FEDERAL TAXATION: "CONVENIENCE OF THE EMPLOYER" RULE APPLIED TO LODGING ON PROPERTY NOT CONTIGUOUS TO PRINCIPAL PLACE OF BUSINESS

UNDER SECTION 119 of the Internal Revenue Code, an employee may often exclude from gross income the value of free meals and lodging which are provided without charge by his employer. One requirement of this section is that the meals or lodging be furnished on the "business premises" of the employer. In interpreting this provision for the first time, the Tax Court in *Charles N. Anderson*[1] found that the business premises is not confined to the physical limitations of the employer's place of business.

In *Anderson*, a motel corporation had furnished its manager with rent-free lodging so he could remain available for duty on a twenty-four hour basis. Despite the fact that this lodging was located two blocks away from the motel, the court found that it was on the "business premises" of the corporation for purposes of section 119.[2] Since the other requirements of that section were also satisfied, the court allowed the employee to exclude the rental value of the house.[3]

From its inception in 1919,[4] the "convenience of the employer" rule[5] has been justified by courts and administrators on the basis

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[1] 42 T.C. 410 (1964).

[2] *Id.* at 411-12.

[3] The employer paid for the taxpayer's utilities and maid service. These were deemed by the court to be part of the lodging and hence their value was excludable. *Id.* at 417-18. The employer also furnished some meals to the taxpayer at the lodging. Having found the lodging to be on the "business premises" and by further finding that the meals were furnished for the convenience of the employer, the court also allowed exclusion of the value of these meals. *Id.* at 418.

[4] The rule appears to originate from O.D. 265, 1 CUM. BULL. 71 (1919). "Board and lodging furnished seamen in addition to their cash compensation is held to be supplied for the convenience of the employer and the value thereof is not required to be reported in such employees' income tax returns." *Ibid.*

[5] See generally Annot., 84 A.L.R.2d 1215 (1962).

In this casenote the term "convenience of the employer" rule, or "convenience" rule, refers to the *policy* of exclusion of meals and lodging, regardless of the tests used in applying it. While this is in accord with some authorities, see, *e.g.*, Annot., 84 A.L.R.2d 1215, 1217 (1962), others use the term to mean the *test* of convenience to the employer, see, *e.g.*, Landman, *The Taxability of Fringe Benefits*, 33 TAXES 173 (1955), and still others apparently use the term in both senses, see, *e.g.*, Gutkin & Beck, *Some Problems in "Convenience of the Employer,"* 36 TAXES 153 (1958).

that meals and lodging furnished employees are often necessary working conditions of employment, rather than income.[6] Prior to 1950, the usual test for applying the rule to allow exclusion of the value of free meals and lodging was whether they were furnished primarily for the employer's convenience.[7] By 1950, however, the Commissioner had apparently become dissatisfied with this test for the reason that some employees were being allowed to exclude essentially compensatory benefits.[8] In that year, therefore, he announced that an exclusion would not be allowed if it could be determined that the meals or lodging were furnished essentially as compensation, and that only in cases where this could not be determined would the original "convenience" test be applied.[9] This modification did not meet with unanimous judicial approval, and a conflict developed among the courts as to the proper application of the "convenience" rule.[10]

In 1954, Congress attempted to end the confusion caused by the Commissioner's 1950 modification by passing Section 119 of the Internal Revenue Code.[11] That section provides:

> 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—
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> . . . .
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> (2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

The Regulations interpret this statutory language to mean that the value of lodging will be excluded from gross income[12] only if three

[6] See, *e.g.*, Jones v. United States, 60 Ct. Cl. 552, 567, 569 (1925); Mim. 5023, 1940-1 CUM. BULL. 14; Treas. Reg. 45, art. 33 (1918), as amended, T.D. 2992, 2 CUM. BULL. 76 (1920); Landman, *supra* note 5, at 176; McDermott, *Meals and Lodging Under the 1954 Code*, 53 MICH. L. REV. 871-72 (1955); Annot., A.L.R.2d 1215, 1220 (1962).

[7] *E.g.*, Mim. 5023, 1940-1 CUM. BULL. 14, Hazel W. Carmichael, 17 P-H Tax Ct. Mem. 239 (1948); see McDermott, *supra* note 6, at 872-73; Annot., 84 A.L.R.2d 1215, 1230-32 (1962).

[8] See Landman, *supra* note 5, at 178.

