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Taxation—Social Security Taxes—Application of Income Tax Regulations.- S.S. Kresge, Inc. v. United States

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desirable result. Exact logic has given way to the realism of the business community, and the individual taxpayers have been given a "fair break."

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Taxation—Social Security Taxes—Application of Income Tax Regulations.—*S. S. Kresge, Inc. v. United States.*[1]—This action was brought by Kresge for refund of taxes, assessed under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, for the value of free meals furnished by the employer-taxpayer to its fountain department employees. In 1954, the Commissioner of Internal Revenue had ruled that the value of the meals did not constitute wages in FICA and FUTA computations. Subsequently, in 1957, the Commissioner reversed this ruling in answer to an inquiry by the taxpayer, based on the intermediate passage of Revenue Ruling 57-471.[2] HELD: Income tax regulations are not applicable to FICA and FUTA computations, and even if they did apply, the taxes were properly assessed here since the meals were not given to enable the employees to perform their duties better during their normal working hours.

Section 119 of the Internal Revenue Code of 1954,[3] regarding income tax, reads:

> there shall be excluded from gross income of an employee the value of any meals or lodging furnished . . . for the convenience of the employer, but only if—
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> (1) *in the case of meals*, the meals are furnished on the business premises of the employer, or
>
> (2) *in the case of lodging*, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment. (Emphasis supplied.)

For meals to be excluded under subsection (1), all that is required is that they be furnished on the employer's premises, and that the purpose served is the convenience of the employer rather than the compensation of the employee.[4] The requirement of convenience has been deemed to be met when

puted *as of* the close of the taxable year . . .)." (Emphasis supplied.) The court read the words "as of" to mean "as of one point in time"—the close of the taxable year. "Such words [as of] imply accrual. . . ." Supra note 1, at 206.

1 218 F. Supp. 240 (E.D. Mich. 1963).

2 Rev. Rul. 471, 1957-2 Cum. Bull. 630.

[I]t is the opinion of the Internal Revenue Service that the furnishing of such meals is recognized as part of the general understanding of the parties to the employment contract, and that as a practical matter of value of such meals is generally regarded as part of the employees' remuneration.

3 Int. Rev. Code of 1954, § 119.

4 Treas. Reg. § 1-119-1(a)-2 (1956).

Likewise, meals furnished will . . . be deemed to be for the convenience of the employer if the furnished meals serve a business purpose of the employer other than providing additional compensation to the employee.

"the furnished meals serve a business purpose of the employer . . . ."[5] There is no requirement that acceptance of the meal be obligatory rather than optional on the part of the employee.[6]

The court in *Kresge* has attempted to read into section 119-1 the requirement of obligatory acceptance by the employee which has been found applicable only to section 119-2. The court's authority is *Saunders v. Commissioner of Internal Revenue*,[7] a case which arose not under section 119, but under the then controlling section 120,[8] which was a special provision for police officers—petitioner Saunders being a New Jersey State Trooper. Reference is made also to *Diamond v. Sturr*[9] and *Boykin v. Commissioner of Internal Revenue*[10] concerning lodging, an area which comes under section 119-2. The IRC itself states that before lodging is excludable, "the employee . . . [must be] required to accept such lodging . . . ."[11] Finally, the court mentions *Commissioner of Internal Revenue v. Doak*,[12] which concerns meals and lodging, but is distinguishable on its facts, in that meals and lodging would have been deductible had petitioners occupied the status of employees.[13]

The defendant suggests that authorization for the transposition of "obligatory acceptance" is found in Mimeograph 5023[14] and states that "the rule . . . [is applicable] *only if* the employee was required to accept . . . ."[15] (Emphasis supplied.) It should be noted, however, that the mimeograph sets up only a suggested situation which will satisfy the convenience test, and that it is not intended to be all inclusive.[16] This is supported by the fact that nowhere in the Bulletin do the words "only if" appear.

It would seem, therefore, that neither the IRC nor the authorities cited sanction the extension of the section 119-2 requirement, making lodging obligatory and not optional, to section 119-1 regarding meals. The Internal Revenue Regulations, in fact, seem to suggest the opposite.[17]

Given this dubious application of law to the factual situation, the essential area of controversy which remains is whether income tax rules and definitions are applicable to compute FICA and FUTA taxes. The controversy

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[5] Ibid. It is not questioned that under subsection (2), an additional requirement of obligatory acceptance by the employee must be met in order to qualify for the exclusion.

[6] Treas. Reg. § 1-119-1(c)-2 (1956).

> The mere fact that an employee . . . may decline to accept meals . . . will not of itself require inclusion of the value thereof in gross income.

[7] 215 F.2d 768 (3rd Cir. 1954).

