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Gregory M. Fowler

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Fringe Benefits, Proposed Section 84, and Tax Policy

The question of whether or not to include fringe benefits in the gross income of an employee has been a much disputed subject. The author examines a recent proposed addition to the Internal Revenue Code which, if adopted, would result in an increase in inclusion of items of fringe benefits. Analyzing this proposed section from both a tax policy and efficiency standpoint, the author concludes that the proposed section is a movement in the right direction of fairness but perhaps does not go far enough.

I. INTRODUCTION

A. Scope

The currents of controversy surrounding the question of the inclusion of certain nonstatutory employee fringe benefits in the gross income of the employee, have generated extensive discussion among legal scholars, and within the administrative and legislative branches of government. It is well recognized that the


3. HOUSE WAYS AND MEANS COMMITTEE TASK FORCE ON EMPLOYEE FRINGE BENEFITS, DISCUSSION DRAFT BILL AND REPORT (1979), which would add a new section 84 to the Internal Revenue Code (see note 43 infra, discussing the text of the proposed § 84). 1979-10 STD. FED. TAX REP. (CCH) § 6156. Throughout this paper reference is made, alternatively, to "proposed section 84," or "section 84." In all
use of fringe benefits as compensation for services rendered results in substantial tax benefit to many high salaried, high tax bracket employees. Because many of these “percs” are not presently included in gross income, either by force of law, administrative practice, or by failure of taxpayers to declare them, the government is currently unable to reach the revenues lost by such exclusion from the tax base.

The present status of many of these “percs” and “benes” is uncertain, and a definitive resolution of this confused situation is not in sight. Congress has withdrawn from the Commissioner of Internal Revenue the authority to promulgate any final fringe benefit regulations until June, 1981. The present uncertainty stems from several factors including the failure of prior regulatory attempts, a belief by many that any rules drawn up by the Service would be too restrictive, and a manifestation of congressional inability (or unwillingness) to come to grips with this important issue.

This article will address the law and policy questions related to the inclusion or exclusion from gross income of items of fringe benefit. The cognate issue of deductibility by the employer is beyond this scope, and as such, will be mentioned only peripherally. Nor will this paper discuss the nebulous category of employee benefits that are presently allowed an explicit exclusion from gross income.

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6. President Carter has caviled against this flip-side aspect of certain fringe benefits by labelling it the “three-martini lunch.” Wall St. J., Sept. 29, 1977, at 1, col. 6. Presently, when dealing with allowable deductions for expenses incurred in the taxpayer’s trade or business that have a nondeductible feature of personal use or gratification, an allocation under the old Cohan rule is utilized (Cohan v. Commissioner, 39 F.2d 540, 543 (2nd Cir. 1939)), or, to the extent it applies (and it applies very broadly), I.R.C. §274. All section references made hereinafter are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. See also I.R.C. §262; Halperin, Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem, 122 U. Pa. L. Rev. 859 (1974).

7. Maximum $50,000 of insurance, exclusion of premiums paid on group term insurance (I.R.C. §79); certain employee death benefits (§101(b)); military injury or sickness benefits (§104(a)(4)); accident or health insurance benefits (§105); contributions to health or accident plans (§106); parsonage rental value (§107); meals and lodging furnished for the convenience of the employer (§119); group legal service plans (§120); moving expenses (§217); employer contributions to qualified pension and profit sharing plans (§§402, 403); and employee allowances in foreign areas (§912).

This paper does not discuss these items, many of which are arguably the types of benefits that should be included in a more comprehensively based income tax
The broad definition of "gross income," as it presently exists, will be explored, leading to the conclusion that most fringe benefits, with de minimus exceptions, are income in the statutory sense. Thereafter will follow a brief synopsis of the current law of fringe benefit taxation, along with a comparative examination of the 1975 Discussion Draft of Proposed Regulations\(^8\) and the proposed section 84, currently pending before the House Ways and Means Committee.\(^9\) Finally, there will be a discussion of the tax policy issues relating to inclusion/exclusion, followed by specific recommendations in this area. It is submitted that the proposed section 84 will definitely be a positive step towards clarifying present uncertainty, provided that certain policy problems extant in the section are corrected.

