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Three Rulings in Search of a Theory: Accelerated Deductions for 401(k) Plan Contributions

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This perspective discusses a return position sometimes adopted by sponsors of 401(k) plans. By deducting 401(k) elective deferrals (and matching contributions) made one year in the preceding taxable year under Section 404(a)(6), these employers accelerate the deduction by a year. The IRS has identified this return position as a "listed transaction" subject to special tax shelter rules. Recently issued Revenue Ruling 2002-46 is the IRS's third piece of guidance that directly or indirectly explains the IRS's thinking on this return position. In this perspective, we explore how the theories underlying the IRS's thinking would have shifted and reversed over the years, and would still seem short of a convincing or adequate construction of the statute.

We here return to a topic we have visited before: accelerated deductions for contributions to a qualified plan under the "grace period" of Code Section 404(a)(6).[1] Like the more familiar grace period for IRA contributions, the Section 404(a)(6) grace period allows the employer to make a contribution to the plan in one year, but deduct it in the preceding taxable year, if it is made by a specified deadline, and is "on account of" that year.

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Qualified plan contributions can be a significant part of an employer's cash flow, so the tax benefit of accelerating the deduction for one year is similarly eye-catching. For this reason, tax return positions making use of Section 404(a)(6) have proliferated in the last decade or so—and IRS opposition has intensified.

A popular variant of these return positions makes use of the grace period to accelerate the deduction for the employer's contribution to its 401(k) plan. The IRS first sighted this idea in its cross-hairs by issuing Revenue Ruling 90-105, which disallowed grace period deductions for 401(k) plan contributions under three separate theories. Then in Notice 2000-15, the IRS included this return position among its listed transactions under Treasury Regulation Section 1.6011-4T; that is, its top-ten "most wanted" bad guy tax shelters, subject to strict registration and reporting requirements, and harsh penalties for noncompliance.

The odd thing—and the subject of this article—is this. For all its hostility to employers' use of the Section 404(a)(6) grace period, the IRS has had enormous difficulty articulating the theory underlying its opposition. It is even having trouble deciding in which Code section the legal obstacle resides.

After lurching from theory to theory, and Code section to Code section, the IRS recently issued its latest thinking on this issue in the form of Revenue Ruling 2002-46 and Notice 2002-48.With almost no explanation or analysis, this latest guidance disallows grace period deductions for 401(k) plan contributions under a completely new theory, and at the same time expressly or implicitly discards all previous theories on which its earlier opposition was based.

In addition, Revenue Ruling 2002-46 provides that certain taxpayers who use the grace period deduction for 401(k) plan contributions may apply for a change in method of accounting under Revenue Procedures 2002-9. That is, by voluntarily bringing its grace period deductions to the attention of the IRS and foregoing this tax return position henceforth, the taxpayer may spread the tax hit of undoing its tax return position over a four-year period. This relatively gentle treatment contrasts with the denial of deduction (with carryforward), plus interest and potential penalties, for taxpayers now or later caught on audit.

For taxpayers who have claimed grace period contributions to their 401(k) plans, the immediate question posed by Revenue Ruling 2002-46 is: what to do now? The hazards of alternative strategies are beyond the scope of this article, but we would make one observation: in assessing risks under the various routes now available to them, these taxpayers may wish to consider their options in light of the IRS's shifting—and still apparently unstable—theories underlying its position.

For the tax professional, the more general question raised by Revenue Ruling 2002-46 is this: why is a tax return position singled out as a listed "tax

shelter transaction," when with over a quarter of a century of guidance the IRS has been unable to articulate a consistent theory explaining why it is "bad" or, even now, a theory that can satisfy the most basic principles of statutory construction. For these observers, as for the IRS, the question might be asked: is name-calling an acceptable substitute for an argument?

