

Rev. Rul. 90-105

Section 404. -- Deduction for Contributions of an employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

1990-2 C.B. 69; 1990 IRB LEXIS 515; 1990-52 I.R.B. 6; REV. RUL. 90-105

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[*1]

Deduction for contributions of an employer. Guidance is issued concerning the application of section 404(a)(6) of the Code to contributions to a cash or deferred arrangement under section 401(k) or to a defined contribution plan as matching contributions, where such contributions are attributable to compensation earned by plan participants after the end of the taxable year.

ISSUE

Whether contributions to a qualified cash or deferred arrangement within the meaning of section 401(k) or to a defined contribution plan as matching contributions within the meaning of section 401(m) are deductible by an employer for a taxable year, if the contributions are attributable to compensation earned by plan participants after the end of that taxable year.

FACTS

Corporation M maintains Plan X, which consists of a qualified cash or deferred arrangement within the meaning of section 401(k), and which also provides for matching contributions within the meaning of section 401(m). M's taxable year is the fiscal year ending June 30. Plan X has a calendar plan year. By the last day of Plan X's 1989 calendar plan year, M had contributed amounts to Plan X in accordance with the terms of the plan. [*2] These amounts consisted of (a) the elective deferral and matching contributions attributable to compensation earned by plan participants before the end of M's taxable year ending June 30, 1989 (Pre-Year End Contributions), and (b) the elective deferral and matching contributions attributable to compensation earned by plan participants after the end of M's taxable year ending June 30, 1989 (Post-Year End Contributions).

M received an extension of time to March 15, 1990, to file the income tax return for its taxable year ending June 30, 1989 (1989 Taxable Year). On the income tax return for its 1989 Taxable Year, which was timely filed on March 1, 1990, M claimed a deduction for the entire amount of the elective deferral and matching contributions made to Plan X during Plan X's 1989 calendar plan year. Approximately one-half of the claimed deduction related to the Pre-Year End Contributions, while the remaining portion of the claimed deduction related to the Post-Year End Contributions. The total amount contributed and claimed by M as a deduction did not exceed 15 percent of the total compensation otherwise paid or accrued during M's 1989 Taxable Year to participants under Plan [*3] X, in accordance with the percentage limitation under section 404(a)(3)(A)(i).

LAW

Section 404(a) provides in relevant part that if contributions are paid to a profit-sharing or stock bonus plan and are otherwise deductible under chapter 1 of the Code, those contributions are deductible under section 404 (subject to

certain limitations) in the taxable year of the employer when paid, and are not deductible under any other section of chapter 1 of the Code. In the case of a contribution that is otherwise deductible under section 162 or 212, section 1.404(a)-1(b) of the *Income Tax Regulations* provides that in order to be deductible under section 404(a), the contribution must be an ordinary and necessary expense during the taxable year in carrying on a trade or business or for the production of income and must be compensation for services actually rendered.

Section 1.404(a)-1T, Q&A-1, of the Regulations provides that in order to be deductible under section 404(a), a contribution otherwise deductible under section 162 or 212 must be paid or incurred for purposes of those sections, in addition to satisfying the other requirements for deductibility under those sections. Section 7701(a)(25) [*4] states that the term "paid or incurred" shall be construed according to the method of accounting used by the taxpayer to compute its taxable income. Section 301.7701-16 of the Regulations adopts the same definition for purposes of the Regulations.

Section 461(a), in conjunction with section 1.461-1(a)(2) of the Regulations, provides that, for a taxpayer using an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of liability and the amount thereof can be determined with reasonable accuracy. Section 1.461-1(a)(2) specifically states that "no accrual shall be made in any case in which all of the events have not occurred which fix the liability . . ."

