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Taxation - Federal Income Tax - Meals and Lodging Under the 1954 Code

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TAXATION—FEDERAL INCOME TAX—MEALS AND LODGING UNDER THE 1954 CODE—Before discussing the application of the 1954 Internal Revenue Code with regard to the taxability of meals and lodging furnished an employee by his employer, several fundamental tax concepts should be examined. The first of these involves the definition of gross income, which for many years has been cast in broad statutory language. For example, section 22(a) of the 1939 Internal Revenue Code provided that gross income includes ". . . gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid. . . ."[1] Comprehensive as these terms appear, gross income has not been interpreted to include all forms of economic benefits received by a taxpayer. Traditionally, for reasons both of policy and administration, the net use value of goods and services owned and used by a taxpayer for his own benefit had been excluded.[2] Similarly, the differential value of improved working conditions is not generally considered to give rise to taxable income. Although better working conditions may have economic value in the eyes of an employee and can exert substantial influence on the rates of ordinary compensation, most non-cash benefits in this sphere have been tax exempt. The main problems, however,

[1] I.R.C. (1939), §22(a).

[2] Helvering v. Independent Life Ins. Co., 292 U.S. 371, 54 S.Ct. 758 (1934); Homer P. Morris, 9 B.T.A. 1273 (1928); Treas. Reg. 118, §39.22(a)(7)(c).

have not arisen in the theoretical definition of income but in classifying particular fact situations. Under what circumstances should the value of meals and lodging furnished by an employer to his employees be excluded?

Treasury regulations under the 1939 code provided:

> "If a person receives as compensation for services rendered a salary and in addition thereto living quarters or meals, the value to such persons of the quarters and meals so furnished constitutes income subject to tax. If, however, living quarters or meals are furnished to employees for the convenience of the employer, the value thereof need not be computed and added to the compensation otherwise received by the employees."[3]

One interpretation of this provision indicates a line between meals and lodging furnished as taxable compensation and those which would be deemed tax exempt improvements in working conditions based primarily on whether the benefits were supplied for the employer's convenience, and this despite the fact that such maintenance has significant compensatory aspects. The use of the term "compensation otherwise received" is noteworthy, there being recognition that meals and lodging may be partly compensatory and yet are to be excluded from gross income.[4] This conclusion was supported in 1940 by language in Mimeograph 5023: "If, however, the living quarters or meals furnished are not compensatory *or* are furnished for the convenience of the employer . . ."[5] their value will be excluded from the employee's gross income.

In the same ruling the Bureau of Internal Revenue also defined the terms "convenience of the employer": "As a general rule, the test of 'convenience of the employer' is satisfied if living quarters or meals are furnished to an employee who is required to accept such quarters and meals *in order to perform properly his duties.*"[6] Previous to this statement by the Bureau the exclusion had been restricted to a narrow range of cases.[7] In addition, prior to 1946, case law had required that

[3] Treas. Reg. 118, §39.22(a)(3).

[4] This conclusion is also supported inferentially by the first sentence of Treas. Reg. 118, §39.22(a)(3) where meals and lodgings received as compensation for services rendered are included within the employee's taxable income.

[5] Mim. 5023, 1940-1 Cum. Bul. 14.

[6] Ibid. Italics added.

[7] O.D. 265, 1 Cum. Bul. 71 (1919); O.D. 814, 4 Cum. Bul. 84 (1921); O.D. 915, 4 Cum. Bul. 85 (1921); I.T. 2253, V-1 Cum. Bul. 32 (1926); Ralph Kitchen, 11 B.T.A. 855 (1928); I.T. 2692, XII-1 Cum. Bul. 28 (1933); Charles A. Frueauff, 30 B.T.A. 449 (1934); Fontaine Fox, 30 B.T.A. 451 (1934); G.C.M. 14710, XIV-1 Cum. Bul. 44 (1935); G.C.M. 14836, XIV-1 Cum. Bul. 45 (1935); Arthur Benaglia, 36 B.T.A. 838 (1937).

meals and lodging be furnished solely for the convenience of the employer.[8] In *Ellis v. Commissioner*[9] this was apparently modified. The petitioner was allowed to exclude from income $1,000 out of a fair rental value of $1,800 for lodgings supplied by his employer. This decision, combined with the Bureau's definition of the rule in Mimeograph 5023, indicated some liberalization of the requirements for exclusion.

In 1948, however, the apparent trend was reversed by the decision in the *Carmichael* case.[10] Five employees of the McLean Gardens project in Washington, D.C. had been supplied rooms in addition to a cash salary. The rental value of these rooms was held taxable in three instances due in some measure to the fact that the furnishing of lodgings had been considered in determining ordinary cash salary. As a result, it appeared that the convenience of the employer rule was subordinate to the more general issue of compensation. This was confirmed in 1950 by Mimeograph 6472:

> "The 'convenience of the employer' rule is simply an administrative test to be applied only in cases in which the compensatory character of such benefits is not otherwise determinable. It follows that the rule should not be applied in any case in which it is evident from other circumstances involved that the receipt of quarters or meals by the employee represents compensation for services rendered."[11]

It was declared, for example, that the value of meals and lodging would be included in the employee's gross income, even though the employee was continuously required to be on the premises, where by state statute the furnishing of such maintenance was made a determinant of the rate of salary compensation. Finally, on August 2, 1951, the Bureau stated:

> "When quarters or meals are furnished in addition to a cash salary (as distinguished from cases in which the value of such benefits is deducted from a total salary) and a differential in pay is generally received by employees not provided with maintenance, there is a rebuttable presumption that maintenance in kind is furnished as part of the employee's compensation."[12]

[8] Ralph Kitchen, 11 B.T.A. 855 (1928).
[9] Ellis v. Commissioner, 6 T.C. 138 (1946).
[10] Hazel C. Carmichael, 7 T.C.M. 278 (1948).
[11] Mim. 6472 (1950-1 Cum. Bul. 15).
[12] Special Ruling, August 2, 1951.

