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Comments

TAX TREATMENT OF COMPENSATION IN KIND

The pendency of a measure before the 81st Congress to include both agricultural workers and domestics within the Social Security Act¹ brings into sharp contrast the difference between the income tax treatment of compensation in kind and that accorded it under other federal and state laws. Though these particular coverage-broadening amendments may not be enacted by the 81st Congress, it seems probable that they will become law at some time not far distant. Their enactment will bring under the Social Security Tax provisions the two largest groups who receive a significant part of their wages in

¹ H. R. 2893, 81st Cong. 1st Sess. (1949). H. R. 6000, 81st Cong. 1st Sess. (1949) which was passed by the House of Representatives this session broadens the present coverage of the Social Security Act to include agricultural processing workers, most domestics, but not other agricultural workers.

compensation in kind, that is, in the form of meals and lodging.² In addition it is at least possible that the Fair Labor Standards Act may be amended in the near future to cover these same classes of individuals. This difference in treatment suggests an inquiry into the methods by which compensation in kind is handled by the several governmental agencies concerned with the problem.

I. FEDERAL INCOME TAX

The federal income tax law is broadly drafted and on its face has no room for exceptions. Section 22(a) of the I. R. C., the equivalent of which has been in every revenue act since 1913, reads as relevant: "‘gross income’ includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid . . . also from . . . the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever." It is difficult to imagine a more inclusive definition of income, nor that room and board furnished an employee by his employer would not be included in it; nevertheless, an exception has been created, represented by the Treasury Regulation now in effect,³ which excludes such items when provided "for the convenience of the employer."

The "Employer's Convenience" Doctrine

The present regulation was precipitated primarily by the decision of the Board of Tax Appeals in *Benaglia v Comm'r*⁴ decided in 1937, three years before its adoption. There a hotel manager was held to be receiving meals and quarters entirely for the convenience of his employer, since the proper performance of his managerial duties required his presence twenty-four hours a day and neither he nor his employer regarded these benefits as part of the compensation, which was determined independently of them.⁵

² In addition to meals and lodging, "compensation in kind" also should include such things as free entertainment, medical services, courtesy discounts, transportation, clothing, free fuel, etc., but because of their relatively negligible value some of these items are mentioned only incidentally in the regulations, and almost no court decisions deal with them except under the Fair Labor Standards Act. For the same reason they may also be accorded special treatment. See *Mim.* 5657, 1944 CUM. BULL. 550, and regulations there quoted. For a general discussion of compensation in kind see VICKERY, *AGENDA FOR PROGRESSIVE TAXATION* (1947) 35-44, and SIMONS, *PERSONAL INCOME TAXATION* (1938) 53.

³ U. S. Treas. Reg. 111 § 29.22(a)-3, as amended by T. D. 4965, 1940-1 CUM. BULL. 13. "If a person receives as compensation for services rendered a salary and in addition thereto living quarters or meals, the value to such person of the quarters and meals so furnished constitutes income subject to tax. If, however, living quarters and 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."

⁴ (1937) 36 B. T. A. 838.

⁵ The majority relied upon the *Jones* and *Tennant* cases (to be discussed subsequently), neither directly in point, and distinguished—justifiably—the *Kitchen*, *Fruehoff*, and *Fox* cases, *infra* note 20. Strangely enough, however, the Board did not mention the

The *Benaglia* precedent was followed in two similar cases the next year involving plantation managers,⁶ and in 1947 it was held⁷ that a janitor whose presence was continually required met the "employer's convenience" test and could avoid inclusion of the rental value of his apartment. In his Mimeograph⁸ explaining Regulation 22(a)-3,⁹ the Commissioner in the meantime had adopted the *Benaglia* standard determining that twenty-four hour call, or the necessity of accepting meals and lodging to perform required duties efficiently, would satisfy the convenience test.

Exception to the Doctrine

In the *Martin* case,¹⁰ the Board of Tax Appeals began the development of an exception to an exception. The petitioner was employed as a wireless operator subject to constant call on a dredge miles at sea and of necessity had to accept meals and quarters if he were to perform his duties at all. Nevertheless the Board decided that he could not exclude from gross income the amounts which the Army, his employer, deducted from his salary on account of furnishing room and board. The distinguishing feature was thought to be that here the allowance for food and room was deducted from a larger salary, instead of (as in the *Benaglia* line of cases) being given in addition to a smaller one, which was deemed to show that neither *Martin* nor the Army considered the allowance for the benefit of the Army.¹¹

This tendency to make mechanical distinctions shown by the decisions is best explained by the lack of a clear understanding as to the reason for the "employer's convenience" exception. Presumably the reason for the Commissioner's original creation of the exception

only Treasury Regulation directly in point, Art. 33, Regs. 45, under the Revenue Act of 1918, which provided that "When living quarters such as at camps are furnished to employees for the convenience of the employer, the rateable value need not be added to the cash compensation of the employee, . . ." By a strained construction this ruling might be deemed to govern the case, but it obviously was not intended to cover one of this type, being aimed rather at remotely located working camps.

A vigorous dissent attacked the factual basis of the "employer's convenience" finding, because, among other reasons, petitioner was the manager of two hotels, and if he was able to manage one while living in the other, he could probably manage both while living in neither. It also attacked the "employer's convenience" exception itself, but probably because of the primarily factual nature of the question involved and the many exceptions its rulings had already created the Treasury took no appeal.

⁶ *Green v. Kanne* (D. C. Haw., 1938) 38-1 U.S.T.C. ¶ 9206; *Renton v. Kanne* (D. C. Haw., 1938) 38-1 U.S.T.C. ¶ 9207.

