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# Change and Continuity in Fringe Benefit Taxation: Seeking Sense and Sensibility

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## I. INTRODUCTION

One of the most central issues in the income taxation of individuals is the treatment of so-called "fringe benefits." This loosely defined phrase includes everything from employer-provided health insurance to discounts on an employer's products to retirement planning services funded by one's present employer. Indeed, the most recent Employer's Guide to this subject from the Internal Revenue Service (IRS) includes the following examples: health benefits, achievement awards, adoption assistance, athletic facilities, dependent care assistance, educational assistance, employee discounts, employee stock options, employer-provided cell phones, group-term life insurance coverage, lodging on employer business premises, meals, moving expense reimbursements, no-additional-cost services, retirement planning services, transportation (commuting) benefits, tuition reduction, and working condition benefits.[1]

The basic allure of fringe benefits results from a fundamental discrepancy in their tax treatment vis-à-vis wages and other cash compensation. Wages are included in the taxable income of employees and are deductible as a business expense by employers. While the cost of providing fringe benefits is similarly deductible by employers, the value of such benefits is often excluded from the taxable income of employees.[2] This anomalous result persists despite the explicit inclusion of "fringe benefits" in the Internal Revenue Code's (IRC) foundational definition of gross income[3] because various exceptions have been created for reasons ranging from avoiding wartime limits on compensation to encouraging energy conservation.[4] As a result of this disparate tax treatment, fringe benefits have increased in both popularity and cost, and today represent a much larger proportion of employee compensation than was the case a half century ago.[5]

This phenomenon of excluding certain fringe benefits from taxation raises several distinct issues for tax reform generally and for understanding the metastatic profusion of tax administrative complexity specifically. One such issue is cost. The exclusion of fringe benefits from employees' income reduced federal income tax revenues by nearly $381 billion in fiscal year 2011, representing more than a third of the forgone tax revenues that are often described as "tax expenditures."[6] Moreover, many of these fringe benefit exclusions carry over to the definition of income that state governments

1. *Employer's Tax Guide to Fringe Benefits: For Use in 2014*, Internal Revenue Serv. 5 (Dec. 4, 2013), http://www.irs.gov/pub/irs-pdf/p15b.pdf; Treas. Reg. § 1.61-21(a)(1) (Westlaw 2012).

2. *See, e.g.*, I.R.C. § 106 (Westlaw 2010); *id.* § 119 (Westlaw 1998); *id.* § 132 (Westlaw 2013).

3. *Id.* § 61(a)(1) (Westlaw 1984).

4. *See, e.g.*, *id.* § 132(f)(1)(A), (B), (D), (f)(5)(A), (B), (F); *see also Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President*, 2 U.S. Dep't Treasury 1, 36 (1984), *available at* http://www.treasury.gov/resourcecenter/taxpolicy/Documents/tres84v2All.pdf.

5. *See* Ken McDonnell, *Finances of Employee Benefits: Health Costs Drive Changing Trends*, 26 Emp. Benefits Res. Inst. Notes 2, 2–3 (Dec. 2005), *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_12-20055.pdf.

6. *Facts from EBRI, Tax Expenditures and Employee Benefits: Estimates from the FY 2011 Budget*, Emp. Benefits Res. Inst. 1 (Mar. 2010), *available at* http://www.ebri.org/pdf/publications/facts/FS-209_Mar10_Bens-Rev-Loss.pdf.

employ in determining their own income tax base.[7] Furthermore, many fringe benefit exclusions, including employer-provided health insurance,[8] also apply well to Social Security's definition of wages,[9] thereby reducing tax receipts for that program—an issue of increasing importance as the Baby Boom generation begins to claim retirement benefits.

Another major issue that fringe benefit treatment necessarily implicates is fairness. Some fringe benefits tend to be widely available to employees of varying economic status.[10] But others, such as first-class air transportation, are generally concentrated among the economic elite within any given business organization.[11] In other cases, a particular fringe benefit—say, food and lodging provided for the convenience of the employer—manifests itself very differently in different contexts. Few taxpayers find anything untoward, for example, when McDonald's workers are able to consume their McWhatevers at work without owing any McTax on their value, but well-paid art museum directors living rent-free in high-priced housing is another matter entirely. Perhaps that is why *The New York Times* deemed it newsworthy in 2010 to report that the president of the American Museum of Natural History owed no income tax on her rent-free use of a $5 million apartment the museum purchased when she was hired.[12] Similar arrangements applied to the director of the Metropolitan Museum of Art's $4 million co-operative apartment and the director of the Museum of Modern Art's $6 million condominium.[13]

Another fundamental issue raised by the exclusion of fringe benefits from taxation is economic efficiency. Goods and services provided as excludable fringes are worth more to employees than taxable forms of compensation because no tax is owed on those goods and services.[14] This absence of tax cost increases the appeal of non-cash

7. Jerome R. Hellerstein & Walter Hellerstein, State and Local Taxation: Cases and Materials 888 (7th ed. 2001) ("Most state personal income taxes conform closely to the federal personal income tax.").

8. I.R.C. § 106 (Westlaw 2010); *id.* § 3121(a)(2) (Westlaw 2008).

9. *Compare id.* § 3121(a), *with* 42 U.S.C.A. § 409 (Westlaw 2008). *See* Maureen B. Cavanaugh, *On the Road to Incoherence: Congress, Economics, and Taxes*, 49 UCLA L. Rev. 685, 702–03 (2002).

10. *See* Susan R. Finneran, *Fringe Benefit or "Condition of Employment": Uniformity, Certainty, and Compliance*, 78 Nw. U. L. Rev. 198, 198–99 (1983).

11. *See, e.g.*, Christopher Falkenberg & Shira Zatcoff, *Employer-Provided Security and the Independent Security Study*, 112 Tax Notes 583, 583 (2006) ("Many corporations provide their senior executives with cars, drivers, and access to private aircraft.").

12. Kevin Flynn & Stephanie Strom, *Fine Perk for Museum Chiefs: Luxury Housing (It's Tax-Free)*, N.Y. Times (Aug. 10, 2010), http://query.nytimes.com/gst/fullpage.html?res=9C07EEDF1330F933A2575BC0A9669D8B63. *See generally* Jane Zhao, *Nights on the Museum: Should Free Housing Provided to Museum Directors Also Be Tax-Free?*, 62 Syracuse L. Rev. 427 (2012).

