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A NEW LOOK AT THE SECTION 119 MEALS AND LODGING EXCLUSION

One of the most problematic areas of income tax law has been the excludability of various employee fringe benefits from taxable income. This article examines the appropriate tax treatment of one type of fringe benefit—meals furnished by an employer to his employee.

Prior to 1954 the excludability of the value of meals furnished by an employer was dependent upon whether the factual circumstances of the case satisfied a "convenience of the employer" rule developed by administrative rulings and case law. In 1954 Congress attempted to end the confusion surrounding the excludability of meals furnished by an employer by enacting section 119 of the Internal Revenue Code. Through this enactment the Congress not only codified the convenience of the employer rule, but it also created a new "on the business premises" requirement. In addition to these two statutory requirements, the legislative history of section 119 reveals that the meals exclusion applies only to the value of meals furnished in kind.

The purpose of this article is to analyze the development of these three integral tax concepts of the meals and lodgings statute: first, meals furnished "for the convenience of the employer"; second, meals furnished "on the business premises"; and third, meals furnished "in kind." In the wake of the traditional problems of section 119 and due to two recent developments—the Supreme Court decision in Commissioner v. Kowalski and the 1978 section 119 amendment—a new look at the meals exclusion is required before the appropriate tax treatment of section 119 can be assured.

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2 Stechel, Effect of Recent Supreme Court Decisions on the Use of Meals and Lodging Exclusions, 20 TAX. FOR ACCOUNTANTS 216 (1978).
   (a) Meals and Lodging Furnished to Employee, His Spouse, and His Dependents, Pursuant to Employment—There shall be excluded from gross income of an employee the value of any meals or lodging furnished
I. CONVENIENCE OF THE EMPLOYER RULE

Prior to the enactment of section 119 in 1954, the excludability of meals from income was dependent upon whether the court determined that the "convenience of the employer" was served by the furnishing of meals to the employee. Both the courts and the Bureau, however, have not consistently agreed upon the proper interpretation of the convenience of the employer rule. One definitional approach—aptly named the employer's characterization rationale—was espoused by several early administrative rulings and can also be found in several cases. In applying the employer's

1. **Convenience of the Employer Rule**

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2. **Special Rules**

   (b) Special Rules.—For purposes of subsection (a)—
   
   (1) Provisions of employment contract or state statute not to be determinative.—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.
   
   (2) Certain factors not taken into account with respect to meals.—In determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals, and the fact that the employee may accept or decline such meals, shall not be taken into account.
   
   (3) **Certain fixed charges for meals**—
       (A) In general—If—
       
       (i) an employee is required to pay on a periodic basis a fixed charge for his meals, and
       
       (ii) such meals are furnished by the employer for the convenience of the employer, there shall be excluded from the employee's gross income an amount equal to such fixed charge.
       
       (B) Application of subparagraph (A)—Subparagraph (A) shall apply—
       
       (i) whether the employee pays the fixed charge out of his stated compensation or out of his own funds, and
       
       (ii) only if the employee is required to make the payment whether he accepts or declines the meals.


* Stechel, supra note 2, at 216.


* O.D. 514, 2 C.B. 90 (1920); O.D. 914, 4 C.B. 85 (1921).

* Jones v. United States, 60 Ct. Cl. 552 (1925); Doran v. Commissioner, 21 T.C. 374 (1953).
characterization rationale, tax consequences ultimately turn upon a determination of the employer's intent.\textsuperscript{12} If it is factually determined that the employer intended the meals furnished to be a form of compensation to his employees, the value of the meals furnished is taxable.\textsuperscript{13}

The following examples illustrate how factual circumstances can disclose the bona fide intentions of the employer in furnishing meals to his employees: first, a federal statute that identifies the meals provided to a government employee as compensation;\textsuperscript{14} second, an employer's company policy of including the value of meals furnished to his employee in the calculation of vacation, sick pay, or compliance with minimum wage laws;\textsuperscript{15} and third, a managerial policy of posting the cost of the meals furnished to employees into the company's salary account.\textsuperscript{16} Regardless of the declarations of the employer, his "characterization" of the meals as compensatory in the above examples was sufficient to warrant their inclusion in the employee's income.