⁷ *Farnham v. Commissioner* (1947) 6 TCM 1049.

⁸ Mim. 5023, 1940-1 CUM. BULL. 14.

⁹ *Martin v. Comm'r.* (1941) 44 B.T.A. 185.

¹⁰ *Ibid.*

¹¹ The Board relied on two of the family corporation cases, *Chandler v. Comm'r.* (C. C. A. 3d 1941) 119 F. (2d) 623; *Frueauff v. Comm'r.* (1934) 30 B.T.A. 449; see note 20 *infra*. These cases are in point only in an extremely mechanical way.

was the realization that board and room supplied a worker by his employer as a required feature of the employment is worth considerably less to the employee than its market value for two reasons: in many cases the facilities are more expensive than those the worker would buy for himself; and the lack of free choice as to the method of supplying them may greatly decrease their value, as, for instance, when he must maintain a separate home for his family. Actually, however, the employee is receiving a tangible benefit, though of a value varying with the individual circumstances of the employee, which usually is less than its market value. While presumably the code through appropriate regulations could have provided a method of compromising this value problem, nevertheless the Bureau has not so provided and the courts have felt the necessity of answering the tax question flatly "yes" or "no," "inclusion" or "exclusion."

In the *Martin* case the court could not see the difference between the employer's deduction of a sum for room and board from the employee's salary, and the employee's paying a third party for the same things. But obviously in the former case the employee did not have the free choice as to the price, the kind and the manner of obtaining them, and if there is to be an "employer's convenience" exception he met the logical requirements to come within it. Whether the allowance is handled as a deduction from salary or an addition to a lower salary is a bookkeeping distinction which could be reversed in any case without affecting the relationship of employer and employee. It is unrealistic to speak of considering board and housing as part of compensation or not part of it, especially where one party is the government and dictates the terms of employment. Moreover, it is not at all obvious that taking the value of such benefits as a deduction from salary shows anything as to the parties' intentions.

Both the *Martin* and the *Benaglia* principles were affirmed in *Carmichael v. Comm'r*,¹² actually five cases decided together, and the most recent judicial pronouncement. The Tax Court used a double test to determine whether apartments were furnished for the "employer's convenience": whether living on the premises was essential to performing the job and whether or not the value was deducted from salary. In two of the cases, where living in a government project was clearly necessary and the apartment was furnished in addition to the cash salary, its value was not subject to tax. In the other three the rental price of the apartments occupied was required to be included in income both because it was on the books of the project as a deduction from salary, and because there was a showing that it was not absolutely essential that the petitioners live there.

¹² (1948) 7 TCM 278.

Historical Development

The "employer's convenience" exception has not always been recognized. In November, 1914, a little more than a year after the first enactment of what has become the present I. R. C. 22(a), a Treasury Decision first used the expression "convenience of the government."¹³ In 1918 the first full blown "employer's convenience" ruling was brought forth as to "living quarters such as camps" in the regulation¹⁴ still in effect but not referred to in the *Benaglia* case. It was not changed until the present regulations came into force in 1940, but by the time of *Jones v. U. S.*,¹⁵ the first court decision on the subject in 1925, the exemption had been broadly extended.¹⁶

The *Jones* case, without benefit of any ruling covering the particular class of taxpayers there concerned, definitely established the "employer's convenience" doctrine as part of the tax law, and it has been cited in almost all subsequent cases though part of its holding carried farther than that. The taxpayer was an Army officer and the court sustained his contention that a cash allowance granted him as commutation of quarters need not be reported as income, failing to grasp any distinction between compensation in kind and the payment of cash in lieu of goods not furnished.¹⁷

Although no further cases have been decided on the point¹⁸ the principle of the *Jones* case of exempting allowance for quarters on the theory that it was the same thing as quarters themselves was

¹³ T. D. 2079 (Nov. 24, 1914) unpublished. After providing that officers' commutation of quarters, or their value if furnished in kind, should be taxable, it provided: "When quarters are furnished in kind, of a greater number of rooms than the number allowed by law, it is to be assumed that the excess number is assigned for the convenience of the government, and the money equivalent only of the number of rooms allowed by law shall be returned as income."

¹⁴ See note 5 *supra*.

¹⁵ (1925) 60 Ct. Cl. 552, reprinted as T. D. 3724 (1925) IV-2 CUM. BULL. 136.

¹⁶ Maintenance furnished to Red Cross employees, O. D. 11 (1919) 1 CUM. BULL. 66; seamen, O. D. 265 (1919) 1 CUM. BULL. 71; fishing and canning employees in remote places, O. D. 814 (1921) 4 CUM. BULL. 84; hospital employees continually on call, O. D. 915 (1921) 4 CUM. BULL. 85; and the receipt of "supper money," O. D. 514 (1920) 2 CUM. BULL. 90. On the other hand, domestics, O. D. 874 (1921) 4 CUM. BULL. 348; and Indian service employees, I. T. 2051 (1924) III-2 CUM. BULL. 55, furnished meals and quarters, as well as employees sent to school at their employer's expense, I. T. 1304 (1922) I-1 CUM. BULL. 72, were specifically required to include the compensation in kind received in income.

¹⁷ The court relied on a series of non-tax cases, *U. S. v. Smith* (1895) 158 U. S. 346; *U. S. v. Mills* (1905) 197 U. S. 223; *Wilson v. U. S.* (1909) 44 Ct. Cl. 428, in which the Supreme Court and the Court of Claims distinguished things somewhat similar to commutation as being allowances rather than compensation. The only tax case cited was decided in England before the turn of the century, *Tennant v. Smith* (1892) App. Cas. 150; there a bank employee required to live in the building was not taxed for the rental value of his quarters, under a tax law considerably more restrictive in its definition of income, using the term "money's worth."