Section 404(a)(6) provides in relevant part that, for purposes of section 404(a)(3), "a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)." The sole effect of section 404(a)(6) is to deem a payment to have been made on the last [*5] day of the preceding taxable year. Section 404(a)(6) does not make a contribution deductible in a taxable year where the contribution could not otherwise have been deducted in that taxable year if it had actually been paid on the last day of the taxable year. See S. Rep. No. 1622, 83d Cong., 2d Sess. 55 (1954) (section 404(a)(6) merely provides to accrual basis taxpayers a grace period to compute the amount of the contribution due to the difficulty of gathering information about the taxable year by the close of the taxable year); H.R. Rep. No. 1280, 93d Cong., 2d. Sess. 347 (1974) (extending the same grace period to cash basis taxpayers); *Don E. Williams Co. v. Commissioner*, 429 U.S. 569, 575 n6 (1977).

Rev. Rul. 76-28, 1976-1 C.B. 106, provides that a contribution made after the close of an employer's taxable year will be deemed to have been made on account of the preceding taxable year under section 404(a)(6) if, among other conditions, the payment is treated by the plan in the same manner as the plan would treat a payment actually received on the last day of such preceding taxable year of the employer.

ANALYSIS

Under section 404(a)(6), as interpreted by *Rev. Rul. 76-28*, [*6] the payment of M's Post-Year End Contributions to Plan X could be deemed to have been made on the last day of M's 1989 Taxable Year, if Plan X treated the payment of those contributions at the time they were actually received in the same manner that the plan would have treated a payment of those same contributions had they instead been received on the last day of M's 1989 Taxable Year. However, Plan X could not have done so. Compensation cannot be deferred and contributed to a plan as elective deferrals, and matching contributions cannot be made to a plan with respect to such elective deferrals, until the underlying compensation has actually been earned. At the time Plan X actually received the payment of M's Post-Year End Contributions, Plan X could properly treat the payment as consisting of elective deferral and matching contributions, because the underlying compensation had already been earned. If Plan X had

instead received a payment of the Post-Year End Contributions on the last day of M's 1989 Taxable Year, Plan X could not at that time have properly treated the payment as consisting of elective deferral and matching contributions, because the underlying compensation had [*7] not been earned. It would have been necessary to wait for six months to determine the amount of compensation actually earned by plan participants after the end of M's 1989 Taxable Year and therefore what portion of the payment could properly be treated as consisting of elective deferral and matching contributions. Accordingly, M did not satisfy section 404(a)(6) with respect to the Post-Year End Contributions. This is true regardless of whether M uses the cash or an accrual method of accounting.

Even if M could have satisfied section 404(a)(6) with respect to the Post-Year End Contributions, section 404(a)(6) does not provide that the Post-Year End Contributions would therefore be deductible for M's 1989 Taxable Year. Section 404(a)(6) merely would have deemed the contributions to have been paid on the last day of that year.

In order for the Post-Year End Contributions to be deductible for M's 1989 Taxable Year, M would have been required to show that the contributions would have been deductible under section 404(a), and in turn would have been otherwise deductible under chapter 1 of the Code, for M's 1989 Taxable Year, if the contributions had actually been paid on the last [*8] day of that taxable year. However, the contributions are attributable to compensation earned by plan participants after the end of M's 1989 Taxable Year, so that as of the last day of that taxable year the payment of the contributions could not have been compensation for services actually rendered. Under section 1.404(a)-1(b) of the Regulations, the Post-Year End Contributions therefore could not have been deducted for M's 1989 Taxable Year. This conclusion applies regardless of whether M uses the cash or an accrual method of accounting.

In addition, if M uses an accrual method of accounting, the application of section 461(a) also would have precluded the Post-Year End Contributions from being deductible for M's 1989 Taxable Year, because all events fixing the fact of M's liability to make the contributions had not occurred as of the end of M's 1989 Taxable Year. Because the Post-Year End Contributions are attributable to compensation earned by plan participants after the end of that taxable year, the compensation could not have been actually deferred as of that date, so that M's liability to make elective deferral and matching contributions with respect to that compensation [*9] would not have been fixed.

