

## Publications

# Recent IRS Snapshot Suggests Audit Interest in Timing of Employer Deductions of Retroactive Contributions to 401(k) Plans

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The IRS recently released an Issue Snapshot, [\*Deductibility of employer contributions to a 401\(k\) plan made after the end of the tax year\*](#), to review the timing rules for employer contribution deductions under Code section 404(a)(6) and the limits on “annual additions” under Code section 415.

The SECURE Act may have heightened the interest of IRS agents in auditing employer deductions of retroactive contributions to 401(k) plans. The rules are relatively complex and sometimes misapplied. And section 201 of the SECURE Act, which became effective for taxable years beginning after December 31, 2019, has added a new rule which allows an employer to retroactively adopt a new 401(k) plan – and make tax-deductible contributions – until the employer’s tax-filing deadline (including extensions) for the taxable year of adoption.

## A. Key Principles Covered In The Snapshot

### *Timing of deductible profit-sharing or matching contributions – in general*

Code section 404(a)(3)(A)(i) generally limits employer deductions of contributions to contributions made in the tax year when paid. However, Code section 404(a)(6) permits an employer to deduct profit-sharing or matching contributions made to a retirement plan after the close of a tax year, but before the employer’s extended tax-filing deadline for that tax year, if certain requirements are met. Whether the employer uses cash or accrual basis accounting, in order to deduct contributions in the prior tax year, the employer must treat its contributions as having been allocated to that tax year, and actually make the contributions to the new retirement plan no later than the employer’s extended tax-filing deadline.

We note, however, that an employer cannot make—and deduct—matching contributions on account of employee contributions of compensation earned after the end of a tax year. As discussed in Rev. Rul. 90-105, unlike a non-elective employer

profit-sharing contribution, an employer matching contribution is keyed to an employee contribution to a retirement plan.

## *Timing of allocations to participant accounts for section 415 purposes*

If an employer does not actually make contributions to a retirement plan by the employer's extended tax-filing deadline, the employer cannot *deduct* the contributions under Code section 404(a)(6) for the prior tax year. However, if the employer makes the contributions to the plan within 30 days of the employer's extended tax-filing deadline, the employer can *allocate* the contributions for the prior tax year, and treat the contributions as prior tax year annual additions for purposes of the Code section 415 limits. Under Treas. Reg. 1.415(c)-1(b)(6)(i)(B), employer contributions to a retirement plan are not treated as credited to a plan participant's account for a particular limitation year, unless the employer actually pays the contributions to the plan within 30 days of the employer's extended tax-filing deadline. The employer can also deduct the contributions for the current tax year, provided that the contributions, when combined with other contributions deducted for the current tax year, do not exceed the Code section 404(a)(3) limitations.

## *Timing of Elective Deferrals*

While the profit-sharing plans of many employers already provide for Code Section 401(k) employee elective deferrals, an employer may choose to add the feature at a later date. Under Treas. Reg. 1.401(k)-1(a)(3)(iii), elective deferrals are permitted only with respect to amounts that are not "currently available" to an employee as of the date of election, because a "qualified cash or deferred arrangement" (CODA) – i.e., the choice between receiving cash compensation or deferring compensation into a plan – must be established before an employee makes an election.

This is an area where SECURE 2.0 also changed the rules a bit. Section 317 of SECURE 2.0 amended Code section 401(b)(2) to allow retroactive elective deferrals for some one-person plans. Effective for plan years beginning after December 29, 2022, an individual who (1) owns the entire interest in an unincorporated business, and (2) is the only employee of that business can adopt a new 401(k) plan after the end of a taxable year, and, for that first year only, may elect to defer net self-employment earnings for the prior year until the individual's tax filing deadline (without extensions).

The IRS snapshot includes five illustrative examples to help explain these principles.

## B. Next Steps

As the IRS advises in its Issue Snapshot, employers should confirm that any deductions and allocations of retroactive contributions to a retirement plan are made to the appropriate tax year.

In an audit of a retirement plan, IRS auditors may seek to confirm that:

- An employer who deducted contributions made to the plan during the current tax year for the prior tax year treated its contributions as having been allocated to the prior tax year, pursuant to a specific plan provision, and actually made contributions no later than the employer's extended tax-filing deadline.
- An employer made retroactive employer contributions in accordance with plan requirements (e.g., contributions must be made by the employer's extended tax filing deadline, or alternatively, within 30 days of that extended tax filing deadline).
- An employer did not deduct any employer contributions made within 30 days of an employer's extended tax filing deadline for the prior tax year, even if the employer allocated such contributions to the prior tax year for purposes of section 415 annual additions.