The business necessity rationale, however, has been the more common application of the convenience of the employer rule. This rationale was adopted by several administrative rulings\textsuperscript{17} and became the authoritative standard of the Internal Revenue when a 1940 revenue ruling\textsuperscript{18} stated: "As a general rule the test of the 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 properly perform his duties."\textsuperscript{19}

The business necessity rationale can also be found in an early Tax Court case, \textit{Kitchen v. Commissioner},\textsuperscript{20} which held that the

\textsuperscript{12} Commissioner v. Kowalski, 434 U.S. 77, 85 n.16 (1977).
\textsuperscript{13} 434 U.S. at 85.
\textsuperscript{14} Diamond v. Sturr, 116 F. Supp. 28 (N.D.N.Y. 1953) rev'd by 221 F.2d 264 (2nd Cir. 1955) (New York Civil Service classified meals and lodging furnished to state employees as compensation for federal tax purposes).
\textsuperscript{15} Bittker, \textit{The Individual as Wage Earner}, 11 N.Y.U. INST. ON FED. TAXATION 1147, 1152-53 (1953).
\textsuperscript{16} O.D. 914, 4 C.B. 85 (1921) (under this ruling the meals and lodging received by employees of the Indian Bureau of the Department of the Interior were determined to be compensatory by the nature of the accounting entry made on the books of the Interior Dept.).
\textsuperscript{17} O.D. 814, 4 C.B. 84 (1921) (cannery workers); O.D. 915, 4 C.B. 85 (1921) (hospital workers).
\textsuperscript{18} Mim. 5023, 1940-1 C.B. 14, 15.
\textsuperscript{19} \textit{Id.} at 15.
\textsuperscript{20} 11 B.T.A. 855 (1928).
exigencies of the hotel business in this case were not sufficient to establish that meals were furnished to the hotel manager for the convenience of his employer. In two succeeding Tax Court cases, Benaglia v. Commissioner, Van Rosen v. Commissioner, the business necessity standard was regarded as the authoritative interpretation of the rule. Van Rosen is of particular interest because it expressly states that the ends of the employer's business must dominate and control and not his intentions.

Despite growing support for the business necessity rationale in the courts, the Internal Revenue became apprehensive about the use of "convenience of the employer" as a catchall phrase to rationalize a meal exclusion. Consequently, the Internal Revenue withdrew its previous support for the rule and instead relegated it to a test applicable only in cases where the compensatory character of the meals could not otherwise be determined. According to a mimeographed letter of the Treasury, the real issue became whether the surrounding circumstances—without regard to the convenience of the employer—showed that the meals were compensatory.

The Tax Court was noticeably shaken by the Bureau's sudden change of mind. In Doran v. Commissioner it too declared that the convenience of the employer rule was no longer the determinative test. But the court's holding did not reflect the broad compensatory inquiry enunciated in the above mentioned memo. Instead, the decision was determined by the existence of a state law which characterized the meals furnished as compensation. The court attempted to apply the employer's characterization rationale previously rejected in Van Rosen and simultaneously claim that the convenience of the employer rule was no longer determinative. The inherent contradiction evidenced in Doran indicates the consequences of the Internal Revenue's sudden rejection of the con-

22 17 T.C. 834 (1951).
23 Id. at 838.
24 Id.
25 Id.
26 Id.
27 21 T.C. 374 (1953).
28 21 T.C. 834, 376 (1953).
29 The court states: "[I]t is apparent from the South Carolina statute that the value of the petitioner's quarters is considered . . . compensation . . . . [C]onsequently, there is no need to apply the convenience of the employer rule."
venience of the employer rule without reinstituting a practicable standard.

In 1954 Congress attempted to end the resulting confusion by enacting section 119.\textsuperscript{29} Despite early differences,\textsuperscript{30} the House of Representatives and the Senate agreed that the convenience of the employer rule be reestablished as the primary test for the exclusion of meals and lodging.\textsuperscript{31} However, Congress did not reveal which prior interpretation of the rule would be authoritative. It was not until the Supreme Court's recent ruling in \textit{Commissioner v. Kowalski} that the business necessity rationale was established as the controlling statutory interpretation of the convenience of the employer rule.\textsuperscript{32} While the Court in \textit{Kowalski} reasoned that the business necessity rationale was authoritative since it was controlling prior to the enactment of section 119,\textsuperscript{33} the statute itself clearly repudiates the employer's characterization rationale and thus affirms by implication the business necessity standard.\textsuperscript{34} Section 119 itself expressly provides: "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."\textsuperscript{35}