HOLDING

Contributions to a qualified cash or deferred arrangement within the meaning of section 401(k) or to a defined contribution plan as matching contributions within the meaning of section 401(m) are not deductible by the employer for a taxable year, if the contributions are attributable to compensation earned by plan participants after the end of that taxable year. This holding applies regardless of whether section 404(a)(6) deems the contributions to have been paid on the last day of that taxable year, and regardless of whether the employer uses the cash or an accrual method of accounting.

APPLICATION

Taxpayers using a method of accounting inconsistent with this revenue ruling are required to change their method of accounting. If a taxpayer makes the change in accordance with this revenue ruling, the change is to be effective for purposes of claiming deductions under section 404(a) for all elective deferral and matching contributions actually paid after December 31, 1989, except to the extent such contributions were deducted on a return filed before December 7, 1989 (the Release Date). Because this change is to be implemented on a "cut-off" [*10] basis, it is made without a section 481(a) adjustment.

In order to make the change in accordance with this revenue ruling, the taxpayer must account for all contributions actually paid after December 31, 1989, consistently with the holding of this revenue ruling, except to the extent

these contributions were deducted on a return filed before the Release Date. Any contribution for which a deduction was claimed on a return filed before the Release Date may not again be deducted on a return filed on or after the Release Date, even though that contribution would, under the holding of this revenue ruling, otherwise be deductible on a return filed after the Release Date. In addition, the taxpayer must type or legibly print on the first return filed after the Release Date the following notation: "Change in Method of Accounting under *Rev. Rul. 90-105*." If a taxpayer changes its method in accordance with this revenue ruling, the Service will not apply the holding in this revenue ruling to contributions actually paid before January 1, 1990, or to contributions actually paid on or after that date for which a deduction was claimed on a return filed before the Release Date (even if the Service [*11] has raised the issue of the deductibility of such a contribution upon examination). A taxpayer who amends a return filed before the Release Date is not required to make the change on that amended return. No taxpayer is permitted to file an amended return on or after the Release Date in order to claim a deduction that is inconsistent with the holding in this revenue ruling, even though such deduction relates to contributions actually paid before January 1, 1990.

Thus, assuming that M has not filed before the Release Date the return for its taxable year ending June 30, 1990 (1990 Return), M is permitted on its 1990 Return to deduct elective deferral and matching contributions actually paid after December 31, 1989, only to the extent those contributions are attributable to compensation earned by plan participants between January 1, 1990, and June 30, 1990. M is not permitted to deduct on its 1990 Return elective deferral and matching contributions attributable to compensation earned by plan participants between July 1, 1989, and December 31, 1989, because those amounts previously were deducted on a return filed before the Release Date (i.e., M's return for its 1989 Taxable Year). [*12] In addition, M is not permitted on its 1990 Return to deduct elective deferral and matching contributions attributable to compensation earned by plan participants on or after July 1, 1990, because deducting those contributions on that return would be inconsistent with the holding in this revenue ruling. If M complies with the requirements set forth in the preceding paragraph, M is not required to amend the return for its 1989 Taxable Year, nor will the Service apply the holding in this revenue ruling to that return (or to a return for any previous year), even though the return may claim a deduction for contributions attributable to compensation earned by plan participants after the last day of the taxable year for which the return was filed.

If a taxpayer, however, fails to change its method of accounting in accordance with this revenue ruling, the Service may require the taxpayer to change its method of accounting in the earliest open taxable year on a cut-off basis, notwithstanding the provisions of *Rev. Proc. 84-74, 1984-2 C.B. 736*.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gretchen Young of the Employee Plans Technical and Actuarial Division. [*13] For further information regarding this revenue ruling, contact the Employee Plans Technical and Actuarial telephone assistance service between the hours of 1:30 and 4:00 p.m., Eastern Time, Monday through Friday, on (202) 566-6783/6784 (not a toll-free call). Ms. Young's telephone number is (202) 343-0729 (not a toll-free call).

ADDITIONAL INFORMATION

This revenue ruling does not address similar issues that may arise under section 404 with respect to plans that are not subject to section 401(k) or (m). The Service anticipates issuing further guidance on these issues.