Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461–1: General rule for taxable year of deduction.
(Also § 1.461–5.)

Taxes, accrual of deduction. Under the all events test of section 461 of the Code, an accrual method employer may deduct in Year 1 its otherwise deductible FICA and FUTA taxes imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, if the requirements of the recurring item exception are met.

Rev. Rul. 96–51

ISSUE

Under the all events test of § 461 of the Internal Revenue Code, may an accrual method employer deduct in Year 1 its otherwise deductible Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2?

FACTS

X, a corporation, employs the accrual method of accounting and uses a calendar taxable year. *X* pays otherwise deductible wages to its employees biweekly on the Friday immediately following a two-week pay period. Wages for the pay period beginning Saturday, December 23, 1995, and ending Friday, January 5, 1996, were paid to *X*'s employees on Friday, January 12, 1996. Prior to filing its 1995 corporate federal income tax return on March 15, 1996, *X* paid the taxes owed under §§ 3111 (the employer's share of FICA taxes) and 3301 (FUTA taxes) with respect to the December 23–31, 1995 wages that *X* properly accrued in 1995. *X* properly adopted the recurring item exception under § 1.461–5 of the Income Tax Regulations as a method of accounting with respect to *X*'s recurring liability for its share of FICA and FUTA taxes imposed in connection with accrued but unpaid year-end wages. On its 1995 return, *X* deducted the FICA and FUTA taxes it paid on the accrued year-end wages.

LAW AND ANALYSIS

Section 461(a) provides that the amount of any deduction or credit must be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 461(h) and § 1.461–1(a)(2)(i) provide that, under the accrual method of accounting, a liability is incurred, and is generally taken into account for federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred with respect to the liability. The economic performance requirement applies to liabilities allowable as a deduction or otherwise incurred after July 18, 1984.

Section 1.461–4(g)(6) provides generally that, if a taxpayer is liable to pay a tax, economic performance occurs as the tax is paid to the governmental authority that imposed it.

Section 1.461–5 provides a recurring item exception to the general rule of economic performance. Under the recurring item exception, a liability is treated as incurred for a taxable year if: (1) at the end of the taxable year, all events have occurred that establish the fact of the liability and the amount can be determined with reasonable accuracy; (2) economic performance occurs on or before the earlier of (a) the date that the taxpayer timely files a return (including extensions), or (b) the 15th day of the ninth calendar month after the close of the taxable year; (3) the liability is recurring in nature; and (4) either the amount of the liability is not material or accrual of the liability in the earlier year results in a better matching of the liability against the income to which it relates.

Section 1.461–5(b)(5)(ii) provides that, in the case of a liability for taxes, the matching requirement of the recurring item exception is deemed satisfied.

Rev. Rul. 74–70, 1974–1 C.B. 116, holds that, under the all events test, an accrual basis employer generally may not deduct its share of FICA taxes payable with respect to wages accrued but unpaid at year-end until the taxable year in which those wages are actually or constructively paid.

In *Eastman Kodak Co. v. United States*, 534 F.2d 252 (Ct. Cl. 1976), *acq.*, this Bulletin, page 4, the court held that an accrual basis employer may deduct its share of FICA, FUTA, and state unemployment taxes with respect to year-end wages in the year the wages were accrued, rather than in the following year when the wages were paid. The court held that, under the all events test, the fact of the liability may be established, and the amount thereof reasonably ascertained, even though no legally enforceable obligation to pay the taxes in issue had arisen by year-end. The court found that the fact of the employer's liability for the taxes was established as an automatic consequence of its definite and legal obligation to pay the underlying year-end accrued wages. *See also Burlington Northern R.R. v. Commissioner*, 82 T.C. 143 (1984), *acq.* this Bulletin, page 4 (reaching the same conclusion on the deductibility of the § 3221 employer tax under the Railroad Retirement Tax Act with respect to accrued year-end wages).

Similarly, *X* satisfied the all events test for the federal employment taxes imposed with respect to accrued year-end wages for 1995 because the fact of its liability to pay those taxes was established as an automatic consequence of its accrual of the underlying wages and the amount of those taxes was reasonably ascertainable. Further, *X* satisfied the requirements of the recurring item exception because the all events test was satisfied by the end of 1995, economic performance occurred within the prescribed time because the taxes were paid prior to the filing of *X*'s 1995 return, the liability was recurring in nature, and the accrual of the tax liability in 1995 is deemed (under § 1.461–5(b)(5)(ii)) to result in a better matching of that liability against the income to which it relates. Accordingly, *X* may deduct on its 1995 return the FICA and FUTA taxes it paid on the accrued year-end wages.

HOLDING

Under the all events test of § 461, an accrual method employer may deduct in Year 1 its otherwise deductible FICA and FUTA taxes imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, provided the employer satisfies the requirements of the recurring item exception with respect to these taxes.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 74–70 is revoked.

APPLICATION

The tax treatment of an employer's FICA and FUTA taxes with respect to year-end wages within the scope of this revenue ruling constitutes a method of accounting. An employer currently treating those taxes in a manner different from that provided in this revenue ruling must seek the Commissioner's consent to change its method of accounting. A change in method of accounting for those taxes is a change in method of accounting to which §§ 446(e) and 481 apply. This change in method of accounting must be made in accordance with Rev. Proc. 92–20, 1992–1 C.B. 685.

DRAFTING INFORMATION

The principal author of this revenue ruling is Barry M. Freiman of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Freiman at (202) 622–4950 (not a toll-free call).