JUL 17 2000

Significant Index No. 446.00-00

200110031

internal Revenue Service

Employee Plans Technical Advice Memorandum

OP:E:EP:A:1

Taxpayer =
Taxpayer's Address =

Taxpayer's Identification Number =
Years Involved = 1989 – 1991

Conference Held on May 18, 1999

Issue

Whether Taxpayer changed its method of accounting when it began to deduct certain payments made to pension plans after the end of the tax year, but within the time period described by § 404(a)(6) of the Internal Revenue Code ("the Code").

Facts

Taxpayer' filed its tax returns on a calendar year basis. Taxpayer makes contributions to various multi-employer pension plans pursuant to negotiated collective bargaining agreements.[2] The pension plans are qualified within the meaning of § 401 of the Code. Contributions to the plans are required to be made on a monthly basis in accordance with the terms of the contracts with the unions.

Prior to 1981, deductions for tax purposes were based on contributions actually made to the plans on account of hours of service performed during the calendar year. For 1981 and later years, contributions to the plans for financial statement purposes continued to be reported on the basis of contributions actually made for hours of service performed during the calendar year. However, the treatment of deductions for income tax purposes was changed for 1981 and subsequent

---

[1] On May 4, 1995, changed its name to The tax returns for 1989-1991 were filed using On August 11, 1995, acquired all shares of which is presently operating as a subsidiary of

[2] The information furnished with the request for technical advice does not provide either the names or the number of plans involved. However, such information is not critical to the legal analysis.

180

years. The deductions taken on the tax returns were based on contributions actually made to the plans on account of hours of service performed after the end of the taxable year, but prior to the due date for the tax return (generally an 8 ½ month period). For 1981 this meant a deduction for 20 ½ months of contributions. For the later years, the taxpayer therefore deducted 3 ½ months of contributions actually made for hours of service performed in the taxable year and 8 ½ months of contributions made for hours of service performed in the next taxable year.

As a result of this method of deducting contributions, amounts were deducted on tax returns in excess of book income in the cumulative amount of $16,781,000 from 1981 through 1989.[3] Stated another way, $16,781,000 of contributions that were made in the first 8 ½ months of 1990 were deducted on the tax return for 1989 because of this change. The contributions made for hours of service performed after the end of the year were generally made on account of the taxable year when contributed and not on account of the earlier taxable year for which they were deducted.[4] Accordingly, such amounts were not properly deductible for the taxable year in which taken. See Lucky Stores Inc. and Subsidiaries v. Commissioner, 107 TC 1(1996), recons. denied, TC Memo 1997-70, aff'd., 153 F. 3d 964 (9th Cir. 1998), cert. denied, 119 S. Ct. 1755 (May 17, 1999), Airborne Freight Corp. v. United States, 153 F. 3d 967 (9th Cir. 1998), cert. denied, 119 S. Ct. 1755 (May 17, 1999), and American Stores Company v. Commissioner, 108 TC No,12 (1997), aff'd., 170 F. 3d 1267 (IO'" Cir. 1999), cert. denied, 145 L. Ed 2d 153 (October 4, 1999).

Even though the contributions made for hours of service performed after the end of the taxable year were not properly deductible for the prior year, the years 1981-1988 are closed years. The District Director believes that the change in treatment in 1981 constitutes a change in accounting method as defined in § 446. He proposes that Taxpayer return to its pre-1981 method of accounting and has computed the appropriate adjustment under § 481(a) of the Code. Taxpayer maintains that the change in treatment in 1981 does not constitute a change in accounting method.

[3] The request for technical advice gives a detailed accounting by year of the $16,781,000 figure. We understand that the amounts are only those made after the end of the year and that the total amounts contributed were much greater.

[4] Note that contributions made in January on account of hours worked in December (or an earlier month) would of course be on account of the earlier year. However, we do not know the details of the contributions. Accordingly, for purposes of the technical advice memorandum, we assumed that all contributions made after the end of the taxable year were on account of hours worked during the year in which the contributions were made.

