

Nova Law Review

Volume 6, Issue 1

1981

Article 4

Tax-Free Fringe Benefits and Social Security: Is It Time to Change the Rules?

Gail Levin Richmond*

*

Copyright ©1981 by the authors. *Nova Law Review* is produced by The Berkeley Electronic Press (bepress). <https://nsuworks.nova.edu/nlr>

Tax-Free Fringe Benefits and Social Security: Is It Time to Change the Rules?

Gail Levin Richmond

Abstract

When then Assistant Attorney General Jackson made the above argument in defense of the social security system, economic conditions were vastly different from those faced by Congress and the Court in 1981.

KEYWORDS: benefits, security, rules

Tax-Free Fringe Benefits and Social Security: Is It Time to Change the Rules?

Gail Levin Richmond*

[I]f benefits were keyed to wages earned, there would be something of a check upon the demands which might be made as to amounts of pensions, and . . . the method in which benefits were made dependent upon wages earned would fit the benefits somewhat to the circumstances of life of the beneficiary, because presumably his way of living would be fixed by the wages he had been in the habit of receiving; and his benefit would be fixed upon the same basis.¹

When then Assistant Attorney General Jackson made the above argument in defense of the social security system, economic conditions were vastly different from those faced by Congress and the Court in 1981. There was no minimum wage, although a twenty-five cent per hour minimum was subsequently enacted in 1938.² The act under attack in *Helvering v. Davis* provided for a tax of only one percent, levied on no more than \$3,000 of an employee's annual wages,³ and its modest retirement benefits were hardly surprising.⁴ Fringe benefits, the sub-

* Associate Dean and Associate Professor, Nova University Center for the Study of Law; J.D., Duke University, 1971; M.B.A., University of Michigan, 1967; A.B., University of Michigan, 1966.

1. Opening Argument of Robert H. Jackson before the Supreme Court of the United States in the case of *Helvering v. Davis*, 301 U.S. 619 (1937), reprinted in S. Doc. No. 71, 75th Cong., 1st Sess. 9 (1937).

2. Fair Labor Standards Act of 1938, ch. 676, § 6, 52 Stat. 1062, *upheld in* *United States v. Darby*, 312 U.S. 100 (1941).

3. Social Security Act, ch. 531, tit. VIII, §§ 801, 811(a), 49 Stat. 636, 639 (1935). Employers paid a like amount. *Id.* § 804, 49 Stat. 637.

4. Monthly benefits ranged from 1/2 of 1% of the first \$3,000 aggregate covered wages to 1/24 of 1% of wages exceeding \$45,000. The maximum benefit allowed was \$85 per month. *Id.* tit. II, § 202, 49 Stat. 623.

The minimum wage has always lagged behind the FICA wage base. In 1940, for example, the thirty cents per hour minimum wage yielded annual earnings of only

ject of this article, were of minor importance; indeed, the Revenue Act of 1936 virtually ignored them.⁵

Several events occurred in 1981 which, considered as a group, suggest a re-examination of the continuing validity of the argument quoted above. The Supreme Court in *Rowan Cos. v. United States*⁶ invalidated a Treasury regulation imposing social security (FICA) tax on the value of meals and lodging furnished employees for the employer's convenience.⁷ Congress excluded from income the use of an employer-provided day care center,⁸ extended the time period during which employer-provided legal assistance plan benefits would be excludible,⁹ and continued until 1984 the moratorium preventing the issuance of Treasury regulations governing the tax status of fringe benefits.¹⁰ And, in a move that has proven highly controversial,¹¹ that body accepted a Reagan administration proposal to eliminate the minimum benefit paid recipients of social security pensions.¹² Such a re-examination is particu-

\$600; the FICA wage base was then \$3,000; in 1981, the amounts involved were, respectively, \$6,700 and \$29,700.

5. The only "fringe benefit" excluded by that act was a rental allowance provided ministers of the gospel. Revenue Act of 1936, ch. 690, § 22(b)(6), 49 Stat. 1658. The 1936 Act repeated the broad language of the 1913 Act taxing "compensation for personal service . . . in whatever form paid . . ." Act of Oct. 3, 1913, ch. 16, § II(B), 38 Stat. 167; Revenue Act of 1936, ch. 690, § 22(a), 49 Stat. 1657.