1. Fringe Benefits Defined

Virtually all non-cash economic benefits received by an employee from the employer incident to the employment relationship may properly be denominated fringe benefits.\(^10\) It is generally presumed that there is a sufficiently close nexus between lowered cash compensation for services and increased non-cash remuneration to treat the latter as having been received in exchange for services.\(^11\) The actual form may vary, including, inter alia:

- employer-furnished subsidized housing, daycare centers, free schools, interest free loans provided to employees, free financial counseling, free trips to conventions for families, reimbursement for or directly furnished free commuting, subsidized cafeteria for employees or executives, health system

\(^{8}\) See Blueprints for Basic Tax Reform, U.S. Department of the Treasury, 1977, hereinafter cited as Blueprints), because, for the present time, they are removed, by virtue of Congressional grace, from the instant controversy. See also A.B.A. Committee on Simplification, Evaluation of the Proposed Model Comprehensive Income Tax, 32 Tax Lawyer 563, 567 (1978) (hereinafter cited as A.B.A. Evaluation).

\(^{9}\) See Sections 2 supra.

\(^{10}\) See note 3 supra. See text of proposed § 84 infra, at note 43.

\(^{11}\) See Handler, note 4 supra, at 31-34; Johnson, Treasury on Fringe Benefits: To Tax or Not to Tax, 4 Tax Notes No. 2, 3, 4 (1970) [hereinafter cited as Johnson].

However, in view of the broad language of such cases as Glenshaw Glass, discussed, infra at text accompanying notes 17-22, such a stringent showing, viz., that the benefits are received in exchange for services may not be necessary. Presumably, if the employer had a "detached and disinterested generosity" in mind, they could be characterized as gifts excluded by virtue of I.R.C. § 102, in admittedly rare cases. See Commissioner v. Duberstein, 363 U.S. 278 (1960); I.R.C. § 274(b), allowing the employer a limited ($25) deduction for gifts made.
care services or medical expense reimbursement plans not exempt by statute, price discounts and rebates for employees, tickets to sporting or cultural events, and employer-paid club dues.\(^{12}\)

In an administrative sense, the Internal Revenue Service has focused on two areas of economic benefit: the fringe that is a "product" of the employer's trade or business (\(e.g.,\) air transportation provided by an airline, and discounts on the employer's own goods) and the "indirect" fringe, such as the provision of company cars for personal, non-business use.\(^{13}\)

As the above suggests, the proffered definition is seemingly all-inclusive, yet exceptions may be seen to exist. Working conditions such as air conditioning, lighting, comfortable (even opulent) office space, and the "psychic enjoyment" associated with work are clearly excludable.\(^{14}\) Additionally, small gifts (\(e.g.,\) a Christmas ham or turkey) do not come within the general rule.\(^{15}\)

**B. Authority to Tax Benefits**

1. Section 61

Gross income includes "compensation for services, including fees, commissions, and similar items." Moreover, absent some specific exclusion, "all income from whatever source derived" is to be included.\(^{16}\) This phrase, one of the broadest inclusion sections in the Code, clearly would sweep within its purview not only all economic benefits received in lieu of compensation, but all accessions to wealth. Indeed, the Supreme Court observed in *Commissioner v. Glenshaw Glass Co.* that "this language was used by Congress to exert in this field the 'full measure of its taxing power.'"\(^{17}\) Section 61 included, as the *Glenshaw Glass* Court noted, all (1) accessions to wealth, that are (2) clearly realized, and (3) under the dominion and control of the taxpayer.

