

DEDUCTIBILITY OF ACCRUED VACATION PAY

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Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

R E P O R T

[To accompany H.R. 16774]

The Committee on Finance, to which was referred the bill (H.R. 16774) to continue for a temporary period certain existing rules relating to the deductibility of accrued vacation pay, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY OF BILL

H.R. 16774 provides that a deduction for accrued vacation pay is not to be denied for any taxable year ending before January 1, 1969, 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 plan or policy must have been communicated to the employees involved before the beginning of the vacation year. This is a continuation for 2 more years of the treatment which has been available for taxable years ending before January 1, 1967.

The Treasury Department has indicated that it does not object to its enactment.

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, provided all of the events necessary to fix the liability of the taxpayer for the vacation pay under the employment contract had occurred by the close of the taxable year. In determining whether the events necessary to fix the liability of the taxpayer for vacation pay 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; only the specific amount of the liability with respect to individuals remained undertain 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 a provision, 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 postponed 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). These actions rendered Revenue Ruling 54-608 inapplicable to taxable years ending before January 1, 1959. In cases involving an agreement with a labor union which was in effect on June 30, 1957, and did not expire until 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 (sec. 97), 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 three actions (Public Law 86-496, Public Law 88-153, and Public Law 88-554) further postponed the effective date of Revenue Ruling 54-608. The first of these laws postponed the effect of this ruling with respect to deductions for accrued vacation pay for any taxable year ending before January 1, 1963, the second law postponed it for these deductions in any taxable year ending before January 1, 1965, and the third postponed it for these deductions in any taxable year ending before January 1, 1967.

This bill postpones for 2 more years the effective date of Revenue Ruling 54-608. As a result, deductions for accrued vacation pay, if computed by an accounting method consistently followed by the taxpayer, will not be denied for any taxable year ending before January 1, 1969, solely because the liability to a specific person for vacation pay has not been clearly established or because the amount of the liability to each individual cannot be computed with reasonable accuracy. This additional time is required so Congress will have further time to consider the problem of the deduction of accrued vacation pay and of other similar accrual-type deductions prior to the application of Revenue Ruling 54-608.

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, as reported, 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, **[1967]** 1969, 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.

