



Self-Employed Individuals – Calculating Your Own Retirement-Plan Contribution and Deduction

If you are self-employed (a sole proprietor or a working partner in a partnership or limited liability company), you must use a special rule to calculate retirement plan contributions for yourself.

Retirement plan contributions are often calculated based on participant compensation. For example, you might decide to contribute 10% of each participant's compensation to your SEP plan. This formula works to determine employees' allocations, but your own contributions are more complicated. You can't simply multiply your net profit on Schedule C by 10%.

You calculate self-employment (SE) tax using the amount of your net earnings from self-employment and following the instructions on Schedule SE, Self-Employment Tax. However, you must make adjustments to your net earnings from self-employment to arrive at the amount of "plan compensation" to use to determine the plan contribution/deduction for yourself.

Plan compensation for a self-employed individual

To calculate your plan compensation, you reduce your net earnings from self-employment by:

- the deductible portion of your SE tax from your Form 1040 return, Schedule 1, on the line for deductible part of self-employment tax, and
- the amount of your own (not your employees') retirement plan contribution from your Form 1040 return, Schedule 1, on the line for self-employed SEP, SIMPLE, and qualified plans.

You use your plan compensation to calculate the amount of your own contribution/deduction. **Note** that your plan compensation and the amount of your own plan contribution/deduction depend on each other - to compute one, you need the other (this is a circular calculation). One way to do this is to use a reduced plan contribution rate. You can use the Table and Worksheets for the Self-Employed (Publication 560) to find the reduced plan contribution rate to calculate the plan contribution and deduction for yourself.

Deducting retirement plan contributions

Total limits on plan contributions depend in part on your plan type. See the contribution limits for your plan.

A limit applies to the amount of annual compensation you can take into account for determining retirement plan contributions. This limit is \$305,000 in 2022, \$290,000 in 2021, \$285,000 in 2020 and \$280,000 in 2019 and is adjusted annually.

Plan contributions for a self-employed individual are deducted on Form 1040, Schedule 1 (on the line for self-employed SEP, SIMPLE, and qualified plans) and not on the Schedule C. If you made the deduction on Schedule C, or made and deducted more than your allowed plan contribution for yourself, you must amend your Form 1040 tax return and Schedule C.

You should amend your Form 1040 tax return and Schedule C if you:

- deducted your own plan contribution on Schedule C instead of on Form 1040, Schedule 1, or
- made and deducted more than the allowable plan contribution for yourself.

If you contributed more for yourself than your plan terms allowed, you should also correct this plan qualification failure by using the IRS correction programs.

Example

Joe, a Schedule C sole proprietor, will have \$100,000 net profit on his 2019 Schedule C (after deducting all Schedule C expenses, including a 10% retirement plan contribution made for his common-law employees but not his own contribution). Joe must pay \$14,130 in SE taxes. To compute his plan compensation, Joe must subtract from his net profit of \$100,000:

- the IRC Section 164(f) deduction, which in this case is ½ of his SE tax ($\$14,130 \times \frac{1}{2}$); and
- the amount of contribution for himself to the plan.

To determine the amount of his plan contribution, Joe must use the reduced plan contribution rate (considering the plan contribution rate of 10%) of 9.0909% from the rate table in Pub. 560. Alternatively, Joe can compute his reduced plan contribution rate by:

1	Taking the plan contribution rate	10%
2	Dividing the plan contribution rate by 100% + plan contribution rate	10%/110%
3	To get the reduced plan contribution rate	9.0909%

Joe can now compute his own contribution/deduction amount as follows:

1		\$100,000	Schedule C net profit
2	-	\$7,065	½ SE tax deduction ($\$14,130 \times \frac{1}{2}$)

3	=	\$92,935	Net profit reduced by ½ SE tax
4	x	9.0909%	Joe's reduced plan contribution rate
5	=	\$8,449	Joe's allowed contribution and deduction

There is simple way to quickly verify the accuracy of Joe's contribution/deduction amount:

1		\$100,000	Joe's Schedule C net profit
2	-	\$7,065	½ SE tax deduction
3	-	\$8,449	Joe's contribution/deduction for himself
4	=	\$84,486	Amount subject to plan's full rate
5	x	10%	Plan's full rate
6	=	\$8,449	Joe's contribution/deduction for himself

If lines 3 and 6 above match, the contribution/deduction calculation is correct.

Additional resources

- Retirement Topics - Contributions
- Retirement Plans for Small Entities and Self-employed
- What is a partner's "compensation" for retirement plan purposes?
- Internal Revenue Code Sections 401(c)(2) and 164(f))