13. Flynn & Strom, *supra* note 12.

14. *See* Robert W. Turner, *A Variety of Forms of Compensation that are Not Taxed*, *in* NTA Encyclopedia of Tax'n & Tax Pol'y 159, 160–61 (Joseph J. Cordes et al. eds., 2d ed. 2005), *available at* http://www.taxpolicycenter.org/taxtopics/encyclopedia/Fringe-Benefits.cfm.

compensation,[15] incentivizing employees to prefer such benefits even when they might not do so otherwise. If all forms of compensation were taxed equally, many employees would likely reject fringe benefits in favor of cash income over which they would have greater control. They could then purchase the goods and services they prefer at prices that would more accurately reflect the demand for them.[16] In this manner, excluding fringe benefits from taxation reduces tax neutrality and creates economic inefficiency.[17]

This article examines the expansion of excludible fringe benefits that has characterized the long history of the federal income tax with a view to returning to first principles of general income inclusion, as propounded in § 61. However, full taxation of all fringe benefits glosses over important distinctions. Accordingly, the ultimate goal is to distinguish between fringe benefits that employers provide primarily for their own business purposes, which are appropriately excluded from an employee's taxable income, and fringe benefits that substitute for essentially personal expenditures made by an employer on an employee's behalf, which should not be so excluded.

Part II of this article examines the history of fringe benefits and the IRS's struggle to create a consistent framework for analyzing fringe benefit exclusions. Part II also demonstrates that the present confusion pervading the fringe benefit area is largely due to the use of varying theories and justifications for excluding fringe benefits that make no pretense of advancing historical tax policy objectives and are often outdated as well. Part III proposes a more straightforward framework to apply to existing and future fringe benefits by arguing that fringe benefits should be excluded from taxation only if they are necessary for employees to complete their duties or are required for closely calibrated administrability concerns. This framework is then applied to the more significant fringe benefit exclusions of the present IRC.

## II. HISTORICAL DEVELOPMENT OF FRINGE BENEFIT EXCLUSION

### *A. Pre-Statutory Administrative Determinations*

The term "fringe benefit" did not appear in Webster's Unabridged Dictionary until 1961,[18] but the concept of excluding certain employer-provided benefits from gross income has existed since the earliest days of the federal income tax. The Revenue Act of 1913 ("Revenue Act") provided that taxable net income "shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid . . . also from interest, rent, dividends, securities . . . or gains or profits and income derived from any source

15. *See id.*; *see also* Julie A. Roin, *United They Stand, Divided They Fall: Public Choice Theory and the Tax Code*, 74 Cornell L. Rev. 62, 62 (1988).

16. *See, e.g.*, Clark C. Havighurst, *The Backlash Against Managed Health Care: Hard Politics Make Bad Policy*, 34 Ind. L. Rev. 395, 399 (2001).

17. *See generally Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President*, 1 U.S. Dep't Treasury 1, 13 (1984), *available at* http://www.treasury.gov/resourcecenter/taxpolicy/Documents/tres84v1All.pdf.

18. Wayne M. Gazur, *Assessing Internal Revenue Code Section 132 After Twenty Years*, 25 Va. Tax Rev. 977, 981 n.14 (2006).

whatever."[19] Despite the broad scope of this language, the IRS quickly began creating nonstatutory exclusions to this provision. By 1921, the IRS had issued administrative decisions excluding from taxable income certain employer-provided meals and lodging,[20] employee death benefits,[21] group-term life insurance payments,[22] and rail passes provided to off-duty railroad employees and their families.[23]

Inconsistent application of these exclusions quickly turned fringe benefits into an area of immense confusion and escalating complexity.[24] With little available in terms of concrete rules, the IRS made subsequent exclusion decisions based on analogy, custom, and so-called "common sense."[25] Reliance on these techniques resulted in a gradual broadening of fringe benefit exclusions, a result inconsistent with the Revenue Act's general purpose of collecting income from "any source whatever."[26] This process is illustrated in the following specific contexts: meals and lodging, health and accident insurance, group-term life insurance, transportation passes, and holiday gifts.

### *1. Convenience of the Employer: Meals and Lodging*

The IRS's original justification for excluding fringe benefits was premised on an understanding that when an employee was required to accept benefits to fulfill his duties, that employee was not actually being compensated for services but was simply accommodating the employer.[27] This rationale came to be known as the "convenience of the employer" doctrine.[28] Many early applications of the doctrine involved employer-provided meals and lodgings,[29] but the IRS often sought to justify other benefits based on a similar connection to a taxpayer's employment.[30]

The first reference to the convenience of the employer doctrine occurred in a 1919 IRS decision, which provided that "[b]oard and lodging furnished to seamen in addition to their cash compensation is held to be supplied for the convenience of the employer."[31] The value of these benefits was excluded from the taxpayer's income.[32]

19. Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167.

20. O.D. 265, 1919-1 C.B. 71; O.D. 514, 1920-2 C.B. 90.

21. *See* Karla W. Simon, *Fringe Benefits and Tax Reform: Historical Blunders and a Proposal for Structural Change*, 36 U. Fla. L. Rev. 871, 889 (1984).

22. T.D. 2992, 1920-2 C.B. 76.

23. O.D. 946, 1921-4 C.B. 110.

24. Simon, *supra* note 21, at 879.

25. Gazur, *supra* note 18, at 982; *see also* Simon, *supra* note 21, at 879.

26. Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167; Simon, *supra* note 21, at 879.

27. Comm'r v. Kowalski, 434 U.S. 77, 85 (1977); Simon, *supra* note 21, at 897.

28. *Kowalski*, 434 U.S. at 84.

29. *See, e.g.*, O.D. 265, 1919-1 C.B. 71.

30. *See, e.g.*, O. 1014, 1920-2 C.B. 88; O.D. 514, 1920-2 C.B. 90.

31. O.D. 265.

32. *Id.*

While not explicitly referencing the doctrine by name, a second 1919 IRS decision held that maintenance payments provided to Red Cross workers were taxable to the extent that they exceeded the workers' actual living expenses.[33]

At the time these rulings were promulgated, nothing in the statutory definition of taxable income indicated that benefits provided for the convenience of the employer were exempt from taxation.[34] Nonetheless, these early determinations showed that the IRS was not prepared to classify every employer-provided benefit as taxable income. Some commentators subsequently suggested that these rulings were based on an assumption that the employees "had to be present where they were, not because they desired it but rather because there was no other way that the duties could be performed."[35] If the benefits provided to these taxpayers were necessary for them to perform their duties, the IRS likely considered the benefits to be no more than tools of the trade, rather than compensation as such.

In 1920, the IRS modified the existing tax regulations to reflect the creation of the doctrine, providing that:

> 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.[36]

That same year, the IRS expanded the convenience of the employer exclusion by ruling that "supper money" provided to an employee working overtime hours "is considered as being paid for the convenience of the employer and for that reason does not represent taxable income to the employee."[37] Two additional facts from the supper money determination are worth mentioning. First, the ruling addressed an employee "who voluntarily performs extra labor for his employer."[38] Second, the exclusion was not applied to actual in-kind benefits, but to cash given for a purportedly noncompensatory purpose.[39]

Unsurprisingly, the IRS had a difficult time reconciling the differences between these early decisions. The voluntary nature of overtime labor in the supper money decision seems distinguishable from the factual scenarios presented in the 1919 decisions. In the seamen decision, the employee was provided in-kind benefits and, based on the nature of his duties, was required to be on the ship to perform his

33. O.D. 11, 1919-1 C.B. 66.

34. Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167; Lawrence Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 Duke L.J. 829, 842–43 (2012).