BACKGROUND

Business expenses are generally deductible under Section 162 of the Code. In contrast, contributions to a qualified plan are not. But if "otherwise deductible" under "this Chapter," which includes Section 162, contributions to a qualified plan are deductible under Section 404(a), in the taxable year "when paid," subject to the dollar limits of that section.[2]

In addition, a grace period under Section 404(a)(6) provides that a contribution made by the tax filing deadline (with extensions) for the employer's preceding taxable year is "deemed" paid during that preceding year if "on account of" that year. The Section 404(a)(6) grace period is almost identical to the more familiar grace period for IRA contributions under Section 219(f)(3), which similarly states that an IRA contribution made by the individual's tax filing deadline (but without extensions) for the preceding taxable year is deemed paid during that preceding year if on account of that year.

Under both grace periods, the result is the same. A contribution paid one year is treated for deduction purposes as paid in the preceding taxable year, if paid during the grace period, and "on account of" that preceding tax year.

In recent years, employers have made various use of the Section 404(a)(6) grace period to accelerate their qualified plan-related deductions. A particularly popular return position involves contributions to a 401(k) plan.

To keep things reasonably simple, we will discuss this position in terms of a hypothetical employer with a 401(k) plan that accepts only elective deferrals, and discretionary employer contributions that are allocated to employees' accounts according to a formula stated in the plan. The 401(k)'s plan year ends June 30. The employer's taxable year is the calendar year. From January 1 though June 30, 2002, plan participants make elective deferrals to the 401(k) plan—that is, elect to have amounts deducted from their paychecks and paid instead to their 401(k) plan accounts—totaling $50 million. This amount is withheld from electing employees' paychecks and the employer pays the entire $50 million to the plan by between January 1 and June 30, 2002.

In the mind of the typical 401(k) plan participant (and in Labor Department guidance under Title I of ERISA), his or her elective deferrals to the 401(k) plan are his or her own contributions, because they are deducted from his or her paycheck. But for Internal Revenue Code purposes, including the deduction rules under Section 404, the elective deferral is the *employer's* contribution.

Because, for deduction purposes, elective deferrals are employer contributions, they are deductible by the employer under Section 404 of the Code. Recall that the $50 million is paid to the plan between January 1 and June 30, 2002: during the employer's 2002 taxable year, but before the end of the tax filing deadline or "grace period" for its 2001 taxable year. The $50 million paid to the plan in 2002 is thus deductible in 2001 under Section 404(a)(6) if it is "on account of" 2001.

The crux of the employer's accelerated deduction, then, is the meaning of the "on account of" requirement of Section 404(a)(6). What does it mean for the $50 million paid in the employer's 2002 taxable year to be "on account of" its 2001 taxable year, and thus deductible for 2001?

We have argued elsewhere that "on account of" under Section 404(a)(6) means no more than that the grace period contribution must satisfy the Code's deduction limit for the preceding taxable year. Moreover, we maintain that no additional requirements apply through the Code's more general deduction rules to block deduction of the grace period contributions in the preceding taxable year.[3] Thus, if the $50 million is no more than 25 percent of compensation paid or accrued in 2001 with respect to covered employees, the contribution is "on account of" 2001 and deductible for that year.[4]

The IRS has never agreed that "on account of" is only a deduction limit test. Nor does it necessarily agree that satisfaction of the "on account of" test under Section 404(a)(6) is the only hurdle to grace period deductions of 401(k) plan contributions.

In Revenue Ruling 2002-46, the IRS sets forth its most recent theory of what "on account of" does mean. Again to keep things relatively simple, we return to the facts of our hypothetical employ-er, tweaked to conform with Revenue Ruling 2002-46. On December 31, 2001—the last day of the 2001 taxable year—the board of directors of our hypothetical employer resolves that a $50 million contribution will be paid to the plan between January 1 and June 30, 2002, for the plan year ended June 30, 2002. It is assumed in the ruling and in this article that the resolution gives rise to a binding contribution obligation.[5]

Of course, the employer cannot predict exactly how many dollars in elective deferrals will be elected by participants through June 2002. If participants elect $45 million, the employer will have committed itself to an excess $5 million contribution. Because the plan contains a formula for allocating discretionary contributions, any of the $50 million obligation not soaked up by elective deferrals will still be paid to the plan and allocated to participants' accounts according to the plan formula.