6. 101 S. Ct. 2288 (1981), *rev'g* 624 F.2d 701 (5th Cir. 1980). *Rowan* invalidated Treas. Reg. § 31.3121(a)-1(f) (1956). Also invalidated was a comparable provision interpreting wages for purposes of the Federal Unemployment Tax Act (FUTA), Treas. Reg. § 31.3306(b)-1(f) (1956). Although the problem discussed also affects the computation of that tax, the \$6,000 wage base provided in I.R.C. § 3306(b)(1) limits its application in most instances.

7. These items are excluded from gross income by I.R.C. § 119.

8. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 124(e), Daily Tax Report, Aug. 3, 1981 (Supp.) (signed Aug. 13, 1981). This provision will be codified as I.R.C. § 129.

9. *Id.* § 802 (extending I.R.C. § 120 through 1984).

10. *Id.* § 801.

11. See, e.g., *House Panel Challenges Administration over Minimum Benefit Data*, Daily Tax Report, Sept. 10, 1981, at G-2.

12. Pub. L. No. 97-35, § 2201, 95 Stat. 830; cf. H.R. 4331, 97th Cong., 1st Sess. (1981). See also H.R. 4342, 97th Cong., 1st Sess. (1981).

larly timely since further cuts in social security benefits, including the percentage of pre-retirement income they will replace, are currently under study.¹³

Development of the Income Tax Rules

Congress did not exclude any fringe benefits from taxation until 1921¹⁴ and then acted very slowly in exempting additional benefits.¹⁵ Thirty-three years later, the 1954 Code excluded only employee death benefits,¹⁶ amounts received under employer-financed health and accident plans¹⁷ (and the amounts paid to fund such benefits¹⁸), meals and lodging furnished for the employer's convenience,¹⁹ and a minister's rental allowance.²⁰ Furthermore, legislative activity between 1954 and 1976 served primarily to reduce the favorable tax treatment granted certain benefits.²¹ Only after the Treasury Department issued its 1975 Discussion Draft of proposed fringe benefits regulations²² did Congress wake up and begin enacting exclusions.

Noting that "[t]he status of most other fringe benefits is not answered expressly by statute,"²³ the Treasury Department proposed

13. Daily Tax Report, May 12, 1981, at X-1; *The Battle over Repairing Social Security*, BUS. WEEK, Sept. 28, 1981, at 116; STAFF OF SENATE COMM. ON FINANCE, 97TH CONG., 1ST SESS., REPORT ON SOCIAL SECURITY FINANCING (Comm. Print 1981).

14. Revenue Act of 1921, ch. 136, § 213(b)(11), 42 Stat. 227, enacting present I.R.C. § 107 (rental allowance furnished to a minister of the gospel). This provision overruled the IRS position expressed in O.D. 862, 4 C.B. 85 (1921).

15. The IRS excluded several benefits on its own, however. *See, e.g.*, O.D. 265, 1 C.B. 71 (1919); L. Op. 1014, 2 C.B. 88 (1920); O.D. 514, 2 C.B. 90 (1920); O.D. 915, 4 C.B. 85 (1921).

16. I.R.C. § 101(b).

17. *Id.* § 105.

18. *Id.* § 106.

19. *Id.* § 119.

20. *Id.* § 107.

21. I.R.C. § 79, enacted in 1964, limited an exclusion previously granted by the Treasury Department. *Compare* Revenue Act of 1964, Pub. L. No. 88-272, § 204, 78 Stat. 36, with Treas. Reg. § 1.61-2(d)(2), T.D. 6272, 1957-2 C.B. 21.

22. 40 Fed. Reg. 41,118 (1975) (proposing Treas. Reg. § 1.61-16) [hereinafter cited as 1975 Discussion Draft].

23. *Id.* at 41,119.

three exclusion categories. Many benefits would be excluded because they arose from the employer's business and the employer incurred no substantial additional costs in providing them; examples included stand-by travel privileges for flight attendants and employee discounts on merchandise.²⁴ Other benefits, such as bodyguards provided the president of a multinational company, qualified under a nine-item "facts and circumstances" test.²⁵ Finally, an exclusion was proposed for any benefit "so small as to make accounting for it unreasonable or administratively impractical."²⁶ These proposals, which were withdrawn in 1976,²⁷ resurfaced several years later.²⁸ By then, however, the list of statutory exclusions exempt from such regulations had been significantly expanded.