Since the business necessity rationale can now be regarded as the only authoritative interpretation of the convenience of the employer rule, the question arises whether the Treasury's "substantial noncompensatory business reason?" test promulgated prior to \textit{Kowalski} is still viable. According to the Treasury, meals will be regarded as furnished for a noncompensatory business reason when they are furnished to the employee so that he

\textsuperscript{29} Int. Rev. Code of 1954, ch. 1 § 119.
\textsuperscript{32} 434 U.S. 77, 93 (1977).
\textsuperscript{33} The Court stated: "As we have noted above, \textit{Van Rosen v. Commissioner}, 17 T.C. 834, provided the controlling court definition at the time of the 1954 recodification and it expressly rejected the Jones theory of 'convenience of the employer'—and by implication the theory of O.D. 514—and adopted as the exclusive rationale the business-necessity theory." \textit{Id}.
\textsuperscript{34} I.R.C. § 119 (1978), supra note 7.
\textsuperscript{35} \textit{Id}.
may be available for emergency call during his meal period, or when the employee must be restricted to a short meal period and can not be expected to eat elsewhere in such a short period, or when there are insufficient eating facilities in the vicinity of the employer's premises.

The regulations also provide that an employee furnished meals for a noncompensatory business reason—such as being required to be on duty at all times—is entitled to a meals exclusion even though the state statute regards such meals as compensation. Meals are not furnished for a noncompensatory business reason, however, when they are designed to promote the morale or goodwill of the employee or to attract prospective employees. Meals furnished before or after the working hours of the employee or on non-working days are also not generally regarded by the Treasury as furnished for the convenience of the employer. The net result of a survey of these Treasury regulations reveals that even though the term "noncompensatory business reasons" purports to encompass a broad compensatory test, the regulations, in actual application, illustrate an adherence to the business necessity maxim: the meals must be necessary for the proper performance of the employees duties.

The most frequent and also most troublesome application of the convenience of the employer rule arises where an employee is "on call" for his employer during his meal hour. This issue has been predominantly litigated by hotel managers and state troopers. The regulations provide that, in order for an employee to be deemed "on call," it must be shown that emergencies have actually occurred, or can reasonably be expected to occur, and would potentially result in the employer calling on the employee to perform his job during the meal period.

The "on call" inquiry is well illustrated in a 1971 revenue ruling. Here, the Internal Revenue ruled on the tax treatment of free meals furnished to a corporation's main office and branch

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office employees under three different factual circumstances.\textsuperscript{44} The first factual situation involved employees who were required to remain at their desks—where they were served lunch—in order to answer infrequent telephone calls by customers of the employer.\textsuperscript{45} The second situation involved employees who were subject to call during their lunch hour but ate in the dining room.\textsuperscript{46} Both of these groups of employees were allowed a meal exclusion by the Internal Revenue.\textsuperscript{47} A third group of employees who were free to run personal errands during the meal period, however, were not allowed an exclusion.\textsuperscript{48} The Bureau concluded that this third group was generally not “needed” for urgent business and therefore it was unlikely their meals would be interrupted for such purposes.\textsuperscript{49}

The Bureau’s ruling should be compared with the recent case, Commissioner \textit{v.} Kowalski, in which the Supreme Court required a New Jersey state trooper—who was “on call” while eating his mid-shift meal in a highway restaurant—to demonstrate that the meal allowance was necessary for the trooper to properly perform his duties.\textsuperscript{50} Despite the state’s contention that the meal allowance system was necessary since otherwise the trooper would be required to leave his assigned area of patrol unguarded for extended periods of time,\textsuperscript{51} the Court held that the record did not suggest the meal allowance was a business necessity.\textsuperscript{52} One can speculate that the Court believed that the freedom of the trooper to eat anywhere inside the patrol area or to bring his meal into the patrol area were both sufficient to undermine the necessity of a state trooper eating his mid-shift meals at a highway restaurant. \textit{Kowalski}, therefore, could be regarded as a substantial narrowing of the business necessity rule to situations where the employee cannot make any other accommodations.\textsuperscript{52,1}

