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## **I.R.C. SECTION 119: AN EXCLUSION FOR MEALS AND LODGING**

**Steven T. Potts**

### **I. INTRODUCTION**

Normally, any property or services provided by an employer to an employee constitute gross income to the employee for federal income tax purposes.<sup>1</sup> Compensation may be paid in many forms other than cash. An employer's provision of meals and lodging to an employee should generally constitute income to the employee. Nevertheless, in some situations it would be unfair to tax an employee on the value of meals and lodging received. These situations arise out of an employer's business necessity and occur when an employee must accept the meals or lodging. Congress, the Treasury Department, and the courts have long recognized the desirability of excluding from an employee's gross income the value of meals and lodging provided in these situations.

Congress provided for exclusion of employer-provided meals and lodging in Internal Revenue Code [hereinafter I.R.C.] section 119. For the value of meals to be excludable, the employer must provide them on the business premises for his convenience. Lodging is excludable only when a third requirement is met: the employee must be required to accept the lodging as a condition of his employment.

Even before Congress enacted section 119, however, the Treasury Department and courts had ruled that the value of meals and lodging was excludable in some instances. In many respects, section 119 is a response to these rulings. Congress intended to adopt some aspects of the judicial and administrative rulings, and also to change others. Since the enactment of section 119, however, courts have tended to apply section 119 by resorting to pre-section 119 concepts. Some courts have strained to apply section 119 to particular fact situations when it seemed fair to do so. At other times taxpayers have successfully used section 119, complying with its technical wording in situations where Congress may not have intended for section 119 to apply.

Even though section 119 has only limited application and may be somewhat confusing, it is useful in a variety of situations. By understanding the statutory requirements and how the Internal Revenue Service [hereinafter I.R.S.] and courts apply them, tax-

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1. I.R.C. §§ 61(a)(1), 83(a) (1982).

payers can take advantage of this provision. This comment addresses the technical requirements of section 119 and its application in certain employment settings. First, the comment analyzes the convenience of the employer doctrine, the requirement that meals and lodging be provided on the business premises, and the requirement that an employee be required to accept lodging for it to be excludable. Next, it discusses application of section 119 to shareholder-employees and partners. Finally, the comment addresses how employers may advantageously use section 119 even when they charge employees for meals or lodging.

## II. "CONVENIENCE OF THE EMPLOYER" SHOULD BE EQUATED WITH BUSINESS NECESSITY

To exclude the value of meals or lodging from gross income under section 119, the employer must furnish them for his convenience.<sup>2</sup> The treasury regulations define convenience of the employer as "a substantial noncompensatory business reason of the employer."<sup>3</sup> The fact that meals or lodging provided to an employee may compensate him does not negate the exclusion if they are provided for a substantial noncompensatory business reason as well.<sup>4</sup>

### A. History

#### 1. Administrative Rulings

The present convenience of the employer doctrine originated in early administrative and judicial decisions. In its earliest rulings, the Treasury Department stated a rule similar to that of section 119:

When living quarters such as camps are furnished to employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employee, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax.<sup>5</sup>

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2. I.R.C. § 119(a) (1982).

3. Treas. Reg. § 1.119-1(a)(2), T.D. 8006, 50 Fed. Reg. 2,964 (1964).

4. *Id.* This apparently includes the situation where an employer provides meals or lodging solely for a noncompensatory business reason but the meals in fact compensate the employee, as well as the situation where the employer provides meals and lodging for compensatory *and* noncompensatory reasons.

