News You Can Use

SHORE TOMPKINS ACTUARIAL RESOURCES, LLC

AUGUST 2025 ISSUE

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I Was Going Solo 401(k), But Then I Needed Help

You may have offered advice to clients on how to establish a solo 401(k) to limit their tax liability while saving for retirement. That plan option may work beautifully for a time, but what happens when the client must hire an additional employee who is not their spouse or a co-owner of the business?

It might be possible to exclude the employee and stay a Solo 401(k):

1. Is the employee under 21, a union employee, or a non-resident alien? If so, the solo 401(k) can exclude the employee.

2. Will the employee complete fewer than 1,000 hours of service in a 12-month period? If so, the solo 401(k) can exclude the employee from employer contributions, but not necessarily from the 401(k) deferrals if certain service minimums are met.

3. If the employee will be a part-time employee, will the employee complete 500 hours of service annually for two consecutive years? If so, the solo 401(k) cannot exclude the employee based on service.

Even if the plan imposes a service requirement, any employee who completes 1,000 hours of service in a 12-month period must be allowed to participate, unless the employee is excluded on some ground other than length of service. Similarly, a part-time employee who meets the long-term part-time employee (LTPTE) standards — that is, 500 hours of service within two consecutive 12-month periods also must be allowed to participate, unless the employee is excluded on some ground other than length of service.

What if the employee can't be excluded? If the employee must become a participant, the plan will no longer be able to operate as a solo 401(k) once the employee begins participating. Your client will either need to convert/restate the solo 401(k) to a regular 401(k) plan or terminate the plan prior to the employee entering the plan as a participant.

For a conversion, your client might need to select a new plan provider if the existing provider does not support regular 401(k) plans.

What Changes When Moving from a Solo 401(k) to a regular 401(k)? If your client converts its solo 401(k) to a regular 401(k), the client will need to become familiar with the additional reporting, testing, and other administrative requirements that apply to regular 401(k) plans. This might include required annual Form 5500 filings, which some solo 401(k) plans will not have done previously. Since the addition of an employee can impact a solo 401(k) in many ways, it's smart to work with your TPA partner to advise your client on the new guidelines and provisions that may impact their plan.

by Jesse St. Cyr, Partner, Poyner Spruill