When services are compensated for by means other than money, the regulations require that the fair market value of the

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12. Joint Committee on Internal Revenue Taxation, 95th Cong., 2d Sess., Taxation of Fringe Benefits (Staff Print 1978).
16. I.R.C. § 61(a) (emphasis added).
property received be included in gross income.\textsuperscript{18} To eliminate one possible means of abuse, it is provided that when the employer transfers property to the employee as compensation, the "spread" between the fair market value of the property received, less the consideration paid (other than in services) is includable.\textsuperscript{19}

2. Section 83

Added by the Tax Reform Act of 1969, section 83 overlaps portions of section 61 and the regulations under section 61. It provides that when property that is transferable or not subject to a substantial risk of forfeiture is provided in connection with the performance of services, the spread between the value of such property and the amount of the consideration paid is included.\textsuperscript{20} Section 83 has been relied upon, in part, to deem as includable employer contributions to trust funds providing college expense benefits to children of key employees.\textsuperscript{21}

Section 83 is potentially of broad application because the property need only be transferred to someone other than the employer to be included in the employee's gross income. Thus, as noted above, receipt of benefits by family members of the employee can trigger inclusion.\textsuperscript{22}

3. Tentative Conclusion

Absent explicit statutory authorization to the contrary, sections 61, 83 (together with the regulations promulgated thereunder) and case law have given the I.R.S. power to mandate inclusion of all nonstatutory fringe benefits. While valid in theory, the next section will show that through administrative inaction, court reluctance, honest uncertainty, and taxpayer exploitation, this tentative conclusion is not borne out in today's practice.

\textsuperscript{18} Treas. Reg. § 1.61-2(d)(1) (1953).
\textsuperscript{20} I.R.C. § 83(a).
\textsuperscript{21} Armantrout v. Commissioner, 570 F.2d 210 (7th Cir. 1978), aff'd, 67 T.C. 996 (1977).
\textsuperscript{22} In Armantrout, the Tax Court read this correctly, in its literal sense. \textit{Id.}
II. SYNOPSIS OF CURRENT LAW

A. Benefits Includable

Due to the uncertainty of whether or not many benefits should be included, it may be more appropriate to employ a negative definition that holds all benefits are includable, with the exception of those to which Congress and the Service have ruled to be excludable. This is consistent with the statutory language.

The Supreme Court in *Commissioner v. Kowalski* provided support for this view when it held that cash receipts by a state trooper as meal allowances were properly included in income. The Court ruled that because the trooper's meals were not consumed on the business premises of the employer, and were not delivered "in-kind," as required by section 119, they were includable as compensation. The Court did not decide what impact, if any, *Kowalski* would have on the older rule that "supper money" is excluded if the employee performs extraordinary services for the employer after regular hours. A literal reading of *Kowalski* and section 119 prompts the conclusion that these are now includable benefits.

There are several other situations wherein certain employee benefits are deemed includable compensation. For example, where the employee uses the employer's property for his own personal, nondeductible use, he must include the value of the benefit received (generally fair market value, or fair rental

23. See note 7 supra.


26. However, in response to *Kowalski*, Congress enacted § 3 of the Fringe Benefits Act, which provided state troopers with retroactive relief. See note 5 supra. See also new I.R.C. § 119(b)(3).

27. O.D. 514, 2 C.B. 90 (1920).

value).\textsuperscript{29} Similarly, bargain sales to employees may result in the inclusion of the "spread" or bargain element, under \textit{Commissioner v. LoBue},\textsuperscript{30} regulation section 1.61-2(d)(i), and section 83.

\textbf{B. Items not Includable}

Two hoary chestnuts from the early days of income taxation still survive with some vitality: O.D. 514\textsuperscript{31} and O.D. 946.\textsuperscript{32} O.D. 514 excluded supper money allowances, and O.D. 946 provided an exclusion for free passes given railroad employees and their families. By direct analogy these free passes can be compared with the receipt by an airline stewardess of free flight benefits. Yet when the idea was promulgated in 1921, the relative value of this exclusion was low. In contrast, current free flight benefits can be of substantial value to the recipient.