Law

Under § 446(e) of the Code and § 1.446-1 (e)(2)(i) of the Income Tax Regulations a taxpayer must secure the consent of the Commissioner before changing the method of accounting used to compute income. A change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. A material item is any item which involves the proper time for the inclusion of the item in income or the taking of a deduction. See § 1.446-1(e)(2)(ii)(a).

A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability. Also, a change in method of accounting does not include adjustment of any item of income or deduction which does not involve the proper time for the inclusion of the item of income or the taking of a deduction. For example, corrections of items that are deducted as business expenses, but which are in fact personal expenses, are not changes in method of accounting. In addition, a change in the method of accounting does not include an adjustment with respect to the addition to a reserve for bad debts or an adjustment in the useful life of a depreciable asset. Although such adjustments may involve the question of the proper time for the taking of a deduction, such items are traditionally corrected by adjustments in the current and future years. In addition, a change in the method of accounting does not include a change in treatment resulting from a change in underlying facts. See § 1.446-1(e)(2)(ii)(b) of the regulations.

Under § 481(a) of the Code, if there is a change in the method of accounting, there shall be taken into account adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. A change in the method of accounting to which § 481 applies includes a change in the overall method of accounting for gross income or deductions, or a change in the treatment of a material item. See § 1.481-l(a)(l) of the regulations.

Rev. Rul. 90-105, 1995-2 C.B. 69, holds that contributions to a qualified cash or deferred arrangement within the meaning of § 401(k) of the Code 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 the taxable year. Rev. Rul. 90-105 required taxpayers using a method of accounting inconsistent with the revenue ruling to change their method of accounting as described therein. Rev. Rul. 90-105 by its terms applies to plans that are subject to § 401 (k) and § 401 (m).

Announcement 90-144, 1990-53 I.R.B. 64, as modified by Announcement 90-144A. provided relief from certain penalties for underpayment of estimated tax in connection with the change in accounting method described in Rev. Rul. 90-105.

Analysis

There is no doubt that after 1980 there was a change in the manner in which pension contributions made after the end of the taxable year were deducted. Prior to 1981, Taxpayer consistently deducted its monthly pension contributions actually made to its pension plans during the taxable year. In 1981, Taxpayer deducted not only the pension contributions actually made during the year, but also the pension contributions actually made during the 8 ½ months following the end of the year that were attributable to service rendered after the close of Taxpayer's taxable year (for a total of 20 ½ months of contributions). For 1982 and thereafter, Taxpayer deducted the 3 ½ months of contributions actually made during the year (after the due date of the return for the prior year) plus the contributions made during the first 8 ½ months of the following year that were attributable to service rendered in the subsequent taxable year.

The years prior to 1989 are closed years. However, if, as the District Director believes, there has been a change in accounting method without the Commissioner's permission, the Taxpayer can be required to change to its pre-1981 method of accounting in the earliest year under examination, which is 1989 An adjustment is then made under § 481(a) to prevent a duplication of the deduction for the amount that was previously deducted. Taxpayer agrees that if, there was a change in accounting method, the required approval of the Commissioner was not obtained. What is in dispute is whether there was a change in accounting method.

The district director maintains that the change in the treatment of the contributions made after the end of the taxable year that were attributable to service rendered after the end of the taxable year was a change in accounting method. Taxpayer argues that there was simply a change in the characterization of the pension contributions. Taxpayer asserts that its method of accounting was (and is) to treat all pension contributions made on account of the prior year as

183

made on the last day of such year, and therefore deduct such contributions for such prior year. To the extent such contributions were not made on account of the prior year, Taxpayer argues there has simply been an error in determining the character of the contributions, not a change in the method of accounting.

