

 Fact Sheet

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Avoiding Incorrect Self-Employed Retirement Deductions

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Retirement plans are not just for big businesses. They are also available for sole proprietorships. If you are self-employed small business owner, you can set up a qualified retirement plan for yourself and your employees.

If you are a sole proprietor, you can deduct contributions you make to the plan for yourself. You can also deduct trustee fees if contributions to the plan do not cover them.

The Internal Revenue Code provides significant tax incentives for employers that establish and maintain retirement plans that comply with the requirements of the Code. Such plans include Simplified Employee Pension (SEP) plans and Savings Incentive Match Plan for Employees Individual Retirement Account (SIMPLE IRA) plans.

Generally under these plans, contributions that are set aside for retirement may be currently deductible by the employer, but are not taxable to the employee until distributed from the plan.

You must set up and fund a qualified retirement plan such as a SEP or SIMPLE-IRA. No matter what type of plan for the self-employed you are considering, you must actually make contributions to a qualified and properly maintained retirement plan account. This fact sheet provides a quick look at preventing incorrect deductions for retirement plans.

Qualifications to claim deductions

If you are self-employed, you may qualify for a tax deduction for contributions you make to a qualified retirement plan. You must have self-employment income to qualify. Self-employment income consists of net profits from Schedule C or Schedule F.

The deduction is the total plan contributions you can subtract from gross income on your federal income tax return. Limits apply to the amount deductible. You can avoid examinations and additional assessments by making sure you qualify for the deduction. The self-employed retirement plan deduction may not be allowable if:

- Form 1040, Schedule SE, Section A (if applicable), Line 4, is less than the amount on Form 1040, Line 28.
- Form 1040, Schedule SE, Section B (if applicable), Line 6, is less than the amount on Form 1040, Line 28.

- Form W-2 indicates an individual is a Statutory Employee and the amount in Box 1 is less than Form 1040, Line 28.

Deduction limits for the self employed

If you contribute to your own SEP-IRA, you must make a special computation to figure your maximum deduction for these contributions. When figuring the deduction for contributions made to your own SEP-IRA, compensation is your net earnings from self-employment which takes into account both of the following deductions:

- Deduction for one-half of your self-employment tax.
- Deduction for contributions to your own SEP-IRA.

Use the rate table or worksheets in chapter 5 of IRS [Publication 560](#), "Retirement Plans for Small Business" for figuring your allowable contribution rate and tax deduction for your SEP-IRA plan contributions.

Deducting contributions

When to deduct contributions for a year depends on the tax year on which the SEP is maintained. If the SEP is maintained on a calendar year basis, you deduct the yearly contributions on your tax return for the year within which the calendar year ends.

If you file your tax return and maintain the SEP using a fiscal year or short tax year, you deduct contributions made for a year on your tax return for that year.

For example, you are a fiscal year taxpayer whose tax year ends June 30. You maintain a SEP on a calendar year basis. You deduct SEP contributions made for calendar year 2008 on your tax return for your tax year ending June 30, 2009.

The allowable deduction for yourself is reported on your Form 1040 Line 28.

More information

There are many other factors to consider when choosing a retirement plan that is right for you and for your business. A retirement plan has many benefits, including investing in the future now for financial security when you retire. As a bonus, you may qualify for significant tax advantages and other incentives.

[Publication 560](#), Retirement Plans for Small Business, is a valuable resource for computing self-employment income and determining limitations on SEP and other retirement contributions and deductions.