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Financial Freedom Through Online Business

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Retirement Planning for Internet Marketers

Leverage Your Self-Employment Earnings for the Future!

By

Robert G. Yetman, Jr.

Once in a while, we will explore associated issues of Internet marketing that, while not immediately identifiable as Internet marketing concepts, are still highly relevant to self-employed Internet marketing businesspeople. For example, we've spent time discussing issues related to the type of business entity that one should select as a self-employed Internet marketer (sole proprietorship, corporation, LLC, etc.) as well as those related to taxation. As you move forward, these sorts of topics will gain relevancy, and so we like to spend time occasionally discussing them at some length.

Today, we thought it might be a good idea to look at the various retirement plan options available to the self-employed Internet marketer. Now, let me point out right away that there's really nothing we'll be discussing that is unique to the profession of Internet marketing, but rather, what we'll be talking about is applicable to any small businessperson. That said, for a good many of you, your Internet marketing businesses represent your first venture into self-employment, and so there may have been previously no reason for you to have spent much, or any, time thinking about retirement planning as a self-employed person. For that matter, you may not know a whole lot about retirement planning at all, so this article is perhaps a way to kill two birds with one stone.

Now, some of you may be aware of Jim Paris's notion that simply having an Internet marketing business is a type of retirement plan; that the income you can derive from the business can serve as supplemental income up until the point of your passing. This is largely true, because of the very nature of the work associated with Internet marketing. Internet marketing work is very mild, in terms of physical rigor—we know that; you're sitting at a computer. Also, it is work that can be done from anywhere that has a reliable Internet connection. This means you can do this from home, certainly, but also from any remote location that still has Internet access. Lastly, there are many income sources you can utilize as an Internet marketer that don't require your direct facilitation; for example, the numerous affiliate opportunities that exist, wherein you are paid simply by having certain ads appearing on your website or blog, are great examples of indirect ways by which you can see income.

All of these features together produce a type of "work" that is, honestly, pretty low-key, and so much so that a person can do it, with only modest effort, very late into his life. This can mean that while your part-time Internet marketing efforts (assuming they *are* part-time) can produce *supplemental* income during your primary working years, that income can go on to be regarded as a sort of

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retirement income once you have ceased your "regular" working activities.

That said, depending on the amount of your disposable income realized on a regular basis, you can take things a step further by actually using your current income from Internet marketing during your principal working years to fund a *tax-deferred retirement plan* above and beyond whatever else you may have from your "regular" job. Even if you use only a portion of your earnings to fund such a plan, the long-term benefit of combining the time value of money with investment in competitive vehicles can go a long way to making even a modest allocation into a plan something very valuable in the long run. Whether your earnings from Internet marketing can fund an additional plan separate from what you may have in place already through your employer, or give you the means to fund even one plan for yourself, the use of your "extra" monies to better prepare you for your future financial security is an excellent avenue down which to travel.

Time Value of Money

I've always been fascinated by the so-called time value of money. Broadly, the time value of money refers to what happens to money when a given rate of interest is applied to it over a given period of time. For investment purposes, it refers to how much a sum of money can grow when the variables of assumed rate of interest and length of time invested are manipulated. On that note, what follows is sample data that is intended to illustrate the performance of various sums of money over various periods of time, assuming a given, annual rate of interest.

$50/mo. for 30 yrs. @ 8%/yr. = $74,500
$100/mo. For 20 yrs. @ 8%/yr. = $59,000
$100/mo. For 30 yrs. @ 8%/yr. = $149,000
$200/mo. For 20 yrs. @ 8%/yr. = $118,000
$200/mo. For 30 yrs. @ 8%/yr. = $298,000
$300/mo. For 20 yrs. @ 8%/yr. = $177,000
$300/mo. For 30 yrs. @ 8%/yr. = $447,000

For the purposes of this illustration, I kept the proposed amounts allocated each month relatively low. I did this to accommodate those people who may be doing their Internet marketing work only as a part-time venture. The assumption of 8% for the average annual rate of return suggests that the person or persons illustrated here might invest their money in stock market-based vehicles; the stock market, overall, has averaged around 11% per year over the last hundred years or so, but I wanted to select a more conservative figure for the purpose of this illustration. Lastly, you will notice that I did not utilize time periods shorter than 20 years. If I'm assuming that someone is setting aside amounts that are just a few hundred dollars or less per month, it stands to reason that the individual doesn't expect to realize a truly helpful sum of money after just a handful of years of doing this. Plus, as I mentioned before, the nature of Internet marketing work is such that someone can do it for about as long as he wants, given that there are really no age-related impediments to sustaining oneself in the field.