5. T.D. 2992, 2 C.B. 76 (1920), amending Article 33 of Regulations 45. *See also* O.D. 265, 1 C.B. 71 (1919).

While these rulings did not define "convenience of the employer," two subsequent rulings explained that this required meals and lodging to be provided as a matter of business necessity.<sup>6</sup>

In 1950, however, the I.R.S. issued Mimeograph 6472,<sup>7</sup> stating that before determining whether meals or lodging could be included in gross income, the I.R.S. should make a preliminary finding based upon facts and circumstances before applying the convenience of the employer rule.<sup>8</sup> Thus, the I.R.S. contended that even though meals or lodging were furnished for an employer's convenience, *other* facts and circumstances might indicate the meals and lodging were compensatory. In such cases, the other facts and circumstances controlled.<sup>9</sup>

## 2. Court Decisions

While the Treasury Department struggled with definition and application of the convenience of the employer doctrine, courts also attempted to apply the concept. In *Benaglia v. Commissioner*,<sup>10</sup> the employer, a hotel corporation, provided meals and lodging at one of its hotels to Benaglia. Benaglia managed several hotels for the company, and could not properly perform his duties without eating and living at the hotel.<sup>11</sup> The Board of Tax Appeals recognized Benaglia had received something of value, although it was merely incidental to performance of his duties.<sup>12</sup> Because the employer provided the meals and lodging at his convenience, the court held the value was not income.<sup>13</sup>

In *Van Rosen v. Commissioner*, the Tax Court elaborated on the *Benaglia* ruling.<sup>14</sup> First, the court espoused a common sense view of the convenience of the employer doctrine. An employer likely regards the salary paid an employee to be for his own conve-

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6. O.D. 814, 4 C.B. 84, 84-5 (1921); O.D. 915, 4 C.B. 85, 85-6 (1921).

7. 1950-1 C.B. 15.

8. *Id.*

9. *Id.* Mimeograph 6472 included an example: a state civil service employee was required to live at an institution so that he would be available for duty at all times. The value of the lodging and meals was considered to be compensation under state statutes, civil service rules and regulations, or the employment contract. Upon these facts, the I.R.S. concluded that the value of meals and lodging was includible in the civil servant's gross income, even though furnished for the convenience of the employer. *Id.* at 15-16.

10. 36 B.T.A. 838 (1937).

11. *Id.* at 839.

12. *Id.* at 840 (citing *Tennant v. Smith*, H.L. (1892) App. Cas. 150, III British Tax Cases 158).

13. *Id.* at 840.

14. 17 T.C. 834 (1951). In *Van Rosen* the taxpayer claimed that cash allowances paid to an employee for the convenience of the employer could be excluded from income. *Id.* at 836. The court held that no exclusion applied. *Id.* at 841.

nience; if he did not, no employment would occur.<sup>15</sup> The court did not agree with that definition. Rather, the *Van Rosen* court, as did the Board of Tax Appeals in *Benaglia*, held that satisfaction of the convenience of the employer test occurred when the employer provided meals and lodging because the employee could not accomplish his duties without them.<sup>16</sup>

In 1953 the Tax Court held that an employee must include meals and lodging in gross income if they compensate him, regardless of whether the employer provided them for his own convenience.<sup>17</sup> While the court did not cite Mimeograph 6472,<sup>18</sup> it followed the same analysis.<sup>19</sup>

### 3. *Enactment of Section 119*

Prior to enactment of section 119 in 1954, the convenience of the employer concept was unclear. When the House of Representatives considered section 119, it intended to change the law.<sup>20</sup> The House Ways and Means Committee Reports show that the House initially intended to exclude employer-provided meals and lodging from an employee's income if they were furnished on the employer's business premises as a condition of employment.<sup>21</sup> The House specifically declined to incorporate the troublesome convenience of the employer concept. Even if meals or lodging were compensatory, an exclusion would exist as if the provisions of the proposed section 119 were met.<sup>22</sup> The Senate Finance Committee

15. *Van Rosen*, 17 T.C. at 838.

16. *Id.* "[T]hough there was an element of gain to the employee, in that he received subsistence and quarters which otherwise he would have had to supply for himself, he had nothing he could take, appropriate, use and expend according to his own dictates, but rather, the ends of the employer's business dominated and controlled, just as in the furnishing of a place to work and in the supplying of the tools and machinery with which to work." *Id.* The court appeared to refer to a lack of choice by the employee, also, although it did not expressly so state.

