OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR District Counsel, Pacific-Northwest District, Seattle

FROM: Chief, Qualified Branch 1 (Tax Exempt and Government Entities) CC:TEGE:QP1

SUBJECT:

This Chief Counsel Advice responds to your memorandum, dated March 2, 2000. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Company A =
Plan X =
$M =
$N =
$P =

ISSUE:

Whether Company A is entitled to deduct contributions to Plan X for the taxable year ending January 31, 1998.

FACTS:

Company A, an accrual basis taxpayer, maintains Plan X which includes a qualified cash or deferred arrangement under section 401(k) of the Internal Revenue Code. Section 5.3 of Plan X provides generally that each participant may defer up to ten percent of his or compensation each year. Section 5.2 of the plan provides for a partial employer matching contribution. Section 5.1 of Plan X provides that Company A shall contribute the amount of the salary deferrals and matching contributions provided for under the terms of the plan.

Company A's taxable year ends January 31. Until 1997, the plan year also ended on January 31. In November 1997, however, Company A amended Plan X

to change the plan year to a year ending on December 31. Accordingly, the 1997 plan year was an eleven month period from January 31, 1997 through December 31, 1997.

Also, in November 1997, Company A authorized the amendment of Plan X to incorporate a fixed minimum employer contribution requirement. Effective January 1, 1998, section 5.11 of Plan X provides that Company A shall make contributions to the Plan in the form of employer contributions at least equal to a specified dollar amount. Section 5.11-1 adds that such amount shall be determined by the Chief Financial Office of Company A on or before the last day of the Company's taxable year that ends within such plan year. Section 5.11-2 of the amended plan provides that Company A shall pay this "Minimum Employer Contribution" at any time during the plan year and, for purposes of deducting such contribution, the Company shall make the contribution not later than the time prescribed by the Code for filing the Company's income tax return, including extensions, for its taxable year that ends within such plan year. This section adds that, notwithstanding any provision of the plan to the contrary, the Minimum Employer Contribution made by the Company shall not revert to, or be returned to, the Company and can be made whether or not the Company has current or accumulated profits.

Section 6.1-4 of the amended plan provides that the Minimum Employer Contribution shall be allocated first to eligible participants as salary deferral contributions and then as employer matching contributions. Any balance remaining after these initial allocations, shall be allocated pro rata to the employer matching contributions account of each non-highly compensated participant. If the amounts so allocated exceed a participant's maximum annual addition then the excess is held in a suspense account to be used to reduce employer contributions in the next and succeeding limitation years.

On January 28, 1998, Company A authorized a Minimum Employer Contribution of $M for the plan year ending December 31, 1998. According to the revenue agent this minimum contribution was paid into the plan in increments as the employer was required to make the salary deferral contribution each month. The minimum contribution purportedly funded the elective deferrals and the matching contributions but the amount of the elective deferrals exceeded the amount of the fixed minimum contribution. Also according to the agent, both before and after the 1997 amendment of the plan, Company A's matching contributions accrued monthly as the liability was established and were paid after the corporate year end but before the due date of the return (including extensions). For example, Company A's matching contribution for the plan year ending December 31, 1997, was paid before the due date of the January 31, 1998, corporate return, plus extensions.

Company A timely requested an extension of time in which to file its corporate tax return for the year January 31, 1998, and it filed that return on October 14, 1998. Among the amounts deducted by Company A on this return was $M for its Employer Minimum Contribution. Of that amount, $N was the amount of the employee deferrals contributed to the plan with respect to compensation earned in January, 1998. The balance, $P, was the amount of employee deferrals over the months of February 1998 though August 1998. Other than the deferrals contributed to the plan in January 1998, Company A paid no money into the Plan until each employee's deferral became effective in the following months. The Service proposes to disallow the deduction for $P, i.e., that portion of the Minimum Employer Contribution attributable to elective deferrals earned after January 31, 1998.

As noted, the Service does not propose to disallow the elective deferrals for the month of January, 1998. A question has arisen, however, with respect to the matching contributions on those deferrals. Section 5.5 of Plan X states that the employer shall pay the salary deferral contributions not later than 30 days after the plan year for which they are deemed to be paid. Further, as to salary deferral contributions accumulated through payroll deductions, the contributions shall be paid by the end of the succeeding month following the payroll deductions. Section 5.5 also states that the employer shall pay the matching contributions "for each Plan Year within the time prescribed by law, including extension of time for filing the Employer's federal income tax return for the Employer's fiscal year in which such Plan Year ends."