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The numbers in the illustration should really speak for themselves, but let's talk through them just a bit. Most significantly, look at the first and last examples listed. In the first example, investing $50 per month, you would realize about $75,000 after 30 years. That means someone getting around to this at age 40 and depositing just a relatively few dollars into a stock-market based account of some kind each month could find himself with another $75,000 or so when he could really use it. Not bad, and certainly useful. However, if that same person could find his way to digging up another $250 per month to go with the $50 he's already setting aside, the total amount realized after 30 years changes dramatically. $450,000 is not simply helpful, but constitutes an amount that is a true game-changer for many people. It is the kind of sum that can literally make the difference between a retirement characterized by minimal subsistence and one of real pleasure and security. The point is that your efforts in the realm of Internet marketing can make these kinds of possible eventualities become realities for you, simply by applying your revenue into the right kinds of investment vehicles.

One other thing I want you to take away from this discussion about the time value of money is just how important the *time* variable is to the equation. Take a look at how much you have by investing $100 per month for 30 years—about $150,000. Now, look at the sum you would have by investing *twice* that amount…$200...for *20* years. Even though you'd be setting aside double, doing that for just 20 years would give you about 20 percent *less* for a total. Look further down at what happens when you invest $300 for 20 years. Even though you'd be investing three times the amount, doing so for "only" 20 years would give you an amount that's about 18 percent more. What do you take from all of this? That if you have to make a choice, you are better off getting started earlier with less money than waiting much later and trying to get it done with larger deposits.

One last thing—if you've come to this Internet marketing "thing" a little later than some...say you're age 55 or 60...you may be wondering just what kind of relevance that investment time periods like 20 or 30 years may have for you. Well, first off, in this day and age, it is not at all unusual for people to live well past 80, so another 20 years or so at age 55 or 60 is still going to be very useful for a lot of us, and even being invested for *30* years when starting at a relatively late age can prove to be extremely helpful. Remember that one of the most important reasons for setting aside money in retirement plans at all is to help cover the increased medical and personal care expenses that will befall a whole bunch of us as we approach the end-stage of life. Accordingly, working toward a substantial lump sum into your 80's and even your 90's is hardly out of place, and actually quite appropriate.

A Closer Look at Retirement Plans for Both Employees and the Self-Employed

Company 401k: Most of us are familiar with the company-sponsored 401(k) plan, even if we don't all have one available to us. 401(k) plans can be powerful retirement vehicles, particularly when one's employer actually matches contributions (usually up to a specified limit). Currently, the annual maximum one may contribute to a 401(k) is $16,500, and if you're age 50 or older, you may contribute another $5,500 per year in the form of a "catch-up" contribution. Note, however, that employers can take it upon themselves to limit annual contributions to their plans, in some cases. Money grows tax-deferred inside of the plans, and as for withdrawals, they can begin penalty-free at age 59 1/2, and MUST begin no later than age 70 1/2; also, they are taxed as ordinary income.

One of the potential problems with a 401(k) is that some of them can have rather poor investment options from which participants may choose. This used to be a bigger problem years ago, and is not as prevalent now, but note that not all 401(k)s are created equal—they are in the broad sense of the IRS rules, but as far as the specific investment options available inside of the plans, those can vary widely from company to company. The reason for that has to do with the choices the company makes about which specific investment options to make available through its plan, and some are a lot better than others. That said, generally, speaking, the 401(k) represents one of the very best ways for people to invest for retirement because it can be done seamlessly through payroll deduction.

