stealing money out of the bank, really, the world has bigger problems at that point. Thanks Sue for the question.

"You always have 2 choices, your commitment versus your fear," A famous quote from Sammy Davis Jr. Those are the words. That's it for this episode. I am your host, Scott Alan Turner. Rock star Katie is my producer. All the links mentioned in the show are available in the show notes at ScottAlanTurner.com. If you have a question you like answered by me, visit GoAskScott.com to get it answered on the show. Thank you so much for listening.

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