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Taxation--Exclusion Under Section 119 Granted Although Employee Was Charged for Value of Quarters Supplied (Boykin v. Commissioner, 260 F.2d 249 (8th Cir. 1958))

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TAXATION — EXCLUSION UNDER SECTION 119 GRANTED ALTHOUGH EMPLOYEE WAS CHARGED FOR VALUE OF QUARTERS SUPPLIED.—Taxpayer, a physician employed by the Veterans' Administration, was required to live in quarters on the hospital grounds. A charge was made against his salary for the value of quarters supplied. The taxpayer deducted [1] this amount from gross income on his return. Section 119 of the Internal Revenue Code [2] allows an exclusion for the value of lodging furnished for the convenience of the employer, on the business premises, as a required condition of employment.[3] The Tax Court[4] held that the requirement that the quarters be "furnished" is not met when the employer charges the employee for the value of quarters supplied. The court of appeals, reversing the Tax Court, *held* that the exclusion will lie even though the employee's salary is subjected to a charge for the value of quarters received. *Boykin v. Commissioner,* 260 F.2d 249 (8th Cir. 1958).

Prior to the enactment of section 119 of the 1954 Code there were no specific statutory provisions concerning the relation of meals and lodging to gross income.[5] Regulations under the 1939 Code [6] provided that if meals and lodging were furnished as part of compensation the value thereof was not excludable from gross income,[7]

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[1] The taxpayer's basic salary under his Civil Service classification was $11,300.12 in 1954 and $12,130.38 in 1955. From his salary his employer, the Veterans' Administration, deducted $1,147.46 in 1954 and $1,188.86 in 1955 as a rental charge for living on the premises. Taxpayer rented a garage on the hospital grounds for which he made direct payments which he also attempted to deduct from his return. Section 119, upon which the taxpayer based his contentions, allows an exclusion from gross income rather than a deduction. No mention of this error is made in the opinion, the Tax Court apparently feeling that the net effect of an exclusion and a deduction is the same. See Boykin v. Commissioner, 29 T.C. 813 (1958). The court of appeals affirmed the Tax Court's decision in disallowing the deduction for the garage rental, since this was not a required condition of the employment.

[2] INT. REV. CODE OF 1954 provides:

> "§ 119. MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER
>
> 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, but only if—
> * * *
>
> (2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a required condition of his employment."

[3] Section 119 allows an exclusion for meals also. In the case of meals, however, there is no requirement that they be accepted as a condition of employment.

[4] Boykin v. Commissioner, 29 T.C. 813, 817-18 (1958).

[5] 2 MERTENS, FEDERAL INCOME TAXATION § 11.16, at 53 (1955).

[6] Treas. Reg. 118, § 39.22(a)-3 (1951).

[7] Prior to the enactment of the 1954 Code the value of quarters, heat, light and laundry furnished to employees of the Veterans' Administration hos-

whereas if they were furnished for the convenience of the employer [8] the exclusion would lie. Difficulty in applying the regulation arose when the "compensation" and "convenience of the employer" factors were both present.[9] To dispel this confusion the Treasury Department issued a ruling which chose the "compensation" test as the determinative factor, the "convenience" test to apply only when the "compensation" element was not present.[10] Section 119 was specifically drafted to deal with this problem.[11] In effect, the section did away with the "compensation" test and added to the "convenience" test the requirement that the quarters be furnished on the employer's business premises. In addition, the requirement that the inherent nature of the employment necessitate that the quarters be furnished is now couched in the term "condition of employment."

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pitals was ruled to be part of the employee's compensation and therefore taxable. I.T. 2692, XII-1 CUM. BULL. 28 (1932).