As befitted its title, the Tax Reform Act of 1976²⁹ was less than generous to fringe benefit recipients. Thus, Congress substantially narrowed the tax-free status of most employer-financed disability income payments,³⁰ basing eligibility to some extent on a needs test.³¹ The only new exclusion enacted, that for employer-financed legal assistance,³² even carried its own sunset provision.³³

Several 1978 acts contained fringe benefits provisions. The Revenue Act of 1978, for example, excluded from gross income educational assistance program benefits.³⁴ Meals and lodging furnished an employee's spouse and dependents, a benefit whose tax status had never

24. *Id.*

25. *Id.* at 41,119-20.

26. *Id.* at 41,120.

27. 41 Fed. Reg. 56,334 (1976).

28. Fringe Benefits Discussion Draft of Jan. 15, 1981, STAND. FED. TAX REP. (CCH) ¶ 8991 (not filed in Fed. Reg.) [hereinafter cited as 1981 Discussion Draft]. See also Discussion Draft Bill, [1979] 10 STAND. FED. TAX REP. (CCH) ¶ 6156 (proposing statutory rules).

29. Pub. L. No. 94-455, 90 Stat. 1520.

30. *Id.* § 505(a), 90 Stat. 1566 (I.R.C. § 105(d)).

31. *Id.*

32. *Id.* § 2134(a), 90 Stat. 1926 (I.R.C. § 120).

33. *Id.* 2134(e). The exclusion, granted for 1977 through 1981, was extended another three years by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 802, Daily Tax Report, Aug. 3, 1981 (Supp.).

34. Pub. L. No. 95-600, § 164, 92 Stat. 2811 (I.R.C. § 127).

been resolved by the Internal Revenue Service,³⁵ were excluded from income by the Tax Treatment Extension Act of 1977.³⁶ That same act imposed a moratorium, extended in yet another 1978 act, preventing the issuance of fringe benefits regulations until 1980.³⁷ Finally, the Energy Tax Act of 1978 added an exclusion for group transportation provided employees between home and work.³⁸

Each of the 1978 benefits can be defended as furthering a particular policy objective. Not only is a well-educated work force presumably more productive, but education is viewed by most people as a route to job advancement.³⁹ Tax laws have frequently been drafted to benefit families; thus, it is not surprising that Congress chose to ease the tax burden of individuals forced to live on the employer's business premises or live apart from the family-member employee.⁴⁰ Likewise, groups of employees traveling together in one vehicle presumably reduce traffic congestion (and the resulting accident rate), cause less highway deterioration, and use less fuel.⁴¹ Nevertheless, each of these benefits would have been taxable if the 1975 Discussion Draft regulations had become final. Each involves an employer outlay which could easily involve substantial additional cost; none of them is so small that accounting for it is unreasonable or impractical; and none of them qualifies under the facts and circumstances test.⁴²

35. *Jacob v. United States*, 493 F.2d 1294 (3d Cir. 1974).

36. Pub. L. No. 95-615, § 205, 92 Stat. 3107 (1978) (amending I.R.C. § 119(a)).

37. *Id.* § 3, 92 Stat. 3097 (Oct. 1, 1977, through June 30, 1978); Act of Oct. 7, 1978, Pub. L. No. 95-427, § 1, 92 Stat. 997 (May 1, 1978, through December 31, 1979). A further extension was imposed by the Act of Dec. 29, 1979, Pub. L. No. 96-167, § 1, 93 Stat. 1275 (1979) (until May 31, 1981).

38. Pub. L. No. 95-618, § 242, 92 Stat. 3193 (redesignating I.R.C. § 124 as § 125 and inserting a new § 124).

39. The Senate Finance Committee was particularly concerned that the then-existing rules constituted a disincentive to upward mobility. S. REP. NO. 1263, 95th Cong., 2d Sess. 101 (1978).

40. The Tax Treatment Extension Act of 1977, of which this was but one provision, dealt in large part with employees working outside the United States.

41. The Senate Finance Committee stated its desire to encourage this energy-saving activity. S. REP. NO. 529, 95th Cong., 1st Sess. 59 (1977). At the same time, it noted that expected energy savings were negligible. *Id.* at 60.