A more important fringe benefit is the interest-free loan provided to employees (who are generally shareholders in a small, closely-held corporation). Although the I.R.S. has viewed this interest bargain as includable in income, it has consistently lost such cases. The Tax Court has repeatedly held that the "imputed interest deduction" that the taxpayer could claim would offset the inclusion of the bargain element in gross income.\textsuperscript{33} However, this rationale assumes that the taxpayer itemizes—an assumption

\begin{itemize}
  \item \textsuperscript{29} Vierling, T.C. Memo 1969-116; Horung v. Commissioner, 47 T.C. 428 (1967); \textit{Joint Committee on Internal Revenue Taxation, 93rd Cong., 2d Sess. Examination of President Nixon's Tax Returns for 1969 Through 1972} (Staff Print 1974); Handler, \textit{supra} note 4, at 31-32.
  \item \textsuperscript{30} 351 U.S. 243 (1956). \textit{See also} Rev. Rul. 62-49, note 24 \textit{supra}. Small retail discounts are not subject to withholding tax. Treas. Reg. \S 31.3401(a)-1(b)(10).
  \item \textsuperscript{31} \textit{See note 27 supra}.
  \item \textsuperscript{32} 4 C.B. 110 (1921).
  \item \textsuperscript{33} Dean v. Commissioner, 35 T.C. 1083 (1961), \textit{nonacq.} 1973-2 C.B. 4. \textit{See also} M. Zager v. Commissioner, 72 T.C. No. 82 (1979); Greenspun v. Commissioner, 72 T.C. No. 78 (1979); \textit{but see} Creel v. Commissioner, 72 T.C. No. 97 (1979). Dolese v. United States 605 F.2d 853 (10th Cir. 1979). This is a tool used to avoid the effect of double taxation on corporate distributions. If the loaned money had been left in the corporation, the interest or income therefrom would have been taxed first to the corporation, and then to the shareholder-employee when received as a dividend. Thus, the taxpayer has successfully avoided two taxes; and, at the rate of 20% (the prime rate at the time of this writing), the interest benefit is quite substantial. The interest free loan can sometimes be deemed a "constructive dividend," that is includable under I.R.C. \S\S 61(a)(7) and 301(c)(1). B. BRITTKER & J. EUSTICE, \textit{FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS} \S 7.05—\textit{et seq.} (4th ed. 1979); Creel v. Commissioner, 72 T.C. No. 97 (1979); Dolese v. United States, 605 F.2d 853 (10th Cir. 1979).
\end{itemize}
perhaps technically incorrect.34

Further exclusions are afforded for the small gifts that are considered de minimus for accounting and administrative purposes. These also include in-kind Christmas gifts,35 but not large cash bonuses. Rarely would these constitute gifts excludable under section 102, because under current practice the employer does not have the required "detached and disinterested generosity." Instead, the bonus is based upon either the employee's productivity during the year, or upon the business's performance as an incentive to the employee to work harder the following year.

Amounts received as moving expenses are required to be included in employee income,36 but may then be deducted directly from gross income as a business expense if the employee meets the tests and falls within the dollar limitations set forth in the Code.37

By far, the largest category of benefits that are in effect "nontaxable" are those in the broad spectrum listed above. The majority of employees do not perceive these fringes as "income" in the same manner as the Service does; rather, the free parking space, lunch, or daycare facility is viewed as a "right" associated with a particular job. The better the position, the greater number of "rights" that accrue.

III. THE 1975 DISCUSSION DRAFT

A. General

The 1975 Discussion Draft of Proposed Regulation 1.61-1638 enjoyed a relatively short life. Proposed on September 5, 1975, it was withdrawn on January 13, 1977, after extensive discussion. This demise was due to a number of factors acting in concert, including intra-departmental disputes between the Secretary and the Commissioner, overall Department preoccupation with the Tax Reform Act of 1976, strong criticism from both the academic and business communities, and the change of Administrations in 1977.39 The rules and examples contained in the Draft were rea-

34. For this criticism of the "imputed deduction" rationale, see Friedrich, Fringe Benefits: Compensation Techniques and Principles, 35 N.Y.U. INST. ON FED. TAX 1555, 1556 (1977). This also assumes that the imputed deduction is not disallowed by I.R.C. § 265(2).
35. See note 15 supra. However, if cash were given to purchase these goods, the amount received would be included in gross income.
36. I.R.C. § 82.
37. I.R.C. § 217. This is an "above the line" deduction, so that itemization is not required; hence, it is available to more taxpayers. See I.R.C. § 62(8).
38. See Discussion Draft, note 2 supra.
39. Wrote Calvin Johnson:

The draft, while it indicates Treasury thinking, [had] no official status. It
sonably liberal, and were structured with practical considerations, rather than precise philosophical distinctions, in mind. Many of the fringe benefits theoretically subject to inclusion under sections 61 and 83 would have survived the lower level of scrutiny provided in the Discussion Draft, thereby escaping the income tax.