[8] "'Convenience of the employer' has been . . . interpreted as meaning not merely the request, direction or pleasure of the employer but that the inherent nature of the employment requires that the employee occupy the premises supplied by the employer, in which the occupation of the designated quarters becomes an inherent part of the services performed." Hazel W. Carmichael, 17 P-H Tax Ct. Mem. 239, 241 (1948). In the following cases and rulings prior to the enactment of the 1954 Code meals and/or lodging received by the taxpayer were excluded from gross income under the "convenience" test: Harry M. Lees, 22 P-H Tax Ct. Mem. 449 (1953) (construction supervisor); George A. Papineau, 16 T.C. 130 (1951) (owner-manager of hotel); Lloyd N. Farnham, 16 P-H Tax Ct. Mem. 898 (1943) (janitor); Arthur Benaglia, 36 B.T.A. 838 (1937) (resident manager of hotel); G.C.M. 14836, XIV-1 CUM. BULL. 45 (1935) (treasury attachés in foreign service); G.C.M. 14710, XIV-1 CUM. BULL. 44 (1935) (Foreign Commerce Service employees); I.T. 2253, V-1 CUM. BULL. 32 (1926) (domestic servants); T.D. 3724, IV-2 CUM. BULL. 136 (1925) (army officers); O.D. 814, 4 CUM. BULL. 84 (1921) (fishermen and canners); O.D. 265, 1 CUM. BULL. 71 (1919) (seamen). The "convenience" test was not met in the following cases: Robert D. Bartilson, 23 P-H Tax Ct. Mem. 1023 (1954) (airline employee); Wilson J. Fisher, 23 T.C. 218 (1954) (hotel entertainer); Hazel W. Carmichael, 17 P-H Tax Ct. Mem. 239 (1948) (assistant auditor and head janitor of a government housing project); Fontaine Fox, 30 B.T.A. 451 (1934) (sole stockholder residing in a corporate-owned residence).

"Convenience of the employer" as used in the 1954 Code, however, means that which serves a business purpose. See Treas. Reg. §§ 1.119(a)-2, (d) Example 2 (1954).

[9] See, *e.g.*, Diamond v. Sturr, 221 F.2d 264 (2d Cir. 1955); Ellis v. Commissioner, 6 T.C. 138 (1946).

[10] Mim. 6472, 1950-1 CUM. BULL. 15 (1950). When the ordinary factors which indicate the presence of compensation do not appear, the Commissioner will look to the "convenience" test to determine whether or not compensation is present. *Ibid.* But as a practical matter if the ordinary circumstances determining whether or not compensation is present do not appear, the fact that the furnished lodgings are for the "convenience of the employer" will permit the exclusion.

[11] See S. REP. No. 1622, 83d Cong., 2d Sess. (1954), in U.S. CODE CONG. & AD. NEWS at 4649 (1954). See generally, Comment, 53 MICH. L. REV. 871 (1955), for a complete discussion of the enactment of section 119.

In situations similar to the *Boykin* case, prior to the enactment of the 1954 Code, where the employer charged the employee for the value of meals and lodging supplied the exclusion was not allowed, since the courts found the "compensation" element present.[12] In the *Herman Martin* case,[13] the taxpayer was employed by the Army Engineers as a wireless operator. His base pay was 2,100 dollars per year from which was deducted forty dollars per month for lodging and subsistence. The board held that where the value of quarters supplied is considered and treated by the employer as compensation rather than as an allowance or gratuity it would be taxable to the recipient.

The issue in the *Boykin* case was whether the requirements of section 119 are met when the employee is charged by his employer for the value of quarters supplied. The Commissioner contended that the word "furnished" as used in section 119 meant furnished without charge or cost to the employee. This argument finds direct support in the regulation applicable to section 119.[14] The Court, in overruling this contention, stated: "We do not believe that the word 'furnished' carries with it the implication that no charge is involved." [15] The Court studied the legislative history of the section and concluded that if Congress had intended the word "furnished" to mean furnished without charge or cost to the employee, section 119 would have so specified.[16] The Court found that there are only three tests that must be met for the exclusion to apply: that the quarters be 1) furnished for the convenience of the employer, 2) on the business premises, and 3) accepted by the employee as a required condition of the employment. In effect, the Court is allowing an exclusion where the employee has "received" cash and then remitted it to the employer for the value of quarters received. The Court favors the view that substance rather than form is the determinative factor in the solution of tax problems [17] and in doing so indicates that the following three examples are to receive the same tax treatment under section 119. Assume that in all the examples, the three tests that the Court looks to are present.

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[12] See, *e.g.*, Robert D. Bartilson, 23 P-H Tax Ct. Mem. 1023 (1954); Joseph L. Doran, 21 T.C. 374 (1953); Herman Martin, 44 B.T.A. 185 (1941). *Contra,* Powell v. White, Am. Fed. Tax R. 2d 1786 (D.C. Ill. 1958).

[13] 44 B.T.A. 185 (1941).