42. Several of the examples contained in the 1975 Discussion Draft, while not exactly on point, provide useful analogies. Example (8) excluded reimbursements for

In early 1981, the Treasury Department again proposed regulations to govern items not mentioned in the Code.⁴³ This version would have taxed employees when they obtained or used any property, service or facility in connection with the performance of services; exceptions were provided only for benefits which constituted working conditions or which were excludible on grounds of administrative convenience.⁴⁴ While many examples in the 1975 proposals reappeared,⁴⁵ several 1981 items were far more onerous.⁴⁶ Thus, Congress' decision to extend the regulations moratorium through December 31, 1983, is hardly surprising.⁴⁷

dinner and taxi fare paid to an employee who works several hours past normal quitting time because of the press of business. At the same time, Example (9) taxes chauffeur service used in transporting top executives to and from work. While Example (9) might be distinguished from the van-pooling allowed by I.R.C. § 124 because the former was limited to top executives, Example (8) would still prove troublesome as I.R.C. § 124 is not limited to overtime situations. *See also* Examples (11)-(15). In judging the exclusion for meals and lodging furnished relatives of an employee, *see* Examples (5)(c) & (6), which provide exclusions where no additional employer costs are involved for the family members.

Although an argument can be made on behalf of the educational benefits, which could enhance job performance, I.R.C. § 127 is not phrased in such narrow terms. Indeed, the only educational benefits it prevents from qualifying are those "involving sports, games, or hobbies." I.R.C. § 127(c)(1). Thus, an unlimited exclusion could easily frustrate the policy behind Treas. Reg. § 1.162-5(b). *See* Example (19), where the same argument is made with regard to employee use of the employer's day care center and the limitations of I.R.C. § 214 (which was repealed in 1976 and replaced with I.R.C. § 44A).

43. 1981 Discussion Draft, proposing Treas. Reg. §§ 1.61-17 to -20.

44. *Id.* § 1.61-17(a).

45. *E.g.*, 1981 Prop. Treas. Reg. § 1.61-18(d)(4) and 1975 Prop. Treas. Reg. § 1.61-16(f)(7) (taxi fare for safety reasons); 1981 Prop. Treas. Reg. § 1.61-18(d)(7) and 1975 Prop. Treas. Reg. § 1.61-16(f)(13) (bodyguards).

46. *Compare* 1981 Prop. Treas. Reg. § 1.61-19(b)(1) *with* 1975 Prop. Treas. Reg. § 1.61-16(f)(3) (employee discounts). *Compare* 1981 Prop. Treas. Reg. § 1.61-18(d)(9) & § 1.61-20(c)(3) *with* 1975 Prop. Treas. Reg. § 1.61-16(f)(6) (family members accompanying employee on business trips at no extra cost to employer). The 1981 proposals are reminiscent of language in S. REP. NO. 768, 93d Cong., 2d Sess. 161, 165-68 (1974), involving the examination of then President Nixon's tax returns; *cf.* INTERNAL REVENUE SERVICE, U.S. DEP'T OF THE TREASURY, PUB. NO. 463, TRAVEL, ENTERTAINMENT AND GIFT EXPENSES 4 (rev. Nov. 1980); Rev. Rul. 56-168, 1956-1 C.B. 94 (example 3).

47. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 801, Daily Tax

Congress also took the opportunity in 1981 to “grandfather in” a new exclusion⁴⁸ and to re-enact an expiring one.⁴⁹ There thus remain few fringe benefits which are not currently excluded from income by statute and, therefore, immune from the scope of any proposed regulations which may be forthcoming in 1984.⁵⁰

Effect of Exclusions

While an employee receiving compensation in kind is in no worse a position than his counterpart who receives cash and uses it to purchase the benefit,⁵¹ this discussion is limited to those compensatory benefits which are excluded from the employee’s income.⁵² Such benefits allow the employee to improve his economic situation over that of the worker receiving cash and purchasing the benefit. The extent of this enrichment varies, as is shown in the following example, with the tax consequences attendant upon the purchase.