35. Simon, *supra* note 21, at 897.

36. T.D. 2992, 1920-2 C.B. 76.

37. O.D. 514, 1920-2 C.B. 90.

38. *Id.*

39. *See id.*

work.[40] Voluntarily performing extra labor, when an employee is presumably free to reject working the extra hours, is hardly comparable to being forced to remain on a ship to complete one's duties. If the 1919 rulings were based on an understanding that employer-provided benefits were necessary for the employees to complete their duties, it was unclear how excess voluntary labor fits into this framework.

Convenience of the employer determinations expanded in 1920, but the IRS drew no clear line between the seemingly distinct seamen and supper money decisions. Rulings issued in 1921 further extended the doctrine to camp lodgings provided to employees of the Indian Service (presently, the federal Bureau of Indian Affairs) so long as it did not consider the right to use the lodging as part of the employees' compensation,[41] and to employees engaged in the fish canning industry "[w]here, from the location and nature of the work, it is necessary that employees engaged in fishing and canning be furnished with lodging and sustenance by the employer."[42]

The divergent readings of the IRS's determinations resulted in the development of two variations of the convenience of the employer doctrine: the "employer-characterization" model and the "business-necessity" model. The employer-characterization model focused on whether the employer intended the benefit to be considered compensation and reflected the supper money exclusion.[43] In *Jones v. United States*, the court relied on this variation of the doctrine in holding that neither the value of lodgings provided to an army officer nor a cash commutation for subsistence provided in lieu of lodgings constituted taxable income.[44] The *Jones* court based its holding on "custom," noting that congressionally appropriated sums were considered distinct from compensation for other state employees (including judges), and on the premise that providing lodging to an officer was a military necessity.[45]

The alternative model focused on the underlying facts and circumstances of the taxpayer's employment to determine whether the benefit was actually necessary for the business to function properly, reflecting the seaman exclusion.[46] The business-necessity model found judicial support in *Van Rosen v. Commissioner*, a case presenting facts similar to *Jones* but reaching the opposite result.[47] Van Rosen was a civilian ship captain employed by the army.[48] While his ship was being repaired, he was given a cash allowance to secure lodging.[49] The court held that the cash constituted taxable

40. *See* O.D. 265, 1919-1 C.B. 71.

41. O.D. 914, 1921-4 C.B. 85.

42. O.D. 814, 1921-4 C.B. 84–85.

43. *See* Comm'r v. Kowalski, 434 U.S. 77, 84–85 (1977).

44. 60 Ct. Cl. 552, 567–68 (1925).

45. *Id.*

46. *See Kowalski*, 434 U.S. at 85; O.D. 265, 1919-1 C.B. 71.

47. *See* 17 T.C. 834, 837 (1951).

48. *Id.* at 834.

49. *Id.* at 835.

income because the benefit was not necessary for Van Rosen to perform his duties as a ship captain.[50]

Additional cases and IRS publications in the 1950s did little to reduce taxpayer confusion.[51] In light of these conflicting doctrines and decisions, Congress enacted § 119 to establish when meals and lodging furnished by an employer can be excluded from an employee's taxable income.[52] This provision embraced the business-necessity model as the statutory convenience of the employer test.[53] To eliminate any residual doubts, the U.S. Supreme Court definitively interpreted § 119 as embracing this view in *Commissioner v. Kowalski*.[54]

### *2. Health and Accident Insurance*

A similar pattern of IRS pronouncement, followed by statutory codification, characterizes one of the most costly and most controversial fringe benefits—namely, employer-provided health and accident insurance for employees. In this circumstance, there was no effort to cast this exclusion as something provided for the employer's convenience, at least as that concept had been understood to that point. Instead, the origin of this benefit relates to World War II and the then-typical pattern of wartime-induced wage and price inflation.[55] With large numbers of workers taken off the employment rolls to implement the war effort, those workers who remained available for employment were in short supply and employers felt the need to increase wages in light of the changed supply-and-demand dynamics.[56]

To prevent such wage increases, the U.S. government limited employers' ability to raise workers' wages to reflect the new employment realities.[57] Since wage increases were thus limited, some employers began to provide health and accident insurance to their employees.[58] In what would become an incredibly pivotal decision for U.S. health care, and for the American economy more generally, the federal government went along with this rather transparent effort to evade the wage restrictions it had imposed. To be sure, health insurance at that time was a relatively novel concept and was fairly inexpensive. In any case, the IRS subsequently ruled that employees did

50. *Id.* at 838.

51. *See Kowalski*, 434 U.S. at 84 (discussing the history of the convenience of the employer doctrine).

52. *Id.* at 90–91 (citing H.R. Rep. No. 83-1337, at 18 (1954), S. Rep. No. 83-1622, at 19 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4649).

53. *Id.* at 93.

54. *Id.* The *Kowalski* Court held that cash reimbursements paid to state highway patrol officers for lunches while on duty were not excludible as meals provided by an employer. *Id.* at 95.

55. *See History of Health Insurance Benefits*, Emp. Benefit Res. Inst. (Mar. 2002), http://www.ebri.org/publications/facts/index.cfm?fa=0302fact.

56. *Id.*

57. *See* David Blumenthal, *Employer-Sponsored Health Insurance in the United States—Origins and Implications*, 355 New Eng. J. Med. 82, 83 (2006).

58. *Id.*

not need to include the value of health insurance premiums paid by their employers in their taxable income.[59]

Nearly a decade after World War II, Congress codified this determination in § 106, which provides that gross income "does not include employer-provided coverage under an accident or health plan."[60] Although the full ramifications of this provision are beyond the scope of this article, this seemingly innocuous fringe benefit tax exclusion led to the development of more comprehensive health insurance. After all, the increased cost of health insurance that covers every check-up and influenza vaccination receives tax-favored treatment when compared to increased wages that would otherwise pay for such costs.[61] Furthermore, the tax-favored treatment of employer-provided health insurance led directly to the pervasive practice of U.S. employees looking to their employers for health insurance[62]—a phenomenon that is largely unique among developed economies.[63] Not until the implementation of the Patient Protection and Affordable Care Act,[64] or ObamaCare, had any significant effort been made to sever the connection between employment and health insurance—a connection with far-reaching consequences for both domains.