The better view is that the Court’s holding was an expression

\textsuperscript{44} Id. at 104.
\textsuperscript{45} Id.
\textsuperscript{46} Id.
\textsuperscript{47} Id.
\textsuperscript{48} Id.
\textsuperscript{49} Id.
\textsuperscript{50} 434 U.S. 77, 95 (1977).
\textsuperscript{51} Id. at 79-80.
\textsuperscript{52} Id. at 95.
\textsuperscript{52,1} \textit{But see} United States Junior Chamber of Commerce \textit{v.} United States, 334 F.2d 660, 664 (Ct. Cl. 1964). The court held that section 119 does not require that the lodging be so necessary to the proper performance of the employee’s duties that the absence of such lodging would render the performance virtually impossible.
of its indignation over the blatant compensatory character of the New Jersey cash allowance system and not a narrowing of the business necessity standard. The Court intermixed the business necessity inquiry with an altogether separate in-kind inquiry. If the Court had solely considered the business necessity standard without reference to the cash allowance system, the state trooper should have been adjudicated to be "on call" because the state trooper could demonstrate that highway emergencies could be reasonably expected to occur and he would be required to respond to these emergencies during his meal period. The meals were therefore necessary for the trooper to properly perform his duties.

While the decision in Kowalski raises speculation concerning the judicial tone of future applications of the rule, the Court did not resurrect a new tax concept or even undercut the present position of the Treasury. The Court's decision, however, is important because it has prevented the "convenience of the employer" from application as a mere catch phrase. The "business necessity" rationale is now both practicable and authoritative. Consequently, judicial equivocation previously tolerated in the application of the convenience of the employer rule can no longer be justified.

II. BUSINESS PREMISES REQUIREMENT

To be eligible for the meals and lodging exclusion, the employee's meals must be furnished "on the business premises" of the employer. Unfortunately, the legislative history of section 119 does not clarify the limitations that geographical boundaries place on the business premises requirement. In fact, the only inkling of the meaning of "on the business premises" is provided by the Conference Report, which states, "the term 'business premises of the employer' is intended, in general, to have the same effect as the term 'place of employment.'" Identical language can be found in the regulations.

But even though the legislative history does not adequately define the scope of the requirement, three interpretations of the term "on the business premises" can be identified. The first ap-

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A second application, a "functional approach," enlarges the scope of the business premises requirement to wherever an employee conducts a substantial portion of his duties or wherever the employer conducts a significant portion of his business. This functional approach is analogous to cases involving the civil procedure question of jurisdiction over property, when for purposes of garnishment, a debt can be attached in whatever jurisdiction the debtor can be personally served. Likewise, for purposes of section 119, a business premises can be found at whatever place the employee performs his duties of employment.

A third application, the "proximity approach," allows an exclusion not only at the place where the employee performs his duties but also "near the place" or "in the vicinity of the place" where the employee performs his duties. Since no services are rendered on the business premises where the meals are furnished, the proximity approach is essentially a functional approach devoid of geographical boundaries. Nevertheless, the proximity approach is not generally utilized since most courts hold the word "on" should not be construed to mean "nearby" or "in the vicinity of."

The functional approach appeared first in a 1964 Court of Claims decision, United States Junior Chamber of Commerce v. United States. In this case, the business premises was defined as "the premises on which the duties of the employee are to be per-

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57 Lindeman v. Commissioner, 60 T.C. 609, 614 (1973); see also, Stechel, supra note 2, at 218.
59 M. Green, Civil Procedure at 38 (5th ed. 1977).
60 See United States v. Moran, 356 F.2d 199, 203 (8th Cir. 1966). The court held Congress did not put geographical bounds on the business premises of the employer.
formed." But in *Anderson v. Commissioner*, the Tax Court went beyond this decision and allowed a meals and lodging exclusion claimed by a motel manager who lived two blocks from the hotel where he worked. The court reasoned:

To conclude that property owned by an employee within two short blocks of a facility managed by an employee who is required to be on 24-hour call for the management of the business is not on the business premises within the meaning of Section 119 . . . is too restrictive an interpretation.