[14] "The exclusion provided by section 119 applies only to meals and lodging furnished in kind, *without charge or cost to the employee.* If the employee has an option to receive additional compensation in lieu of meals or lodging furnished in kind, *or is required to reimburse the employer for meals or lodging furnished in kind,* the value of such meals and lodging is not excluded from gross income. . . ." Treas. Reg. § 1.119(c)-2 (1954). (Emphasis added.)

[15] Boykin v. Commissioner, 260 F.2d 249, 251 (8th Cir. 1958).

[16] *Id.* at 251-52.

[17] *Id.* at 254.

1) Employee *X* receives 10,000 dollars in salary, and in addition thereto is supplied quarters, the value of which is 1,000 dollars. The exclusion would be allowed even if the value of the quarters were intended by the employer to be additional compensation to the employee. This situation falls directly within the wording of section 119.

2) Employee *Y* receives 10,000 dollars in salary, in addition to which 1,000 dollars is received as an allowance for quarters, which is in turn deducted by the employer—in other words, a bookkeeping device rather than a true "salary" deduction.

3) Employee *Z* is entitled to 11,000 dollars in salary whether he lives on or off the premises. This is the situation in the *Boykin* case, since government employees are salaried according to their respective job classifications. Boykin was required to live on the premises because he was the hospital manager and chief of professional services. The money he was charged was not an additional allowance, but was part of his government contract salary.

If the Court were confronted with a situation similar to that in example 2, there would be sound justification for its decision, since in substance it is similar to the situation in example 1, the form difference being in the bookkeeping systems used by the employers. In example 3, however, the taxpayer is given the benefit of an exclusion, while others in the same wage classification who live off the employer's premises are not. The legislative history of section 119 gives no indication that Congress gave any thought to the exclusion from gross income of the value of lodgings for which the employer was charged; in fact it indicates rather clearly that Congress was thinking only about the exclusion from income when the charge element was not present.[18]

Closely analogous to example 3 is the case in which the employee receives a cash allowance in lieu of facilities furnished in kind.[19] This situation usually occurs when the employer does not have adequate facilities on his business premises. *Jones v. United States*[20] held that cash payments to an army officer, where subsistence in kind could not be furnished, were not taxable provided the "convenience" test was met. The Tax Court in *Van Rosen v. Commissioner*[21] held that cash subsistence allowances to civilian employees were taxable since the taxpayer had dominion and control over the money received. *Saunders v. Commissioner*[22] criticized the *Van Rosen* decision and

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[18] See H.R. REP. No. 1337, 83d Cong., 2d Sess. (1954), in U.S. CODE CONG. & AD. NEWS 4175 (1954).

[19] The regulations impose the requirement that the meals and lodging be furnished in kind for the exclusion to be applicable. Treas. Reg. § 1.119(c)-2 (1954).

[20] 60 Ct. Cl. 552 (1925).

[21] 17 T.C. 834 (1951); *accord*, Hyslope v. Commissioner, 21 T.C. 131 (1953).

[22] 215 F.2d 768 (3d Cir. 1954). The court stated: "[B]ecause the result

reasoned that if instead of a cash allowance, the subsistence were furnished in kind and met the test for exclusion, the cash allowance in lieu thereof would be likewise excludable.[23] At the time of the enactment of the 1954 Code the Senate Finance Committee Report [24] stated that all cash allowances are to be included in gross income to the extent that they represent compensation.[25] Since the "compensation" test was done away with in determining whether the exclusion is allowed when the meals and lodging are furnished in kind,[26] there appears to be a conflict in this area. There seems to be more justification for allowing an exclusion here than in the *Boykin* case, since the allowance is not a part of the employee's salary.

A related area is that of employee fringe benefits [27]—a considerable expense in industry today.[28] Although these benefits lack the "charge" element present in the *Boykin* case, employees often accept a lower wage because of the facilities and other benefits that are offered by employers.[29] The cost of these benefits is an allowable employer deduction [30] if in fact they are reasonable and necessary.[31]

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in this case should not be dependent on whether meals are furnished in cash or in kind, we may refer to the principle of convenience of the employer rule in deciding the classification of this rations allowance just as we may when meals themselves are furnished." *Id.* at 772.