17. *Doran v. Commissioner*, 21 T.C. 374 (1953).

18. 1950-1 C.B. 52. See *supra* notes 6-8 and accompanying text.

19. See *Commissioner v. Kowalski*, 434 U.S. 77, 89-90 (1977). The Second Circuit Court of Appeals, in *Diamond v. Sturr*, 221 F.2d 264 (2d Cir. 1955), disagreed with the Tax Court's approach in *Doran*, and held that the convenience of the employer test was determinative regardless of whether meals and lodging provided by the employer might also tend to compensate the employee. *Id.* at 268.

20. H.R. Rep., 83d Cong., 2d Sess. 3, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4137, 4175.

21. *Id.* Note that the House requirement that meals and lodging must be furnished on the employer's business premises as a condition of employment are identical to the second and third requirements necessary to exclude the value of lodging currently under § 119. The statute ultimately did not expressly require meals to be furnished as a condition of employment. I.R.C. § 119(a).

22. H.R. Rep., 83d Cong., 2d Sess. 3, reprinted in 1954 U.S. CODE CONG. & AD. NEWS

added the convenience of the employer standard back into the bill, however,<sup>23</sup> and Congress ultimately enacted this version.<sup>24</sup> To demonstrate that the new statute changed prior law, the Senate Report included an example with facts identical to those in Mimeograph 6472.<sup>25</sup> Under the new law, meals furnished to a state civil-service employee could be excluded from income.<sup>26</sup> Thus, the fact that meals or lodging might also be compensatory no longer controlled, if the requirements of section 119 were met.

### B. *Judicial Interpretations*

Interpretation and application of the convenience of the employer doctrine has been left primarily to the courts. Arguably, any meals and lodging could be considered furnished for the employer's convenience, but, of course, such a result would contradict Congress' intent.<sup>27</sup> The Tax Court requires a "direct nexus between the lodging furnished and the asserted business interests of the employer served thereby."<sup>28</sup>

This nexus may be demonstrated by contrasting two decisions of the Tax Court. In *Olkjer v. Commissioner*,<sup>29</sup> the taxpayer was employed at a remote site in Greenland. The employer provided meals and lodging for employees because no other facilities were available.<sup>30</sup> The court stated that without the provision of meals and lodging, it would be impossible to employ the taxpayer at all.<sup>31</sup> Hence, a direct nexus existed. The Tax Court could not find a direct nexus in *McDonald v. Commissioner*,<sup>32</sup> however. In *McDonald*, a subsidiary of the Gulf Oil Corporation provided an apartment to a manager assigned to work in Tokyo, Japan. The taxpayer argued that providing housing served Gulf's interests and that, if Gulf had not provided housing, other accommodations

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at 4175.

23. H.R. Rep., 83d Cong., 2d Sess. 3, reprinted in 1954 U.S. CODE CONG. & AD. NEWS at 4825.

24. Internal Revenue Code of 1954, Pub. L. No. 83-591, § 119, 68A Stat. 39 (1954).

25. 1950-1 C.B. 15. See text accompanying notes 6-8, *supra*.

26. S. Rep., 83d Cong., 2d Sess. 3, reprinted in 1954 U.S. CODE CONG. & AD. NEWS at 4825.

27. See text accompanying footnotes 19-24.

28. *McDonald v. Commissioner*, 66 T.C. 223, 230 (1976); *Olkjer v. Commissioner*, 32 T.C. 464, 468-69 (1959).

29. 32 T.C. at 464.

30. *Id.* at 466.