[9] See Mim. 6472, 1950-1 CUM. BULL. 15.

[10] *Compare* Joseph L. Doran, 21 T.C. 374, 376 (1953), *with* Diamond v. Sturr, 221 F.2d 264, 268 (2d Cir. 1955) (rejecting the modification as inconsistent with long established Regulations and case law). See Annot., 84 A.L.R.2d 1215, 1230-31 (1962).

[11] "The House and your committee has adopted provisions designed to end the confusion as to the tax status of meals and lodging furnished an employee by his employer." S. REP. No. 1622, 83d Cong., 2d Sess. 19 (1954); H.R. REP. No. 1337, 83d Cong., 2d Sess. 18 (1954).

[12] Gross income is broadly defined in INT. REV. CODE OF 1954, § 61 (a); subsequent

separate tests are met: the lodging must be furnished for the convenience of the employer; the employee must be required to accept such lodging as a condition of employment; and the lodging must be on the business premises of the employer.[13] If these tests are met, the exclusion is allowed irrespective of whether the lodging constitutes "compensation."[14] This construction of section 119 is in accord with the plain meaning of the statute and finds some support in the language of the Senate Report which accompanied the bill.[15] Under this interpretation of the section, an employee could qualify under the "convenience" test and still be denied the exclusion for failure to meet the "business premises" test.

The *Anderson* case is significant in that it is the first Tax Court case in which the principal issue was whether the lodging in question was on the "business premises."[16] The court had little difficulty finding that the house was furnished for the employer's convenience and that the employee was required to accept it as a condition of his employment.[17] These tests had been judicially in-

sections contain specific inclusions and exclusions in computing this sum. INT. REV. CODE OF 1954, §§ 71-78, 101-121. Meals and living quarters provided by an employer which do not qualify under § 119 are items of gross income. Treas. Reg. § 1.61-2 (d) (3) (1957).

[13] Treas. Reg. § 1.119-1 (b) (1956), as amended, T.D. 6745, 1 P-H 1964 FED. TAXES ¶ 8683.

[14] *Ibid.*

[15] "[T]here is excluded from the gross income of an employee the value of meals or lodging furnished to him for the convenience of his employer whether or not such meals or lodging are furnished as compensation. . . . In the case of lodging the exclusion is permitted only if the employee is required to accept the lodging on the business premises of the employer . . . ." S. REP. No. 1622, *supra* note 11, at 190. See H.R. REP. No. 2543, 83d Cong., 2d Sess. 26 (1954). While three separate tests are indicated, this does not necessarily imply that there is no interrelation between the tests or that all three tests are of equal importance. See note 23 *infra.*

[16] Only one other case has considered the precise issue involved in the instant case. In United States v. Barrett, 321 F.2d 911 (5th Cir. 1963), the court held that the "business premises" of the state highway patrol extended to all the highways of the state, and therefore patrolmen could exclude the value of meals eaten at restaurants along the highways. There, however, the court did not attempt to analyze the meaning of the business premises test.

The Court of Claims in United States Junior Chamber of Commerce v. United States, CCH 1964 STAND. FED. TAX REP. (64-2 U.S. Tax Cas.) ¶ 9637 (Ct. Cl. July 17, 1964), briefly discussed the "business premises" test, but resolved the issue easily by finding that the house in question was on the "business premises" because the employee carried on his work in the house itself. This argument was also advanced by the taxpayer in *Anderson.* Brief for Petitioner, pp. 16-17. The court apparently rejected this contention, because it is not discussed in the opinion.

In two other Tax Court cases, the "business premises" test was briefly discussed but not analyzed. John L. Nolen, P-H TAX CT. REP. & MEM. DEC. (P-H Tax Ct. Mem.) ¶ 64,099 (April 17, 1964); Mary B. Heyward, 36 T.C. 739, 743 (1961).

[17] The Service apparently did not seriously contend that these tests had not been

terpreted both before and after passage of section 119.[18] However, prior to 1954 the "convenience" rule had never included a "business premises" requirement,[19] and it was therefore necessary for the *Anderson* court to apply the "business premises" test according to its reading of legislative intent.