[23] The *Saunders* case involved a police officer's subsistence allowance. Section 120 of the 1954 Code provided for an exclusion from gross income, not to exceed $5 per day, for statutory subsistence allowances paid to police officers. The section was repealed by § 3 of the Technical Amendments Act of 1958, 72 Stat. 1606 (1958). The intention of the legislature was to do away with the exclusion entirely. However, police officers may deduct allowable away-from-home travel expenses. S. REP. No. 1983, 85th Cong., 2d Sess. (1958), in U. S. CODE CONG. & AD. NEWS 6811 (1958).

[24] S. REP. No. 1622, 83d Cong., 2d Sess. (1954), in U.S. CODE CONG. & AD. NEWS 4825 (1954).

[25] At present there are several subsistence allowances which have been held excludable from gross income. Among them are allowances to government employees in the Foreign Service, INT. REV. CODE OF 1954, § 912, rent payments for clergymen, INT. REV. CODE OF 1954, § 107, and supper money for overtime workers, O.D. 514, 2 CUM. BULL. 90 (1920).

[26] See Treas. Reg. § 1.119(B) (1954).

[27] "[F]ringe benefits are goods and services in addition to wage payments as conditions of employment, as incentives for greater effort, as conveniences for the employer, and/or as promoters of employee health, good will and efficiency." Landman, *The Taxability of Fringe Benefits,* 33 TAXES 173 (1955).

[28] See Landman, *The Taxability of Fringe Benefits,* 33 TAXES 173 (1955).

[29] See SURREY & WARREN, FEDERAL INCOME TAXATION 106, 107 (1955 ed.).

[30] See, *e.g.,* Rev. Rul. 59-58, 1959 INT. REV. BULL. No. 8, at 8 (holiday turkeys and hams); Rev. Rul. 131, 1953-2 CUM. BULL. 112 (employee tornado relief fund); Slaymaker Lock Co., 18 T.C. 1001 (1952) (employee outings and dances); Jesse S. Rinehart, 18 T.C. 672 (1952) (employee moving expenses); Paul McWilliams, 19 P-H Tax Ct. Mem. 771 (1950) (flowers for ill employees); Abe Wolkowitz, 18 P-H Tax Ct. Mem. 664 (1949) (Christmas parties).

[31] INT. REV. CODE OF 1954, § 162(a).

Because of the sudden rise in the variety of these benefits and the liberal attitude of the Treasury Department in respect to them, they are for the most part enjoyed tax-free.[32] Several of them have been held to be excluded from gross income.[33]

The *Boykin* case seems to be in line with the liberal view of nontaxability of fringe benefits in that it broadens the scope of section 119. It appears that the only sound justification for the decision is the petitioner's lack of freedom of choice, due to the requirements of his employment status.

As a simple matter of economics, although it can be said that the value of subsistence and quarters does not constitute taxable income to the employee when it comes directly within the statute, the employee has received, tax-free, accommodations which if otherwise acquired would have required payment therefor out of his taxable salary. The problem that arises is whether the taxpayer's lack of freedom of choice is a sufficient reason for allowing the exclusion. Section 61(a),[34] defining gross income, is a section of broad sweep. Everything that is encompassed within the phrase "income from whatever source derived" is includable in gross income unless a specific provision authorizes exclusion or other special treatment. In order to come within the exclusion of section 119 its requirements should be met to the letter. Whether the other circuits will share the view taken by the Court in the *Boykin* case remains to be seen.

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[32] See generally, Landman, *supra* note 28, at 179. However, the author indicates that the tax-free status of many of these benefits is now in jeopardy. *Ibid.*

[33] See, *e.g.*, Rev. Rul. 59-58, 1959 INT. REV. BULL. No. 8, at 7 (holiday turkeys and hams); INT. REV. CODE OF 1954, §§ 104-06 (employee injury benefits), 101(B)(2)(A) (death benefit payments to employees' widows); Mim. 6477, 1950-1 CUM. BULL. 16 (group health and hospitalization payments made by employers); S.S.T. 302, 1938-1 CUM. BULL. 456 (employee courtesy discounts); O.D. 514, 2 CUM. BULL. 90 (1920) (supper money for overtime workers). Other benefits have been held to be includible in gross income: N. H. Van Sicklen, Jr., 33 B.T.A. 544 (1935) (Christmas bonuses); Treas. Reg. § 1.74-1(b) (1958) (awards received from employer-sponsored contests).

[34] INT. REV. CODE OF 1954, § 61