As it happens, participants elect $50 million in elective deferrals by June 30, 2002, and the employer pays that amount to the plan between January 1

and June 30, 2002. The employer thus pays the entire $50 million to the plan during its 2002 taxable year, but seeks to deduct it in 2001, under Section 404(a)(6).

Revenue Ruling 2002-46 holds that the employer cannot deduct the $50 million in 2001, for the reason that the contributions are not "on account of" 2001 as required under Section 404(a)(6). The ruling so holds even though the employer's obligation to pay the $50 million contribution was fixed in 2001. The amount is not "on account of" the preceding year, the ruling reasons, because "attributable to compensation earned after the end of" the 2001 taxable year.

A companion piece of guidance, Notice 2002-48, highlights the holding of Revenue Ruling 2002-46. Again tweaking the facts slightly to fit our hypothetical: instead of fixing a liability to pay $50 million to the plan, the Notice 2002-48 employer actually pays $50 million to the plan on December 31, 2001, for the plan year ended June 30, 2002. The December 31, 2001, payment is allocated to participants' accounts between January 1 and June 30, 2002, on the basis of their elective deferrals during that period. Notice 2002-48 holds that, pending further guidance, the $50 million December 31, 2001, payment is deductible in 2001, even though not allocated to participants' accounts until 2002 as compensation for services in 2002. The notice observes that the $50 million December 31, 2001, contribution is deductible in 2001 under Section 404(a)(3), in the taxable year "when paid." The "on account of" requirement for claiming deductions in the preceding taxable year under Section 404(a)(6) does not apply.

To sum up the net effect of these two pieces of guidance: under both the ruling and the notice, a contribution paid to the plan December 31, 2001, and one paid January 1, 2002, would be treated in the same manner by the plan. Both would get allocated to participants' accounts according to their elective deferrals from January 1 to June 30, 2002. But they would get different treatment for deduction purposes. The first is deductible in 2001, the taxable year "when paid" under Section 404(a)(3). The second is not deductible in 2001, because "attributable to" compensation earned after that year, and thus not "on account of" that year as required by Section 404(a)(6). It would, of course, generally be deductible in 2002, "when paid" under Section 404(a)(3).

A STROLL THROUGH THE BONEYARD

Before we examine how startling this new theory is on its own terms, we first give a brief tour of the IRS's previous theories now apparently discarded—implicitly or expressly—in their entirety.

"In the Same Manner"

In the IRS's first guidance under Section 404(a)(6), Revenue Ruling 76-28 held that a contribution to a qualified plan was "on account of" the preceding taxable year if claimed on the return for that year, and treated by the plan "in the same manner" as a contribution paid to the plan on the last day of that preceding taxable year.

With its "in the same manner" test for "on account of," the IRS may be said to have traded one obscure term for another. The "in the same manner as" rule is "hardly pellucid," observed the 10th Circuit.[6] Even the IRS has had trouble articulating its own rule, and in a technical advice memorandum conceded that the "in the same manner" rule is "meaningless" when applied to a defined benefit plan.[7]

In Revenue Ruling 90-105, the IRS made another run at "in the same manner." Revenue Ruling 90-105, like Revenue Ruling 2002-46, confined its holding to elective deferrals and matching contributions. We discuss Revenue Ruling 90-105 in terms of facts tweaked to conform with the example we are already working with: that is, the employer pays $50 million to the plan between January 1 to June 30, 2002, to satisfy employees' elective deferrals between those dates, and attempts to claim the $50 million as a deduction in 2001 under Section 404(a)(6). (In contrast with Revenue Ruling 2002-46, the Revenue Ruling 90-105 employer does not fix an obligation in 2001 to pay a minimum contribution to the plan in 2002.)

In holding that the $50 million is not deductible in 2001 under Section 404(a)(6), Revenue Ruling 90-105 starts its analysis by noting that, under Revenue Ruling 76-28, the employer's 2002 contributions are "on account of" 2001 only if the plan treated the contributions "in the same manner" as a contribution made on the last day of 2001. But the plan "could not have done so." This is so because, explains the ruling:

> If Plan X had instead received a payment of the Post-Year End Contributions on the last day of M's [2001] 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 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 [2001] Taxable Year and therefore what portion of the payment could properly be treated as consisting of elective deferral and matching contributions

That is, Revenue Ruling 90-105 compares the $50 million actually paid in 2002 with a hypothetical $50 million contribution paid December 31, 2001. In a convoluted "impossibility" theory, the ruling argues that the plan "could not" treat the hypothetical $50 million contribution as elective deferrals paid

in 2002 because, as of December 31, 2001, the underlying compensation had not yet been earned—and concludes that the "in the same manner" test is thus not satisfied.