### *3. Group-Term Life Insurance*

The IRS's early struggles to consistently apply a clearly defined test for the convenience of the employer doctrine extended beyond meals and lodging into an area that seems completely unrelated—namely, group-term life insurance. When the IRS first considered the tax consequences of employer-provided group-term life insurance premiums, it concluded that these payments were deductible for the employer and taxable income for the employee.[65] This conclusion was based on an understanding that reasonable premiums are "clearly a legitimate expense of the corporation, being in the nature of additional compensation to the employees."[66]

In a 1920 Solicitor's Law Opinion, the IRS changed positions, establishing that employer-provided group-term life insurance was not part of an employee's taxable

59. Special Ruling, 433 Standard Fed. Tax Serv. (CCH), ¶ 6587 (Nov. 24, 1943).

60. I.R.C. § 106(a) (Westlaw 2010).

61. *See* Richard L. Kaplan, *Who's Afraid of Personal Responsibility? Health Savings Accounts and the Future of American Health Care*, 36 McGeorge L. Rev. 535, 546–47 (2005).

62. *Id.* at 538–39.

63. *See* Karen Davis, *Slowing the Growth of Health Care Costs—Learning from International Experience*, 359 New Eng. J. Med. 1751, 1751 (2008) ("The United States spends twice per capita what other major industrialized countries spend on health care but is the only one that fails to provide near-universal health insurance coverage."). *See generally* Robert Kuttner, *Market-Based Failure—A Second Opinion on U.S. Health Care Costs*, 358 New Eng. J. Med. 549 (2008).

64. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

65. O. 1014, 1920-2 C.B. 88.

66. *Id.*

income.[67] The IRS concluded that the only benefit an employee received under the plan was "the feeling of contentment that provision has been made for dependents," as the dependents were the only ones to receive the monetary benefits of the plan.[68] Interestingly, the IRS concluded that the payments were deductible to the corporation as an "ordinary and necessary expense[]" because premiums are not compensation to the employee "but an investment in increased efficiency" that lasts only while the employee is employed.[69] Although premiums for group-term life insurance thus received favorable tax treatment, premiums for individual and group-permanent life insurance did not.[70]

This position continued until it was codified in § 79 by the Revenue Act of 1964.[71] In drafting § 79, Congress recognized the inequitable effect of excluding group-term life insurance premiums while taxing premiums paid for other insurance policies.[72] Congress further rejected the IRS's rationale for the exclusion, noting that "the employee . . . receives a substantial economic benefit from this insurance protection whether or not the policy for a specific year leads to a payment to his beneficiary."[73] Nonetheless, § 79 continues to exclude from taxation the cost of any group-term life insurance provided by an employer to the extent that the face value of such insurance does not exceed $50,000.[74] The cost of any insurance over this threshold is taxable to the employee.[75]

This peculiarly Solomonic resolution elides the notion that this fringe benefit has any significant business rationale to the employer providing such insurance, especially since the $50,000 threshold has not been adjusted for inflation in the half century since its enactment.[76] Indeed, many employees are unaware that this provision even exists until they find additional income in their end-of-year tax statement representing the employer's premium cost for life insurance exceeding the $50,000 threshold. To be sure, this insurance is not permanent and often ends when a worker's employment

67. *Id.*

68. *Id.*

69. *Id.* at 89; *see also* Lee v. United States, 219 F. Supp. 225, 229 (W.D.S.C. 1963) (distinguishing group-term life insurance premiums from individual plans and noting that the former are an investment in increased employee efficiency).

70. *Lee*, 219 F. Supp. at 229.

71. Simon, *supra* note 21, at 905.

72. H.R. Rep. No. 88-749, pt. 2, at 1030 (1963).

73. *Id.* at 1064.

74. I.R.C. § 79(a)(1) (Westlaw 2012).

75. *Id.*

76. Using the Consumer Price Index from the U.S. Department of Labor's Bureau of Labor Statistics, the $50,000 threshold would be approximately $376,000 adjusted through November 2013. U.S. Dep't of Labor, *C.P.I. Inflation Calculator*, Bureau Lab. Stat., http://data.bls.gov/cgi-bin/cpicalc.pl (last visited Jan. 25, 2015).

terminates,[77] but until then, an employee can designate who will receive the insurance proceeds upon the employee's death.[78] In other words, such insurance functions just like term insurance that an employee might purchase on own initiative.

*4. Transportation Passes and Holiday "Gifts"*

Beyond the convenience of the employer doctrine, certain employer-provided fringe benefits were excluded by the IRS on the rationale that they constituted gifts. The concept of a "gift" in the early days of the IRC was more expansive before the 1986 statutory amendment declaring that gifts do not include "any amount transferred by or for an employer to, or for the benefit of, an employee."[79]

In 1921, the IRS held that personal transportation passes provided to railroad employees and their families were considered gifts when not required in the employment contract.[80] Nearly sixty years later, the tax court observed that treating free railroad passes as anything other than additional compensation is "out of touch with reality,"[81] but the gift/compensation distinction has had strong traction with taxpayers. Indeed, the railroad ruling would later be invoked to justify excluding free airplane tickets provided to airline employees.[82] The IRS continued to allow this exclusion even after the U.S. Supreme Court narrowed the definition of a gift[83] in *Commissioner v. Duberstein*.[84]

In 1959, the IRS ruled that the value of a Christmas turkey, ham, or other merchandise of similar nominal value would not constitute income or be subject to wage withholding if the gifts were part of a general distribution to employees to promote goodwill.[85] Similar to the rationale in the original group-term life insurance exclusion, the IRS held that the value of these items was deductible as an ordinary and necessary business expense if distributed primarily for the business purpose of promoting good relations among employees.[86] Although the IRS paid particular

77. *See* Treas. Reg. § 1.79-1(b) (Westlaw 2005) (providing that group-term life insurance may not provide a "permanent benefit").

78. Lauren Bikoff et al., U.S. Master Employee Benefits Guide 504 (2013 ed. 2013).

79. I.R.C. § 102(c)(1) (Westlaw 1986) (originally enacted as Tax Reform Act of 1986, Pub. L. No. 99-514, § 122(b), 100 Stat. 2085, 2110).

80. O.D. 946, 1921-4 C.B. 110 ("Personal transportation passes issued by a railroad company to its employees and their families, to be used when not engaged on business for the company, and which are not provided for in the contracts of employment, are considered gifts and the value thereof does not constitute taxable income to the employees.").

81. Zelenak, *supra* note 34, at 843; *see* Zager v. Comm'r, 72 T.C. 1009, 1014 n.3 (1979), *action on dec.*, 1980-67 (Dec. 19, 1979), *aff'd sub nom*. Martin v. Comm'r, 649 F.2d 1133 (5th Cir. 1981).

82. *Zager*, 72 T.C. at 1013–14; *see* Wendy Gerzog Shaller, *The New Fringe Benefit Legislation: A Codification of Historical Inequities*, 34 Cath. U. L. Rev. 425, 429 (1985).

83. *See* Shaller, *supra* note 82, at 429.

84. 363 U.S. 278 (1960).

