Deductibility; timing. Contributions made during a grace period to a section 401(k) plan or as matching contributions to a qualified defined contribution plan 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.

Rev. Rul. 2002–46

ISSUE

Whether contributions made during the § 404(a)(6) grace period to a qualified cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 401(m) are deductible by an employer for a taxable year, if the contributions are designated as satisfying a liability established before the end of that taxable year but 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 § 401(k) and which also provides for matching contributions within the meaning of § 401(m). M's taxable year is the fiscal year ending June 30. Plan X has a calendar plan year. Plan X was amended to provide for M's Board of Directors to set a minimum contribution for a plan year, to be allocated first toward elective deferrals and matching contributions, with any excess to be allocated to participants as of the end of the plan year in proportion to compensation earned during the plan year. Pursuant to this plan amendment, M's Board of Directors adopted a resolution on June 15, 2001, setting a minimum contribution of $8,000,000 for the 2001 calendar plan year. By December 31, 2001 (the last day of Plan X's 2001 calendar plan year), M had contributed $8,000,000 to Plan X in accordance with the terms of the plan. These amounts consisted of (a) $3,800,000 for elective deferrals and matching contributions attributable to compensation earned by plan participants before the end of M's taxable year ending June 30, 2001 (Pre-Year End Service Contributions), and (b) $4,200,000 for elective deferrals and matching contributions attributable to compensation earned by plan participants after the end of M's taxable year ending June 30, 2001 (Post-Year End Service Contributions). M made each contribution attributable to compensation earned during each pay period contemporaneously with the issuance of wage payments for the pay period.

M received an extension of time to March 15, 2002, to file the income tax return for its taxable year ending June 30, 2001 (2001 Taxable Year). On the income tax return for its 2001 Taxable Year, which was timely filed on March 1, 2002, M claimed a deduction for the entire $8,000,000 for elective deferrals and matching contributions made to Plan X during Plan X's 2001 calendar plan year, relating to both Pre-Year End Service Contributions and Post-Year End Service 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 2001 Taxable Year to participants under Plan X (and thus did not exceed the applicable percentage limitation for that year under § 404(a)(3)(A)(i)).

LAW AND ANALYSIS

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 § 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.

Section 404(a)(6) provides in relevant part that, for this purpose, "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)."

Rev. Rul. 90–105, 1990–2 C.B. 69, applies § 404(a)(6), as interpreted by Rev. Rul. 76–28, 1976–1 C.B. 106, to a situation involving a contribution to a 401(k) plan made after the end of the plan year. Rev. Rul. 90–105 holds that contributions to a qualified cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 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. *See also* Rev. Rul. 76–28 (providing 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 § 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) and *Lucky Stores, Inc. v. Commissioner*, 153 F.3d 964 (9th Cir. 1998), *cert. denied*, 526 U.S. 1111 (1999) (indicating, in the context of a defined benefit plan, that the plain meaning of § 404(a)(6) precludes deduction in the preceding taxable year of grace period contributions that are required under collective bargaining agreements for work performed after the end of that preceding taxable year).

The facts in this revenue ruling are the same as the facts in Rev. Rul. 90–105, except for the addition of the plan amendment and the board resolution setting a minimum contribution for the plan year. These factual differences do not change the result. The plan amendment and the board resolution setting a minimum contribution for the plan year establish a liability, prior to the end of M's taxable year, to make that contribution. However, M's Post-Year End Service Contributions still are attributable to compensation earned by plan participants after the end of the taxable year. Neither the plan amendment nor the board resolution bear on when that compensation is earned. Thus, for example, the Post-Year End Service Contributions in these circumstances are still on account of that subsequent taxable year rather than on account of M's 2001 Taxable Year, and so cannot be deemed paid at the end of M's 2001 Taxable Year under § 404(a)(6). Therefore, the holding of Rev. Rul. 90–105

applies to the facts of this revenue ruling, and M's Post-Year End Service Contributions are not deductible for M's 2001 Taxable Year.

HOLDING

Grace period contributions to a qualified cash or deferred arrangement within the meaning of § 401(k) or to a defined contribution plan as matching contributions within the meaning of § 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 the employer's liability to make a minimum contribution is fixed before the close of that taxable year.

APPLICATION

A change in a taxpayer's treatment of contributions to a method consistent with this revenue ruling is a change in method of accounting to which §§ 446 and 481 apply. A taxpayer that wants to change its treatment of contributions to a method consistent with this revenue ruling must follow the automatic change in method of accounting provisions in Rev. Proc. 2002–9, 2002–3 I.R.B. 327 (as modified by Rev. Proc. 2002–19, 2002–13 I.R.B. 696, and as modified and clarified by Announcement 2002–17, 2002–8 I.R.B. 561), with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply, provided the taxpayer's method of accounting for contributions addressed in this revenue ruling is not an issue under consideration for taxable years under examination, within the meaning of section 3.09(1) of Rev. Proc. 2002–9, at the time the Form 3115 is filed with the national office.

(2) To assist the Service in processing changes in method of accounting under this revenue ruling, and to ensure proper handling, section 6.02(4)(a) of Rev. Proc. 2002–9 is modified to require that a Form 3115 filed under this revenue ruling include the statement: "Automatic Change Filed Under Rev. Rul. 2002–46." This statement should be legibly printed or typed on the appropriate line on any Form 3115 filed under this revenue ruling.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include in the APPENDIX a change to a method consistent with this revenue ruling.

LISTED TRANSACTIONS

The transaction described in this revenue ruling is substantially similar to the transaction described in Rev. Rul. 90–105, 1990–2 C.B. 69. Under Notice 2000–15, 2000–1 C.B. 826, and Notice 2001–51, 2001–34 I.R.B. 190, transactions that are the same as or substantially similar to transactions described in that notice (including transactions described in Rev. Rul. 90–105) are tax avoidance transactions and are identified as "listed transactions" for purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. Those provisions impose certain requirements on taxpayers that participate in listed transactions, and on promoters of listed transactions.

ALTERNATIVE RATIONALE IN REV. RUL. 90–105

An alternative rationale in Rev. Rul. 90–105 was based upon language in § 1.404(a)–1(b) of the Income Tax Regulations requiring that contributions be compensation for services actually rendered. As indicated in Notice 2002–48, elsewhere in this bulletin, the Service has concluded upon further consideration that this language is relevant only where the reasonableness of an employee's compensation is in question, and thus is not an appropriate basis upon which to determine the timing of deductions for the contributions described in Notice 2002–48, Rev. Rul. 90–105, or this revenue ruling.

DRAFTING INFORMATION

The principal authors of this revenue ruling are James E. Holland, Jr., of the Employee Plans, Tax Exempt and Government Entities Division and John Richards of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact the Employee Plans taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number) between the hours of 8:00 a.m. and 4:00 p.m., Eastern Time, Monday through Friday. Mr. Holland's telephone number is (202) 283–9699 (not a toll-free call). Mr. Richards's telephone number is (202) 622–6090 (not a toll-free call).