¹⁸ *Connolly v. Comm'r.* (1947) 8 T. C. 848 held that a taxpayer was not a commissioned officer in the Coast Guard so as to qualify for the tax benefit.

rapidly extended to other groups by Bureau rulings, in certain situations reversing a ruling which had required inclusion.¹⁹

The largest group of cases involving the tax treatment of housing provided rent free, those involving the additional factor that the taxpayer or his immediate family owns the stock in the corporation which has title to the dwelling in question, are for the most part not relevant at all, but some of them have been discussed in the cases spelling out the "employer's convenience" doctrine.²⁰

Can anything be done to improve the federal income tax picture in regard to compensation in kind, or is the employer's convenience test the only practicable one? To answer this question requires a consideration of the treatment of compensation in kind under the Federal Social Security Act, the state Unemployment Insurance acts, the Fair Labor Standards act and the state Workmen's Compensation acts.

¹⁹ Among the new categories covered were the Coast Guard, Coast and Geodetic Survey, etc., I. T. 2232 (1925) IV-2 CUM. BULL. 144 revoking O. D. 1098 (1921) 5 CUM. BULL. 85. T. D. 4724, 1937-1 CUM. BULL. 58; Military Chaplains, I. T. 2760 (1934) XIII-1 CUM. BULL. 35 revoking I. T. 1307 (1922) I-1 CUM. BULL. 110; domestics, I. T. 2253 (1926) V-1 CUM. BULL. 32, *but cf.* O. D. 874, *supra* note 16; overseas employees of the State, Commerce and Treasury Departments, G. C. M. 12,300 (1933) XII-2 CUM. BULL. 30; G. C. M. 14,710 (1935) XIV-1 CUM. BULL. 44 revoking G. C. M. 13,442 (1934) XIII-2 CUM. BULL. 119; G. C. M. 14,836 (1935) XIV-1 CUM. BULL. 45 revoking G. C. M. 11,453 (1933) XII-1 CUM. BULL. 26; and women in the military service, I. T. 3420, 1940-2 CUM. BULL. 40.

Still specifically required to be included in gross income is the fair market value of compensation in kind furnished to Veterans' Administration employees, I. T. 2692 (1933) XII-1 CUM. BULL. 28. This ruling was subsequently extended to all government employees not covered by other rulings, Min. 4717 (Jan. 12, 1938). *Cf.* G. C. M. 341 (1926) V-2 CUM. BULL. 23.

²⁰ For example, see note 5 *supra*. However, *Kitchen v. Comm'r.* (1928) 11 B. T. A. 855, is in point, for it held that the taxpayer, assistant manager of a hotel owned by a family corporation of which he was the majority stockholder, who together with his wife was furnished meals and rooms without charge, must include their value in his income because he had not shown that the facilities were provided "solely" for the convenience of the employer, and presumably they were only partly so provided. *Cf.* *Godson v. Comm'r.* (1946) 5 TCM 648; *Heiss v. Comm'r.* (1937) 36 B. T. A. 833.

This result was disapproved subsequently in a similar case in which the court allowed the taxpayer-manager to exclude only \$1,000 of the \$1,800 yearly rental as the amount required for the convenience of the employer. There was, however, a convenient yardstick for apportionment, absent in the *Kitchen* case, in the value of the smaller apartment furnished the previous manager in an arm's-length contract. *Ellis v. Comm'r.* (1946) 6 T. C. 138.

Fox v. Comm'r. (1934) 30 B. T. A. 451 and *Frueauff v. Comm'r.*, *supra* note 11, were properly distinguished in the *Benaglia* case, for the convenience of the employer was not argued. Instead the issue was whether the free rent was compensation for services or a corporate gift. For the same reason the reliance on the *Frueauff* case together with *Chandler v. Comm'r.*, *supra* note 11, a similar case, was improper in the *Martin* decision.

In accord with the *Fox* and *Frueauff* cases are the following: *Hillman v. Comm'r.* (C. C. A. 3d 1934) 71 F. (2d) 688; *Dean v. Comm'r.* (1947) 9 T. C. 256; *Roberts v. Comm'r.* (1948) 7 TCM 599. *Contra:* *Richards v. Comm'r.* (C. C. A. 5th 1940) 111 F. (2d) 376; *Gritmon v. Comm'r.* (1945) 4 TCM 552. *Cf.* *Comm'r. v. Plant* (C. C. A. 2d 1935) 76 F. (2d) 8; *Leadbetter v. Comm'r.* (1939) 39 B. T. A. 629.

II. FEDERAL SOCIAL SECURITY ACT

The Old Age and Survivors and Unemployment Insurance provisions of the Federal Social Security Act base their taxes and the computation of benefits on a definition of wages uniform throughout the act: "... all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; . . ."²¹ This provision is no broader than the definition of gross income for the Income Tax as illustrated by the almost identical wording of the withholding of income tax provisions,²² but the results have been very different.