A brief summary and discussion of the criteria contained in the Draft will follow because of its close similarity to the currently proposed section 84. As will be noted later however, section 84 is in some respects less strict than the Discussion Draft.

B. Test for Exclusion

The Draft established a three-tiered test. Under this test, the taxpayer could escape inclusion in his gross income if he was able to establish that he came within the scope of any one of the three “tiers.”

1. First Tier

At this level of review, the taxpayer would have to establish three elements to avoid inclusion: (1) the benefit provided must be for a purpose primarily related to business use and not personal consumption, and must be owned by or under the control of the employer; (2) the employer must have incurred no substantial additional cost in providing the benefits; and (3) the benefit was made available to a reasonable classification of employees, but could not be a class consisting primarily of the most highly compensated.40

2. Second Tier

Failure to establish coverage under the first tier led the taxpayer to the second tier, where inclusion or exclusion would have been determined by examination of “all the facts and circum-

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40. Discussion Draft, note 2 supra, at § 1.61-16(a)(1)-(3).

stances.” The following factors, no one of which was to be controlling, would have indicated that the benefit should be excluded:

1. The cost incurred by the employer in providing the benefit is not identifiable or significant in relation to the fair market value of the benefit received by the employee.
2. The personal use occurs during, immediately before, or immediately after working hours at or near the business premises of the employer and has a proximate relation to work performed by the employee.
3. The benefit is provided to employees generally or to reasonable classifications of employees determined, . . . [by] work, seniority, or similar factors . . . but not . . . the most highly compensated . . . .
4. The benefit is similar to a service or other benefit which is commonly provided by [government entities] . . . not readily available to the employees because of the location of their [work].
5. The benefit accommodates an important requirement of the employer or relieves the employer of significant expense or inconvenience.
6. The benefit is reimbursement of a greater than usual item of expense which was incurred by the employee for a purpose thought primarily personal but which is incurred because a business requirement of the employer prevented the employee from obtaining the item in the ordinary manner.
7. The benefit is provided primarily to insure the employee’s safety by protecting against significant risk arising from the employment relation.
8. The benefit is not a substantial amount absolutely or in comparison to the employee’s stated compensation.
9. The item generally is not thought of as constituting compensation includable in gross income.\textsuperscript{41}

3. Third Tier

The final tier established a \textit{de minimus} test, covering those items so small as to have made accounting for them unreasonable or impractical, in comparison with the revenues that would have been generated by their inclusion.\textsuperscript{42}

C. Valuation

The amount determined to be includable in gross income was to have been at the fair market price of the benefit received, less any consideration paid. This was consistent with the valuation rules under sections 61 and 83.

IV. PROPOSED SECTION 84

A. Inclusion

The newly proposed section 84\textsuperscript{43} (currently pending before the House Ways and Means Committee) states that unless the tax-

\textsuperscript{41} Id., at § 1.61-16(b)(1)-(9).
\textsuperscript{42} Id., at § 1.61-16(c).
\textsuperscript{43} See note 3 \textit{supra}. The proposed bill reads, in pertinent part, as follows:
SEC. 84. FRINGE BENEFITS.
(a) General Rule.—Except as otherwise provided in this section, gross income of an employee includes an amount equal to the aggregate value
payers comes within its parameters, the fair market value of all fringe benefits received on account of services performed by the employee are to be included in gross income,\textsuperscript{44} except as otherwise provided in the Code.

\section*{B. Exclusion}

As with the Draft, the proposed section 84 also establishes a three-tiered filter to determine excludability, and authorizes the Secretary to prescribe regulations designed to exclude other benefits from gross income.\textsuperscript{45}

\subsection*{1. First Tier: Section 84(b)}

If the taxpayer satisfies all of the three elements in section 84(b), an exclusion is allowed. First, the benefit must be made of the fringe benefits received by any person during the taxable year on account of services performed by such employee.

