Multiple 401(k) Rules

I first wrote about this subject over two years ago in a post entitled Beating the $51K Limit (for which I am still eternally grateful to Mike Piper for the pearl that grew into that post.) Well, the $51K limit has since grown into the $55K limit thanks to inflation, but all the same principles still apply. I get tons of questions on this subject in online forums, in the comments sections of the posts on this site and by email. I’m mostly writing this post so I can copy and paste its URL instead of typing the same old stuff over and over again. (Come to think of it, that was the motivation for starting this site in the first place.)

Here’s the deal. Many physicians work for multiple employers or work as an employee and either an independent contractor or a consultant. Many others have a side job of another type. Their incomes are far higher than they require for their current spending needs, but they’re behind on their savings or otherwise have a desire to maximize the amount of money they can put into retirement accounts, especially tax-deferred retirement accounts. Obviously, these types of accounts minimize tax, maximize returns, increase asset protection, and facilitate estate planning. Who wouldn’t want to get more money into them? However, most of these doctors are surprised to learn that you can have more than one 401(k). That’s right,
YOU CAN HAVE MORE THAN ONE 401(K)!

Okay, now that I’ve got that out of my system, let’s make a list of the 7 governing rules for using more than one 401(k):

Rule # 1 One Employee Contribution Total

The IRS only allows you to make a total of $18,500 ($24,500 if 50 or over) worth of “employee contributions” to all of your 401(k)s (or 403(b)s) no matter how many unrelated employers you have. If you have access to two 401(k)s, you can split this up, but the total must be $18.5K ($24.5K if over 50) or less.

Rule # 2 $55K Per Unrelated Employer

The IRS also only allows you and your employer (which might also be you) to put a total of $55,000 per year into a 401(k). This includes the employee contribution, any match from the employer, and any employer contributions. This is the same limit for a SEP-IRA (which is technically all employer contributions.) However, unlike rule # 1, this limit applies to each unrelated employer separately.

Unrelated employers means that the businesses doing the employing are not a “controlled group.” There are two types of controlled groups. The first is a “parent-subsidiary” group. This is when a parent business (corporation, sole proprietor, LLC, partnership etc) owns 80%+ of another business. The second type is a “brother-sister” group. This is where 5 or fewer individuals, estates, or trusts own a controlling interest (again, 80%+) of two different businesses.

So if the two businesses you are involved in aren’t a controlled group, and they each have a 401(k), (or a 401(k) and a SEP-IRA) you get two $55K limits. Pretty cool huh? There are several common examples where this could apply to a physician:
Example One

A 40-year-old single physician is an employee of two completely unrelated hospitals. The first pays him $200K per year and matches 100% his first $5K put into the 401(k). It also offers him a 457. The second pays him $100K per year and matches 50% of the first $7K he puts into his 401(k). What retirement accounts should this physician use in order to maximize his contributions?

- Hospital 1 401(k): At least $5K (plus the $5K match) = $10K
- Hospital 1 457: $18K
- Hospital 2 401(k): At least $7K (plus the $3,500 match) = $10,500
- Plus another $6K into either hospital’s 401(k) (pick the one with the better investments)
- Plus $5,500 into a backdoor Roth IRA
- Total: $50,000

Example Two

A 40-year-old married physician whose spouse doesn’t work is a partner in a 100 doctor partnership which offers a 401(k)/Profit-sharing plan in which he can “self-match” up to the $55K limit. The partnership also offers a defined benefit/cash balance plan with a $30K limit. He makes $300K practicing medicine. He is also the sole owner of a website on the side that makes $300K per year and has its own individual 401(k). Both 401(k)s offer a Roth option. What is the maximum amount he can put into Roth accounts in any given year without doing a conversion of tax-deferred dollars?

- Partnership 401(k)/PSP: $55K, of which $18.5K can be Roth
- Partnership DB/CBP: $30K, of which $0K can be Roth
- Website Individual 401(k): $55K, of which $18.5K could be Roth if none of the Partnership 401(k) money represents an “employee contribution.” Otherwise, $0K
Roth.
- Personal Backdoor Roth IRA: $5,500
- Spousal Backdoor Roth IRA: $5,500
- HSA: $6,650
- Total: $157,650 of which $29K can be Roth

Example Three

This 52-year-old married physician (spouse doesn’t work) is an employee of a hospital where she is paid $200K. She has a 401(k) with a set $20K employer contribution (not a match) and the hospital pays most of the premiums on a non-high-deductible health plan. She moonlights across town as an independent contractor and is paid on a 1099, where she earns $100K and has opened up an individual 401(k). The hospital 401(k) has terrible investments and high fees. How should she allocate her retirement savings in order to best use these options?

- Hospital 401(k): $20K employer contribution
- Individual 401(k): $24.5K employee contribution + 20% * $100K = $20K employer contribution = $44.5K (technically slightly less due to Rule # 5 below)
- Personal Backdoor Roth IRA: $6,500
- Spousal Backdoor Roth IRA: $6,500
- Total: $57.5K
Example Four

A 40-year-old single physician is in a business partnership with one other physician and they have several employees. Due to hassles and the costs of their employees, they have opted to use a SIMPLE 401(k) for their practice. He makes $200K. He also does some consulting work on his own as a sole proprietorship where he is paid on a 1099, about $50K per year. He and his physician business partner recently opened up another business where they sell a medical device. They are the only owners of both the practice and of the corporation that sells the device (which has no employees.) He makes another $50K from this company of which $25K is salary and $25K is a “distribution” from the S Corp. What kind of retirement set-up should this physician do?