31. *Id.* at 468-69. The court even described the food and lodging provided by the employer in *Olkjer* as "more than a mere convenience of the employer." *Id.*

32. 66 T.C. at 223.

would have been unavailable.<sup>33</sup> While the court did not dispute that Gulf's interests might be served by providing housing, it found that the employee's interests were primarily benefitted. In contrast to the finding in *Olkjer* where no other facilities were available to employees, the court in *McDonald* could find nothing clearly indicating employer convenience.<sup>34</sup>

Courts realize that an employer's provision of meals and lodging will involve convenience to the employee as well as to the employer. However, the exclusion granted in section 119 applies only when the employer provides the meals or lodging *primarily* for his convenience.<sup>35</sup> This determination should be made on the basis of all the facts and circumstances.<sup>36</sup> In deciding whether meals and lodging are in fact provided for the employer's convenience, courts should determine whether a *reasonable* employer would provide meals or lodging to employees rather than whether this particular employer would do so. In other words, an objective test should be used.<sup>37</sup>

The convenience of the employer test is not the only condition to be satisfied under section 119. The employer must have provided the meals and lodging on the business premises, and the lodging must have been accepted as a condition of employment.<sup>38</sup> These factors are discussed below, but it is important to note that definition of "convenience of the employer" depends at least in part upon these two other requirements.

### III. MEALS AND LODGING MUST BE PROVIDED ON THE EMPLOYER'S BUSINESS PREMISES

A second important requirement must be met before the value of meals and lodging may be excluded from gross income. The meals and lodging must be provided by the employer on the business premises.<sup>39</sup> The regulations define "business premises of the employer" to mean generally "the place of employment of the employee."<sup>40</sup> This construction of the phrase has given rise to two

33. *Id.* at 229.

34. *Id.* at 230.

35. *See, e.g.,* Nicath Realty Co. v. Commissioner, 25 T.C.M. (CCH) 1260, 1265 (1966).

36. Bob Jones Univ. v. United States, 670 F.2d 167, 174 (Ct. Cl. 1982).

37. *Id.* (quoting *Dole v. Commissioner*, 43 T.C. 697, 706, *aff'd per curiam*, 351 F.2d 308 (1st Cir. 1965)).

38. I.R.C. § 119(a).

39. *Id.*

40. Treas. Reg. § 1.119-1(c)(1), T.D. 6745, 29 Fed. Reg. 9380 (1964). Note that even though § 119 speaks in terms of "business premises," nothing requires the employer to be engaged in business as opposed to governmental, not-for-profit, or even personal endeavors.

meanings: (1) a place where the employee performs a significant portion of his duties, or (2) a place where the employer carries on a significant portion of its business.<sup>41</sup> If the taxpayer can satisfy either interpretation, then courts consider the meals or lodging to be provided on the employer's business premises.

At first glance, defining "business premises" as the place where the employer carries on a significant portion of its business appears to be straightforward. In *Lindeman v. Commissioner*,<sup>42</sup> the Tax Court possibly stretched this interpretation when it held that a house located across the street from the employer's hotel but next to a hotel parking lot constituted part of the business premises. The court explained in *Lindeman* that "on the business premises" means just that, not "nearby," "close to," or "contiguous to."<sup>43</sup> No doubt the tax court partially based its holding upon a finding that the employee performed significant services at the home.<sup>44</sup> Hence, the home could have been considered an extension of the premises.

One problem with the definition of "business premises" as a place where the employer carries on a significant portion of its business arises because section 119 may allow an employee to exclude the value of meals or lodging provided at a location different from that at which the employee performs services. In *Dole v. Commissioner*,<sup>45</sup> the court stated that Congress probably did not intend that result.<sup>46</sup> But the I.R.S. has ruled that the meals of an employee who normally works at one location but eats at another of the employer's locations may be considered to be provided on the employer's business premises.<sup>47</sup>

If a taxpayer fails to make a strong showing that the employer

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*Id.*

41. *Commissioner v. Anderson*, 371 F.2d 59 (6th Cir. 1966), *cert. denied*, 387 U.S. 906 (1967); *Dole*, 43 T.C. 697. At least one court has characterized "business premises" three ways. In *Winchell v. United States*, 564 F. Supp. 131 (D. Neb.), *aff'd*, 725 F.2d 689 (8th Cir. 1983), the court listed the two meanings given in *Anderson* and *Dole*, but included a third, "living quarters that constitute an integral part of the business property," citing *Bob Jones*. *Id.* at 136. A reading of *Bob Jones* discloses that the Claims Court was aware of only two constructions of "business premises," however.

