

Tax reporting for distributions from section 457(b) deferred comp plans

Tax reporting for distributions from nonqualified section 457(b) 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.

Employee tax reporting (W-2)

Wage reporting

Distributions to employees from 457(b) 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 nonqualified 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 com 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.

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 457(b) 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 shouldn’t be filed if the employee won’t be age 62 or older by the end of the year.

Box 12 reporting

Although the words “deferred compensation” appear in the W-2 instructions, Box 12 is used for reporting contributions to qualified 401(k) plans and 457(b) plans. 457(b) plan **distributions** should not be reported in Box 12.

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 organization's board of directors, may be eligible to participate in a deferred comp plan. 457(b) plan distributions paid are reported on Form 1099-NEC and are subject to income tax and self-employment tax at the time of distribution.



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