85. Rev. Rul. 59-58, 1959-1 C.B. 17.

86. *Id.*

attention to the small amounts involved and the gift-like nature of the items, it was careful to note that its ruling would not apply to "cash, gift certificates, and similar items of readily convertible cash value, regardless of the amount involved."[87]

After articulating this clear and unambiguous limit on the tax treatment of non-cash holiday gifts, holiday gifts in the form of $25 and $15 gift cards were excluded in *Hallmark Cards, Inc. v. United States*.[88] In the spirit of Christmas, the court held that the clear intention of the company was to provide gifts to its employees.[89] The court reasoned that the gift cards were no more than a means of promoting goodwill among employees because they were relatively small in value and not readily convertible into cash.[90]

Similarly, in *Zager v. Commissioner*, employer discounts provided to retail employees were considered exempt from gross income on the same rationale.[91] The *Zager* court noted that these discounts "have traditionally been treated as non-taxable, notwithstanding the familiar and oft-repeated statement that in considering what is to be included in gross income Congress intended to use its power to the full extent."[92] It appears that the IRS analogized this position from its earlier holiday cases, excluding the discount from gross income when it was of a relatively small value provided to promote employee health, goodwill, or efficiency.[93]

### *B. The Reforms of 1984*

Even after Congress began codifying fringe benefit provisions in 1954, a large number of nonstatutory fringe benefits continued to exist. Recognizing the confusion generated from six decades of inconsistent rulings, the IRS felt that better guidance was required for the treatment of nonstatutory fringe benefits. During 1975 and 1976, the IRS attempted to end confusion by formally recognizing certain nonstatutory fringe benefits.[94] But this effort met considerable criticism,[95] and Congress then enacted legislation to prohibit the issuance of final regulations relating to fringe benefits[96] while it sought to formulate the best way to treat these exclusions.[97]

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87. *Id.*

88. 200 F. Supp. 847, 850 (W.D. Mo. 1961).

89. *Id.*

90. *Id.*

91. 72 T.C. 1009, 1013–14 (1979).

92. *Id.*

93. Gazur, *supra* note 18, at 985.

94. Shaller, *supra* note 82, at 429–30.

95. *Id.*

96. Act of Oct. 7, 1978, Pub. L. No. 95-427, § 1(a), 92 Stat. 996, 996.

97. H.R. Rep. No. 98-432, at 286 (1983), *reprinted in* Bernard D. Reams, Jr., 3 Tax Reform 1984: A Legislative History of the Tax Reform Act of 1984: The Law, Reports, Hearings, Debates and Related Documents 3 (1985) [hereinafter Tax Reform History].

Thirty years ago, Congress enacted its solution in the Deficit Reduction Act of 1984.[98] Section 132 was designed to simplify the IRC, prevent tax benefits from causing distortions in economic behavior, and improve the fairness and efficiency of the tax system.[99] To that end, Congress fashioned four general categories of tax-free fringe benefits, but without any consistent underlying rationale. These categories are now described briefly and then evaluated, after which, subsequently added exclusions will be considered.

*1. General Fringe Benefit Exclusions*

One such category excludes benefits for which the employer incurs no "substantial additional cost,"[100] and the classic examples include using an otherwise empty hotel room or flying in an otherwise unoccupied airline seat.[101] A second general category covers employee discounts within stipulated limits—namely, the gross profit percentage for goods[102] and 20% for services.[103] Interestingly, these two fringe benefit categories are subject to a nondiscrimination rule that precludes the application of these exclusions to "highly compensated employees" unless the particular exclusion is available "on substantially the same terms" to a broadly defined classification of employees.[104] The details implementing this rule are set forth in the Treasury Regulations ("Regulations"),[105] but the main point here is that this requirement explicitly recognizes the importance of fairness issues in the fringe benefit area, as noted earlier in this article.[106]

The other two general categories—namely, working condition and de minimis benefits—speak directly to how fringe benefit exclusions often originated and to their appropriate scope according to this article. Working condition fringes are benefits "that, if the employee paid for [them], such payment would be allowable as a [trade or business] deduction."[107] Benefits excludable under this provision include "property or services [that] reasonably can be expected to occur in connection with the employee's performance."[108]

98. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 531(a)(1), 98 Stat. 494, 877–81 (adding I.R.C. § 132).

99. Tax Reform History, *supra* note 97, at 42.

100. I.R.C. § 132(a)(1) (Westlaw 2013).

101. Treas. Reg. § 1.132-2(a)(2) (Westlaw 1989).

102. I.R.C. § 132(a)(2), (c)(1)(A), (c)(2)(A)(i)–(ii).

103. *Id.* § 132(c)(1)(B).

104. *Id.* § 132(j)(1).

105. *See* Treas. Reg. § 1.132-8(a)(i)–(ii) (Westlaw 1989).

106. Finneran, *supra* note 10, at 199 n.11.

107. I.R.C. § 132(d).

108. *Rules for the Federal Tax Treatment of Fringe Benefits: Hearing on H.R. 3525 Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means*, 98th Cong. 60 (1983), *reprinted in* Bernard Reams, Jr., 11 Tax Reform 1984: A Legislative History of the Tax Reform Act of 1984: The Law, Reports, Hearings, Debates and Related Documents (1985) (explaining H.R. 3525's working condition fringe definition).

Receipts of cash payments by an employer must be verified with adequate records,[109] and any amount unspent must be returned to the employer.[110]

Although the working condition fringe benefit exclusion does not employ the convenience of the employer rubric, it embodies a correlative notion of business-necessity by incorporating the "ordinary and necessary" standards that § 162 requires for the deduction of "trade or business" expenses.[111] In effect, this exclusion recognizes that if an employer provides a benefit that the employee could otherwise deduct, the cleanest administrative approach is to ignore the transaction entirely.[112] Despite this approach, some benefits—such as employer-provided outplacement counseling[113] and voluntary employee fishing trips[114]—have been excluded under this provision.

The exclusion for de minimis fringe benefits is unassailably sensible. The law should not bother with "any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable."[115] Classic examples include free "coffee, doughnuts, and soft drinks."[116] With that being said, the current Regulations exclude certain benefits such as "occasional personal use of an employer's copying machine"[117] that could easily be rendered accountable using modern technology.[118]

### *2. Evaluating the General Fringe Benefit Exclusions*

Congress justified the preferential tax treatment of these fringe benefits by relying on custom, administrative difficulties, and legitimate noncompensatory business purposes.[119] The House Report on the Deficit Reduction Act states that free transportation passes and employee discounts were "long established" and had been relied upon by taxpayers and the IRS for some time.[120] Administrative difficulties in keeping track of employee discounts and no-additional-cost services were also cited to

109. Treas. Reg. § 1.132-5(a)(1)(v)(B) (Westlaw 2010).

110. *Id.* § 1.132-5(a)(1)(v)(C).

111. I.R.C. § 162(a) (Westlaw 2011).

112. Gazur, *supra* note 18, at 1013.

113. Rev. Rul. 92-69, 1992-2 C.B. 51.

114. *See* Townsend Indus., Inc. v. United States, 342 F.3d 890, 891 (8th Cir. 2003).