42. 60 T.C. 609 (1973).

43. *Id.* at 614.

44. *Id.* at 616. The court described how the employee used the house for some of his office work, entertaining business guests, and observing part of the hotel.

45. 43 T.C. 697.

46. *Id.* at 707.

47. Rev. Rul. 71-411, 1971-2 C.B. 103, 104. Of course, the convenience-of-the-employer and condition-of-employment (for lodging) requirements must still be met. In Rev. Rul. 71-411, the employer served meals because either the employees needed to be able to answer telephones at all times or they were limited to a short meal period.

provides the meals or lodging at a location where the employer carries on a significant portion of its business, courts will deny the section 119 exclusion. In one case, a hotel manager received employer-provided lodging two *short* blocks away from the hotel. The court held this employer had not provided lodging on the business premises.<sup>48</sup> The taxpayer who finds himself in this situation must look to the other definition of business premises: a place where the employee performs a significant portion of his duties.

The taxpayer in *Adams v. United States* espoused this theory.<sup>49</sup> The taxpayer, an executive of a Mobil Oil Corporation subsidiary in Japan, proved he worked in his employer-provided house at night and on weekends, held business meetings there, and entertained business guests at the home.<sup>50</sup> Importantly, the court believed the taxpayer's effectiveness as a corporate official would have been impaired if the employer had not provided a large, well-furnished home.<sup>51</sup> The court explained that "on the business premises" includes lodging facilities where the employee performs significant duties because the phrase "infers a functional rather than a spatial unity."<sup>52</sup>

A relationship exists between the business premises and convenience of the employer requirements. While an employer might provide meals or lodging off the business premises for his own convenience, the requirement that the meals or lodging be provided upon the premises tends to guarantee that they are provided for the convenience of the employer. If a court cannot find meals or lodging provided upon the employer's business premises, it probably will consider them to be provided neither for the employer's convenience nor as a condition of employment.<sup>53</sup> Thus, there exists a clear relationship between these requirements.

#### IV. LODGING MUST BE PROVIDED TO AN EMPLOYEE AS A CONDITION OF EMPLOYMENT

The third requirement applies only to lodging: lodging must be provided by an employer to an employee as a condition of his

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48. *Anderson*, 371 F.2d at 67. Likewise, the tax court has held that lodging provided twelve miles from the job site was not on the employer's business premises. *Crowe v. Commissioner*, 40 T.C.M. (CCH) 380 (1980).

49. 585 F.2d 1060 (Ct. Cl. 1978). See also *United States Junior Chamber of Commerce v. United States*, 334 F.2d 660 (Ct. Cl. 1964).

50. *Adams*, 585 F.2d at 1062.

51. *Id.* at 1066.

52. *Id.* See also *Winchell*, 564 F. Supp. at 136-37; *Bob Jones Univ.*, 670 F.2d at 176.

53. See *Bob Jones Univ.*, 670 F.2d 167; *Winchell*, 564 F. Supp. 131.

employment.<sup>54</sup> Originally, the House of Representatives had intended for this requirement to apply to the provision of both meals and lodging.<sup>55</sup> When the Senate added "convenience of the employer" language to section 119, it deleted reference to providing meals as a condition of employment.<sup>56</sup>

In defining the phrase, the Senate Finance Committee stated: "[R]equired as a condition of his employment' means required in order for the employee to properly perform the duties of his employment."<sup>57</sup> The phrase clearly does not mean that the *employer* must require the employee to be housed on business premises, but only that circumstances necessitate this result.<sup>58</sup>

Viewed in this light, it is not surprising that courts uniformly equate the condition of employment requirement with convenience of the employer. The Court of Claims in *United States Junior Chamber of Commerce v. United States*<sup>59</sup> found that the Senate's explanation of "required as a condition of his employment" was so similar to the convenience of the employer definition given in Mimeograph 5023<sup>60</sup> that Congress must have intended for no "substantial difference" to exist between the two.<sup>61</sup>