- Practice SIMPLE IRA: $12,500 employee contribution plus $6K (3% of salary) employer contribution: $18,500
- Unfortunately, these three entities are part of a “controlled group”, so he cannot have a separate retirement plan for either of the other two entities that ignore the employees in the practice.
- Total: $18,500

Rule # 3 Employer Contributions Are 20% of “Net Earnings From Self-Employment”

When calculating the employer contribution for a SEP-IRA or an Individual 401(k), you use your “net earnings from self-employment” This includes any amount used for an employee contribution, but excludes the amount used for S Corp distributions (those aren’t “earned income” and so can’t be used for retirement account contributions) and used for the employer half of the payroll taxes (same as the self-employment tax deduction.) The employer contribution in an individual 401(k) and a SEP-IRA is exactly the same, but since you can also make an employee contribution into an individual
401(k) (and 401(k) money isn’t included in the backdoor Roth pro-rata calculation,) a 401(k) is generally the better option for the self-employed, even if it is slightly more complicated to open (and must be opened in the calendar year rather than before tax day of the next year.)

**Rule # 4  You Only Get One SEP, SIMPLE, or 401(k) Per Unrelated Employer Per Year**

Each unrelated employer should only have one of these three types of accounts for each tax year. However, you could open a SEP-IRA for your self-employment income in March 2015 for tax year 2014, and then open an individual 401(k) in June 2015 for tax year 2015 if you like. Remember that just because you are the sole owner of two separate businesses doesn’t mean you get two different retirement accounts. Those businesses are a controlled group.

**Rule # 5  These Rules Have Nothing to do With 457s, IRAs, HSAs, or DBPs**

457(b)s, Backdoor Roth IRAs, HSAs, and defined benefit/cash balance plans all have their own separate limits that have nothing to do with the limits for 401(k)s, 403(b)s, SEP-IRAs, and SIMPLE IRAs. Putting more into a Roth IRA doesn’t mean you can’t still max out your 401(k).

**Rule # 6 Catch-up Contributions Also Allow You to Beat the $55K Limit**

Many accounts have catch up contributions if you’re old enough (usually 50 or older, but 55 or older for HSAs.) Roth IRAs have a $1000 catch-up, HSAs, have a $1,000 catch-up, and 401(k)/403(b)s have a $6,000 catch up. That $6,000 catch-up is in addition to the $55K limit, so if you’re over 50, you’re self-employed with lots of income, and you make your full
$24,000 employee contribution to your individual 401(k), the $55K limit becomes a $61K limit.

[Update 2/25/15: If you follow the discussion in the comments section below, you’ll see there is one more rule that readers need to be aware of, which I have turned into Rule # 7.]

Rule # 7 403(b)s Are Not 401(k)s

Many physicians have access to a 403(b) by working for a hospital or public entity. There is a unique rule for 403(b)s, however, which will prevent many doctors who use a 403(b) at their main job from maxing out an individual 401(k) on the side, at least if they own 50% or more of the company for which they have an individual 401(k) (and they probably do.) It doesn’t make much sense, but neither do many tax and retirement plan rules out there. Basically, your 403(b) at work, unlike a 401(k), is considered to be controlled by you. So you are stuck with the same 415c limit of $55K (see Chapter 3.) So if you put $18.5K into your 403(b) at work, you are only allowed to put $55K-$18.5K=$36.5K into an individual 401(k).

My Accountant Doesn’t Believe You

Obviously, having access to multiple 401(k)s is an unusual situation among Americans in general, even if it is quite common among doctors. As such, an unbelievable number of accountants (and especially their clients) have a misunderstanding of the rules noted above, particularly the one about having a separate $53K limit for each unrelated employer. However, taking a look at this article on IRS.Gov written in layman’s language, you can see this is true:

**Overall limit on contributions**
Total annual contributions (annual additions) to all of your accounts in plans maintained by one employer (and any related employer) are limited. The limit applies to the total of:

- elective deferrals
- employer matching contributions
- employer nonelective contributions
- allocations of forfeitures

The annual additions paid to a participant’s account cannot exceed the lesser of

1. 100% of the participant’s compensation, or
2. $52,000 ($57,500 including catch-up contributions) for 2014 ($53,000, or $59,000 including catch-up contributions for 2015).

There are separate, smaller limits for SIMPLE 401(k) plans.

If that’s not enough for your accountant, you can simply go straight to the actual code sections in question, in this case, 415(c) (where the $55K limit comes from, originally $40K.) Be sure to scroll through subsections (f) through (h) where the relevant examples are used:

(f) **Combining of plans**

(1) **In general**

For purposes of applying the limitations of subsections (b) and (c)—
(A) all defined benefit plans (whether or not terminated) of an employer are to be treated as one defined benefit plan, and
(B) all defined contribution plans (whether or not terminated) of an employer are to be treated as one defined contribution plan.

Note how it says all defined contribution plans OF AN EMPLOYER are to be treated as one plan. Section (g) reads similarly:

(g) Aggregation of plans

... the Secretary, in applying the provisions of this section to benefits or contributions under more than one plan maintained by the same employer, ...with respect to which the participant has the control required under section 414 (b) or (c)...shall...disqualify one or more...plans...until such benefits or contributions do not exceed the limitations contained in this section.

Again note the key words- BY THE SAME EMPLOYER. So, different employer, totally separate $55K limit. What do you think? Are you using multiple retirement plans at unrelated employers? What is your set-up? Comment below!