

Payroll taxation of employer contributions for IRC Section 457(f) plans

Federal income-tax withholding

Amounts contributed by employers to Internal Revenue Code Section 457(f) (IRC Section 457(f)) accounts, and earnings on those accounts, are not subject to income taxes in an IRC Section 457(f) plan until a participant's account in the plan becomes vested.¹ IRC Section 457(f) plans may allow multiple participant accounts with different specific events triggering vesting. Only the balance in the account that vests is taxable to the participant at the time of the vesting event.

IRC Section 457(f) plan accounts are taxable to the participant at the time of vesting, not when the distribution is actually made. Normally, participants will receive a distribution from the plan at vesting, since the account is taxable to them at that time. If a distribution occurs upon vesting, income taxes may be withheld from the distribution. Alternatively, if a distribution does not occur, income taxes may be withheld by distributing a portion of the participant's account balance from the plan. If the actual distribution is delayed after vesting, the full amount that vests is considered taxable income upon vesting, and any additional earnings over the amount originally vested that are paid later would be considered taxable income at the time of distribution.

State income-tax withholding

Most states follow the federal rules for income-tax withholding. Check with your state for any differences from federal rules.

Social Security and Medicare withholding (FICA), and Federal Unemployment Taxes (FUTA)

Employer contributions are subject to FICA taxes, and generally FUTA taxes, at the later of:

- When the services are performed.
- When the employee no longer has a substantial risk of forfeiting the deferred compensation.

As with income-tax withholding, FICA taxes are due at the time a participant's account in the IRC Section 457(f) plan vests. **Note:** Internal Revenue Code Section 501(c)(3) organizations are exempt from FUTA.

State unemployment taxes

State unemployment tax rules may vary, so check with your state for any differences.

1099 independent contractors

Independent contractors subject to Form 1099-NEC reporting may be eligible to participate in a nonqualified IRC Section 457(f) plan. No income taxes or self-employment taxes are due on deferrals, employer contributions, or earnings in the plan until the participant's account vests. Any vested amounts are reported on Form 1099-NEC in the tax year of vesting, and all taxes are paid at that time.

Form 990 Reporting

Amounts contributed by an employer under an IRC Section 457(f) plan, that are not substantially vested, must be reported on Schedule J Form 990, Part II, column C.

Amounts substantially vested (includible in income) under an IRC Section 457(f) must be reported on Schedule J Form 990, Part II, column B(iii).

¹ See IRC Sec. 457(f)(1)(A); Treas. Reg. §1.457-11(a)(1).



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