This discussion involves Employee X, whose employer will pay him a salary of \$20,000 in 1982.⁵³ The employer will also purchase Blue Cross health insurance coverage for X, pay tuition for X to attend law

Report, Aug. 3, 1981 (Supp.). Although the moratorium ended May 31, and the act was not passed by Congress until August, the Treasury Department acceded to Congressional warnings to promulgate no regulations during this period. *See* Daily Tax Report, June 17, 1981, at G-2.

48. Pub. L. No. 97-34, § 124(e). I.R.C. § 129, which this provision added, is discussed in notes 65-66 *infra*.

49. *Id.* § 802, extending the I.R.C. § 120 exclusion for group legal assistance plans through December 31, 1984.

50. *But see* S. 1479, 97th Cong., 1st Sess. (1981) (adoption subsidies). As there is a large group of tax practitioners supporting Congressional, rather than administrative, resolution of the fringe benefits problem, the 1984 rules may instead be statutory. *See, e.g.,* Discussion Draft Bill, [1979] 10 STAND. FED. TAX REP. (CCH) ¶ 6156.

51. If the benefit is taxable, he will have gross income equal to that of his counterpart receiving cash, and any deduction allowed for such purchase will reduce the amount of his income. If the benefit is excludible, he will have no increase in his taxable income whether or not he could have deducted the purchase.

52. As the discussion thus far indicates, those items are substantial in number. *See* I.R.C. § 125, which allows an employee to be taxed with reference to the benefits he chooses, rather than the benefits he could have chosen, when his employer offers a choice among benefits; *cf.* I.R.C. § 305(b)(1).

53. This example is based on the law in effect during 1982.

school part-time, and allow X's child to stay in the day care center connected to its office. Each of these benefits is worth \$600 to X, who is a widower and has no other source of income.

Because X's employer will deduct its cost for all these items,⁵⁴ any item excluded by X will be one on which neither party is taxed. While such omissions may result in a higher level of tax rates overall,⁵⁵ that issue does not concern X. He would rather know if any of the in-kind benefits are taxable and whether his tax consequences would have differed had his employer increased his salary by \$1,800 and offered no benefits.⁵⁶

Only the cash salary will be included in X's 1982 income.⁵⁷ Thus X will have a gross income of \$20,000 if he receives the fringe benefits in kind, and \$21,800 if he instead receives their cash value. In the latter instance his tax liability will increase unless he can offset the additional \$1,800 by deductions or credits arising from his purchasing the benefits himself.

Code Section 213 provides a deduction for medical care expenses, including premiums for insurance designed to reimburse the taxpayer for costs incurred.⁵⁸ Because the Section 213 deduction is computed with reference to a taxpayer's income, X may be limited to a deduction of only \$150 and be left with a residual tax liability.⁵⁹ In fact, unless X itemizes his deductions, he will receive no relief at all.⁶⁰

Regulations covering allowable trade or business expense deductions are relevant to the tuition benefit.⁶¹ Because Code Section 162

54. I.R.C. § 162(a)(1).

55. See, e.g., Ott, Ott & Turner, *Burden Distribution of a Broad-Based Personal Income Tax System and Its Implications for Tax Reform Discussions*, 34 LAW & CONTEMP. PROB. 805 (1969).

56. See *Martin v. Commissioner*, 649 F.2d 1133, 1134 (5th Cir. 1981) (Goldberg, J., dissenting) for a discussion of this issue in the context of a different fringe benefit, an interest-free loan from employer to employee.

57. I.R.C. §§ 106, 127, 129.

58. *Id.* § 213(e)(1)(C).

59. Medical expenses are deductible only to the extent they exceed 3% of adjusted gross income; insurance premiums can be deducted without regard to that floor to the extent they do not exceed the lesser of \$150 or one-half of the premiums. *Id.* § 213(a).

60. *Id.* § 63(b) & (c).