It is unclear whether the "impossibility" posited by Revenue Ruling 90-105 is legal or epistemological—although the ruling suggests it might be both. In either case, as far as tax law is concerned, the "impossibility" theory would appear to be misguided.

Return to the hypothetical $50 million paid December 31, 2001. This would be permitted by Treasury regulations to be paid to the plan and initially held unallocated in suspense account, until allocated gradually to participants' accounts on the basis of their elective deferrals between January 1 and June 30, 2002—just like the actual $50 million paid between those dates.[8] Thus, the hypothetical $50 million paid December 31, 2001, is treated by the plan "in the same manner" as the actual $50 million paid between January 1 and June 30, 2002. There is nothing legally "impossible" about it.

What about the ruling's suggestion of epistemological impossibility—that the "in the same manner" test of Revenue Ruling 76-28 is failed because the employer could not have certain knowledge on December 31, 2001, that the $50 million payment would be allocated as elective deferrals in 2002?

If this is indeed the ruling's argument (it is quite unclear), it is an interpretive leap that Revenue Ruling 90-105 does not attempt to explain or justify. On its face, the "in the same manner" rule of Revenue Ruling 76-28 requires that the hypothetical December 31, 2001, contribution be treated by the plan "in the same manner" as the actual January-through-June 2002 ones—not that its treatment by the plan would have been predictable with certainty *ex ante* had it actually been paid on that date. On a *post hoc* basis, the employer's actual contributions paid January through June of 2002 are necessarily treated by the plan in the same manner as a hypothetical contribution of the same amount paid December 31, 2001. Without more explanation otherwise, this is all that Revenue Ruling 76-28 would on its face appear to require.

After 12 years of sticking to its "impossibility" articulation of the "in the same manner" rule, the IRS seems to have implicitly—but not expressly—acknowledged the weakness of the underlying test. Maybe the IRS even got dizzy—as we do—trying to articulate its almost scholastic, angels-on-the-head-of-a-pin quality. In any event, in Revenue Ruling 2002-46 and Notice 2002-48, the IRS implicitly repeals the "in the same manner" theory altogether.

Recall that the Notice 2002-48 employer (as we have tweaked the facts) pays $50 million to the plan December 31, 2001, for allocation to participants' accounts from January 1 through June 30, 2002. The Revenue Ruling 2002-46 employer pays $50 million January 1 through June 30, 2002, for allocation to participants' accounts during the same dates. In both cases, the $50

million is allocated, by the plan, according to participants' elective deferrals between January 1 and June 30, 2002. That is, the $50 million December 31, 2001, payment in the Notice is treated "by the plan" *exactly* "in the same manner" as the $50 million grace period payments in the Revenue Ruling.

Yet despite manifestly being treated by the plan "in the same manner" as the December 31, 2001 payment, the grace period contributions paid to the plan from January through June 2002 are not "on account of" 2002, according to Revenue Ruling 2002-46. Under this latest guidance, then, it is apparent that meeting the "in the same manner" test no longer meets the Section 404(a)(6) "on account of" requirement. Under the ruling and notice read together, the "in the same manner" test is now seemingly irrelevant. In short, both the "in the same manner" rule of Revenue Ruling 76-28—and the more specific "impossibility" gloss on this rule under Revenue Ruling 90-105—have apparently been revoked utterly, albeit silently.

Services Actually Rendered

Revenue Ruling 90-105 also held that grace period contributions allocated to participants' accounts in 2002 could not be deducted in 2002, because they are compensation for services performed after the year in which the deduction is claimed. Thus, Revenue Ruling 90-105 held, the contributions could not be compensation for services "actually rendered" as required by Section 162, the threshold requirement for pension deductions generally.

