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TAXATION—FEDERAL INCOME TAX—DEDUCTIBLE CONTRIBUTIONS TO NON-QUALIFIED PROFIT-SHARING PLANS—In 1942 plaintiff employer adopted a profit-sharing plan under which a percentage of each year's profits was to be deposited in irrevocable trusts for distribution to its employees in succeeding years. The plan was not "qualified" under the Internal Revenue Code.[1] Although under the terms of the trusts each employee's rights in the fund vested at the time the contribution was made by the em-

[1] For a plan to qualify for a deduction without regard to the forfeitability of the employees' rights, it must benefit a specified percentage of employees and be nondiscriminatory. Revenue Act of 1942, 56 Stat. 862, §162 (a), now I.R.C., §401.

ployer, these rights would be forfeited by voluntary resignation prior to a fixed date. In 1945 plaintiff deducted the amount contributed to the trust in that year as a contribution to a non-qualified profit-sharing plan under subsection (D) of section 23 (p) (1),[2] but the Commissioner of Internal Revenue disallowed any deduction in that or any other year for amounts contributed to or paid from any of the funds, alleging that at the time the contribution was made to the trust the rights of the employees were forfeitable.[3] In an action to recover overpayment of income and excess profits taxes, *held,* Commissioner's determination overruled, and recovery allowed, one judge dissenting. Under subsection (D) of section 23 (p) (1), plaintiff is allowed to deduct in 1945 not the amount contributed to the trust in that year, but rather the amount actually paid from the trust to the employee-beneficiaries in that year, because nonforfeitability in that subsection refers to the time of payment from the trust, and not to the time of payment to the trust. *Russell Manufacturing Co. v. United States,* (Ct. Cl. 1959) 175 F. Supp. 159.

Prior to 1942 contributions to all profit-sharing plans were deductible as ordinary and necessary business expenses,[4] thus permitting deductions for contributions to plans which clearly discriminated in favor of a few highly-paid employees and which did not benefit the majority of employees. In order to remedy what it deemed to be an undesirable situation,[5] Congress in 1942 amended section 23 (p), to make it the only section under which such deductions could be taken.[6] The amendment specified that a contribution would be deductible if it were made to a plan which was qualified under section 165 (a) as amended,[7] thus benefiting a specified percentage of employees and not discriminating. This deduction, restricted only in amount, was to be allowed regardless of the forfeitability of the employee's rights.[8] In addition, subsection (D) provided for the deduction of contributions to plans not meeting these requirements, but only if "the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the

[2] A contribution is deductible "In the taxable year when paid, if the plan is not one included in paragraphs (A), (B), or (C), if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid." Revenue Act of 1942, 56 Stat. 865, §162 (b) (1) (D), now I.R.C., §404 (a) (5).

[3] The regulations provide: "If an amount is paid during the taxable year to a trust or under a plan and the employee's rights to such amounts are forfeitable at the time the amount is paid, no deduction is allowable for such amount for any taxable year." Treas. Reg. 111, §29.23 (p)-11 (1942), as amended, T.D. 5666, 1948-2 Cum. Bul. 46.

[4] I.R.C. (1939), §23 (a), now I.R.C., §162 (a).

[5] See H. Rep. 2333, 77th Cong., 2d sess., pp. 50-51 (1942).

[6] Revenue Act of 1942, 56 Stat. 863, §162 (b), now I.R.C., §404. Deductions are allowable under this section only to the extent that they would have been deductible under §23 (a), dealing with ordinary and necessary business expenses, in the absence of §23 (p).

[7] See note 1 supra.

[8] Revenue Act of 1942, 56 Stat. 863, §162 (b) (1) (A)-(C), now I.R.C., §404 (a) (1)-(3).

time the contribution or compensation is paid."[9] This requirement of nonforfeitability in the provision dealing with non-qualified plans was intended to be a deterrent to the creation of discriminatory trust arrangements, a part of the overall congressional scheme of encouraging nondiscriminatory plans. Under the construction of this provision by the court in the principal case, the policy of the 1942 amendments[10] is ignored, for almost all payments would be nonforfeitable at the time of actual payment to the employee; as a result, an employer could create the very discriminatory plans which Congress sought to deter and could deduct the contributions to them in the later year when they became nonforfeitable through actual payment to the employee.