61. Treas. Reg. § 1.162-5, as amended by T.D. 6918, 1967-1 C.B. 36.

allows deduction of expenses incurred in carrying on a trade or business, these regulations forbid a deduction for education expenses which would qualify the taxpayer for a new trade or business.⁶² If X is already an attorney pursuing post-graduate studies, a deduction will be allowed; if he is seeking a J.D. degree, he could not deduct his tuition.⁶³ Moreover, because he is not self-employed, X must itemize to take any deduction otherwise allowed.⁶⁴

Child care costs incurred so that a taxpayer can work are allowed as credits whether or not the taxpayer itemizes deductions, but Code Section 44A limits the credit to twenty percent of the amount paid.⁶⁵ Thus, while payment by X of \$600 would save him \$120 in tax, including that \$600 in his income results in a larger tax increase.⁶⁶

As the above example illustrates, a taxpayer receiving benefits in kind will frequently be better off financially than a taxpayer receiving cash remuneration who purchased comparable benefits. Even in those instances where their income tax consequences are identical, the former is further benefited by the in-kind payment because it saves him the trouble of reporting an item of income and offsetting it on his tax return by the allowable deduction or credit.

Employment Taxes

The question involved in *Rowan* was not one of gross income, but rather one of employment taxes. The particular benefit, meals and lodging for employees, had been subjected to FICA and FUTA, but not withholding taxes despite similar statutory language in the three provi-

62. *Id.* § 1.162-5(b)(3).

63. The Tax Court has denied a New York attorney a deduction for a bar review course undertaken to qualify him for practice in California. *Sharon v. Commissioner*, 66 T.C. 515 (1976), *aff'd*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979).

64. Compare the varying treatments of § 162 deductions granted by I.R.C. § 62(1) (self-employed individuals) and § 62(2) (employees).

65. Had X's 1982 income been substantially lower, the credit might have been as high as 30%. I.R.C. § 44A(a)(2). Because X has only one dependent, the amount against which the percentage is applied is limited to \$2,400. *Id.* § 44A(d).

66. Based upon 1982 rates for an unmarried head of household, his marginal rate would exceed 20% so long as his taxable income exceeded \$11,800. *Id.* § 1(b)(1), 2(b).

sions.⁶⁷ A brief discussion of these provisions' evolution will aid in understanding the Court's opinion.

The federal government first instituted a withholding system for taxes when it established the social security system in 1935.⁶⁸ Because that tax was imposed at a flat rate, with no exemptions for low income taxpayers, and because a matching contribution was due from employers, this method of collection was more efficient for the government than that used for the income tax since its 1913 enactment. In fact, the relative ease of using withholding as a collection device led Congress to adopt it for the income tax in 1942 when World War II forced a "drastic increase in rates."⁶⁹

As the Court noted in *Rowan*, certain exceptions to the definition of wages found in the 1942 legislation were identical to exceptions in the social security provisions.⁷⁰ However, the Senate Finance Committee justified these exceptions as a means of relieving farmers, housewives and certain other groups of the burden of collecting and accounting for small amounts.⁷¹ This justification would be inapplicable to remuneration paid in kind by an employer who was already withholding tax on cash remuneration.⁷²

The *Rowan* Litigation

Although the general statutory scheme for withholding and em-

67. *Id.* §§ 3121(a) (FICA), 3306(b) (FUTA), 3401(a) (income tax withholding).

68. Social Security Act, ch. 531, tit. VIII, 49 Stat. 636 (1935).

69. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 14 (1942). Congress was also interested in promoting a more uniform application of income tax law; reducing the administrative problems of collection; and reducing inflation through restricting spending. *Id.* at 14-15. See also *Hearings on Withholding Provisions Before a Subcomm. of the Senate Comm. on Finance*, 77th Cong., 2d Sess. 125-36 (1942) (statement of Milton Friedman, Division of Tax Research, Treasury Department) (confidential Comm. Print).

70. S. REP. NO. 1631, 77th Cong., 2d Sess. 166 (1942); 101 S. Ct. at 2293.

71. S. REP. NO. 1631, *supra* note 70, at 166. The government itself would be relieved of the "administrative burden and cost of collection entailed in the handling of numerous returns involving only nominal amounts." *Id.*

72. The Act clearly included non-cash compensation within its coverage. Revenue Act of 1942, ch. 619, § 172(a), 56 Stat. 884, 887; S. REP. NO. 1631, *supra* note 70, at 166.

ployment taxes still treats non-cash remuneration as wages,⁷³ Congress has specifically excluded from coverage many of the fringe benefits previously discussed.⁷⁴ The particular benefit provided in *Rowan* was not among these exclusions.