In reading services "actually rendered" under Section 162 to mean services "already rendered," Revenue Ruling 90-105 ran contrary to a Tax Court case nearly on point, a Supreme Court case, and other authority.[9]

The IRS apparently recognized its vulnerability on this argument. In Revenue Ruling 2002-48 and Notice 2002-48, the IRS expressly revokes this prong of Revenue Ruling 90-105. "Upon further con-sideration, the Service has concluded that this language is relevant only where the reasonable 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 Rev. Rul. 90-105." [10]

Accrual

Revenue Ruling 76-28 held that grace period contributions to a qualified plan are "on account of" the preceding year under Section 404(a)(6) if the "in the same manner test" is met, even if not accrued in that year. Although the holding is narrower, the implication of Revenue Ruling 76-28 is that no accrual requirement applies to deductions for qualified plan contributions generally. (Why would the ruling bother granting an express pass on the accrual

requirement for grace period contributions, if it assumed that there was an underlying accrual requirement for qualified plan contributions generally?)

In Revenue Ruling 90-105, the IRS did a flip flop on this position. Under its second of three theories for denying the grace period deductions at issue, Revenue Ruling 90-105 held that the grace period contributions were not deductible in the preceding taxable year because not accrued in that year. The ruling found the locus of the accrual requirement not in the "on account of" language of Section 404(a)(6), but rather in the threshold requirement for deductions under Section 404(a), which states that contributions are deductible under that section only if "otherwise deductible" under the Code.

By finding an accrual requirement for qualified plan contributions generally, Revenue Ruling 90-105 was consistent with other IRS guidance issued at about the same time. Temporary Treasury regulations under Section 461 held that a contribution to a qualified plan is deductible under Section 404 "only to the extent that the all events test . . . and the economic performance requirement of Section 461(h) are satisfied."[11] Both Revenue Ruling 90-105 and the temporary regulation under Section 461, however, ran counter to long-standing Treasury regulations under Section 404(a), as well as to a Supreme Court case stating that Section 404(a) puts accrual basis taxpayers on a cash basis for purposes of qualified plan contributions.[12]

After issuance of both Revenue Ruling 90-105 and the temporary regulation, the IRS apparently reconsidered its position that an accrual requirement applies generally to qualified plan contributions. Final regulations under Section 461 omit the above-stated provision of the temporary regulation. The preamble to the final regulation explains that the provision was deleted because "the specific timing rules of Section 404 generally should take precedence over the more general economic performance rules."[13] We must conclude that the IRS has rescinded the position of Revenue Ruling 90-105 and the temporary regulation that an accrual requirement applies to qualified plan contributions generally.

In tax litigation, however, the IRS continued to argue that there is an accrual requirement for grace period contributions—even if not for nongrace period contributions—because of the "on account of" language of 404(a)(6).[14]

In Revenue Ruling 2002-46, the IRS beclouds this argument as well. The ruling states that the contributions at issue are not deductible in the preceding taxable year under its "attributable to compensation earned" theory—whether or not the obligation to make the contribution arose in that preceding year. Thus, under the ruling, it seems that "accrual" is not sufficient for satisfaction of the "on account of" test.

Has the IRS abandoned altogether its litigating position that "on account of" the preceding taxable year means "accrued in" that year? The ruling is not

clear, and does not necessarily imply this conclusion. It could be that the IRS takes the position that "on account of" the preceding taxable year means "accrued in" that year plus something else—the something else being "not attributable to compensation earned after" that year. Whether the simple words of the statute can sustain the freight of this new and possibly piled-on requirement is addressed in the following section.

Revenue Ruling 2002-46

Having briefly looked at the various things the IRS used to say that "on account of" means—but doesn't any more—we turn to what the IRS now says it means.

Revenue Ruling 2002-46 holds that a grace period contribution paid to a qualified plan as elective deferrals or matching contributions is not "on account of" the preceding taxable year if "attributable to" compensation earned after the end of that year.