The leading case of *Pacific American Fisheries v. U. S.*²³ decided by the Ninth Circuit held that where because of the remoteness of the cannery the meals and quarters provided by the employer were the only ones available to most of the employees, the value of these benefits must be taken into account in computing the employer's Social Security Tax. The court reasoned that the circumstances together with the definition of wages in the Act showed that such facilities were included, and that the "employer's convenience" test was not applicable, but added as a further thought that these facilities were not furnished for the convenience of the employer.²⁴

A number of regulations and rulings support the position that compensation in kind is included in wages regardless of the employer's convenience.²⁵ Among the classes specifically held taxable, including many as to which an opposite result was reached under the income

²¹ This provision appears after the 1939 amendments as follows: Insurance Contributions Act, INT. REV. CODE § 1426(a), 42 U.S.C. 1011(a); Federal Unemployment Tax Act, INT. REV. CODE § 1607(b), 42 U.S.C. § 1107(b); 42 U.S.C. § 409(a). The Federal Unemployment Tax Act and its predecessor in the Social Security Act applies, because of the crediting system, only to the 0.3% tax collected by the Federal Government for distribution to cover State administration expenses, as opposed to the 2.7% tax, used for the benefit payments themselves, which is controlled by state law.

²² "... all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; . . ." INT. REV. CODE § 1621(a).

²³ (C. C. A. 9th 1943) 138 F. (2d) 464. *Accord*: *Jacobson v. U. S.* (W.D. Wash. 1942) 44 F. Supp. 685. *Cf. Patton v. Federal Security Agency* (E.D.N.Y. 1946) 69 F. Supp. 282.

²⁴ *Pacific American Fisheries v. U. S.*, *supra* note 23 at 466: "This differential paid in cash to workers who resided in Alaska and did not receive board and lodging strongly indicates that board and lodging were part of the wages and not merely for the convenience of the employer."

²⁵ Reg. 106 § 402.227, printed in *Mim.* 5657, 1944 CUM. BULL. 550; formerly Reg. 91, Art. 14; Reg. 107 § 403.27, printed in *Mim.* 5657 *supra*, formerly Reg. 90, Art. 207; S.S.T. 321, 1938—2 CUM. BULL. 323; O.B. 1020.1 (Dec. 1, 1947) (GC-41) 1; H.R. REP. No. 615, 74th Cong., 1st Sess. (1935) 32 and 36. O.B. 1020.1, *supra*, reads in part: "The value of housing and appurtenances furnished an employee is wages within the meaning of Section 209(a) of the amended Act regardless of how greatly the employer may be inconvenienced, if, in fact, the housing and appurtenances constituted part of the employee's remuneration."

tax, are waiters for a sorority,²⁶ student nurses receiving maintenance and clothing,²⁷ employees required to live at an isolated sanitarium,²⁸ ship's crew and officers,²⁹ employees furnished "bunkhouse" facilities where no others are available,³⁰ and the general manager of a hotel and his family, the janitors, maintenance employees and the like.³¹ Government employees and members of the armed forces are not within the coverage provisions of the Social Security Act.

There is an exception to this rule of inclusion in the case of certain items classed as "facilities or privileges (such as entertainment, medical services, or so-called 'courtesy' discounts . . .)" ³² if they are of small value and are intended to promote the good will of the employees, but these terms do not "ordinarily" include meals and lodging, clothing, laundry and the like.³³ Such treatment is justified, for the administrative expense of keeping track of and computing the value of such negligible items would probably exceed the resulting receipts. Another very limited exception was made when the Bureau advised that the value of lunches furnished or the equivalent amount in cash where no lunch facilities are available should not be included because in the particular case³⁴ they were furnished so exclusively for the employer's benefit that it would be unfair to consider their value as wages. This is an unfortunate exception, for the employee receiving lunch is benefited just as much as in the case of any other meal regardless of the motivation of the employer; and it has apparently been confined to its facts, for, in a later ruling,³⁵ an employer was denied exemption from tax because he had not shown ". . . that the payments [for lunches] in question are made solely to promote . . ." his interests.

The differences with regard to compensation in kind in the income and social security taxes are well summed up in Mimeograph 5657:³⁶ although quarters and meals furnished for the convenience of the

²⁶ S. S. T. 96, 1937—1 CUM. BULL. 439.

²⁷ S. S. T. 148, 1937—1 CUM. BULL. 380.

²⁸ S. S. T. 321, 1938—2 CUM. BULL. 323.

²⁹ S. S. T. 386, 1940—1 CUM. BULL. 211.

³⁰ Digest of Treasury Dept. Letter to Prentice-Hall Inc. (June 17, 1937) 1 P-H Soc. SEC. TAX. SERV. ¶ 33796.50. Cf. O. B. 1020.1 (Dec. 1, 1947) (GC-41) 1.

³¹ Statement of Treasury Dept. (June 6, 1941) 1 P-H Soc. SEC. TAX. SERV. ¶ 33796.51; Letter of G. J. Scheneman, Deputy Comm'r. (Dec. 15, 1943) 1 P-H Soc. SEC. TAX. SERV. ¶ 33796.52.

³² Identical provisions Reg. 106 § 402.227, and Reg. 107 § 403.227, printed in Mim. 5657, 1944 CUM. BULL. 550.

³³ Regs. 106 and 107, note 32 *supra*; S. S. T. 321, 1938—2 CUM. BULL. 323; S. S. T. 386, 1940—1 CUM. BULL. 211; H. R. REP. No. 615, 74th Cong., 1st Sess. (1935) 32 and 36.

³⁴ S. S. T. 302, 1938—1 CUM. BULL. 456, reversing S. S. T. 192, 1937—2 CUM. BULL. 449.

³⁵ S. S. T. 348, 1939—1 CUM. BULL. 304.

³⁶ 1944 CUM. BULL. 550.

employer, that is where the employee is required to accept living quarters and meals furnished by the employer in order properly to perform his duties, may be excluded in computing wages subject to the withholding of income tax, they must be included in computing wages subject to the Social Security taxes.