Regular IRA: The regular IRA (termed that way to distinguish it from the Roth IRA and other IRAs unique to the self-employed) is basically available to everyone. It gives those people without access to company-sponsored plans a good retirement account option, but even those who *do* have access to company-sponsored plans can participate in IRAs, as well. Currently, those under 50 years of age may contribute up to $5,000 per year to a regular IRA, and those 50 or older may make total contributions of up to $6,000 (note: these total contributions also include contributions you might make to a Roth IRA, as well, which we'll discuss shortly). As with 401(k) plans, the same basic rules for tax-deferral and withdrawals apply. Additionally, it's important to note that contributions to regular IRAs are tax deductible, subject to certain income limits and other restrictions.

Roth IRA: Roth IRAs have replaced regular or "traditional" IRAs in popularity for many people, and with good reason. When you've reached the minimum age (again, at least 59 1/2) to begin taking withdrawals penalty-free, your withdrawals from the Roth are tax-free. The idea of being able to see one's money grow without the burden of ongoing capital gains tax liabilities, and then be able to take it out without any ordinary income taxation due, is naturally very appealing.

Upon reading this, you might be thinking, "Well, this is a no-brainer—the Roth is the way to go for me." Not so fast. While that might well be the case, make note of a few important details. For one thing, contributions to a Roth IRA are *not* tax deductible, which means the Roth contributor sees no current-year tax savings in the ways the regular IRA contributor does. On a related issue, the tax-free withdrawal benefit of the Roth may not be the way to go for those who think that they may find themselves in a lower tax bracket at retirement than that in which they exist currently. Here's why: If you believe you'll be in a lower tax bracket upon retirement, then you might be better off to contribute to the regular IRA, where you can realize the tax-deduction benefit while in the higher, current bracket; if you believe you'll be in a higher bracket once you retire, then the Roth is likely the way to go—you'll receive the tax savings when it's most appropriate for you to do so...while you're in the higher bracket.

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In the end, if you've decided to have either a regular IRA or Roth IRA and need help deciding which is right for you, it's smart to seek out the assistance of a tax advisor, as it will principally be one's individual tax profile, both current and expected future, that really serves as the deciding factor in one's choice between the two. If you're serious about selecting one (or both, depending on your situation), be sure you're in possession of all of the relevant facts from a financial professional, so you'll know in which direction to go.

Variable Annuity: A variable annuity is a tax-deferred retirement plan that's funded with *after-tax* dollars and is comprised principally of stock market-based mutual fund investments. Because they're funded with after-tax dollars, your contributions to a variable annuity are not tax-deductible. In that way, they're sort of like *private* retirement plans, because the contributions themselves do not offer any tax benefit in the year in which they're made. Still, however, the tax-deferred benefit...meaning the money can grow without any capital gains liability...is a feature that makes these kinds of accounts superior to regular, taxable investment accounts, even if they don't offer as many tax-related benefits as 401(k)s, IRAs, or other similarly qualified plans.

A few important details about variable annuities. For one thing, annuities are, technically, insurance products, even if they don't look and act like more common sorts of insurance products that you might be more used to seeing. So, if you want to purchase a variable annuity, you would do so through an insurance company. Now, because they *are* insurance products, they will sometimes come with insurance features. For example, it is very common for a variable annuity to have a guaranteed death benefit feature, which means that if you die before you begin making withdrawals from the plan, the beneficiary is guaranteed to receive no less than the total amount of contributions you made into the annuity. This can be a valuable feature of an investment account that is principally made up of stock market-based vehicles.

Also, there are, for all practical purposes, no annual contribution limits to variable annuities; if you want to contribute $100,000 in a single year to an annuity, you may do so.

Again, the plans I've just outlined here are not specific to the self-employed, but are basically available to anyone. I wanted to cover these because, as a self-employed person, you have access to them if you also have regular, employee income...and here's the really cool part: In general, you can have full access to both "everyone" plans (e.g., a regular IRA) *and* self-employed plans as long as you have enough income to qualify. For example, if you are under 50 years of age, you can contribute $5,000 to a regular IRA for a given year (if you had at least $5,000 in employee income), and then contribute another, say, $8,000 in self-employed income (if you had at least that much income from your self-employment) into one of the self-employed retirement plans we'll be discussing shortly. This is why I wanted to spend some time on these "universal" retirement plans, so I could clarify the benefit that's available if you have income from your part-time Internet business: you can have access to both.