The only description of the term in the reports accompanying the bill is found in the Conference Committee Report, which explains the Senate substitution of "business premises" for "place of employment" as follows: "The term 'business premises of the employer' is intended, in general, to have the same effect as the term 'place of employment' in the House bill."[20] This paucity of legislative explanation would permit a variety of interpretations. Thus, an attempt should be made to analyze the congressional purpose regarding the section *in its entirety* in order to arrive at a consistent construction of the "business premises" test.[21]

In passing section 119 Congress rejected the restrictive 1950 modification of the Commissioner,[22] and indicated instead that the "convenience" test was to be the primary criterion for determining allowance of the exclusion.[23] Since Congress has apparently relegated the "business premises" test to a position of secondary importance, it seems reasonable that it should not be rigidly applied where the employee clearly meets the primary criterion.[24] A liberal

met. 42 T.C. at 415. Even so, the court discussed these tests in relation to the facts at hand and found them to be fully satisfied. *Ibid.*

[18] See, *e.g.*, Mary B. Heyward, 36 T.C. 739, 743 (1961); Annot., 84 A.L.R.2d 1215, 1219-25 (1962).

[19] See, *e.g.*, administrative regulations and rulings *supra*, notes 4, 6, 9; Annot., 84 A.L.R.2d 1215, 1225 (1962).

In at least one pre-1954 case, an exclusion was allowed when the employee did not live on the "business premises" under any reasonable interpretation of that term as used in § 119. Jones v. United States, 60 Ct. Cl. 552 (1925) (exclusion allowed where army officer lived away from base).

[20] H.R. REP. No. 2543, *supra* note 15, at 27.

[21] The opinion itself does not state this conclusion. However, the court alludes to the congressional history and apparently recognizes that legislative intent is a controlling factor. 42 T.C. at 416-17.

[22] Congress recognized that meals and lodging were not excludable if furnished as compensation under the Commissioner's 1950 announcement. S. REP. No. 1622, *supra* note 11, at 19; see 2 MERTENS, FEDERAL INCOME TAXATION § 11.16, at 60 (1961 revision); Landman, *supra* note 5, at 188-89; McDermott, *supra* note 6, at 875-76; Annot., 84 A.L.R.2d 1215, 1231-32 (1962).

[23] "Your committee has provided that the basic test of exclusion is to be whether the meals or lodging are furnished primarily for the convenience of the employer (and thus excludable) or whether they were primarily for the convenience of the employee (and therefore taxable)." S. REP. No. 1622, *supra* note 11, at 19. *But see* note 15 *supra*.

[24] "But there will be many times when the courts will find that common sense

application seems even more justifiable in light of the legislative development of the "business premises" test. The ambiguity of the term "place of employment"[25] in the House bill indicates that a strict meaning was not intended. The examples given in the House Report show that the exclusion was to apply to institutional employees, whose quarters are frequently furnished in separate buildings;[26] thus the exclusion was not to be limited to the precise work area of the employee.

The Senate changed this term to "on the business premises,"[27] without indicating the reasons for this change.[28] However, the same examples of institutional employees are used in the Senate Report;[29] thus it can be said that a restrictive definition was not intended. The Conference Committee indicated that the terms were very similar in effect, and two further examples of the coverage of "business premises" were provided: a domestic servant furnished lodging in his employer's home, and a cowhand furnished meals on land simply leased by his employer.[30]

The tenor of all these legislative examples seems to show a con-

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says that meals and lodgings are furnished for the convenience of the employer, but they are furnished at a place which the employer does not own or lease . . . . Obviously the 'convenience of the employer' rule should be applied in such cases, but the courts will have an interesting time explaining why these sites constitute 'business premises of the employer.'" Annot., 84 A.L.R.2d 1215, 1225 (1962).

[25] See H.R. REP. No. 1337, *supra* note 11, at 18.

[26] "A civil service employee of a State is employed at an institution and is required, as a condition of his employment, to live and eat at the institution . . . ." *Id.* at A39. Although the term "at the institution" does nothing more than say "at the place of employment," Congress must be deemed to have realized that institutional employees often live in separate buildings on the same plot of land as the institution. See, *e.g.*, Joseph L. Doran, 21 T.C. 374, 375 (1953); Diamond v. Sturr, 116 F. Supp. 28, 29 (N.D.N.Y. 1953), *rev'd*, 221 F.2d 264 (2d Cir. 1955). Thus, the selection of this example indicates that Congress cannot have intended to restrict the "business premises" to the exact situs of work.

[27] See S. REP. No. 1622, *supra* note 11, at 190.