[8] Int. Rev. Code of 1954, § 120. Repealed by 72 Stat. 1607 (1958), 26 U.S.C. § 120 (1958).

[9] 221 F.2d 264 (2d Cir. 1955).

[10] 260 F.2d 249 (8th Cir. 1958).

[11] Supra note 3.

[12] 234 F.2d 704 (4th Cir. 1956).

[13] Id. at 707.

[14] 1940-1 Cum. Bull. 14.

> As a general rule, the test of "convenience of the employer" is satisfied if . . . meals are furnished to an employee who is required to accept such . . . meals in order to perform properly his duties.

[15] Brief for Defendant, p. 18, S. S. Kresge, Inc. v. United States, supra note 1.

[16] Supra note 14.

[17] Supra notes 4, 5.

revolves around the construction of the term "wages,"[18] the prime area relating to the exclusionary provisions regulating non-cash items.

When comparing analogous statutes, the controlling factor has generally been the relation of the structure and purpose of the legislation in question.[19] Analogous construction, known as the "in pari materia" doctrine, was recognized in this area in *Northern Pac. Ry. Co. v. United States*,[20] where it was held that, "the doctrine . . . is applicable when construing . . . legislation concerned with a specific subject such as . . . taxes."[21] In applying the doctrine to the present controversy, therefore, the problem should be considered from the dual viewpoint of structure and purpose.

Some similarities are immediately evident among the statutes in question. The term "wages" as used in the IRC,[22] and in the FICA and FUTA[23] are similar. The exclusion from wages for accident and health plans are identical.[24] Finally, sections of the income tax provisions have been incorporated into the FUTA.[25] It might be noted that all three taxes are part of the same Internal Revenue Code,[26] are by nature revenue raising measures,[27] are such that their proceeds "are subject to appropriation like public monies generally,"[28] and are not earmarked in any way.[29] A review of the administrative regulations dealing with the exclusion of non-cash items from wages, either under the social security or withholding provisions, will show the interrelated treatment given them in the past.

In 1936 the convenience test was part of the "facilities and privileges" exclusion applicable to FICA and FUTA taxes. Under the revenue provisions of the Social Security Act, the Treasury Department had ruled that:

> Ordinarily, facilities or privileges (such as entertainment, cafeterias, restaurants, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for services if such facilities or privileges are offered or furnished by the employer

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[18] Int. Rev. Code of 1954, §§ 3121(a) (FICA), 3306(b) (FUTA).

> [T]he term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash . . . .

Int. Rev. Code of 1954, § 3401 (Withholding).

> [T]he term "wages" means all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash . . . .

It should be noted that these sections, representing the legislation in question, are identical in substance.

[19] Burnet v. Guggenheim, 288 U.S. 280, 286-88 (1933); Hesslein v. Hoey, 91 F.2d 954 (2d Cir. 1937), cert. denied, 302 U.S. 756 (1937).

[20] 156 F.2d 346 (7th Cir. 1946), aff'd, 330 U.S. 248 (1947).

[21] Id. at 350.

[22] Int. Rev. Code of 1954, § 61.

[23] Int. Rev. Code of 1954, § 3306.

[24] Int. Rev. Code of 1954, §§ 105, 3306(b)(2).

[25] Int. Rev. Code of 1954, § 3306(b)(5) incorporates by reference Int. Rev. Code of 1954 §§ 401(a), 501(a).

[26] Int. Rev. Code of 1954, §§ 1, 3101, 3301.

[27] U.S. Const. art. I, § 8.

[28] Cincinnati Soap Co. v. United States, 301 U.S. 308 (1937).

[29] Steward Mach. Co. v. Davis, 301 U.S. 548, 574 (1934).

> merely as a convenience to the employer or as a means of promoting the health, good will, contentment, or efficiency of his employees.[30]

The following year the convenience test took on a dual capacity, for in addition to being merely a test of non-remuneration, it was set out as an absolute rule of exclusion.[31] This extension came as a result of a previous ruling which stated that meals would constitute compensation in the instance of two employees performing the same job where there was a great difference in pay scales: one employee receiving less pay due to the furnishing of a meal by the employer.[32] Based upon this same ruling, the "facilities or privileges" clause was amended[33] so that the current regulations provide that,

> [t]he term "facilities or privileges," however, does not *ordinarily* include the value of meals . . . furnished . . . since *generally* these items constitute an appreciable part of the total remuneration of such employees.[34] (Emphasis supplied.)