In enacting these amendments, taking the deductions for contributions to profit-sharing plans out of the ordinary and necessary business expense category and placing conditions on the deductibility of such contributions, Congress clearly demonstrated an intent that unless these conditions were met, no deduction would be allowed. One such condition, that the deduction is allowed only "in the taxable year when paid," expressed as it is in all the subsections allowing deductions for contributions to employee trusts,[11] demonstrated clearly that a deduction was to be allowed *only* in the taxable year when paid by the employer to the trust, and not when paid by the trustee to the employee.[12] This has consistently been the interpretation of the three provisions dealing with qualified plans.[13] Thus, under the rule that when the same phrase is used in different parts of the same statute it is presumed to be used in the same sense throughout,[14] a like interpretation should be given to subsection (D) as is given to the other three. Moreover, the Internal Revenue Code provided that the term "paid" should be construed according to the method of accounting used by the taxpayer.[15] Thus, if the taxpayer is on the accrual method,

[9] See note 2 supra.

[10] See note 5 supra.

[11] Revenue Act of 1942, 56 Stat. 863, §162 (b) (1) (A-D), now I.R.C., §404 (a) (1) - (3), (5).

[12] H. Rep. 2333, 77th Cong., 2d sess., p. 105 (1942). "The amendments to §23 (p) provide that the amounts paid into a trust that is exempt under §165 (a) shall be deductible only in the year when paid into the trust. . . ." p. 106: "If compensation is paid to a trust which does not meet the requirements of §165 (a) . . . the employer will receive no deduction . . . unless the employee's rights are nonforfeitable, in which case, the employer will be allowed a deduction for the full compensation in the year in which the compensation is paid to the trust." See also S. Rep. 1631, 77th Cong., 2d sess., pp. 140-141 (1942).

[13] Commissioner v. Produce Reporter Co., (7th Cir. 1953) 207 F. (2d) 586; Tavannes Watch Co. v. Commissioner, (2d Cir. 1949) 176 F. (2d) 211; Philadelphia Suburban Transportation Co. v. Smith, (E.D. Pa. 1952) 105 F. Supp. 650; Gross-Given Mfg. Co. v. Kelm, (D.C. Minn. 1951) 99 F. Supp. 144.

[14] Pampanga Sugar Mills v. Trinidad, 279 U.S. 211 (1929); Manufacturers Life Ins. Co. v. United States, (Ct. Cl. 1940) 32 F. Supp. 284; In re Associated Gas and Electric Co., (N.D. N.Y. 1935) 11 F. Supp. 359.

[15] I.R.C. (1939) §48 (c), now I.R.C., §7701 (a) (25).

as was the plaintiff in the principal case, a deduction is allowed only in the year when a liability to pay becomes absolute.[16] Even though the contributions in the principal case accrued and were distributed to the trust from the plaintiff's assets in one year, the court allowed a deduction in a different year, contrary to the express provision of the code. The conclusion of the Commissioner, as stated in the regulations,[17] is warranted by the wording of the statute and is consonant with the congressional policy behind section 23 (p). Because the Internal Revenue Service has refused to acquiesce in the decision of the principal case,[18] and since subsection (D) continues unmodified in the 1954 code,[19] it would behoove an employer who contemplates the creation of a profit-sharing plan to make use of the Pension Trust Division of the service, and obtain its approval before embarking on what may be the dangerous path marked by the principal case.

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[16] Pierce Estates v. Commissioner, (3d Cir. 1952) 195 F. (2d) 475. See also Treas. Reg. 1.461-1 (a) (2) (1957).

[17] See note 3 supra.

[18] I.R.S., T.I.R.-182, 10/23/59, 28 U.S. LAW WEEK 2187 (1959). See also current regulations, Treas. Reg. 1.404 (a)-12 (1956).

[19] I.R.C., §404 (a) (5).