[28] The most probable explanation is that the Senate believed the term "place of employment" might be interpreted too restrictively. This was the view of the American Bar Association in a memorandum which it submitted to the Senate Finance Committee, reprinted in *Hearings Before the Senate Committee on Finance on H.R. 8300*, 83d Cong., 2d Sess., pt. 1, at 485 (1954).

If this was in fact the reason for the change, the use of both terms interchangeably in the report would seem to be merely an oversight on the part of the Committee. See S. REP. No. 1622, *supra* note 11, at 19.

[29] S. REP. No. 1622, *supra* note 11, at 191.

[30] See H.R. REP. No. 2543, *supra* note 15, at 27. The inclusion of these examples was probably the result of discussion in the Conference Committee on which of the two terms was the better. While use of "place of employment" would negate the need for these two examples, the Senate may have urged "business premises" for the reason stated in note 28 *supra*.

gressional concern merely for *proximity* of the lodging to the *place of work,* and an intention to allow exclusion only when the employee is living in quarters which serve a business purpose of the employer.[31] In light of these examples, any attempt to define rigid, physical standards delineating the "business premises" seems clearly contrary to congressional intent. Thus, mere physical separation becomes a secondary issue. The primary consideration would appear to be whether the lodging is *close enough* to that business area of the employer at which the employee is engaged to justify a conclusion that it is an integral part of the business premises.[32] This conclusion would depend, of course, on the facts in each individual case.

This analysis of congressional purpose seems to accord with the view taken by the Tax Court in *Anderson.* The court's decision indicates that the "business premises" test should be liberally interpreted when the "convenience" and "condition of employment" tests are clearly met.[33] The court found that the house in question was "business property" because it had been purchased for a business purpose,[34] and from that viewpoint could be considered "business premises" of the employer.[35] Proximity of the lodging to the business area where the employee works was recognized by the court as an important factor,[36] and mere physical separation of the house

[31] Presumably Congress had in mind the situation in Gunnar Van Rosen, 17 T.C. 834 (1952). There the employee ordinarily received free meals and lodging while at sea aboard ship. When the ship happened to go into dry dock in the employee's city of residence and quarters aboard ship were made unavailable by the repairs, he lived in his own home some forty blocks away. Despite the fact that he was technically on twenty-four-hour call during the repair period, the court refused to allow exclusion of lodging allowances which he received.

[32] This approximates the definition worked out by a long line of decisions interpreting "premises" in the law of workmen's compensation. See 1 LARSON, WORKMEN'S COMPENSATION § 15.41 (1964); 8 SCHNEIDER, WORKMEN'S COMPENSATION TEXT § 1714 (perm. ed. 1951).

[33] "In our view, . . . property owned by an employer within two short blocks of a facility being managed by an employee *who is required* to be available on 24-hour call for management of the employer's business, is . . . on the business premises of the employer within the meaning of section 119, where the *employee is required to accept such lodgings for the convenience of the employer . . . .*" 42 T.C. at 417. (Emphasis added.)

[34] The employer had purchased the house in order to move the taxpayer out of the valuable, rent-producing motel rooms which he and his family had been occupying and still keep him close enough to the motel to perform his duties. *Id.* at 415-16.

[35] *Id.* at 416-17.

[36] In discussing two prior cases, the court refers to "close proximity to or vicinity of the area where the . . . work was being done." *Id.* at 416 (discussing George I. Stone, 32 T.C. 1021 (1959); William I. Olkjer, 32 T.C. 464 (1959)).

from the business area was not deemed fatal. The court concluded that even the Commissioner recognized that some separation was allowable[37] and that to deny the exclusion under the facts of the case would result in too restrictive an application of the statute.[38]

Although the extent to which Congress intended to broaden the "convenience" rule is difficult to determine from the legislative history, there are cogent reasons for deciding that the rule should at least cover the *Anderson* situation. If the "business premises" test were applied in a limited sense, the decision to grant an exclusion would rest solely upon fortuitous circumstances. If, for example, the employer had purchased a house located on land bordering the motel property, an exclusion would have been granted even under a strict application of the "business premises" test.[39] However, any number of practical considerations might have militated against such a purchase,[40] and the policy of the statute was clearly satisfied

[37] "Respondent's regulations state that 'the term "business premises," generally means the place of employment of the employee.' By use of the word 'generally' respondent apparently recognizes that under certain circumstances the place of employment might be separated somewhat from the living quarters." 42 T.C. at 416.