115. I.R.C. § 132(e)(1) (Westlaw 2013).

116. Treas. Reg. § 1.132-6(e)(1) (Westlaw 1992).

117. *Id.*

118. *See, e.g.*, *Xerox Job Tracking Captures Data for Office Print Tracking*, Xerox, http://www.consulting.xerox.com/print-tracking/enus.html (last visited Jan. 25, 2015).

119. *See* Tax Reform History, *supra* note 97, at 286.

120. *See id.*

justify exclusion,[121] especially for airline passes.[122] Additionally, Congress felt there was a legitimate, noncompensatory business purpose justifying the qualified employee discount and no-additional-cost service provisions. [123] By way of example, the Committee Reports provided that "a retail clothing business will want its salespersons to wear, when they deal with customers, the clothing which it seeks to sell to the public."[124] To some congressional leaders, exclusions of travel passes to airline employees and discounts to retail employees were considered two of the "most important [exclusions] to many working taxpayers."[125] It is unclear who these "working taxpayers" might be outside of the retail and airline industries.

Congress's attempt to justify these exclusions through a business purpose is reminiscent of the IRS's early efforts to justify administrative exclusions based on employer convenience.[126] Applying different tests for employer convenience led to inconsistent rulings that ultimately forced congressional intervention to reconcile the discrepancies.[127] The business purpose articulated here is also reminiscent of the "increased efficiency" rationale offered by the IRS in its initial exclusion of group-term life insurance.[128] But, unlike traditional convenience of the employer determinations, these exclusions are not necessary for an employer's business to function.[129]

The administrative difficulties of reporting employee discounts and no-additional-cost services are also suspect. Even assuming that the recordkeeping burden is too onerous for these benefits to be taxable—which is not a convincing argument given the IRS's ability to value prize money and gratuitous tips[130]—administrative concerns do not justify broadening the definition of an employee to include his *parents*, as is the case with airline passes.[131]

### *3. Subsequently Added Exclusions*

Section 132 has subsequently been amended to exclude additional benefits that are even further afield from whatever rationale the 1984 reforms sought to implement.[132] Less than a decade after those reforms were enacted, Congress decided to increase the United States' environmental consciousness by creating fringe benefit exclusions for

121. Shaller, *supra* note 82, at 430–31.

122. *Id.* at 436.

123. *See* Tax Reform History, *supra* note 97, at 286.

124. *Id.*

125. *Id.* at 1308.

126. *See, e.g.*, O.D. 814, 1921-4 C.B. 84; O.D. 914, 1921-4 C.B. 85.

127. *See supra* text accompanying notes 71–90.

128. O. 1014, 1920-2 C.B. 88–89.

129. *See* Shaller, *supra* note 82, at 428.

130. *See id.* at 436–38.

131. I.R.C. § 132(h)(3) (Westlaw 2013).

132. *See generally id.* § 132 (originally enacted as Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494).

employer-provided mass transit passes, employer-run commuter vehicles, and parking near an employer's premises[133]—even though subsidizing such parking would seem to undercut efforts to reduce energy consumption.[134] Nearly a decade after those additions were made, employer-provided retirement planning services were added to the list of exclusions,[135] although the nondiscrimination rule that previously was restricted to no-additional-cost services and employee discounts was extended to this particular benefit.[136] The most recent addition to this increasingly diverse collection of provisions was added to assist those Americans who are affected by the closing of military bases.[137] As a result, the barely coherent scheme of § 132 has become less so due to subsequent legislative additions.

## III. RETHINKING THE EXCLUSION OF FRINGE BENEFITS

The tax reform effort of thirty years ago was not an effective temporizing solution. It provided few convincing reasons for taxing some fringe benefits and not others, and it failed to stem the proliferation of additional exclusions. It is time for a different approach to this perennial problem. It is time to take seriously the IRC's imperative to tax compensation regardless of the form it takes, including most fringe benefits.[138]

Despite the enormous changes that have taken place during the century of the federal income tax law's existence, the IRS's original effort to distinguish between business-necessitated benefits that facilitate the enterprise of the employer and benefits that substitute for wages remains sound. Accordingly, a comprehensive effort should be undertaken to draw this line of demarcation as clearly as possible without regard to historic "custom" and similar theoretical shortcuts. In this regard, the IRS's 1984 approach should be renewed and applied with a presumption that *all* fringe benefits are taxable unless they predominantly benefit the employer or are necessary to avoid onerous recordkeeping. In other words, exclusions should be limited to those fringe benefits that are necessary to complete employment tasks in line with the original personal/employer-necessity distinction drawn by the IRS.[139]

Under this framework, primarily personal benefits would be included in income while benefits that are necessary for an employee to complete an employer's task are excludable. Factors such as the value of the provided good or service and whether readily available noncompensatory alternatives exist to accomplish the employer's

133. *Id*. § 132(f)(1), *amended by* Energy Policy Act of 1992, Pub. L. No. 102-486, § 1911(b), 106 Stat. 2776, 3012–13.

134. *See generally* Jennifer L. Shoulberg, *Pedaling Toward a More Equitable Tax-Ride for Cyclists*, 55 St. Louis U. L.J. 423 (2010).

135. I.R.C. § 132(m)(1), *amended by* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 665(b), 115 Stat. 38, 143.

136. *Id.* § 132(m)(2).

137. *Id.* § 132(n)(1), *amended by* Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, § 103(b), 117 Stat. 1335, 1337–38.

138. *See generally id.* § 132.

139. *See, e.g.*, O.D. 265, 1919-1 C.B. 71; Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167.

goals should be considered in making this determination. An employer's assessment that a particular benefit is necessary would not be controlling, and each case would require an objective analysis of the underlying facts and circumstances.[140] De minimis items that are legitimately too difficult to administer would continue to be excluded.

The results of this approach would be more equitable and more efficient than the current model, which eliminates nearly all of the fringe benefit exclusions that are currently available. Eliminating these exclusions would simplify the IRC, further easing the cost of taxpayer compliance. Applications of this approach to the fringe benefits previously described now follow, beginning with health and accident insurance, group-term life insurance, the specific exclusions of § 132, and finally, meals and lodging.

### *A. Health and Accident Insurance*

Tackling first the biggest elephant in the proverbial room, there is no inherent reason for employer-provided health and accident insurance to be a tax-free fringe benefit. Other than the obvious reality that employers need healthy workers, health insurance is about as personal a benefit as one can imagine. The idea that employers should design policy options and alternatives for a diverse workforce that has little in common beyond their source of employment is both wrong-headed and dangerous.[141] Employees may be single or married, healthy or not quite so healthy, smokers, exercisers, food addicts, drug abusers, etc. These characteristics, and many others, play important roles in determining the most appropriate health insurance that an employee might prefer. The employer is not in the best position to assess the varying preferences of its employees and would not have accepted this burden but for a policy developed over seventy years ago to avoid wartime constraints on allowable pay increases.[142] No other developed economy assigns such a major role to employers in securing health insurance coverage for its citizens. That an employer's highest prerogative in this context is cost minimization further underscores the poor fit that health insurance has as a tax-free fringe benefit. On the proposed divide between business-necessity and personal-expenditure surrogate, health insurance clearly falls within the personal-expenditure category.