Retirement Plans for the Self-Employed

Let's now look at what's available in the way of retirement plans designed specifically for the self-employed. I'm not going to get into a discussion of every, single plan that's available, but rather talk about a few of the most common and easiest to maintain. To that end, our discussion here is going to focus on the following: SEP IRAs, SIMPLE IRAs, and Solo 401(k) plans. The vast majority of self-employed Internet marketers in search of an appropriate plan through which to shelter and grow their earnings from self employment will find that one (or more) of these plans will be perfectly sufficient.

SEP IRAs and SIMPLE IRAs: Through the years of the evolution of retirement plans for the self-employed, SEPs and SIMPLEs have come to represent, overall, the most straightforward and easiest-to-set-up of all those available. They are not the oldest versions of such plans, but have become very popular because of their relative simplicity in structure. All they really are, when it comes down to it, are IRAs that have different contribution rules. That's basically it, in terms of differences from the other IRAs on which we touched earlier. "SEP" stands for "Simplified Employee Pension," and as far as the contribution rules go, an individual can contribute the lesser of 25% of net earnings or $49,000. "SIMPLE" stands for "Savings Incentive Match Plan for Employees," and the contribution limits and rules differ from those of the SEP. With the SIMPLE, you can contribute up to 100% of your net earnings from self employment, up to $11,500 if you're under age 50 and up to $14,000 if you're 50 or older.

Again, for all practical purposes, the only difference between these plans and the regular and Roth IRAs are the contribution limits (note: these plans allow for the deductibility of contributions, like the regular, but, again, that deductibility is not available in the Roth). As for differences between the SEP and the SIMPLE, those principally come down to the differences in contribution limits between the two. As a function of your income from self employment, if your net earnings are less than $46,000, a SIMPLE will allow you to set aside more than will a SEP; this is because while the SEP allows a higher potential raw dollar contribution...up to $49,000 for the SEP vs. up to $11,500 (or $14,500 if 50 or over) for the SIMPLE...that $49,000 is subordinate to the SEP criterion that says you may contribute no more than 25% of net earnings. So, let's say your net earnings from self employment in a given year are $30,000. With a SEP, you can contribute only up to 25% of $30,000, or $7,500; with a SIMPLE, you can contribute up to $11,500 or up to $14,500, depending on your age. Ultimately, it's the 25% limitation on the SEP that really defines the difference between the two.

I also made mention a little earlier about how cheap and easy to maintain SEPs and SIMPLEs are in comparison to other, more exotic sorts of retirement plans for the self-employed. This is because they are IRAs, first and foremost; other plans generally have higher administration costs because they are more involved and have greater reporting requirements and other sorts of demands on them that IRAs do not. Other than an annual fee of about $10 to $25, payable to whatever custodian (brokerage, bank, mutual fund company, etc.) you decide to use as the "home" for your IRA account, there's really no additional fee or administration that applies on behalf of the account, above and beyond just the normal activity that goes with placing trades or buying the investments therein.

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Something else I should probably mention before we move on from SEPs and SIMPLEs is that each plan allows for the coverage of employees, if that becomes something you eventually want to do. You never know, but if you think that's a possibility and you're weighing all of the plan options available to you, you can do that with these; you cannot do that with the Solo 401(k), which we'll be discussing shortly.

Lastly, it's important to note that SEPs and SIMPLEs have provisions by which it is much easier and less costly to make random, premature withdrawals, which does not apply nearly as universally to other retirement plans for the self employed. For example, premature...meaning before you turn age 59 and a half...withdrawals are not available in the Solo 401(k), whereas you can make them from SEPs and SIMPLEs. With rare exception, premature distributions from these IRAs incur a 10% penalty, but the point is that you can actually get the money, which is not always the case in other plans.