In support of its argument, Taxpayer cites Underhill v. Commissioner, 45 T.C. 489 (1966), McPike, Inc. v. United States of America, 15 Cl. Ct. 94 (1988), and W. A. Holt Company v. United States, 365 F.2d 31 1(5th Cir. 1966), aff'g, 65-2 USTC paragraph 9464 (WD TX 1965). In Underhill the question of whether certain debt obligations were speculative, and thus, recoveries during the taxable year were taxable or nontaxable, was determined to be a factual question, not a method of accounting. In McPike the question of whether certain payroll costs were of the type that required capitalization or were susceptible of current deductibility was determined to be factual, not a method of accounting. In W. A. Holt the question of whether bad debts were worthless concerned an improper deduction which was determined to be a distortion of income, not a change in accounting method.

A method of accounting assigns items of income and expense to taxable years to determine taxable income. A change in the method of assigning items of income or expense among the taxable years (i.e., the time) changes when the items are taken into account for purposes of determining taxable income. Accordingly, a change in the method of assigning when an item is taken into account is a change in accounting method.

The sole effect of the change in the way that Taxpayer treated the contributions attributable to hours of service performed after the end of the taxable year was to change the taxable year to which they were assigned and thereby change the timing of the deduction for such amounts. Regardless of whether the pre-1981 or the post-1980 method was used to assign contributions to a taxable year, there is no permanent difference in income. Thus, by changing the way that contributions attributable to service after the end of the taxable year were assigned to a taxable year, Taxpayer was changing the timing of the deduction for such contributions. Such a change in treatment is a change in accounting method.

Taxpayer is incorrect in asserting that the change in treatment was a change in the characterization, or was a mistake in determining whether the contribution was on account of the prior year (i.e., a factual mistake). Furthermore, the cases

184

cited for support are distinguishable from the instant situation. In Underhill the question was whether the notes held by the taxpayer were speculative or not speculative, and thus whether the recoveries on those notes during the taxable year were taxable or nontaxable, which does not itself relate to timing. Similarly, in McPike the question was whether the taxpayer's payroll costs should have been deducted or capitalized, a substantive issue which does not itself relate to timing. Finally, in W.A.Holt, the question of whether a bad debt was worthless concerns more than simply the timing of a deduction. Each of these cases involved a question of "what kind of item?" In the instant case, there is no question of what kind of contributions were being made to the pension plan. The only question is the assignment of the contributions to taxable years.

In its post-conference submission dated July 30, 1999, Taxpayer argues that once a factual determination is made as to whether a contribution is made on account of a particular taxable year, the issue of when the contribution is deductible is governed by statute. In support of this argument, Taxpayer cites Standard Oil v. Commissioner, 77 T.C. 349, 383 (1981). However, in our view, Standard Oil is clearly distinguishable.

Standard Oil was concerned with whether certain costs qualified as intangible drilling and development costs ("IDCs") and were thus deductible in accord with the taxpayer's election under § 263(c) of the Code and § 1.612-4 of the regulations. The court specifically stated that it was not suggesting that § 446(e) would not be applicable in the situation where a taxpayer has previously capitalized all IDCs and then seeks to deduct such costs without the Commissioner's consent. (Standard Oil at 383.)

Unlike the situation in Standard Oil, for 1980 and earlier taxable years, Taxpayer had treated all contributions made for hours of service performed after the end of the taxable year in a similar manner. In 1981, Taxpayer changed the treatment for such contributions. Both before 1981 and after 1980 the contributions at issue were made for hours of service performed after the close of the taxable year. What has changed is the taxable year to which contributions are assigned and in which contributions are deducted. Such a change in treatment is a change in accounting method.

185

Conclusion

Taxpayer changed its method of accounting in 1981 when it changed the treatment of pension contributions made for hours of serviceperformed after the end of the taxable year.

This memorandum only applies to the taxpayer involved. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This memorandum has been coordinated with the Associate Chief Counsel, Income Tax and Accounting (CC:IT&A) and the Division Counsel/Associate Chief Counsel, Tax Exempt and Government Entities (CC:TEGE:EB:QP1).

-END-

186