Lodging usually should be considered provided as a condition of employment when the employee has no choice but to accept it. This requirement will be met when an employee must reside on the business premises to accomplish his assigned tasks,<sup>62</sup> or when other lodging is unavailable within a reasonable distance.<sup>63</sup> In both cases the employee would be "unable to properly perform [his] duties."<sup>64</sup>

As with the convenience of the employer doctrine, courts ap-

54. I.R.C. § 119(a)(2).

55. H.R. Rep., 83d Cong., 2d Sess. 3, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS at 4175.

56. H.R. Rep., 83d Cong., 2d Sess. 3, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS at 4825.

57. *Id.*

58. *Setal v. Commissioner*, 20 T.C.M. (CCH) 780, 782 (1961).

59. 334 F.2d 660, 663 (Ct. Cl. 1964).

60. 1940-1 C.B. 14. As a general rule, the test of "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 perform properly his duties.

61. *United States Junior Chamber of Commerce*, 334 F.2d at 663.

62. *See, e.g.*, Treas. Reg. § 1.119-1(d) ex. (5); *Hatt v. Commissioner*, 28 T.C.M (CCH) 1194 (1969), *aff'd*, 457 F.2d 499 (7th Cir. 1972); *Adolph Coors Co. v. Commissioner*, 27 T.C.M (CCH) 1351 (1968).

63. *See, e.g.*, Treas. Reg. § 1.119-1(d) ex. (7); *Setal*, 20 T.C.M (CCH) at 782; *Stone v. Commissioner*, 32 T.C. 1021 (1959).

64. S. Rep., 83d Cong., 2d Sess. 3, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS at 4825.

ply an objective test to determine whether the employer provided the lodging as a condition of employment.<sup>65</sup> Thus, even an employment contract requiring the employee to live on the employer's premises would not control. Because a rule based upon the presence or absence of such a provision could be easily manipulated, the proper analysis considers all the facts and circumstances. The existence of a contractual lodging requirement is just one of the facts or circumstances to be taken into account.<sup>66</sup>

## V. USE OF SECTION 119

I.R.C. section 119 may be used by taxpayers in a variety of situations; proper planning can expand application of the exclusion. For example, section 119 may be used successfully by stockholder-employees and partners. Further, use of the section 119 exclusion allows both employers and employees to avoid employment taxes.

### A. General Applicability

Section 119 applies to nearly any occupational setting. Thus, restaurant employees,<sup>67</sup> bank employees,<sup>68</sup> construction workers,<sup>69</sup> miners,<sup>70</sup> hotel employees,<sup>71</sup> and agriculture employees<sup>72</sup> may qualify to exclude the value of meals and lodging received. A taxpayer simply must determine whether the employer provides meals and lodging on his business premises for his own convenience, and whether the employer provides lodging as a condition of employment. Some occupations enjoy a greater likelihood that section 119 will exclude the employer-provided meals and lodging.

### B. Applicability of Section 119 to Shareholder-Employees

Perhaps more interesting, however, is the application of section 119 to shareholder-employees of a corporation. A farm or ranch corporation provides a good example. In *Harrison v. Commissioner*,<sup>73</sup> taxpayers formed a corporation and transferred their homes to it. A corporate resolution authorized payment for meals

65. *Winchell*, 564 F. Supp. at 135.

66. *Setal*, 20 T.C.M. (CCH) at 782-83.

67. Treas. Reg. § 1.119-1(f) Ex. (1).

68. Treas. Reg. § 1.119-1(f) Ex. (3).

69. Treas. Reg. § 1.119-1(f) Ex. (7); *Stone*, 32 T.C. 1021.

70. *Setal*, 20 T.C.M. (CCH) 780.

71. *Benaglia*, 36 B.T.A. 838.

72. *Harrison v. Commissioner*, 41 T.C.M. (CCH) 1384 (1981).

