

Effect of nonqualified deferred comp on Social Security benefits

For individuals who have not yet reached full retirement age, Social Security retirement benefits may be reduced if “earned income” exceeds certain limits. The Social Security definition of earned income is different from the definitions that apply for Form W-2 “Wages, Tips and Other Compensation” or Form 1099-NEC “Non-employee Compensation”. It’s important for both the company and plan participant to understand the difference in these definitions and how earned income may affect Social Security benefits.

Special rules govern the coordination of Social Security retirement benefits with earned income.

- For retirees under full retirement age, Social Security benefits are reduced by \$1 for every \$2 in earned income above an annual limit, indexed for inflation. Please see [Key Federal Tax Rates and Amounts](#).
- In the year a retiree reaches full retirement age, more complex rules apply. If Social Security benefits are received in the months before reaching full retirement age, these benefits are reduced by \$1 for every \$3 in earned income above an annual limit, indexed for inflation. Please see [Key Federal Tax Rates and Amounts](#). For any benefits received after full retirement age, there’s no benefit reduction for earned income.

Nonqualified retirement plan distributions are considered taxable income to the participant and are reported either on Form W-2 in Box 1 as “Wages” or Form 1099-NEC as “Nonemployee Compensation”. Social Security would normally consider these amounts as earned income and require a reduction in benefits to the participants. However, when determining the effect on benefits, Social Security looks at deferred comp income when it’s **earned (i.e., the year when awarded)** rather than when it’s **paid**.

How does the Social Security Administration know what income is actually earned?

- Deferred comp distributions are reported in Box 11 of a participant’s Form W-2. This reporting tells the Social Security Administration that the income was earned in prior years. In a year in which a participant had both (a distribution and anything related to the plan subject to FICA) deferrals into and distributions from a nonqualified plan, the IRS instructs the plan sponsor to leave Box 11 blank and file Form SSA-131 with the Social Security Administration. Since this affects only participants who may be receiving early retirement benefits, it’s necessary to file the form only if the participant is age 62 or older during the tax year of reporting.
- Generally, Form SSA-131 provides that for “nonqualified” deferred compensation, only Box 6 needs to be reported. Basically, how much did the participant earn in the current year for services performed in the current year for purposes of the earnings test. The calculation is Box 1 of Form W-2, plus elective deferrals, plus any “current year immediately vested” employer contributions minus the distribution. See IRS Publication 957 for details.
- The test for self-employed individuals is not the amount of income reported on Form 1099-NEC; it’s the amount of time spent working in the business. Social Security regulations specify that individuals who work more than 45 hours a month are not retired. Those who work less than 15 hours a month

are retired. Specific facts and circumstances are taken into account for time worked between 15 and 45 hours per month.

Deferred compensation is always earned before it's paid, and therefore, should not affect Social Security benefits paid to retirees. It's important for the employer to properly report deferred compensation payments and for participants to know the rules regarding earned income to protect their Social Security benefits.



principal.com

Insurance products issued by Principal National Life Insurance Co. (except in NY) and Principal Life Insurance Company. Plan administrative services offered by Principal Life. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities offered through Principal Securities, Inc., Member SIPC and/or independent broker/dealers. Referenced companies are members of the Principal Financial Group®, Des Moines, IA 50392.

The subject matter in this communication is educational only and provided with the understanding that Principal® is not rendering legal, accounting, investment, or tax advice. You should consult with appropriate counsel, financial professionals, and other advisors on all matters pertaining to legal, tax, investment, or accounting obligations and requirements.

No part of this presentation may be reproduced or used in any form or by any means, electronic or mechanical, including photocopying or recording, or by any information storage and retrieval system, without prior written permission from the Principal Financial Group®.

Principal®, Principal Financial Group® and the Principal logo design are registered trademarks of Principal Financial Services, Inc., a Principal Financial Group company, in the United States and are trademarks and service marks of Principal Financial Services, Inc., in various countries around the world.