Rowan Companies (Rowan) operated drilling rigs, some of which were as far as sixty miles offshore. Because transporting employees between land and these rigs was more costly than feeding and housing them at the worksite,⁷⁵ Rowan provided meals and lodging at that site.⁷⁶ The company did not treat the value of these items as wages subject to withholding; nor did it consider them wages for purposes of computing FICA or FUTA tax contributions.⁷⁷ Acting in accord with its regulations,⁷⁸ the Internal Revenue Service claimed that the latter two taxes were due. Rowan paid the amount in dispute and sued for a refund. Although the government prevailed in district court as well as in the Fifth Circuit,⁷⁹ Rowan's position was upheld by the Supreme Court.⁸⁰

The Court described in great detail the development of Code and regulations provisions defining wages.⁸¹ Although the challenged regulations originated in 1940, the government's inconsistencies in interpretation negated its use of the re-enactment doctrine to refute Rowan's claim that Congress intended a uniform definition of wages for income and employment taxes.⁸² More important, in the Court's view, was the fact that wages are defined in substantially the same terms for purposes

73. I.R.C. §§ 3121(a) (FICA), 3306(b) (FUTA), 3401(a) (income tax withholding).

74. *Id.* § 3121(a)(2), (17) & (18); § 3306(b)(2), (12) & (13); § 3401(a)(14) & (19).

75. 101 S. Ct. at 2290.

76. Only employees assigned to offshore rigs received this benefit. *Id.*

77. *Id.*

78. Treas. Reg. §§ 31.3121(a)-1(f), 31.3306(b)-1(f) (1956).

79. 624 F.2d 701 (5th Cir. 1980) (*aff'g* an unreported grant of summary judgment by the district court for the Southern District of Texas).

80. 101 S. Ct. at 2288.

81. *Id.* at 2293-97.

82. *Id.* at 2296. "The differing interpretations were not substantially contemporaneous constructions of the statutes Nor is there evidence of any particular consideration of these regulations by Congress during re-enactment." *Id.* at 2297.

of withholding and employment taxes,⁸³ particularly since the withholding statute was the last of the three enacted.⁸⁴ Finally, the Court was impressed with an idea expressed by it in an earlier decision,⁸⁵ that "wages" is a narrower concept than "income";⁸⁶ an item excluded from a taxpayer's income could thus not be included in his wages.⁸⁷

The inconsistencies the Court noted are very real. But they become somewhat less important when it is remembered that Congress did not merely re-enact the employment and withholding tax provisions in 1954 and then stop legislating. Between 1954 and 1967, the first year litigated in *Rowan*, Congress made several changes in the statutory rules governing fringe benefits and thus had ample opportunity to express displeasure with Treasury regulations interpreting the definitions of wages.⁸⁸ Further, while the Court is correct in stating that the three definitions of wages are substantially the same, the coverage of these taxes has never been identical.⁸⁹ Indeed, in view of the different Congressional goals, differences should be expected. Employment taxes are designed to finance replacement of income during periods of unemployment, voluntary or otherwise; if an employee's fringe benefits also cease during such periods, he will need more than a mere percentage replacement of cash wages to maintain his life style.

As it clearly reduces the employer's and employee's reporting requirements (as well as their tax liabilities), the Court's determination that an item excluded from income cannot be included in wages is appealing from an administrative standpoint. Any other determination would be nonsensical for purposes of income tax withholding, since an excluded item is never taxed and the withheld amount would eventually be refunded to the taxpayer. But for purposes of the employment taxes,

83. *Id.* at 2293.

84. *Id.*

85. *Central Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21 (1978).

86. *Id.* at 25. *See Rev. Proc. 80-53*, 1980-2 C.B. 848, providing for reporting items excluded from withholding as "other compensation" on the Form W-2 issued by the employer.

87. 101 S. Ct. at 2293.

88. For example, Congress enacted I.R.C. § 79 in 1964. Revenue Act of 1964, Pub. L. No. 88-272, § 204(a)(1), 78 Stat. 36.