It is unclear at first glance what is meant by "attributable to" in this context. The ruling cites the Ninth Circuit's opinion in *Lucky Stores v. Commissioner*, 153 F.3d 964 (9th Cir. 1998). The court in this case examined the validity of grace period deductions for contributions made to a multiemployer defined benefit plan, pursuant to the terms of a collective bargaining agreement. The court held that, under the "plain meaning" of the statute, the contributions made one year were not "on account of" the preceding taxable year, and thus not deductible in that preceding taxable year under Section 404(a)(6). The *Lucky Stores* court based its conclusion on its finding that the contribution in any month was contractually required by the terms of the collective bargaining agreement to be made in that month, and could thus not be "on account of" earlier periods:

> The first payment that Lucky made after the end of the 1986 taxable year was clearly "on account of" that year because the payment was required under the collective bargaining agreements for hours worked by covered employees during the final month of the taxable year. The following seven or eight payments were required to be paid because of work done during the taxable year ended in 1987 not the previous year. The bare language of the statute precludes the deduction of those payments on the 1986 return.[15]

That is, in *Lucky Stores*, "on account of" the preceding taxable year means: attributable to services performed in that year giving rise to the contribution obligation.

But this is clearly not the meaning of "attributable to compensation earned" under Revenue Ruling 2002-46. We are told in the facts of the ruling that the "compensation earned" by participants during the grace period in

2002 does *not* give rise to the contribution obligation. Rather, the contribution obligation arises in the *preceding* taxable year, in 2001, and is created by a board resolution fixing the employer's minimum contribution obligation.

If "compensation earned" in the year does not give rise to the contribution obligation, what does it give rise to, such that the contributions are "attributable" to it? Its only apparent significance in Revenue Ruling 2002-46 is that it is the basis for *allocation* of the contribution to participants' accounts. Thus, the only discern- able meaning of "attributable to compensation" earned in a year is "allocated to participants' accounts on the basis of compensation" earned in a year.

To our minds, this meaning of "on account of" has a number of difficulties on general principles of statutory construction.

By its terms, Revenue Ruling 2002-46 applies only to elective deferrals to a 401(k) plan and matching contributions. It thus purports to interpret "on account of" only for such contributions. But the statutory "on account of" requirement of Section 404(a)(6) applies to grace period contributions to all types of qualified plans, including both defined benefit and defined contribution plans. And the ruling's definition of "on account of" would appear to be inadequate or meaningless as applied to all but a handful of these types of plans.

First, by essentially defining "on account of" the preceding year as "allocated to participants' accounts on the basis of compensation earned" before the end of that year, the ruling articulates a definition that has no meaning as applied to defined benefit plans, in which contributions are not allocated to participants' accounts, but rather sit unallocated in a common trust until paid as benefits.

Moreover, even within the universe of defined contribution plans, the ruling's definition of "on account of" appears to be meaningless for a subset of them.

Under the facts of Revenue Ruling 2002-46, compensation is indeed the means for allocating contributions, as participants specify their elective deferrals as a percentage of compensation. But consider a discretionary profit sharing plan with a last-day-of-the-plan-year requirement. To sharpen this a little, consider that the plan has a plan year ended January 31, the employer's taxable year ends December 31, and the employer makes a contribution February 15, 2002, for the plan year ended January 31, 2002, which is allocated to participants' accounts on the basis of their compensation for the plan year, but only for those in service on January 31, 2002. What part of the contribution is attributable to compensation earned after 2001—all of it or a pro-rata piece, equal to the proportion of participants' January 2002 compensation to their February to December 2001 compensation? What if all participants are so highly compensated that they reach their maximum permitted allocation

some time during 2001? Can the entirety of the contributions allocated to their accounts safely be said to be "attributable to compensation earned" in 2001? The vagueness of the "on account of compensation earned" in a taxable year gives rise to all of these questions—and can answer none of them.

The statutory "on account of" rule is not confined to qualified plan contributions. Recall that the statutory grace period for IRA contributions under Section 219 is almost identical, and contains the identical requirement that the grace period contribution be "on account of" the preceding taxable year. Consider an individual who makes a contribution to an IRA on April 15, 2002, and claims it as a deduction on his 2001 tax return. In what sense can the contribution be said to be "attributable to compensation earned" in any particular taxable year? The answer is: in no sense at all. The ruling's definition of "on account of" under Section 404(a)(6) has no discernable meaning when applied to IRA contributions under Section 219.

