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Ken Berry • Aug. 08, 2022

There's one type of tax-qualified retirement plan designed especially for self-employed individuals. The Keogh plan—named for the Congressman who spearheaded the legislation approving the plan—isn't the hot commodity it was back in the day. But this is still a viable option for sole proprietors to consider.

Compare the benefits of a Keogh plan to other alternatives like SIMPLEs, SEPs and solo 401(k) plans.

Background: You can adopt either a defined contribution Keogh plan or a defined benefit Keogh plan. As you might expect, the rules for these variations generally mirror those of traditional defined contribution and defined benefit plans, including

limit for 2022 is $245,000.

However, watch out for a couple of tax twists. When you compute "earned income" for this purpose, your earnings from self-employment must be reduced by your contributions and one-half of the self- employment tax paid. In addition, the maximum amount of compensation taken into account can't exceed an indexed annual amount. It's $305,000 in 2022.

That's the hard part. Otherwise, most of the other rules for qualified retirement plans are extended to Keogh plans. For example, early withdrawals made prior to age 59½ are hit with a 10% tax penalty on top of regular income tax, unless one of several special exceptions applies. Similarly, you must begin taking required minimum distributions (RMDs) in the year after the year in which you attain age 72 (recently increased from age 70½).

Suppose you have other employees on your staff. In that case, you're required to cover them under the Keogh plan in the same percentage proportion as you do for yourself. Accordingly, the actual dollars allocated to yourself can exceed the amounts contributed for other staff members. This may appeal to you as opposed to some other qualified plans like a SIMPLE or a SEP.

Also, if a Keogh plan is found to be "top-heavy," certain minimum contributions must be made for employees. A plan is considered top-heavy if more than 60% of contributions or benefits go to key employees. These rules are complex, so consult your professional tax advisors for more details.

Last point: The deadline for contributions to a Keogh plan for 2022 is your tax return due date, plus extensions, as long as the plan is set up before January 1, 2023. This provides a unique year planning opportunity for self-employed individuals. Do your due diligence if a Keogh makes sense for you.