Two years later the Tax Court retreated from the "proximity approach" implicit in *Anderson* and emphasized that meals must be furnished "on the business premises." In *Dole v. Commissioner*, the court ruled an employee who lived in a company owned house approximately one mile away from the mill could not exclude the cost of meals or lodging even though the taxpayer had supervisory duties which required him to live in close proximity to the mill. The court expressed doubt that Congress ever intended section 119 to apply to situations where the employee does his work in one location and resides at another location some distance away. In a concurring opinion Judge Raum stressed that no business of the employer was conducted in these company owned houses.

When the decision in *Anderson* was appealed, the Sixth Circuit did not hesitate to overrule the earlier Tax Court's holding. Relying heavily upon the concurring opinion of Judge Raum in *Dole*, the Sixth Circuit responded: "[t]o make 'two short blocks' or nearness to the other property the test is to disregard the word 'on' as contained in the phrase 'on the business premises of the employer.' " In contrast, the Sixth Circuit advocated that "on the business premises" should only be construed as "either at a place where the employee performs a significant portion of his duties or on the premises where the employer conducts a significant portion of his business." In *Lindeman v. Commissioner*, the functional

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63 *Id.* at 684-65.
64 42 T.C. 410 (1964), rev'd, 371 F.2d 59 (6th Cir. 1966).
65 *Id.* at 417.
66 43 T.C. 697 (1965), aff'd, 351 F.2d 308 (1st Cir. 1965).
67 *Id.* at 706-07.
68 *Id.* at 707.
69 *Id.* at 708.
70 Commissioner v. Anderson, 371 F.2d 59 (6th Cir. 1966).
71 *Id.* at 67.
72 *Id.*
MEALS AND LODGING EXCLUSIONS

The approach espoused by the Sixth Circuit was adopted by the Tax Court. Moreover, in a 1971 revenue ruling, the Internal Revenue ruled that meals furnished to branch officers at a place where the employer performs a significant portion of his business qualified these employees for the meals exclusion.

Although the Sixth Circuit has refused to extend the business premises requirement beyond a functional view, it has acceded that in some special circumstances "near the business premises" may be so equivalent to "on the business premises" that it may be absurd to distinguish between the two. This tax anomaly can be found in Lindeman, a case in which the residence of the hotel manager was located across the street from the hotel and adjacent to its parking lot. The Tax Court allowed the exclusion on the basis that the house was within the parameter of the hotel premises. It explained: "[t]he house in which . . . [the hotel manager] . . . lives is an indispensable and inseparable part of the hotel plant." The court apparently considered the hotel, the hotel parking lot, and the hotel manager's residence to be so closely situated and interdependent that to attempt to distinguish them would result in hairsplitting. In addition, the Tax Court has applied an "adjacent to the premises" concept where the apartment of an employee was located one floor above the premises leased by his employer for the business.

The courts, however, have been divided on the question of whether state troopers who receive meals in private restaurants adjacent to a public highway are "on the business premises." Both the First22 and Fourth23 Circuits have rejected the "adjacent to the premises" argument presented by state troopers in New Hampshire and West Virginia respectively. These circuits contend that the private restaurants are not a place where the employee per-

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21 Id. at 615.
24 Id. at 104.
7 Commissioner v. Anderson, 371 F.2d at 67 (6th Cir. 1966).
9 Id. at 612.
15 Id. at 617.
8 Koerner v. United States, 550 F.2d 1362 (4th Cir. 1977).
forms a significant amount of his duties. The state troopers were off duty and therefore these highway restaurants do not satisfy the business premises requirement.

On the other hand, the Third, Fifth, Eighth and Tenth Circuits find the construction of the opposing First and Fourth Circuits theoretically arguable but nevertheless unrealistic in view of the special nature of the state trooper's work. The Eighth Circuit even rejected any contention that Congress placed any geographical bounds on the business premises requirement. In its view, the major business of the state's law enforcement agency covers every highway in the state; therefore, since meal facilities cannot be made available "on the highway" it would be ludicrous to prohibit a meals exclusion on the basis that the restaurant was physically adjacent to, a quarter of a block, or a mile away from the highway.

In the case of the state trooper, the crux of the "on the business premises" issue is whether the state trooper is "on call" or "off duty." Although the holding in Commissioner v. Kowalski was adverse to the New Jersey state troopers, the Court did not address the business premises question. In fact, the frequent emergency duties of a state trooper seem to be in accord with the Treasury's "on call" regulations. On this basis, the state trooper would be on the business premises since he performs significant duties of his employment at the restaurant—being "on call" for highway emergencies.