III. STATE UNEMPLOYMENT INSURANCE ACTS

In general the state Unemployment Insurance acts follow the Social Security definition of wages, but in addition five states specifically provide for the inclusion in tax of "... the reasonable money value of board, rent, housing, lodging, payments in kind and similar advantages."³⁷ To simplify the computation the states generally have provided, although not without considerable variation, schedules of flat rates for the value of meals and rent,³⁸ which will satisfy the law, although there is generally an opportunity offered for the parties to prove a different value where the schedule rates would be inequitable.

Under the California Act³⁹ the "employer's convenience" test was refused application in the *Black-Foxe* case,⁴⁰ both as a matter of original intent and as good social policy, although the squareness of the holding was somewhat impaired by a finding that the board and lodging were not furnished to the instructors at defendant's military school "solely" for the convenience of the employer. The same result is reached in the regulations of the California Employment Commission,⁴¹ and in rulings with particular mention of ships' crews,⁴² and apartment house managers.⁴³ The Commission's regulations in the absence of a union contract provision also establish a prima facie minimum rate for compliance, two thirds of the market rental value of housing and \$1.15 for a day's meals, with lesser amounts for single meals.⁴⁴ Of particular interest is a provision gearing meal valuation

³⁷ As of 1940, Alabama, Kentucky, New Hampshire, New York and Wisconsin had this provision. The other forty-three states and the District of Columbia defined wages as "... all remuneration payable for personal services, including commissions, bonuses and the cash value of all remuneration in any medium other than cash." R. T. COMPTON, *SOCIAL SECURITY PAYROLL TAXES* (1940) 73-75.

³⁸ P-H SOC. SEC. TAX. SERV. ¶ 27436 (all states).

³⁹ 3 CAL. GEN. LAWS (Deering's), Act 8780(d) (Supp. 1947).

⁴⁰ *Cal. Emp. Comm. v. Black-Foxe Military Institute* (Super. Ct. Los Angeles Co., App. Dept., 1941) 110 P. (2d) 729.

⁴¹ "It is immaterial for the purposes of this Section that the facilities furnished by the employer are furnished for his convenience or the convenience of the employee." (D. E. Reg. (as amended Apr. 1, 1948) Art. 6, § 62(d), 2 P-H Soc. SEC. TAX. SERV. (Calif.) ¶ 27436.1.

⁴² D. E. Tax Man. §§ 9030.021 and 9030.92 (1948) 2 P-H Soc. SEC. TAX. SERV. (Calif.) ¶¶ 27436.2 and 27436.3.

⁴³ Digest App. Bd. Dec. (1943) T. D. 40 (382), 2 P-H Soc. SEC. TAX. SERV. (Calif.) ¶ 27436.6.

⁴⁴ D. E. Reg. (as amended Apr. 1, 1948) Art. 6, § 62(a), 2 P-H Soc. SEC. TAX. SERV. (Calif.) ¶ 27436.1.

to the cost of living index in case of a variation of more than 10% from the base year of 1948 according to Bureau of Labor Statistics figures.

New York also has a minimum compliance schedule which sets flat rates for both room and meals, but because it was last revised in 1944 and has no automatic adjustment provision, it has fallen well behind the cost of living, the value of full room and board for a week being set at \$7.75.⁴⁵ One Appellate Board decision indicates that New York will sometimes not tax as wages room and board furnished for the convenience of the employer,⁴⁶ but later decisions refused application of the rule to the staff of a private hospital and the resident custodian of an apartment building.⁴⁷ It is of interest that New York adheres to the doctrine, for it reaches a different result under its income tax law.⁴⁸

IV. FEDERAL FAIR LABOR STANDARDS ACT

Section 3(m) of the Fair Labor Standards Act⁴⁹ provides: " 'Wage' paid to any employee includes the reasonable cost, as determined by the Administrator, to the employer of furnishing such employee with board, lodging, or other facilities, if such board, lodging or other facilities, are customarily furnished by such employer to his employees."

Two tendencies have appeared which approached the creation of an "employer's convenience" exception, both apparently firmly checked at the present time. It is provided in the regulations defining "cost . . . to the employer" under Section 3(m) that: "The cost of furnishing 'facilities' which are primarily for the benefit or convenience of the employer will not be recognized as reasonable and may not therefore be included in computing wages."⁵⁰ However, the Administrator's examples suggest that "facilities" are in the nature of tools of the trade, uniforms and the like.⁵¹ The Administrator's present position is that board and lodging are not "facilities" as used in the regulations, so that even if furnished for the convenience of the

⁴⁵ Ind. Comm'r. Rule, derived from U. I.—5-41 (1941), 5 P-H Soc. SEC. TAX. SERV. (N.Y.) ¶ 27436.1.

⁴⁶ Digest App. Bd. Dec. 636-39 (1939), 5 P-H Soc. SEC. TAX. SERV. (N.Y.) ¶ 27436.4.

⁴⁷ Digest App. Bd. Decs. 6895-42 (1942) and 1888-39 (1940), 5 P-H Soc. SEC. TAX. SERV. (N.Y.) ¶¶ 27436.5 and 27436.6.

⁴⁸ See note 65 *infra*.

⁴⁹ (1946) 29 U. S. C. §§ 200 *et seq.* Section 3(m) is (1946) 29 U. S. C. § 203(m).

⁵⁰ 29 CODE FED. REGS. § 531.1(d) (Cum. Supp. 1943).