The Code has other provisions for grace period contributions, worded virtually identically to the grace period for IRA and qualified plan contributions, and containing the identical "on account of" requirement. Section 468A, which provides deductions for contributions to a nuclear decommissioning fund, states that a contribution paid one year is "deemed paid" on the last day of the preceding taxable year if "on account of" that preceding year and paid within two months after year's end. Section 192, which allows a deduction for employer contributions to a black lung trust fund, states that payments to the fund in one year are "deemed paid" on the last day of the preceding taxable year if "on account of" that preceding year, and paid by the tax filing deadline for that year. In both cases, there is no conceivable meaning in interpreting "on account of" the preceding year as "attributable to compensation earned" before the end of that year. In short, four statutory grace periods, under four different Code sections, with four identical "on account of" requirements.

Revenue Ruling 2002-46's definition of "on account of" has any discernable meaning only with respect to one of those Code sections, and then only to one subset of contributions. The limited applicability of this definition does not meet the standards of ordinary principles of statutory construction. Moreover, even within the class of contributions for which the "attributable to compensation earned" rule has any meaning, the ruling has odd results, or collapses even further under its own weight.

Again return to our employer with a taxable year ended December 31, and with a 401(k) plan with plan year ended June 30. This time, however, the plan has a 50 percent matching contribution. For the entire plan year running June 1, 2001, to June 30, 2002, participants make elective deferrals of $100 million. The employer pays the $50 million matching contribution in a lump

sum on January 2, 2003, and attempts to claim the $50 million as a deduction for 2002, under Section 404(a)(6).

Assume that $24 million of the matching contribution is attributable to elective deferrals between June 1 and December 31, 2001—that is, before the 2002 taxable year. Is this $24 million deductible in 2002? Or is it not deductible under Section 404(a)(6), because it is not "attributable to compensation earned" in 2002? If the latter answer is correct, then part of the benefit of the grace period is lost. The $24 million not deductible in 2002 under Section 404(a)(6) is deductible only in 2003, the taxable year "when paid," under Section 404(a)(3).

Moreover, if the plan is terminated June 30, 2002, at the end of the 2002 plan year, the $24 million is never deductible. This is because Section 404(a)(3) limits the deduction for employer contributions to a profit sharing plan to 25 percent of the compensation paid or accrued with respect to covered employees in the taxable year of the deduction. But we have just assumed that the plan is terminated June 30, 2002. So in the taxable year of the deduction (the calendar year running January 1 to December 31, 2002), the compensation of covered employees is zero and the allowable deduction is zero. Thus, under this reading of the ruling, for a plan with a finite life, the grace period contribution deduction might be lost forever.

This odd result drives us to the narrowest possible reading of Revenue Ruling 2002-46. Literally, the ruling holds that the $50 million January 3, 2003, contribution is not "on account of" 2002 if attributable to compensation paid *after* 2002 [emphasis supplied]. Strictly read, the ruling allows a contribution to be "on account of" the preceding year if "attributable to" compensation paid *in* that year, or *before* that year, as long as it is not after that year.

Again, under general principles of statutory construction, we question the validity of this very narrow reading of the statutory term "on account of" the preceding taxable year.

Our skepticism is grounded not in the ruling's narrow holding, per se. Rather, we begin with our previous observation that an identical "on account of" grace period rule applies to contributions to defined benefit plans, defined contributions plans, IRAs, black lung trust funds, and nuclear decommissioning funds. We then note that the ruling's interpretation of "on account of" is not just inadequate but conceptually meaningless as applied to most of these contributions.

In short, given the broad application of the "on account of" rule, we are not persuaded that it was intended by Congress to mean: allocated to participants' accounts in a profit sharing plan with a qualified cash or deferred arrangement, on the basis of compensation earned in that year or before the beginning of that year, but in no event after the end of that year.