If the state trooper is adjudicated to be off duty while eating his meals in a private restaurant off the highway, as the First and Fourth Circuits contend, the business premises requirement would not be satisfied since neither the employee nor the employer performs a significant portion of his business in such a restaurant. At this point, since the state trooper is not "on" the business premises

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84 Wilson v. United States, 412 F.2d 694, 696 (1st Cir. 1969).
85 Id.
87 United States v. Barrett, 321 F.2d 911 (5th Cir. 1963).
88 United States v. Morelan, 356 F.2d 199 (8th Cir. 1966).
89 United States v. Keeton, 383 F.2d 429 (10th Cir. 1967).
91 United States v. Morelan, 356 F.2d 199, 203 (8th Cir. 1968).
92 Id.
he can only hope for a rare application of a "proximity" approach or advance an "adjacent to the premises" argument alluded to by the Sixth Circuit in Commissioner v. Anderson. But even the Tax Court should be wary of holding that a public highway and its "adjacent" private restaurant are integral parts of the same business property. Furthermore, "adjacent" has been so loosely applied in state trooper cases that the integrity of the term is questionable where a restaurant is not contiguous to the highway but located two blocks or even a mile away. It would be more appropriate to characterize such highway restaurants as "in the vicinity of" the public highway and thus disclose a clear departure from a functional approach.

Despite the stretching of the business premises requirement by courts favorable to state troopers, the preeminence of the functional approach remains generally intact. The functional approach has been adopted by both the Internal Revenue Service and the Tax Court. In general, the circuit courts have also utilized this approach. But as the state trooper cases have disclosed, the "significance" or "substantiality" of the employee's duties necessary to satisfy the business premises requirement will ultimately be dependent upon both the factual circumstances of the case and the conservative or liberal attitude of the court.

III. IN-KIND REQUIREMENT

The in-kind requirement cannot be found in the text of section 119. Nevertheless, its authority is assured by the Supreme Court's recent interpretation of the statute's legislative history. In Commissioner v. Kowalski, the Court emphatically stated: "The form of § 119 which Congress enacted in the Senate and the report accompanying the Senate Bill is very clear: 'Section 119 applies

371 F.2d 59, 67 (6th Cir. 1966). (Next footnote number is 97)
only to meals furnished in kind.’”\textsuperscript{101} Although the viability of the in-kind requirement itself can no longer be challenged, its scope remains an unsettled issue. In the past, three general types of business meal policies instituted by employers have been problematic for the courts: (a) the meal or subsistence allowance, (b) salary deductions from the employee’s salary, and (c) a policy of reimbursement for meals actually paid for by the employee for meals eaten in the course of his duties.

A cash or subsistence allowance is a regular stipend paid to the employee to “reimburse” him for the cost of his subsistence. As the \textit{Kowalski} case illustrates, a cash allowance is not a bona fide reimbursement but instead contains compensatory features.\textsuperscript{102} In \textit{Kowalski}, the New Jersey state trooper received an annual stipend of $1,740 as a “reimbursement” for the cost of meals incurred while on patrol.\textsuperscript{103} The payment of the stipend, however, was not even contingent upon the state trooper spending his allowance on meals or even accounting for the money spent on midshift meals.\textsuperscript{104} Also, the amount of the allowance was determined by officer rank.\textsuperscript{105} Furthermore, the meal allowance was paid even if the trooper was not on patrol.\textsuperscript{106} Thus, \textit{Kowalski} was an easy “in-kind” case for the Court since the New Jersey cash allowance meal plan was exactly the type of meal plan singled out by the legislative history of section 119 as includable in income.\textsuperscript{107} The substantive issue in \textit{Kowalski} that occupied the Court’s attention was not the in-kind or in-cash distinction but whether section 119 preempted the once-recognized doctrine that benefits conferred on an employee for the convenience of the employer were not taxable income.\textsuperscript{108}

In some cases the duties of the employee may require the furnishing of meals but the employer may not wish to provide free meals to his employees. Instead, the employer may choose to charge the employees a fixed or varying rate. For example, Em-