⁵¹ 29 CODE FED. REGS. § 777.7 (1949), 13 FED. REG. 420 (1948). *Walling v. Dunbar Transfer & Storage Co.* (W. D. Tenn., 1943) 3 WH Cases 284; *Walling v. New Orleans Private Patrol Service, Inc.* (E. D. La., 1944) 57 F. Supp. 143. Cf. *Anderson v. Mt. Clemens Pottery Co.* (E. D. Mich., 1943) 60 F. Supp. 146.

employer they must be included in wages,⁵² for the regulations must be interpreted as subordinate to the statute which they amplify, which provides specifically for their inclusion. Another troublesome provision is that to be included in wages "... it is essential that his [the employee's] acceptance of the facility be voluntary and uncoerced."⁵³ Though this presents an interesting problem if board and lodging are considered as "facilities," this is not the Administrator's present policy; moreover, "voluntary and uncoerced" is so ambiguous as to exclude few facilities from wages.⁵⁴

The other attack on the inclusion policy has come in a series of National Railway Adjustment Board awards with some judicial support.⁵⁵ Although not empowered to administer the Fair Labor Standards Act, the Board can determine disputes under that act which fall within its jurisdiction. In so doing it held that where meals had for a long time been customarily furnished free to the employees, primarily to benefit the employer, they were not part of wages in determining compliance with minimum wage provisions. However, after the refusal of enforcement of one award⁵⁶ the Board in a later case⁵⁷ changed its policy to conform to the prevailing view in the courts. The Ninth Circuit in reversing an order of enforcement of another award⁵⁸ talked throughout in terms of "employer's convenience" and based the decision primarily on a failure to show that meals were furnished to dining car waiters for the convenience of the railroad. Though its standard would evidently be more exacting than that of the Bureau of Internal Revenue with regard to income tax, the clear implication is that with a sufficient showing of convenience an exclusion would be possible.

⁵² Letter to author dated July 5, 1949 from Harold C. Nystrom, Chief Interpretations Branch, Office of the Solicitor, Department of Labor.

⁵³ 29 CODE FED. REGS. § 777.5 (1949), 13 FED. REG. 420 (1948).

⁵⁴ This provision was evidently inserted because of several "bad faith" cases in which the employer attempted to include in wages, to meet the legal minimum, certain items which employees were required to accept although they had no use for and did not use them. *Morgan v. Atlantic Coast Line R. R.* (S. D. Ga. 1940) 32 F. Supp. 617; *Williams v. Atlantic Coast Line R. R.* (E. D. N. C. 1940) 1 WH Cases 289. *Cf. Cotton v. Ottenheimer Bros.* (E. D. Ark. 1941) 1 WH Cases 483.

⁵⁵ Nat. Ry. Adjustment Bd., Award No. 1726; Award No. 1727, *Rev'd sub nom. Brotherhood of Maintenance of Way Employees v. Nashville C. & St. L. Ry.* (M. D. Tenn. 1944) 56 F. Supp. 559; Award No. 2098; Award No. 2206, *Rev'd sub. nom. Joint Council of Dining Car Employees v. New York Central R.* (N. D. Ill. Jan. 14, 1949) 16 CCH LAB. CAS. ¶ 64,948; Award No. 2207; Award No. 2208; Award No. 2663, *Aff'd sub nom. Joint Council of Dining Car Employees v. Southern Pacific R.* (N. D. Cal. 1946) 11 CCH LAB. CAS. ¶ 63,383, *reversed* (C. C. A. 9th 1947) 165 F. (2d) 26. *Contra: Shelton v. Missouri-Kansas-Texas R.* (E. D. Mo. 1940) 74 F. Supp. 961.

⁵⁶ Award No. 1727 *supra* note 55.

⁵⁷ Nat. Ry. Adjustment Bd., Award No. 2699.

⁵⁸ *Southern Pac. Co. v. Joint Council Dining Car Employees* (C. C. A. 9th 1947) 165 F. (2d) 26.

The policy considerations are not as clear with regard to the inclusion of compensation in kind as wages under this act. The definition of wages is basic to both the minimum wage and overtime provisions, and from the employee's standpoint there are conflicting interests. In determining minimum wages he will benefit by the exclusion of board and room, while in computing overtime the reverse is true.

The Lesinski Bill, now before Congress,⁵⁹ furnishes an interesting development, for if passed it would write the "employer's convenience" doctrine into the Fair Labor Standards Act. There are convincing policy arguments in support of this elimination of "lessened-value" compensation since those on the minimum wage borderline need additional compensation far more than those who would lose through a lower regular rate upon which to base overtime.

However these policy considerations obviously do not apply to the income tax field—in fact quite the opposite is true. Moreover, it is one thing to write an exception into a statute, quite another to make an exception where none is indicated.

V. STATE WORKMEN'S COMPENSATION ACTS

Under the state Workmen's Compensation acts, board and room is generally included in the computation of wages,⁶⁰ under definitions not as broad as that of the Internal Revenue Code,⁶¹ although three states have laws with contrary provisions.⁶² The cases largely rely upon a common law rule that "wages" is defined broadly enough to include all compensation in kind.⁶³

⁵⁹ H. R. 3190, 81st Cong., 1st Sess. (1949), including in § 3(m) the proviso "That the cost of board, lodging, and other facilities shall not be included in the wage paid to any employee if the furnishing of such facilities is an incident of and necessary to the employment and such facilities are practicably available only from the employer." See H. R. REP. No. 267, 81st Cong., 1st Sess. (1949) 33: "... This provision would require the payment of the minimum wage free and clear to such employees as seamen, meal service employees on common carriers, or employees in isolated lumber camps, who cannot, as a practical matter obtain such facilities other than through the employer." Pub. L. 393, 81st Cong., 1st Sess. (1949), raised the minimum wage to seventy-five cents an hour but did not change § 3(m).