Solo 401(k) Plans

As I finished up the previous section, I pointed out some provisions of the SEP and SIMPLE IRAs that made them perhaps look a little more flexible...and thus superior...to the Solo 401(k). That said, I happen to think that for the person who has the means to sock a lot of money away into a self-employed retirement plan, the Solo 401(k) may really be the way to go these days. The Solo 401 (k), as the name implies, brings all of the benefits of the traditional, company-sponsored 401(k) to the doorstep of the sole proprietor.

For example, as with a "regular" 401(k), there remains the beneficial contribution allowances on behalf of both employer and employee, but, in this case, you are able to maximize each of those benefits entirely for yourself. So, as the employer, you can make a tax-deductible contribution of up to 25% of compensation, and also, as the employee, you can make a contribution of up to $16,500 per year, which is a figure you should recognize from our earlier discussion of the 401(k) as a more typical, company-sponsored retirement account. That said, there *is* a maximum, annual contribution limit to the Solo 401(k): In consideration of both sides of the contribution...employer and employee...you are ultimately limited in any given year to the lesser of $49,000 or 100% of compensation (as of 2011).

Something to note on the employee side of the contribution: again, this is a 401(k), and because of that, your total allowable contributions in a given year must take into account *all* contributions you make to *all* 401 (k)s in a year. This means that if you currently keep a "regular " job in addition to your work as a self-employed Internet marketer, your contributions to your workplace 401(k) must be included with whatever contributions you make into your Solo 401(k) in consideration of the maximum allowable contributions for the year. This is a bit of an exception to the general rule that contributions made to non-self-employed plans put no limitation on contributions that can be made to self-employed plans, and vice versa.

Something else to know about the Solo 401(k): Again, because it is a 401(k) plan and is governed by the same rules that oversee all 401(k) plans, you can take a loan out of your Solo 401(k) of up to 50% of the plan's balance, and up to a maximum dollar amount of $50,000. If you currently have access to a company-sponsored 401(k) at your place of employment, you may be already familiar with this provision, but now you know it can be utilized on behalf of your Solo 401(k). If this kind of access to your retirement funds is something you suspect you might need or want at some point, it can be another reason to opt for a Solo 401(k) instead of a SEP or SIMPLE IRA; you cannot take a loan against an IRA.

Fully Fund Both a Regular Retirement Plan As Well As a Self-Employed Plan

I touched on this briefly, but I want to talk about it some more. It's important to note that your ability to contribute to a regular (non-self-employed) retirement plan, like a regular IRA, Roth IRA, and company-sponsored 401(k), is not diminished by contributing to a self-employed plan, and vice versa. As long as you have income of a type that qualifies you to contribute to both kinds of plans, you may do so fully. This ability to shelter even more money than you might otherwise is phenomenally beneficial. That said, it's important that you consult with a tax professional or other qualified retirement specialist before you move forward with setting up plans and making contributions, to be sure that you will be in full compliance with IRS regulations on behalf of your situation.

Where to Set Up Your Plan

These days, you can choose as the custodian of your self-employed retirement plan practically any sort of financial institution. On that note, it's important to distinguish the plan from the investments that go into the plan; an IRA, for example, is not an investment—an IRA is a retirement plan, a tax-deferred "umbrella," if you will, into which investments are placed, and where you choose to open that umbrella will determine what sorts of investments you may put into it. For example, if you set up your plan at a specific mutual fund company, you can choose from any of the funds offered by that company, but nothing more. If you elect to have a discount brokerage, like TD Ameritrade or Charles Schwab, serve as custodian, you will have a far-ranging number of investment choices, from stocks, to mutual funds, to exchange-traded funds, and much more. Once you decide on the *type* of plan to open, it would be wise to seek the advice of a fee-only financial planner to assist you with helping to select the kinds of investments best-suited for your investment goals and objectives, and hand-in-hand with *that* decision will go the selection of the best place to serve as custodian of the plan.

Your career as an Internet marketer has the potential to provide you with an opportunity...or *additional* opportunity...to procure the funds through which to build a significant retirement account. We have presented this article on retirement planning in the interest of serving the "whole" entrepreneur, and trust that there are some nuggets of information contained herein that can serve you well. All the very best to you, as you turn your Internet marketing experience into something well beyond the scope of a "second job."