\textsuperscript{101} \textit{Id.}
\textsuperscript{102} \textit{Id.} at 80.
\textsuperscript{103} \textit{Id.}
\textsuperscript{104} \textit{Id.}
\textsuperscript{105} \textit{Id.}
\textsuperscript{106} \textit{Id.}
\textsuperscript{107} S. REP. No. 1622, 83d Cong., 2d Sess. 19, \textit{reprinted in} [1954] U.S. Code Cong. & Ad. News 4785, 4825, which reads in pertinent part: “Section 119 applies only to meals and lodging furnished in kind. Therefore, any cash allowances for meals or lodging received by an employee will continue to be includable in gross income to the extent that such allowances constitute compensation.”
ployee X has a base salary of $10,000 and Employer Y deducts $40 per month for the meals furnished to Employee X. A question arises whether the $40 per month is excludable from the income of Employee X.

Prior to 1964 both the Tax Court and the Treasury held that these salary deductions were taxable income; therefore, Employee X would be required to report as taxable income the full $10,000. In Boykin v. Commissioner, the Eighth Circuit disagreed with these holdings. The court concluded that the net economic benefit to the employee was the same whether the salary was paid at a net amount with no charge for the meals or at a gross amount with a deduction for meals. The Eighth Circuit also rejected any contention that Congress limited the meals and lodgings exclusion to meals furnished without charge. In later years, the Internal Revenue and the Treasury conceded the result in Boykin.

Commissioner v. Kowalski, however, discourages the excludability of cash payments of any kind under section 119, and thus logically intimates a return to the pre-Boykin position. But the statute, as recently amended, dispels the Court’s apparent notion that all financial transactions are precluded by the in-kind requirement. According to the amended statute: “In determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals, and the fact that an employee may accept or decline such meals, shall not be taken into account.” Special rules apply to fixed charges. According to the amended statute, a fixed charge is excludable only if the employee is required to make the payment whether he accepts or declines the meals. In addition, it makes no difference whether the fixed charge is paid out of his stated compensation as a salary deduction or paid out of the employee’s own funds on a periodic basis.

The amendment of section 119 negates any judicial notion that only free meals are excludable under the meals and lodgings

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110 260 F.2d 249 (8th Cir. 1958).
111 Id. at 254.
112 Id.
115 Id.
116 Id.
117 Id.
The presence of a financial transaction—such as a salary deduction—is no longer a justifiable basis on which the "in-kind" and "in-cash" distinction can be made. But this proposition is not unique to the amended statute. The legislative history of the original statute intimated that only the value of meals provided must be furnished in kind and not the actual meals themselves.\(^\text{118}\)

But what is meant by the "value" of meals furnished to an employee? Value denotes the monetary worth of something, that is, its equivalent in goods, services or money. In *Commissioner v. Kowalski*, for example, the Court correctly determined that the New Jersey cash allowance system did not contain the features of a simple reimbursement plan.\(^\text{117}\) This plan would not assure that the state troopers would receive only goods, services or money that constituted a fair return on the cost of midshift meals required by their employment. The amendment to section 119 has extended this value concept to salary deductions.\(^\text{119}\) Here, the "value" of the meals excludable is equivalent to either the amount the employee pays on a periodic basis or the amount deducted by the employer from his salary.\(^\text{120}\)

Since the value of meals furnished is the appropriate guide for applying the in-kind requirement, a bona fide reimbursement plan should be excludable from the income of the employee. But in *Kowalski*, which was decided prior to the amendment of section 119, the Court did not distinguish between meal reimbursement plans and cash allowance systems. In fact, the Court stated: "By its terms § 119 covers meals furnished by the employer and not cash reimbursements for meals."\(^\text{121}\) Following this statement by the Supreme Court, one district court, in *Smith v. United States*,\(^\text{122}\) held that the *Kowalski* decision precluded even a bona

\(^\text{118}\) H.R. REP. No. 1232, 95th Cong., 2d Sess., reprinted in [1978] U.S. CODE CONG. & AD. NEWS 3815, 4239, which reads: "The legislative history of Section 119 indicates that its exclusion applies only to the value of meals furnished in kind." (emphasis supplied) It is noteworthy that the legislative materials pertaining to the original 1954 statute did not use the word value but merely said "the exclusion applies only to meals furnished in kind." Commissioner v. Kowalski, 434 U.S. 77, 84 (1977). See infra note 123.


\(^\text{120}\) Id.