⁶⁰ *O'Callahan v. Dermedy* (1923) 197 Iowa 632, 196 N. W. 10, *Reheard* (on another point) 197 Iowa 632, 197 N. W. 456; *Bernstein v. Beth Israel Hospital* (1923) 236 N. Y. 268, 140 N. E. 694; *Maryland Casualty Co. v. Geary* (1932) 123 Neb. 851, 244 N. W. 797; *American Surety Co. v. Underwood* (Tex. Civ. App. 1934) 74 S. W. (2d) 551; *Copeland v. Martin Metal Mfg. Co.* (1935) 141 Kan. 725, 42 P. (2d) 982, 80 A. L. R. 188.

⁶¹ IOWA CODE (1946) Ch. 85, § 85.36(1): "The compensation shall be computed on the bases of the annual earnings which the injured person received as salary, wages, or earnings. . . ."

⁶² Delaware, Nebraska, Maryland; see *O'Callahan v. Dermedy* (1923) 197 Iowa 632, 196 N. W. 10, note 60 *supra*.

⁶³ *Schumann v. Calif. Cotton Credit Corp.* (1930) 105 Cal. App. 136, 140, 286 Pac. 1068, 1070; *O'Callahan v. Dermedy*, *supra* note 60 at 640, 196 N. W. 10, 13; 67 C. J. 284, and cases cited in each of the above.

VI. CONCLUSIONS

From the standpoint of equity it would seem that the employer's convenience principle should be removed from the income tax law. It is unjust that those receiving certain benefits through the receipt of board and lodging should not bear their fair share of the tax burden. Inclusion would bring onto the tax rolls a large number of taxpayers in the lower income group, who now enjoy an arbitrary tax benefit, and increase the tax of others. The additional tax per person in most cases would be small but the aggregate, with current rates and exemptions, might increase revenue by as much as \$100,000,000.

Several states, including New York, already have such provisions for inclusion of compensation in kind in income for tax,⁶⁴ without any particular difficulties, and with substantial production of revenue.⁶⁵

It may be conceded that certain administrative problems would result from inclusion in income of room and board. The problem that merits the most attention is how to value compensation in kind. Obviously there are considerations of administrative feasibility that must be balanced against the equity of the taxpayer—what the facilities are worth to him.

Valuation

The inclusion of compensation in kind in gross income in all cases would tax the receipt of such to upwards of a million presently privileged taxpayers, in each of whose cases some estimate of value would have to be made. This would not constitute an insolvable administrative problem if the experience of other agencies is a fair indication. None of the states following the inclusion rule have apparently had any administrative difficulty, nor has the Bureau of Internal Revenue in cases presently taxed as not within the permissible exception. In all the income tax cases cited in this comment the value of board and lodging was stipulated when it was potentially in issue. It

⁶⁴ Arizona, Iowa, Indiana, New York, Oregon, South Dakota (until 1943), and Wisconsin; while as many others—California, Colorado, Kansas, Kentucky, Minnesota, Mississippi and Oklahoma—have followed the Federal plan.

⁶⁵ New York with a definition of gross income no broader than and very similar to that of the Federal Government, N. Y. Laws (1919) c. 627, amending N. Y. Laws (1909) c. 2, as amended annually through 1948, N. Y. Laws (1948) cc. 34, 62, 90, 91, 123, 357, 499, 547; Art. 16, § 359, expressly includes by regulation the value, regardless of convenience, of maintenance furnished an employee, with the exception of that received by members of the armed forces, N. Y. State Tax Comm., Income Tax Bur. (Jan. 21, 1941) Bull. 102. The valuation technique is to use the actual value of the item to the employee, N. Y. Personal Income Tax Regs. 47, Art. 25, p. 15, with a modification in that as to the tax of state employees Civil Service Regulations setting the value of board and lodging in computing retirement and amounts designated in the State budget are controlling. N. Y. State Tax. Comm., Income Tax Bur., Bull. 5 (March 14, 1935), and Bull. 141 (March 20, 1944).

may be assumed that usually the taxpayer would report a reasonable value of such items which the Bureau would accept.

Under the Fair Labor Standards Act provision is made⁶⁶ for formal administrative hearings to be had upon proper request, but to date only three of these proceedings have been necessary,⁶⁷ and only one court case has legitimately involved a valuation question.⁶⁸

The auditors of the California Unemployment Insurance offices have had no great problem in evaluating compensation in kind. Under the Regulations it is necessary to determine only the ordinary rental value of rooms, since experience has shown that employers rely almost exclusively upon the schedule value for meals. Investigations are fairly common, potentially being necessary for every apartment house and hotel, since the California Act includes businesses with as few as one employee. These are made on a payroll unit basis, the estimated required time being a half day to two days depending upon the number of employees involved. The federal Collectors could also make investigations by payroll groups, but this would not be necessary except where State unemployment insurance or income tax coverage is not broad enough, since the state determinations could be relied upon. The Federal Social Security Tax follows this system, relying upon state unemployment insurance standards,⁶⁹ and the local office of the Collector of Internal Revenue reports that employers hardly ever avail themselves of the opportunity for independent Federal Social Security Tax determination.