Though this article is about tax policy, a proposal to end the exclusion for health insurance necessarily requires some non-tax exposition. It is worth noting, for example, that eliminating the exclusion for health insurance would have additional salutary benefits in dissolving the tie between employment and health insurance. Losing one's job would no longer mean losing one's health insurance as well.

Another salutary benefit would be ending "job lock," the phenomenon whereby employees may stay with an employer longer than they would otherwise because they

140. Bob Jones Univ. v. United States, 670 F.2d 167, 169, 174 (Ct. Cl. 1982) (quoting Dole v. Comm'r, 43 T.C. 697, 706 (1965), *aff'd per curiam*, 351 F.2d 308 (1st Cir. 1965)).

141. *See* Kaplan, *supra* note 61, at 536–37.

142. *See supra* notes 55–59 and accompanying text.

or their families need the health insurance their employer provides.[143] When President Obama's health reform law is fully implemented, employees will be able to secure health insurance regardless of health status.[144] Indeed, preexisting conditions that preclude health insurance coverage have historically been a major benefit of securing health insurance through an employer. But if employees can obtain such insurance regardless of their medical history, there is less reason to preserve a link between employment and health insurance that was never deliberately fashioned.

Severing the employment-insurance linkage would also eliminate many of the intrusive efforts of some employers to monitor employees' health and personal habits regarding diet, exercise, smoking, and other non-work related behaviors.[145] If an employer pays for health insurance, the employer has a facially legitimate claim to knowing about the factors that determine its costs. *A fortiori*, if health insurance is not an employer-provided benefit, these inherently personal aspects of an employee's life should be off-limits to employers. Finally, terminating health insurance as a tax-free fringe benefit would eliminate the exclusion's present incentive to have expensive first-dollar coverage. Instead, Americans would approach health insurance as they do home and automobile insurance: buy insurance to cover large unanticipated expenses but pay for smaller, more predictable expenditures directly.[146] The present tax exclusion encourages the opposite approach by substituting tax-free health insurance for taxable compensation. Quite apart from tax policy reasons, the fringe benefit exclusion for employer-provided health insurance should be eliminated as part of a general rationalization of how Americans finance their health care costs.

### *B. Group-Term Life Insurance*

As noted previously, the enactment of § 79 with its unadjusted $50,000 limitation dissolved any coherent rationale for excluding employer-provided group-term life insurance.[147] Such insurance provides almost exclusively personal benefits. It does not enhance, let alone facilitate, an employee's ability to accomplish his assigned duties. Life insurance is widely available to the public and many employees, particularly those without family responsibilities, who might forgo such coverage if their employer did not provide such insurance. Applying the business-necessity

143. *See* David A. Hyman & Mark Hall, *Two Cheers for Employment-Based Health Insurance*, 2 Yale J. Health Pol'y L. & Ethics 23, 28 (2001).

144. 42 U.S.C.A. § 300gg-3(a) (Westlaw 2011), *amended by* Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1201(2)(A), 124 Stat. 119, 154 (2010).

145. *See, e.g.*, Howard M. Leichter, *"Evil Habits" and "Personal Choices": Assigning Responsibility for Health in the 20th Century*, 81 Milbank Q. 603, 609 (2003) (noting that some employers decline to hire smokers while others increase cost-sharing for overweight employees); Kris Maher, *Companies are Closing Doors on Job Applicants Who Smoke*, Wall St. J. (Dec. 21, 2004, 12:01 AM), http://online.wsj.com/news/articles/SB110358443336005295.

146. *See* Kaplan, *supra* note 61, at 566–67.

147. *See supra* notes 71–78 and accompanying text.

versus personal framework, group-term life insurance should not be a tax-free fringe benefit, even to the limited extent that it is today.

### *C. No-Additional-Cost Services and Employee Discounts*

The current exclusions for no-additional-cost services and employee discounts should be eliminated as well. These benefits are not necessary for an employee to complete his appointed tasks. To think that a retail worker cannot stock shelves, check out customers, or otherwise perform his duties without an employee discount is preposterous. Similarly, airline employees could continue to maintain airplanes, attend to customers, and fly airplanes without off-duty passes for free flights. Indeed, the availability of airline passes to family members,[148] including parents of employees,[149] makes any business-necessity claim laughable on its face. These benefits quite simply represent compensation in another form and should be taxed as such. Eliminating the present exclusions for them would have the additional administrative benefit of no longer needing to apply the inherently ambiguous nondiscrimination test[150] because that test pertains primarily to the no-additional-cost services and employee discount fringe benefit provisions.[151]

Despite the airline industry's original administrative concerns, web-based solutions and other services now provide deals on last-minute flights, which make determining the fair market value of these flights far easier than when the provision was first enacted.[152] Alternatively, the value of these flights could be determined in the same way as tips or prizes.[153] The bottom line is that these benefits no longer make sense under either an employer-necessity or administrative rationale.

### *D. Working Condition and De Minimis Fringes*

Under an employer's business-necessity test, working condition fringe benefits would continue to be excludible as long as they are necessary for employees to fulfill their duties. Business use of company-provided transportation, as well as office equipment and other tools of the modern workplace such as cell phones and similar items, would therefore experience no change in tax treatment—assuming that appropriate documentation of such business use is undertaken. After all, such documentation is presently required for businesses to deduct travel and related

148. I.R.C. § 132(h)(2) (Westlaw 2013).

149. *Id.* § 132(h)(3). See generally Joel S. Newman, *Fly Me, Fly My Mother*, 35 Tax Notes 291 (1987), for a comprehensive and insightful history of this extension.

150. Treas. Reg. § 1.132-8(d) (Westlaw 1989).

151. *Id.*; I.R.C. § 132(a)(1)–(2), (j)(1).

152. Services like Priceline.com and Expedia claim to offer the best deals on "last minute" airfare by comparing the prices of flights offered across multiple airlines. *See, e.g.*, Priceline.com, http://www.priceline.com (last visited Jan. 25, 2015); Expedia, http://www.expedia.com/Flights#tab-deals_item_2 (last visited Jan. 25, 2015).

153. *See* Shaller, *supra* note 82, at 436–38.

costs,[154] so this requirement is neither burdensome nor unprecedented. Other benefits, such as employer-provided outplacement services and fishing trips, however, would not meet the new standard. While these services may be tangentially related to employment, they are not necessary for an employee to perform his job. These examples show that as long as any fringe benefits are tax-free, the necessity for careful line-drawing will not completely disappear—but at least its problematic scope can be minimized.

