

Client Alert

IRS Guidance Impacts Timing of Deduction Related to Annual Bonus Payments

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Early last month, the IRS released a Chief Counsel Memorandum, dated July 28, 2009,¹ that addresses the proper year in which a tax deduction can be taken related to an annual bonus. In the situation analyzed, an annual bonus for Year 1 was paid within the first 2½ months of the beginning of Year 2, but the employee's right to the payment was subject to his/her continued employment and service through the date of payment. The IRS memo found that in such a situation the "all events test" had not been satisfied in Year 1, so the company could not take a deduction for the bonus amount paid in Year 2, even though the bonus amount was accrued on the company's books at the end of Year 1 and then paid within the first 2½ months of the start of Year 2.

Practical Considerations

As a practical matter, companies should review their annual bonus plans and payment terms to determine if they are subject to a requirement that employees continue their employment through the date the bonus is paid.

If so, companies should review their specific set of facts to ensure they are taking the tax deduction for such bonus payments in the proper year, i.e., in Year 2 in the situation discussed in the memo.

Of course, if a company wants to take the deduction for the Year 1 bonus in Year 1, then any service requirement in Year 2 should be revised so that the tax deduction can be taken in Year 1.

Note: *We understand that some states' laws actually find such provisions for continued employment through the date of payment after a performance period has ended to be unenforceable, e.g., California. Consequently, companies should check with their legal counsel to determine if and how state law might impact this analysis and the timing of the tax deductibility of annual bonus payments.*

¹ Office of Chief Counsel Internal Revenue Service Memorandum, *Accrual of Bonus Compensation*, December 4, 2009, available at: <http://www.irs.gov/pub/irs-wd/0949040.pdf>



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