The market value of meals and lodging should not be used as the guide, for the employee as a rule is benefited only to the extent of some lesser value. The California Unemployment Insurance valuation scheme was adopted after full hearings in which both unions and employers were represented. Its philosophy is that the value to the employee is the ideal standard, but since it is administratively impossible to review in detail every case, rough justice is worked by taking as the value a fixed fraction of the market value, for the meal schedule is at least as much below going rates as is the two thirds allowance for housing. The fractional valuation will tend to make up to the taxpayer any disadvantage from the receipt of facilities more expensive than he would purchase for himself, or which are of a de-

⁶⁶ (1946) 29 U. S. C. § 203(m) "... reasonable cost, as determined by the Administrator, to the employer . . ." 29 CODE FED. REGS. § 531.2 (Cum. Supp. 1943).

⁶⁷ Letter to the author from William R. McComb, Adm'r Wage, Hour and Public Contract Division, Dept. of Labor, under date of April 22, 1949.

⁶⁸ *Walling v. Peavy-Wilson Lumber Co.* (W.D. La. 1943) 49 F. Supp. 846. The cases of *Morgan v. Atl. Coast Line R. R. Co.* and *Williams v. Atl. Coast Line R. R. Co.*, both *supra* note 54, were obvious attempts at evasion and not provisions of compensation in kind at all.

⁶⁹ S. S. T. 51 (1936) XV-2 CUM. BULL. 421.

creased value because he must maintain a separate home and dinner table. To the extent that they are current, it would be safe to follow state unemployment insurance minimum compliance schedules for income tax as well as social security tax, for at the time they were made most of them represented some kind of a compromise such as California's. The cost of living fluctuation might be taken care of as in California, for some of the states have not revised their schedules since the late thirties and are thus even more out of line than New York. It could be provided also that if the taxpayer could show that the value to him of the benefits received was materially less than the provision in the schedule, then as in the State Regulations⁷⁰ the schedule would not be conclusive.

Proposed Changes in the Law

As the valuation problem can be solved, the next question is to determine how the desired result can be reached. Because of the wording of Section 22(a) of the Internal Revenue Code, all of the changes above mentioned could be made without any change in the statutory definition; but because of the considerable period of contrary judicial and administrative interpretation the desired changes should be expressly enacted into law.

The statute and regulations should be changed to include all compensation in kind, except "*de minimis*" type benefits, in gross income. To determine its value to the taxpayer, the state unemployment insurance minimum compliance schedule should be used. If the employee is not covered by the state unemployment insurance law, reliance may be had upon state income tax determinations, and in case he is covered by neither, upon a federal schedule. This schedule should provide that two thirds of the market value of lodging and a fixed sum (which should approximate two thirds of the market value) per day and per meal will suffice for the tax return. In all the above schedules account must be taken of material changes in the cost of living since the last revision if they are to afford a basis for valuation. In addition these schedules should be conclusive upon the government but not on the taxpayer.

Particular care must be taken in spelling out the exception from gross income for *de minimis* items of compensation in kind. New York handles this problem by means of an exception in general terms in the income tax regulations,⁷¹ while the Federal Social Security Tax

⁷⁰ Ind. Comm'r. Rule, derived from UI-5-41 (1944) 5 P-H Soc. Sec. TAX. SERV. (N. Y.) ¶ 27436.1; cf. D. E. Reg. (1948) Art. 6, §§ 62 (a) (2) and 62 (a) (4), 2 P-H Soc. Sec. TAX. SERV. (Calif.) ¶ 27436.1.

⁷¹ New York Personal Income Tax Regulations 47, Art. 25, p. 15: "However, where such remuneration constitutes purely a gratuity or voluntary payment independent of the contract of employment and no pecuniary benefit or profit accrues to the employee therefrom, the same will not be considered as taxable income"

Regulations tend toward specific enumeration.⁷² It would be best for the Treasury to write into the Regulations a representative list of benefits of this type that need not be reported. Considering the strong hold of the "employer's convenience" doctrine upon the courts, any exception in the Code in general terms such as "gratuities independent of the contract" or "facilities which are part of the working conditions" could conceivably be expanded judicially so as to create all over again the equivalent of the legislatively discarded doctrine. Some form of authorization for the Treasury to exempt *de minimis* items will be required in the Code; the criteria might best be the difficulty of valuation compared with probable revenue yield.

Beyond doubt, the proposal just outlined does not represent the only possible solution. As some slight indication of whether it would be a satisfactory one the method may be seen by which several additional questions which are raised by typical criticisms of any proposal for eliminating the present rule would be handled.

One of these deals with the hardships which will result from such a change for state hospitals and charitable institutions, many of whose employees receive room and board now tax free. It is said that the institutions will have a new expense as they will have to compensate their employees through higher wages for the increased tax. Even granting the here implicit assumption of an unlikely degree of elasticity of the labor market, the simplest analysis shows that the result of change would be to eliminate an existing inequity, not to create a new one. If it has been possible for these institutions to secure employees below prevailing wages because of the tax advantage achieved, it means that because of the fortuitous circumstance that they furnish many of their workers maintenance they have been receiving a tax subsidy as compared with other taxpayers or other types of charities. If a tax subsidy for such institutions is legislatively desirable, it should be made by Congress by the specific grant of exemption to such employees, not by the haphazard method of "employer's convenience."

Another challenge is presented by the task of evaluating fairly the living quarters of certain employees who are furnished housing which is far more expensive than they could or would obtain for themselves. Take, for example, the president of a large university, to whom may be furnished without charge a sumptuous dwelling to befit the dignity of such an institution and to allow facilities for the entertainment of official guests. How shall he be taxed on these quarters, unquestionably tax free under present regulations, assuming that he would not ordinarily live in such an expensive residence and

⁷² See notes 32 and 33 *supra*.