73. *Id.*

and lodging of its employees and required them to reside on the premises to be available for emergency calls.<sup>74</sup> The employees were also stockholders and officers in the corporation. The nature of the corporation's operations required "constant supervision and availability of personnel."<sup>75</sup> Accordingly, the taxpayers met three section 119 requirements.<sup>76</sup> One problem, however, centered on whether the employees received meals, or simply groceries. Since section 119 provides an exclusion for meals but not groceries, the taxpayers carefully demonstrated that meals had been provided. They showed that some of the employees (who just happened to be wives) had the duties of buying groceries, preparing meals, and serving themselves, their husbands, and other employees.<sup>77</sup> The court held that meals had been served.<sup>78</sup>

### C. Application to Partners

Because section 119 specifies that the exclusion applies only to meals provided to employees, partners in a partnership would apparently not qualify. In some instances, however, the Code recognizes that a partner does not always act as a partner, but rather in some other capacity. When that situation exists, the Code characterizes transactions between the partnership and the partner as if the partnership relation does not exist.<sup>79</sup> The taxpayer in *Armstrong v. Phinney*<sup>80</sup> recognized this and applied it to the meals and lodging he received as manager of a ranch. A partnership owned the ranch, and the taxpayer-manager owned five percent of the partnership.<sup>81</sup> The court recognized that both aggregate<sup>82</sup> and entity<sup>83</sup> concepts may apply to a partnership, but that Congress explicitly recognized the entity theory when it enacted section

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74. *Id.* at 1386.

75. *Id.*

76. *Id.* at 1390-91.

77. *Id.* at 1386.

78. *Id.* at 1390. The corporation received a § 162 trade or business deduction for the cost of the meals served. *Id.* at 1390-91. A similar case, involving a Montana ranch corporation, is *McDowell v. Commissioner*, 33 T.C.M. (CCH) 372 (1974).

79. I.R.C. § 707(a) (1982).

80. 394 F.2d 661 (5th Cir. 1968).

81. *Id.* at 662.

82. Under the aggregate concept, "a partnership is simply an aggregation of individuals, each of whom should be treated as the owner of a direct undivided interest in partnership assets and operations." W. McKee, W. Nelson & R. Whitmore, *Federal Taxation of Partnerships and Partners* ¶ 1.02 (1977).

83. The entity concept views "a partnership [a]s a separate entity, apart from the partners. Under this view, a partner has no direct interest in partnership assets or operations, only an interest in the partnership entity separate and apart from its assets and operations." W. McKee, W. Nelson & R. Whitmore, *supra* note 82, at ¶ 1.02.

707(a).<sup>84</sup> The court held that Congress had intended section 707(a) to relate to section 119. It found no intent to the contrary.<sup>85</sup> Hence, a partner may be an "employee" for section 119 purposes, depending upon the particular facts of a case.

## VI. EXCLUSION WHEN EMPLOYER CHARGES EMPLOYEE FOR MEALS AND LODGING

When an employer provides meals and lodging in addition to salary or wages, section 119 easily applies if the taxpayer meets all the requirements. Many tax practitioners have found section 119 difficult to understand when an employer charges an employee for meals and lodging.

Section 119 clearly provides for an exclusion when an employer charges for meals. The Code specifies first that "[i]n determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals . . . shall not be taken into account."<sup>86</sup> Further, when an employer imposes a fixed charge for meals on a periodic basis, the amount of the fixed charge should be excluded from the employee's income.<sup>87</sup> Of course, the meals must still be furnished on the business premises and for the convenience of the employer.<sup>88</sup> Thus, "if an employee has a choice of accepting the meals and paying for them or of not paying for them and providing his meals in another manner," the employer has not provided meals for his convenience, and section 119 does not apply.<sup>89</sup> But if the employee must pay for the meals regardless of whether he actually eats them, the exclusion may still apply.<sup>90</sup> Here the taxpayer must still show that a business necessity exists for providing the meals. An employee who never eats the employer-provided meals but pays the fixed periodic charge should not be entitled to the exclusion.