\(^\text{122}\) 41 AFTR 2d 78-1161 (D.C. Miss.). Cash reimbursement was income to Mississippi state policeman. This case had been redecided in light of *Kowalski*. 
fide reimbursement plan from qualifying as a meals exclusion.

The resolution of the meal reimbursement issue lies primarily in the legislative history of the original statute, which reads: "Section 119 applies only to meals or lodging furnished in kind. Therefore, any cash allowances for meals or lodging received by an employee will continue to be includable in gross income to the extent that such allowances constitute compensation." The Supreme Court has interpreted the second sentence of the above quote as a reference to another section of the code. The more cogent interpretation is that the in-kind requirement was directed at cash allowance systems that exceed the value of such meals furnished. The surplus cash received would represent compensation and thus be includable in income. Furthermore, since the amended section 119 now allows a meals exclusion for salary deductions, consistency requires that a bona fide meal reimbursement plan would also be excludable. The net economic benefit to the employee is the same whether the employee is provided free meals or whether the employee pays for the meals and is later reimbursed for their actual cost.

It is also noteworthy that in Commissioner v. Kowalski the Court specifically declined to rule upon two types of meal reimbursement policies outside of the parameters of section 119: the exclusions for "supper money" and "sporadic meal reimbursements." Subsequent judicial developments indicate that prior judicial acquiescence to these two exclusions is waning. In Central Illinois Public Service Co. v. United States, the Supreme Court intimated that lunch expenses may be held to constitute taxable income to employees who are reimbursed. In addition, two recent Tax Court cases and one letter ruling indicate that the mere fact that a taxpayer works an extra long day does not make his dinner deductible. While the tax treatment of "supper money" and

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122 Id. at 92 n. 28. The Court said: "We do not decide today whether, notwithstanding §119, the 'supper money' exclusion may be justified on other grounds. Nor do we decide whether sporadic meal reimbursements may be excluded from income." See O.D. 514, 2 C.B. 90 (1920).

124 435 U.S. 21, 24 (1978). The Court held that reimbursements of lunch expenses of employees on non-overnight company travel were not "wages" for the purpose of the withholding provisions.

127 20 Tax. for Accountants 139 (1978); Picknally, T.C.M. 1977-321 (P-H); Melsa, T.C.M. 1977-415 (P-H).
"sporadic meal reimbursements" are not synonymous with the section 119 inquiry, the Court's increasing scrutiny of these two fringe benefits indicates a conservative attitude in the Supreme Court toward the taxation of meals and lodgings in general. This judicial attitude, however, may now conflict with the spirit of the recent amendment of section 119.

IV. Conclusion

While the meals and lodging exclusion remains a forum for judicial dispute, for the first time the inquiry can be reduced to three legal rubrics. Now, in making the meals and lodging inquiry, three questions must be asked: Are the meals necessary for the proper performance of the employee's duties? Were the meals furnished to the employee at a place where the employee performs a significant portion of his duties or where the employer performs a substantial portion of his business? Was the value of the meals furnished to the employee in-kind? A negative answer to any one of the above questions will preclude a meals exclusion under section 119.

The first two questions are the product of the judiciary's futile attempt to implement two standardless statutory requirements. But recent developments indicate that the "convenience of the employer" rule and the "on the business premises" requirement will no longer operate as mere catch phrases. Commissioner v. Kowalski demonstrates that "convenience of the employer" is now a misnomer and in the future a "necessity of the business" rule must be satisfied. The regulations provide ample insight into what circumstances will satisfy this current business necessity standard. In addition, by refusing to construe the term "on the business premises" as the equivalent of "near the business premises," the courts have also clarified the geographical scope of the business premises requirement.

The in-kind inquiry is the most difficult application of the meals and lodging exclusion. It is clear that cash allowance systems will not satisfy the in-kind requirement. It is also evident that the "value" of meals furnished can no longer be narrowly restricted to "meals themselves" or "free meals" and may now include various financial transactions. Meal reimbursement plans have yet to find judicial acceptance but salary deductions adminis-

tered by employers and periodic payments made by employees are now clearly excludable if the requirements of section 119, as amended, are met. In light of the amendment, the most appropriate basis for delineating between "in-cash" and "in-kind" meals is whether the value of the meals furnished the employee confers the same economic benefit upon the employee as if he had been furnished free meals by his employer.

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