Similarly, de minimis fringe benefits would continue to be excludible, but only to the extent that there are genuine administrative difficulties in accounting for these benefits. This article does not propose changing the present statutory de minimis standard, but it insists on a stricter application of that standard. Employers should not have to bear excessive costs to comply with the IRC, but given the possibility of under-the-radar abuse, close monitoring is certainly appropriate. Employers, moreover, can always decide that the effort to provide these benefits is not worth the hassle and inconvenience, and provide cash remuneration instead.

Under this article's framework, the exclusions currently allowed in the Regulations for overtime meals, meal money, or local transportation[155] would be eliminated. Providing cash to employees for these items can easily be accounted for, especially via electronic media such as debit cards and similar prepaid mechanisms. Moreover, the supper money ruling[156] that undergirds the exclusion in the current Regulations involved an employee who voluntarily worked overtime. In an era when work hours are increasingly flexible, there is little justification for this exclusion to continue.

### *E. Transportation Expenditures and Retirement Planning*

The fringe benefit exclusions for transportation costs and retirement planning reflect laudable non-tax policy objectives but have no place in the business-necessity approach to this area. These provisions encourage employers to subsidize all types of commuting expenses from mass transit[157] to special "commuter highway vehicles"[158] that may carry as few as six passengers (excluding the driver)[159] to parking for individual passenger automobiles "on or near the business premises of the employer."[160]

Commuting expenses have long been recognized as personal expenditures that cannot be deducted[161] and are classified as nondeductible "personal, living, or family

154. I.R.C. § 274(d) (Westlaw 2005).

155. Treas. Reg. § 1.132-6(d)(2) (Westlaw 1992).

156. O.D. 514, 1920-2 C.B. 90.

157. I.R.C. § 132(f)(1)(B), (f)(5)(A)(i) (Westlaw 2013).

158. *Id.* § 132(f)(1)(A), (f)(5)(B).

159. *Id.* § 132(f)(5)(B)(i). In addition, at least 80% of the mileage of such vehicles must "be reasonably expected" to be transporting employees between their homes and their workplace on trips during which employees occupy at least half of the "adult seating capacity" of the vehicle. *Id.* § 132(f)(5)(B)(ii).

160. *Id.* § 132(f)(1)(C), (f)(5)(C).

161. Treas. Reg. § 1.162-2(e) (Westlaw 1960).

expenses."[162] As the applicable Regulations provide, "[t]he taxpayer's costs of commuting to his place of business or employment are personal expenses."[163] In light of the inherently personal character of such expenses, the transportation fringe benefit provisions should be repealed in their entirety.

The present exclusion for retirement planning services[164] is equally problematic. Like transportation costs, expenses for retirement planning are not necessary for an employee to complete his duties. Indeed, retirement planning is explicitly about leaving the compensated workplace rather than fulfilling one's responsibilities while employed. For that reason alone, this exclusion should be repealed. Moreover, the present exclusion limits its benefits to "retirement planning advice or information"[165] and does not include other critical planning services such as "tax preparation, accounting, legal, or brokerage services."[166] It is difficult to discern any important distinction between the services that may be provided on a tax-favored basis and those that may not because all such services are inherently personal and are for the benefit of the employee rather than the employer. Furthermore, retirement planning is a major growth industry and there is no shortage of willing vendors to provide these services to any employee who wants them.[167] Inasmuch as these fringe benefits clearly substitute for expenditures that employees would make on their own, they should be taxable.

### *F. Meals and Lodging*

This article ends where it began, with meals and lodging provided for the convenience of the employer, as codified in § 119. The proposed fringe benefit framework, however, would return this provision to its roots and allow the exclusion only when employer-provided meals and lodging are necessary for an employee to complete his duties. It would also require more than a "substantial noncompensatory business reason" for the provision of meals as articulated in the current Regulations.[168] The definition of employee would also be limited to individuals currently working for the employer, removing existing exclusions for spouses and dependents.[169] These

162. I.R.C. § 262(a) (Westlaw 1988).

163. Treas. Reg. § 1.262-1(b)(5) (Westlaw 1972).

164. I.R.C. § 132(m)(1).

165. *Id.*

166. Internal Revenue Serv., *supra* note 1, at 6.

167. *See, e.g.*, Hilary Johnson, *Next Hot Industry? Retirement Planning*, Inv. News (Jan. 10, 2010, 12:01 AM), http://www.investmentnews.com/article/20100110/REG/301109994#; *Occupational Outlook Handbook: Personal Financial Advisors*, U.S. Dep't Lab. Bureau Lab. Stat., http://www.bls.gov/ooh/business-and-financial/personal-financial-advisors.htm (last visited Jan. 25, 2015) (describing the projected growth of personal financial advisors as "much faster than average"). Indeed, Kiplinger publishes *Retirement Report*, a monthly publication that is devoted exclusively to retirement planning. *Kiplinger's Retirement Report*, Kiplinger, https://www.kiplinger.com/store/krr (last visited Jan. 25, 2015).

168. Treas. Reg. § 1.119-1(a)(2)(i) (Westlaw 1985).

169. I.R.C. § 119(a) (Westlaw 1998).

restrictions reduce the likelihood that employer-provided lodging will simply be compensation in disguise.

What about those art museum directors living in multimillion dollar homes at their employer's expense while not recognizing any economic benefit from these arrangements? The museums in question claim that expensive lodging is necessary for their directors to entertain guests and receive donations, but it is not clear why lodging is required for this important job function. After all, would potential donors not be equally inclined to donate to the museum while being feted in the museum that they are being asked to support? Such a reasonable, noncompensatory alternative is just as viable and likely to be just as effective. Indeed, a 2010 survey by the Association of Art Museum Directors found that only 14% of its member organizations offered free housing to their executives, and at least one commentator believes that these benefits are not eligible for exclusion under the law as it stands today.[170] Employer-provided lodging for art museum executives should be included in these executives' gross income, absent a very clear showing of business necessity.

## IV. CONCLUSION

From the earliest days of the income tax system, Congress and the IRS have struggled to create a sensible framework for the treatment of fringe benefits. Springing from a natural impulse to not tax employees on economic benefits that employers provide for their own business purposes, the development of tax-free fringe benefits has metastasized to encompass a wide range of increasingly personal services. Indeed, these benefits usually have little, if anything, to do with accomplishing the objectives of the employer and everything to do with maximizing the potential for tax-free wage substitutes.

This article advocates a return to first principles to clear out the Augean Stable of fringe benefits and confine the scope of tax-free emoluments to those provided by employers pursuant to the exigencies and requirements of their business. No longer should health insurance, life insurance, employee discounts, airline passes, commuting expenses, and retirement planning services receive tax-free treatment simply because an employer is the nominal purchaser of items that employees could acquire on their own. Under this framework, the IRC would achieve significant simplification and be able to start its second century unencumbered by provisions that bedevil rationalization and complicate administrability at every turn. In addition, this approach would generate substantial revenue, increase fairness between taxpayers, and provide greater economic efficiency—a tough combination to beat.

170. *See* Zhao, *supra* note 12, at 429, 447–48.