

Tax reporting for distributions from deferred comp plans

Tax reporting for distributions from nonqualified deferred compensation plans depends on the employment status of the plan participant. Tax information for **employees** is reported using Form W-2, while tax information for **independent contractors** (i.e., agents or members of the board of directors) is reported using Form 1099-NEC for compensation.

Employee tax reporting (W-2)

Wage reporting

Distributions to employees from deferred comp plans are considered wages subject to income tax upon distribution. Since nonqualified deferred comp distributions are subject to income taxes, these amounts should be included in amounts reported on Form W-2 in Box 1, Wages, Tips and Other Compensation. Most states follow the federal rules for reporting distributions from deferred comp plans, so please consult local counsel.

Income tax withholding

Distributions from deferred comp plans are normally considered to be “supplemental wages” for income tax withholding purposes. If the participant’s total supplemental wages from all sources exceeds \$1 million, IRS regulations specify that federal tax must be withheld at the flat rate of 37% on all supplemental wages in excess of \$1 million. For supplemental wages of \$1 million or less, for simplicity of operation, many employers choose to use the IRS’s “optional” flat withholding tax rate of 22%. (This rate applies from 2018 through 2025.) Withholding on amounts of \$1 million or less may also be based on the employee’s current W-4 status (see current IRS withholding instructions for details). State rules vary, so please consult local counsel.

Social Security and Medicare reporting

Deferred comp distributions are not normally subject to Social Security or Medicare taxes, since these have been collected during the plan participant’s service with the employer. However, any unvested amounts that become vested at distribution would be subject to Social Security and Medicare taxes at that time.

Box 11 reporting

The purpose of Box 11 is for the Social Security Administration to determine whether any wages reported on Form W-2 were earned in prior years. Since distributions from a deferred comp plan are normally earned in prior years, these amounts should be included in Box 11.

In a year when a plan participant has both deferrals and distributions from a nonqualified deferred comp plan, special reporting rules apply. Publication 957 has detailed instructions for reporting when this occurs:

- Do not complete Box 11 if both deferrals and distributions occur in the same year.
- Report to the Social Security Administration on Form SSA-131 the amount earned during the current year. Current Form W-2 instructions specify, however, that a Form SSA-131 should not be filed if the employee will not be age 62 or older by the end of the year.

Box 12 reporting

Nonqualified deferred comp distributions are not reported in Box 12. These amounts should **only** be reported using Code Z if the amount is subject to additional taxation and penalties due to a violation of Section 409A. Section 409A also requires reporting of “deferrals” in Box 12 using Code Y, but the Internal Revenue Service has suspended the Code Y reporting requirements until further regulations are issued.

Distributions to beneficiaries of deceased plan participants

Distributions to the beneficiaries of deceased deferred comp plan participants are reported on Form 1099-MISC.

Independent contractor reporting (1099 NEC)

Independent contractors subject to Form 1099 reporting, such as agents or members of the company’s board of directors, may be eligible to participate in a deferred comp plan. Deferred comp plan distributions paid are reported in Box 1 on Form 1099-NEC and are subject to income tax and self-employment tax (SECA) at the time of distribution. If the plan is in violation of Section 409A, then amounts subject to penalties would be reported on Form 1099-MISC in Box 15b.



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