

DEDUCTIBILITY OF ACCRUED VACATION PAY

SEPTEMBER 12, 1963.—Ordered to be printed

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 6246]

The Committee on Finance, to whom was referred the bill (H.R. 6246) relating to the deductibility of accrued vacation pay, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY OF BILL

H.R. 6246 provides that a deduction for accrued vacation pay is not to be denied for any taxable year ending before January 1, 1965, solely because the liability for it to a specific person has not been fixed or because the liability for it to each individual cannot be computed with reasonable accuracy. However, for the corporation to obtain the deduction, the employee must have performed the qualifying service necessary under a plan or policy which provides for vacations with pay to qualified employees and the liability must be reasonably determinable with respect to the group of employees involved. This is a continuation for 2 more years of the treatment which has been available for taxable years ending before January 1, 1963.

II. GENERAL STATEMENT

Under the 1939 code (sec. 43), the period of time for taking deductions was stated to be the taxable year in which the expenses were "paid or accrued" or "paid or incurred," depending upon the method of accounting, "unless in order to clearly reflect the income, the deductions or credits should be taken as of a different period." Under this provision, it was held that vacation pay for the next year could be accrued as of the close of the taxable year in which the qualifying services were rendered. However, under the employment contract, all of the events necessary to fix the liability of the taxpayer for the

vacation pay must have occurred by the close of the taxable year. In determining whether the events necessary to fix the liability of the taxpayer for vacation had occurred, the fact that the employee's rights to a vacation (or payment in lieu of vacation) in the following year might be terminated if his employment ended before the scheduled period was not regarded as making the liability a contingent one (rather than a fixed one). It was held that the liability was not contingent since the employer could expect the employees as a group to receive the vacation pay and, therefore, that only the specific amount of the liability with respect to individuals remained uncertain at the close of the year (GCM 25261, C.B. 1947-2, 44; I.T. 3956, C.B. 1949-1, 78).

In 1954, Congress enacted section 462 of the 1954 code which provided for the deduction of additions to reserves for certain estimated expenses. With this provision in the Internal Revenue Code, it was thought that reserves for vacation pay generally would be covered and, therefore, that it was no longer necessary to maintain the liberal administrative position described above with respect to vacation pay. As a result, in Revenue Ruling 54-608 (C.B. 1954-2, 8), the Internal Revenue Service revised its position on the deductibility of vacation pay. In this ruling, it held that no accrual of vacation pay could occur until the fact of liability with respect to specific employees was clearly established and the amount of the liability to each individual employee was capable of computation with reasonable accuracy. It was thought that taxpayers accruing vacation pay under plans which did not meet the requirements of the strict accrual rule set forth in this ruling would utilize section 462 of the 1954 code. This ruling was initially made applicable to taxable years ending on or after June 30, 1955.

Because section 462 of the code was repealed, the Treasury Department in a series of actions continued to postpone the effective date of Revenue Ruling 54-608 until January 1, 1959 (the last of these postponements was made in Revenue Ruling 57-325, C.B. 1957-2, 302, July 8, 1957). It stated that Revenue Ruling 54-608 was to be inapplicable to taxable years ending before January 1, 1959, and also that in cases involving an agreement with a labor union which was in effect on June 30, 1957, which expired after December 31, 1958, the ruling was to be applicable for the first time to taxable years ending on or after the 90th day following the date the labor agreement expired.

Congress, in the Technical Amendments Act of 1958, further postponed the effective date of Revenue Ruling 54-608 for 2 more years, making it inapplicable to taxable years ending before January 1, 1961. Subsequently, Congress in Public Law 86-496 still further postponed the effective date of Revenue Ruling 54-608. This law provided that this ruling was not to become effective with respect to deductions for accrued vacation pay for any taxable year ending before January 1, 1963.

This bill postpones for 2 more years the effective date of Revenue Ruling 54-608. As a result, deductions for accrued vacation pay will not be denied for any taxable year ending before January 1, 1965, solely by reason of the fact that the liability for the vacation pay to a specific person has not been clearly established or that the amount of the liability to each individual is not capable of computation with

reasonable accuracy. This additional time is provided by this bill so Congress will have an opportunity to consider the problem of the deduction of accrued vacation pay and other similar accrual-type deductions prior to the application of this Revenue Ruling 54-608 which provides stringent rules in this area.

III. DEPARTMENTAL REPORT

The report of the Department of the Treasury follows:

TREASURY DEPARTMENT,
Washington, August 9, 1963.

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reference to your request for the views and recommendations of this Department on H.R. 6246, relating to the deductibility of accrued vacation pay, which passed the House of Representatives June 27, 1963.

Section 97 of the Technical Amendments Act of 1958, as amended, provides that where there is a plan or policy providing for vacations with pay to qualified employees, deductions for accrued vacation pay shall not be denied for taxable years ending before January 1, 1963, solely because the liability for the vacation pay to specific employees is not fixed or cannot be computed as of the close of the taxable year for which the deductions are taken. The purpose of enacting this section was to enable Congress to study the question of the treatment of vacation pay before permitting the application of a revenue ruling of the Internal Revenue Service which provides that vacation pay does not accrue until the liability with respect to specific employees is fixed and the amount of the liability is capable of computation.

As originally enacted, section 97 of the Technical Amendments Act of 1958 applied to taxable years ending before January 1, 1961. In 1960 Congress enacted Public Law 86-496, which extended the applicability of section 97 to taxable years ending before January 1, 1963, in order to give Congress further time to study this question. The above-mentioned bill would again extend the applicability of section 97 to taxable years ending before January 1, 1965. If Congress should want to extend the applicability of section 97 of the Technical Amendments Act of 1958 in this manner, the Department would not object.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the Administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

IV. CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman):

SECTION 97 OF THE TECHNICAL AMENDMENTS ACT OF 1958

(26 U.S.C., sec 162 note)

SEC. 97. DEDUCTIBILITY OF ACCRUED VACATION PAY.

Deduction under section 162 of the Internal Revenue Code of 1954 for accrued vacation pay, computed in accordance with the method of accounting consistently followed by the taxpayer in arriving at such deduction, shall not be denied for any taxable year ending before January 1, ~~1963~~ 1965, solely by reason of the fact that (1) the liability for the vacation pay to a specific person has not been clearly established, or (2) the amount of the liability to each individual is not capable of computation with reasonable accuracy, if at the time of the accrual the employee in respect of whom the vacation pay is accrued has performed the qualifying service necessary under a plan or policy (communicated to the employee before the beginning of the vacation year) which provides for vacations with pay to qualified employees.