Although the Code fails to discuss the effect of an employer-imposed charge for lodging provided to an employee, the regulations do. The regulations set forth rules nearly identical to those discussed above for meals.<sup>91</sup>

Thus, the Code and regulations clearly provide that a taxpayer

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84. *Armstrong*, 394 F.2d at 661.

85. *Id.* at 663-64.

86. I.R.C. § 119(b)(2).

87. I.R.C. § 119(b)(3)(A).

88. Treas. Reg. § 1.119-1(a)(3)(ii).

89. Treas. Reg. § 1.119-1(a)(3)(i).

90. I.R.C. § 119(b)(3)(B)(ii).

91. Treas. Reg. § 1.119-1(b).

who meets other requirements of section 119 may claim an exclusion even though he must pay the employer for meals and lodging. The employee should *not* be treated as receiving compensation from the employer with a corresponding sale of meals and lodging by the employer. One problem is that employers may account for these transactions according to the cash that actually changes hands. If the employer simply gives meals or lodging to an employee, the exclusion is "prerecorded." If no cash changes hands, and no records are kept, neither employer nor employee will remember to report the value of meals and lodging as income. Hopefully, the employee will be entitled to the exclusion in that case.

If the employer does impose a charge for meals and lodging, he should report the value of compensation *after* the exclusion to the employee and to taxing authorities. Employers may believe they have little incentive to do so, but they should remember that some employment taxes are imposed upon the value of compensation after the exclusion.

Tax imposed under the Federal Insurance Contributions Act<sup>92</sup> is the most significant such tax. The tax is imposed upon "wages" as defined by Code section 3121(a).<sup>93</sup> Basically, "wages" includes all remuneration, with some exceptions. This definition is analogous to the definition of wages for federal income tax purposes.<sup>94</sup> Although the definitions were similar, the Treasury Department historically interpreted FICA wages to include the value of all employer-provided meals and lodging,<sup>95</sup> while it interpreted wages for federal income tax withholding purposes not to include meals and lodging provided pursuant to section 119.<sup>96</sup> In 1981, however, the Supreme Court held in *Rowan Companies v. United States*<sup>97</sup> that the different interpretations could not be sustained in light of the similarity in wording of the two statutes. Congress simply had not intended such a difference in enacting the two statutes.<sup>98</sup> Accordingly, the statute imposes FICA taxes upon wages after excluding the value of meals and lodging. Likewise, federal unemployment tax is also imposed after excluding these values.<sup>99</sup> Apparently the Montana Department of Labor and Industry does not allow an exclusion for the value of meals and lodging for purposes of calculat-

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92. I.R.C. § 3111 (1985) [hereinafter "FICA"].

93. I.R.C. § 3121(a) (1982).

94. I.R.C. § 3401(a) (1982).

95. Treas. Reg. § 31.3121(a)-1(e), (f) (1980).

96. Treas. Reg. § 31.3401(a)-1(b)(9) (1980).

97. 452 U.S. 247 (1981).

98. *Id.* at 263.

99. *Id.*

ing state unemployment tax.<sup>100</sup> Because the exclusions provided for federal employment tax purposes can be significant, employers have good reason to report an employee's compensation after excluding the value of meals and lodging.

## VII. CONCLUSION

Section 119 presents a useful and often necessary exclusion from gross income. Because employer-provided meals and lodging also constitute a benefit to employees, Congress, the Treasury Department, and the courts have had difficulty providing a general standard for application of the exclusion. The convenience of the employer doctrine, the business premises requirement, and the condition of employment requirement represent the best attempts to apply what seems a simple idea: an exclusion should exist only when an employer provides meals and lodging as a matter of business necessity. Even with the confusion surrounding section 119, taxpayers may still use it advantageously. Section 119 may be applied in the close corporation and partnership contexts. Even in other situations, when the employer and employee do not have similar interests, employment tax consequences can make the use of section 119 beneficial to both parties.

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100. Mont. Admin. Reg. § 24.11.808(1)(f) (1980).