89. *E.g.*, Students employed by their universities are not subject to FICA tax withholding, but they are subject to income tax withholding. I.R.C. § 3121(b)(10) has no counterpart in § 3401.

that rationale need not apply to compensatory items.⁹⁰ Not only do employment taxes have a different purpose, but on several occasions Congress itself has used language indicating that it considers the concepts of income and wages to be intersecting, rather than concentric.⁹¹

Conclusion

Rowan is a troublesome case in terms of employment taxes. Both the magnitude of the particular type of fringe benefit in relation to monetary wages, and the fact that the statute did not clearly exclude these items from wages, are arguments justifying a different result.⁹² However, *Rowan* involves one particular exclusion from employment taxes. In no way does it diminish other exclusions which have a statu-

90. If the item is not compensatory in nature, there is no justification for the employer's deduction. I.R.C. § 162(a)(1). See H.R. REP. NO. 615, 74th Cong., 1st Sess. 32 (1935), rejected by the *Rowan* Court as ambiguous. 101 S. Ct. at 2295.

91. In the Revenue Act of 1924, ch. 234, 43 Stat. 253, Congress provided a tax credit for earned net income. In so doing, it defined earned income to include "wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered . . ." *Id.* § 209(a)(1), 43 Stat. 263. That definition was changed in 1934 to include the following language: "but does not include any amount not included in gross income . . ." Revenue Act of 1934, ch. 277, § 25(a)(5)(A), 48 Stat. 692. The Senate made specific mention of this change and included by way of example "a taxpayer whose entire earned income consists of a salary which is exempt from tax . . ." S. REP. NO. 558, 73d Cong., 2d Sess. 27 (1934).

Likewise, in 1976 Congress enacted § 120, but it did not make the conforming amendment, § 3121(a)(17), until 1978. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2134(a), 90 Stat. 1926; Act of Oct. 17, 1978, Pub. L. No. 95-472, § 3(b), 92 Stat. 1333. Moreover, I.R.C. § 3401(a) contains no comparable language.

Finally, the Senate Finance Committee Report accompanying the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, contains the following language: "Remuneration is not necessarily excluded from the definition of employment tax wages for purposes of employment taxes and income tax withholding simply because it is excludible from gross income under some other section of the Code." S. REP. NO. 1263, 95th Cong., 2d Sess. 100 (1978). While the above language does lend credence to the Court's argument that wages is defined the same way for purposes of each tax, it also shows that Congress was not troubled by the idea that income was sometimes narrower than wages.

92. Unlike the exemptions for group legal services plans and educational benefits programs, there is no statutory language excluding meals and lodging from any of the three taxes.

tory basis; those items would still have been excluded even had the government prevailed in *Rowan*.⁹³

The impact of these exclusions reaches beyond the taxpayer's calculations for a particular year. To the extent an individual bases his life style upon items of compensation⁹⁴ which are not included in the tax base for social security benefits, he is likely to find his post-retirement life style inferior to that which he maintained during his working years. While individuals whose includible compensation exceeds the applicable wage base upon which FICA contributions are assessed are expected to encounter this phenomenon,⁹⁵ lower-paid workers may encounter a more acute problem.⁹⁶ Although some benefits may be continued by the former employer,⁹⁷ and others may be available through government transfer programs,⁹⁸ the retiree must self finance or forego the remainder. Before it extends tax-free status to any additional fringe benefits, Congress should consider whether subjecting such benefits to FICA tax now would result in significantly higher future benefits for individuals presently earning less than the FICA wage base. Perhaps it is time to rewrite Code Section 3121(a), not merely to reverse the result in *Rowan*, but to restore meaning to its definition of wages.⁹⁹

93. See, e.g., I.R.C. § 3121(a)(2), (17) & (18).

94. Although excluded from gross income, these items still constitute "compensation." See, e.g., *id.* § 119(b)(1); Treas. Reg. § 1.119-1(a)(1), T.D. 6220, 1957-1 C.B. 56-57.

95. Individuals whose salaries exceed \$29,700 are presumably better able to save for retirement than are individuals earning the minimum wage.

96. Particularly hard hit will be workers who are not covered by an employer-financed pension plan.

97. See, e.g., I.R.C. § 79(b)(1); Rev. Rul. 75-22, 1975-1 C.B. 49.

98. E.g., Medicare and Legal Aid.

99. The Internal Revenue Service has already issued a ruling effectuating the holding in *Rowan* but warning taxpayers that meals and lodging which do not satisfy the I.R.C. § 119 tests are subject to FICA. Rev. Rul. 81-222, 1981-39 I.R.B. 8.