LAW AND ANALYSIS

Section 404(a) of the Internal Revenue Code provides in relevant part that if contributions are paid to a profit-sharing 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.

Section 1.404(a)-1(b) of the 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) 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)(3) provides, in part, that contributions paid into a profit-sharing plan are deductible "[i]n the taxable year when paid...." 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)." See also, Rev. Rul. 76-28, 1976-1 C.B. 106 (sets forth circumstances under which contributions are considered to be "on account of" the preceding taxable year.)

Revenue Ruling 90-105, 1990-2 C.B. 69, states that contributions to a 401(k) plan or to a defined contribution plan as matching contributions 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 the taxable year. The revenue ruling states that such contributions would fail to satisfy §1.404(a)-1(b) of the regulations since they would not be for services actually rendered. The ruling also states that, for a taxpayer using an accrual method of accounting, the application of section 461(a) would also preclude the deduction of such contributions since all the events fixing the fact of the employer's liability to make the contributions would not be fixed as of the end of the employer's tax year.

A. Matching contributions

In your request to this office, you conclude that the amounts contributed to satisfy the elective deferrals for the month of January 1998 are deductible for the taxable year ending January 31, 1998, but suggest that the matching contributions on these deferrals are not deductible because Plan X provides that Company A "shall pay the matching contributions for each Plan Year within the time prescribed by law, including extension of time for filing the Employer's federal income tax return for the Employer's fiscal year in which such Plan Year ends." Based upon this language, you argue that since the 1998 plan year did not end within Company A's fiscal year ending January 31, 1998, the matching contributions are not deductible on Company A's corporate tax return for the year ending January 31, 1998.

We do not believe this plan language restricts the contributions in the manner you suggest. The plan language places an outside limit on the time the contributions must be made, but it does not prohibit contributions from being made earlier. The plan states that the matching contributions shall be paid within the time prescribed by law, including extensions. Under 404(a)(3) and 404(a)(6), assuming all other applicable requirements and restrictions are satisfied, the contribution is deductible when paid or deemed paid. Section 404(a)(6) provides that payment is deemed made 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). You have indicated that, according to the agent, both before and after the 1997 amendment of the plan, Company A's matching contributions accrued monthly as the liability was established and were paid after the corporate year end but before the due date of the return (including extensions). As such, the contributions for January, 1998, appear to come within the requirements of section 404(a)(6). We do not construe the provisions of section 5.5 of the plan to require Company A to pay the contribution at a later date. Accordingly, assuming that the other requirements and restrictions for deductibility under section 404 are satisfied, we conclude that the matching contributions for the month of January, 1998, paid by Company A within the time provided by section 404(a)(6) are deductible by Company A in the fiscal year ending January 31, 1998.

B. Minimum Employer Contribution

Your request also seeks advice regarding the deductibility of that portion of the Minimum Employer Contribution which Company A "agreed to guarantee" on January 28, 1998, but which was not paid until after the end of the January 31, 1998 tax year (but before the due date of the corporate tax return, as extended).

Company A argues that the entire minimum employer contribution of $M is deductible in Company A's taxable year ending January 31, 1998. Company A argues that because it obligated itself before the end of the taxable year to make fixed minimum contributions to Plan X, the amount of the fixed contributions accrued at the end of such year. Company A argues that under section 404(a)(6) a taxpayer on the accrual method can deduct an accrued contribution in the year of accrual provided payment is actually made no later than the time prescribed by law for filing the return for the taxable year of the accrual (including extensions).

Company A attempts to distinguish Revenue Ruling 90-105 by pointing out that, in contrast to the scenarios in that revenue ruling, Company A incurred a fixed obligation to make the minimum contribution by the end of the taxable year. Company A states that it was obligated to make the contribution regardless of subsequent events such as the termination of the plan or the firing of all employees. Company A thus claims that the contribution is attributable to a liability

that was properly accrued during the taxable year and not to compensation earned after the year.

The issues raised by your request have not been addressed by the Service or by the courts and are similar to issues raised in other cases currently under review by the Service. We anticipate that guidance will be issued in the future with respect to the issue raised here as well as those related issues. Accordingly, we do not believe that we can respond to this request at this time.

Please call if you have any further questions.