Early in 1954 the House Ways and Means Committee in drafting the new Internal Revenue Code sought to clarify the confusion created by recent statements of the Bureau and the *Carmichael* case. Section 119 of the 1954 code was specifically drafted to deal with the problem. The House version of this section did not use the term "convenience of the employer," but substituted two specific, objective requirements for exclusion:

> "There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer (whether or not furnished as compensation) but only if—
>
> (1) such meals or lodging are furnished at the place of employment, and
>
> (2) the employee is required to accept such meals or lodging at the place of employment as a condition of his employment."[13]

Examination of this provision indicates that little practical change was intended from the older "convenience of the employer" rule as interpreted prior to the *Carmichael* case. Once more that rule was made superior to the general tests for determining taxable compensation.

The Senate, agreeing in principle with the House Ways and Means Committee, sought further clarification:

> "Your committee believes that the House provision is ambiguous in providing that meals or lodging furnished on the employer's premises, which the employee is required to accept as a condition of his employment, are excludable from income whether or not furnished as compensation. Your committee has provided that the basic test of exclusion is to be whether the meals or lodging are furnished primarily for the convenience of the employer (and thus excludable) or whether they were primarily for the convenience of the employee (and therefore taxable)."[14]

In addition to reincorporating the "convenience of the employer" language with reference to both meals and lodging, the Senate Finance Committee eliminated the second of the lower chamber's specific requirements (relating to required conditions of employment) as it affected meals. The net result of these two changes was as follows:

> "There shall be excluded from the gross income of an employee the value of any meals or lodging furnished to him by his employer for the [i] convenience of the employer, but only if—

[13] H.R. 8300, 83d Cong., 2d sess., §119 (1954).

[14] S. Rep. 1622, 83d Cong., 2d sess., part I, p. 19 (1954).

(1) in the case of meals, the meals are furnished [ii] on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging [ii] on the business premises of his employer [iii] as a condition of his employment."[15]

No purpose is indicated for the different statutory treatment specifically accorded meals as distinguished from lodging, and the result from the standpoint of statutory construction is not wholly clear. The Senate Report defines the phrase "required as a condition of his employment" as meaning "required in order for the employee *to properly perform the duties of his employment.*"[16] Note that on several occasions in the past, the definition of convenience of the employer had been in exactly the same terms.[17] Did the elimination of the specific requirement that meals be furnished as a condition of employment, as that requirement is defined by the Senate, thereby indicate an intention to nullify the general "convenience of the employer" doctrine as to meals? From a practical standpoint such a construction is questionable. If allowed, all meals furnished on the business premises of the employer would be excludable from gross income under this section. This conclusion is therefore unlikely although the draftsmanship of section 119 is dubious.

The Senate also eliminated from the House bill the phrase "notwithstanding the fact that such meals or lodging represents additional compensation to the employee."[18] This language was considered too broad and the following provision was substituted:

"In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation."[19]

The direct purpose of this latter provision evidently was to contradict the example of meals and lodging included within gross income as expressed by the Bureau in Mimeograph 6472.[20] For that purpose it was consistent with the Senate's declared purpose that the basic test of exclusion should be convenience of the employer as opposed to

[15] I.R.C. (1954), §119.
[16] S. Rep. 1622, 83d Cong., 2d sess., part II, p. 190 (1954). Italics added.
[17] Mim. 5023 (1940-1 Cum. Bul. 14); Special Ruling, February 25, 1943.
[18] H.R. 8300, 83d Cong., 2d sess., §119 (1954).
[19] I.R.C. (1954), §119.
[20] Mim. 6472 (1950-1 Cum. Bul. 15).

convenience of the employee.[21] Unfortunately, difficult problems again arise in construing the provision as enacted. *If the employment contract is not to be determinative of whether maintenance is intended as compensation, the inference is that the compensatory aspects of such maintenance still have some relevance to the general issue of taxability.* This, of course, is very close to the position taken by the Bureau after the *Carmichael* case. If it is still important to the application of the "convenience of the employer" rule that meals and lodging are considered in determining salary, the new provision may have little effect on prior law. Considering, however, the fact that the House accepted all of the changes made in the bill by the Senate, and the statements reported by the Senate Finance Committee, the error is probably in draftsmanship. The Senate Report, adopting some of the comments made by the House Ways and Means Committee as background to section 119, states:

> "Under present law meals and lodging have been held to be taxable to the employee unless they were furnished for the convenience of the employer. Even in such cases, however, they would not be excluded from the gross income of the employee if there is any indication that they are intended to be compensatory."[22]

The 1954 code was enacted in part for the purpose of clarifying and in part for the purpose of changing existing law. In either case precision in the statutory language is essential. The ambiguities of section 119 do not indicate a fulfillment of that requirement. Consideration should be directed to this area in working out the projected Technical Changes Act of 1955. A suggested revision of section 119, to conform more accurately with the objectives stated in the Senate Report, might be substantially as follows:

> There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer, provided that such meals or lodging are furnished on the business premises of the employer. The provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are furnished for the convenience of the employer.*

[21] S. Rep. 1622, 83d Cong., 2d sess., part I, p. 19 (1954).

[22] Ibid.

* This comment was prepared by John H. McDermott in a Taxation Seminar at the University of Michigan Law School.—Ed.