CONCLUSION

The IRS has long opposed taxpayers' position that contributions made as elective deferrals to a 401(k) plan can be claimed in the preceding taxable year under the Section 401(a)(6) grace period. In Revenue Ruling 2002-46, it takes its most recent stab at articulating a theory underlying its opposition. The ruling both devises an entirely new interpretation of the statutory "on account of" requirement for grace period contributions and seems to throw out—either expressly or implicitly—most of the IRS's previous theories governing these contributions.

The IRS has devoted a lot of firepower to the issue over the years. It has issued three revenue rulings attempting to articulate the meaning of the "on account of" requirement of Section 404(a)(6). None of the rulings is consistent with the others. And the IRS's most recent attempt—Revenue Ruling 2002-46—formulates a definition of "on account of" that has no discernable connection to the statute and, indeed, has no apparent meaning when applied to most of the contributions the statute covers. Having decided that the Code prohibits the return position at issue in Revenue Ruling 2002-46, the IRS is still having a hard time, it would seem, figuring out what part of the Code that might be. It has attempted to settle the issue by designating the position as a listed tax shelter transaction—even though unable to articulate why it is contrary to law. This is what in the end we find most troublesome. Whatever the purpose of the listed transaction program may be, we believe it should not be used as a substitute for the articulation of substantive tax law.

NOTES

1. See Barker and O'Brien, "*American Stores*: IRS Wins Battle But May Have Lost War Against Accelerated Pension Deductions," 12 *Benefits Law Journal* No. 2 (Summer 1999); "The Ghost in the Machine; Does the All-Events Test Survive in the Qualified Plan Deduction Rules? 11 *Benefits Law Journal* No. 4 (Winter 1998).

2. Code §§ 404(a)(1) (pension trusts), 404(a)(3) (stock bonus and profit sharing trusts).

3. See generally Barker and O'Brien, n1.

4. Code. § 404(a)(3)(A)(i).

5. IRS guidance issued before ERISA held that a board resolution to make a qualified plan contribution is sufficient to give rise to an accruable liability. It is assumed in Rev. Rul. 2002-46 that, even after ERISA's enactment, a board resolution to make a contribution to an ERISA plan creates an employer obligation determinable as to fact and amount. It is assumed for purposes of our article that this assumption is correct.

6. *American Stores v. Commissioner,* 170 F3d. 1267 (10th Cir. 1999).

7. TAM 8210014 (the "in the same manner" requirement is "meaningless" when applied to a defined benefit plan because all contributions to a defined benefit plan are treated in the same way in that they are held in a common trust fund for payment of benefits). And as can be seen from its litigating posture in cases involving multiemployer defined benefit plans, the IRS has since recanted the position taken in TAM 8210014.

8. Treas. Reg. § 401(b)-1(b)(1)(ii).

9. *Plastic Engineering & Mfg. Co. v. Commissioner,* 78 T.C. 1187, 1193 (1982) (services not required to be rendered in year of deduction under 404(a)); *Lucas v. Ox Fibre Brush Co.*, 281 U.S. 11 (1939) ("actually rendered" of § 162 does not require that services be performed in same year–*dictum* as to services *after* year of deduction); GCM 34962 (1972) ("actually rendered" of § 162 does not require services in year of deduction); *Ware Knitters, Inc. v. United States*, 168 F. Supp. 208 (Ct. Cl. 1958) (services "actually rendered" can mean services rendered in present, past or future).

10. Notice 2002-48.

11. Temp. Treas. Reg. § 1.461(h)-4T.

12. *Don E. William Co. v. Commissioner*, 429 US 569, 578-9. Treas. Reg. § 1.404(a)-1(c) (contributions under Section 404(a) deductible in year paid, "regardless of the fact that the taxpayer may make his returns on the accrual method of accounting").

13. Treas. Reg. § 1.461(h)-4 and preamble. T.D. 8408, 1992-1 C.B. 155, 158.

14. See, e.g., Commissioner's Br, *American Stores v. Commissioner,* 170 F3d. 1267 (10th Cir. 1999).

15. *Lucky Stores v. Commissioner*, 153 F.3d at 966.

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