This reasoning seems to be erroneous. The statement in the Regulations quoted above obviously comes from the Conference Committee Report. See text accompanying note 20 *supra*. In making this statement, the Conference Committee was not alluding to a separation between the place of employment and the quarters, but rather to the difference between the terms "place of employment" and "business premises." See H.R. REP. No. 2543, *supra* note 15, at 27; note 30 *supra* and accompanying text.

[38] 42 T.C. at 417. Militating for a restrictive application of § 119 is the fact that the policy of the exclusion has been vigorously attacked as an unfair erosion of the tax base. See HOUSE COMM. ON WAYS AND MEANS, 86TH CONG., 1ST SESS., TAX REVISION COMPENDIUM 322, 325-26, 334-35, 347-48 (Comm. Print 1959); Note, 3 WM. & MARY L. REV. 166, 169-73 (1961). Despite these attacks, however, Congress has not amended the section since its enactment.

[39] The examples given in the reports would seem to cover this situation. See notes 26 and 29 *supra* and accompanying text. In similar situations the Commissioner has not even argued the point. See Boykin v. Commissioner, 260 F.2d 249 (8th Cir.), *modifying* 29 T.C. 813 (1958) (hospital employee in separate building); Manuel G. Setal, 30 P-H Tax Ct. Mem. 853 (1961) (mine worker in remote area furnished lodging in camp); William I. Olkjer, 32 T.C. 464 (1959) (construction worker in Greenland furnished lodging at job-site); Rodney E. Wolf, 27 P-H Tax Ct. Mem. 580 (1958) (cottage master at correctional institution).

A strict application of the business premises test would appear patently absurd if the employer in *Anderson* could have satisfied such a test merely by purchasing a narrow easement connecting the motel and the lodging.

[40] For example, adjoining land might not have been zoned for residences; or may have been too expensive, simply unavailable, or otherwise less desirable economically. It should be noted that all these possibilities refer to business considerations of the employer and not to preferences of the employee.

in spite of the physical separation.[41] To contend that the "business premises" test should be restrictively applied to facilitate administration would produce inequitable results.

The facts in other cases may present more difficult problems than did *Anderson.* Suppose a distributor is provided rent-free lodging which is not proximate to his employer's principal place of business, but is centrally located within the area to which the distributor delivers.[42] Or take another example, suppose an employer maintained two plants separated by several miles and his superintendent, who was often needed at both plants on a 24-hour basis, was provided with a house halfway between.[43] In both cases, the "business premises" test appears to be met since the lodging serves a business purpose of the employer and is proximate to the employee's place of work. Where the particular function of the employee becomes increasingly localized, however, the permissible area of proximity shrinks accordingly.[44] Thus, if a manufacturer needed 100 percent employee attendance for efficient operation of his factory, and required his employees to live in employer-owned apartments for the purpose of providing company transportation, assuming the apartments were somewhat removed from the place of employment, the requisite proximity would be missing. As an additional consideration, it will be difficult in many situations for the employee to satisfy the other two tests contained in section 119.

The liberal view taken by the Tax Court in *Anderson* produced a palpable result under the facts of the case. However, the court should have explained more adequately its construction of the ambiguous "business premises" phrase. In line with *Anderson,* and

[41] The facts in *Anderson* show that the employer purchased the closest piece of property which was zoned for dwellings and built a house thereon, even though property with a dwelling already constructed could have been purchased at only a slightly greater distance from the motel. 42 T.C. at 412.

[42] See the similar situation in United States v. Barrett, 321 F.2d 911 (5th Cir. 1963).

[43] If business is conducted in the lodging itself, there is no problem in finding it to be on the "business premises." See United States Junior Chamber of Commerce v. United States, CCH 1964 STAND. FED. TAX REP. (64-2 U.S. Tax Cas.) ¶ 9637 (Ct. Cl. July 17, 1964).

[44] By the same token, where the particular function assumes larger geographic proportions, centrally located lodging may cease to have a business purpose. Thus, in the two previous examples, if the distributor drove a truck between New York and Chicago, or if the superintendent's two factories were located in those two cities, there is no evidence of a business purpose if the employer requires his employee to live in lodging provided in Cleveland. On the other hand, if rent-free lodging is provided in both New York and Chicago, the test would appear to be met.

until further clarification is forthcoming from Congress or the Commissioner, the courts would do well to refrain from a restrictive, technical application of the "business premises" test whenever the "convenience" and "condition of employment" requirements are clearly satisfied.