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Some Bonuses Can Be Deducted Even BEFORE They Are Paid

Can a company deduct pay **before** paying it? That sounds like a trick question. Usually the answer is no. Sometimes, though, a tax deduction can come **first** and the pay can be handed over months **later**.

First, ask if the company is cash or accrual basis. Cash basis companies—like individuals—usually can deduct only when they pay. Accrual basis means you deduct when you are legally obligated to pay, even though the cash comes later. The flip side is that accrual basis companies have income when they send an invoice out—since it's payable—even if payment arrives next year.

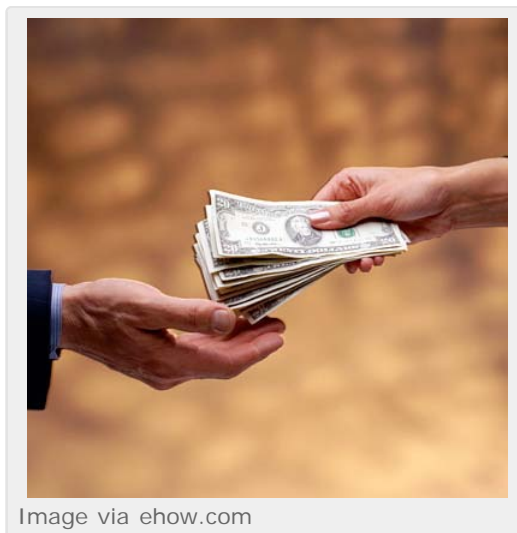


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For pay and bonuses, the IRS has ruled that an accrual-method employer can deduct bonuses payable to a group of employees, even though it does not know the identity of any particular bonus recipient or the amount payable to that individual until **after** the end of the tax year. As long as the money won't revert to the employer, it's OK.

Accrual-basis employers can deduct a year-end bonus in the year they accrue it rather than the year they actually pay it. To take advantage of this rule, though, the bonus must **actually** be paid no later than 2-1/2-

months following the close of the tax year and an “all events” test is met. Traditionally, the IRS and the court required exact detail about who was going to get exactly what before this all events test was met. But now the IRS has relaxed it.

A series of tax cases over the years lead up to this development. In 1986, the Supreme Court in [*United States v. Hughes Properties*](#), allowed a casino operator to deduct guaranteed progressive slot machine jackpots even though the jackpots had not yet been won by casino patrons. The Court reasoned that since the casino had a fixed obligation to pay the guaranteed amounts, its liability was established, even though it didn't yet know **who** the jackpot recipients would be.

Now, in [Revenue Ruling 2011-29](#), the IRS said as long as an amount will be spread across a group of eligible employees, with no amounts coming back to the company, it's OK to deduct it. The company's liability is fixed even though the ultimate recipients and individual amounts aren't determined before the end of the tax year. This is an illustration of the ways in which effective use of the tax law can make the economics of a transaction even more advantaged.

For more, see:

[The Deductibility Of Group Bonuses](#)

[Bonus To Terminated Employee Contested But Still Deductible](#)

[Giving Back Bonuses: Easy: Getting Tax Deductions: Priceless](#)

[Boomerang Bonuses: Tax Effects When You Get It But Give It Back](#)

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