The government's interpretation limited the amended version[35] to situations in which the value of the meal did not involve a substantial amount of the total remuneration, while confirming the absolute character of the convenience rule as a valid exclusion in the same area.[36] To clear up this apparent contradiction the Commissioner in 1944 declared the "convenience" rule inapplicable to FICA and FUTA computations.[37] It would appear that the inapplicability of the rule went only to its absolute character and not to its use as an auxiliary of the "facilities or privileges" clause. This contention seems plausible for in 1954 the convenience test was again held inapplicable as it is used in income tax computations, *i.e.*, as an absolute exclusionary test.[38] The Commissioner's issuance of the private ruling to Kresge further strengthens this position, since in light of the denial of the application of the rule in the same year,[39] the basis of the ruling cannot be employer convenience as an absolute, but rather it must be convenience as regarding the "facilities or privileges" clause of which it has been a part for almost a decade.

This process of piecemeal change and modification was taken a step further in 1962 when a ruling was issued, stating the test to be whether the value of the meal is an appreciable part of the total remuneration. It was

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[30] Treas. Reg. 106, § 402.227 (1936).

[31] S.S.T. 302, 1938-1 Cum. Bull. 456. This ruling emphasized that without regard to whether the meals were an appreciable part of the total remuneration, the "value of lunches . . . to . . . employees does not constitute wages within . . . the Social Security Act."

[32] S.S.T. 321, 1938-2 Cum. Bull. 323.

[33] S.S.T. 386, 1940-1 Cum. Bull. 211.

[34] Treas. Reg. § 31.3121(a)-1(f) (1940). It should be noted that all that is done by this amendment is to reemphasize that the meals will only be excluded under the "facilities or privileges" clause if their value is not a substantial part of the total remuneration.

[35] Ibid.

[36] Supra notes 14 and 31.

[37] Mim. 5657, 1944 Cum. Bull. 550. It is to be noted that no distinction between the test as part of the "facilities or privileges" clause and as an absolute exclusionary test is considered. It is suggested that this failure is the source of the present confusion.

[38] Rev. Rul. 54-593, 1954-2 Cum. Bull. 30.

[39] Ibid.

declared that the value of one meal per day would be considered appreciable without any regard to its actual value.[40] It should be noted that this ruling reiterates the "facilities or privileges" test but adds a definitive treatment of the word "appreciable," which addition is unacceptable in light of the nature of the test it modifies. The basis of the test had been a mathematical proportion between the value of the meal and the total remuneration to the employee. The new addition is set in absolute terms without any regard to the proportional amounts involved. This is self-contradictory and irrational on its face. Is the test one of factual computation or is it an absolute? It would appear that it cannot be both.

The court based the inapplicability of comparing income tax regulations to social security taxes on the differing inherent natures of the taxes. It concluded: "it is *possible* that what *might* not be taxable as wages for income tax purposes *might* constitute wages under the Social Security Act."[41] (Emphasis supplied.) This would seem to be a rather non-committal statement and hardly any authority on which to base a broad policy decision. The "might" language regarding the nature of the taxes is dicta[42] and its speculative nature causes it to fall short of the position of confidence given it in the present opinion. It would appear that a difference in the uses to which the various taxes are to be put is not a valid basis on which to deny any interrelation of definitions, especially where the revenue raised goes into a common fund with all other taxes.[43] In its opinion, the court has attempted to analogize FICA and FUTA with the Fair Labor Standards Act—an analogy between taxing and non-taxing statutes. However, it would appear that an analogy between taxing statutes, as is suggested here, would be somewhat less strained.[44]

Though due regard must be given to the opinion of the Commissioner, it has been held that any doubtfulness in a tax act is to be decided in favor of the taxpayer.[45] It is obvious from the preceding outline of the administrative regulations that doubt is present in this area.

With the economic considerations involved and the inconsistency and confusion evolving from the administrative handling of this subsection in recent rulings, the court had an excellent opportunity to clarify the state of the law. Rather than a mere pronouncement of its ruling, the court might better have filled the need for a thorough analysis of the problem by handing down an opinion which assessed the authority on both sides and which left no question as to its basis for the decision.

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[40] Rev. Rul. 62-150, 1962-2 Cum. Bull. 213.

[41] Pacific American Fisheries v. United States, 138 F.2d 464, 465 (9th Cir. 1943).

[42] The court found that the meals and lodging, based on the evidence, were a means used to provide additional compensation which alone is sufficient to bar the exclusion, even in its absolute form.

[43] Regarding the lack of importance of the manner in which monies derived are expended, cf. Railroad Retirement Bd. v. Alton R. R. Co., 295 U.S. 330 (1935); California v. Anglim, 129 F.2d 455 (9th Cir. 1942), cert. denied, 317 U.S. 669 (1942).

[44] The attempt here is to establish that these statutes are similar, though not identical, and therefore that there does appear to be a rational basis for construing them analogously.

[45] United States v. Merriam, 263 U.S. 179 (1923).