\textit{General Guidelines for Excluding Certain Fringe Benefits.}—Gross income does not include the value of any fringe benefit if all of the following requirements are met:

1. the fringe benefit is made available to employees generally, or to a reasonable classification of employees,

2. no substantial incremental cost is incurred in providing such benefit, and,

3. in the case of any employee, the total value of all fringe benefits received during the taxable year on account of services performed by the employee for any person is not substantial either in absolute terms or in comparison to the employee's total compensation from such person.

For purposes of paragraph (3), the value of any fringe benefit to which subsection (c) or (d) applies shall not be taken into account.

\textit{Certain Other Fringe Benefits Excluded From Gross Income.}—Gross income does not include the value of any fringe benefit if any one of the following requirements is met:

1. Benefits provided to facilitate the furnishing of services.—Such benefit is made available primarily for the purpose of facilitating the employee's performance of the services and substantially all of the use of such benefit can reasonably be expected to be in connection with the performance of such services.

2. De minimus amounts.—The value of such benefit is so small as to make accounting for it unreasonable or administratively impracticable.

\textit{Section Not to Apply to Benefits Covered by Other Sections of This Chapter}. . .

\textsuperscript{44} See note 43 supra, proposed § 84(a). Under the proposed language, the continuing problem of gift vs. compensation will be perpetuated. See also note 11, supra.

\textsuperscript{45} See note 3 supra, proposed § 84(c)(3). A literal reading of this subsection would bar the Secretary from issuing regulations that could include benefits.
available to all employees or to reasonable classifications of em-
ployees. Second, the employer must incur no substantial incre-
mental cost in providing the benefit. Finally, the total value of
benefits received during the year cannot be substantial either (1)
in absolute terms, or (2) when compared to normal compensation.
This will be referred to as the "aggregation/comparison" test.

2. Second and Third Tiers: Sections 84(c)(1) & (2)

Under the second tier, if the benefit is used to further the em-
ployee's performance of services, and substantially all of it is so
used, then no inclusion in income results. The third tier makes
provision for the exclusion of de minimus amounts, similar to that
provided in the Discussion Draft.

C. Valuation

Fair market valuation is also adopted in proposed section 84.

V. DISCUSSION DRAFT AND PROPOSED SECTION 84 COMPARED

A. General

At first reading, many of the provisions in the two proposals ap-
pear similar. There are, however, several important points of
departure. Proposed section 84 suffers from various deficiencies,
many of which will be commented upon in the following section
of this article.

Proposed section 84 begins with a better statutory presumption:
all fringe benefits are included, unless made expressly exempt.
The Discussion Draft contained no such presumption. Section 84
is therefore more consistent with section 61 and existing case
law. Proposed section 84 would provide the Commissioner with
a more specific congressional declaration which would augment
the presently considerable language of section 61. In this manner,
section 84 would, in its own right, be able to deal with non-quali-
fied fringe benefits.

46. Apparently, tax history may be about to repeat itself:
Section 83 of the Code dealing with property transferred in connection
with the performance of services was partially generated by the publica-
1968] amending the regulations dealing with the tax treatment of property
received subject to substantial restrictions. ... [T]he publication of pro-
posed regulations resulted in a storm of protest from taxpayers and ... the
proposed regulations were withdrawn—only to reappear shortly there-
after in the form of legislation.
Warble, Taxation of Fringe Benefits and Perquisites, 36 N.Y.U. Inst. on Fed. Tax
693, 708 (1976).
47. See text accompanying notes 16-23 supra.
B. De Minimus Amounts

The language is virtually identical in both proposals, representing a widely accepted view that some relatively minor benefits ought to be exempted. Even some of the harsher critics of the Draft agree with this.48 The accounting and administrative burdens both on employers and upon the Service would be too high when compared to the marginal increase in revenue that would be generated. This is consistent with existing law, and at the threshold presents no serious policy violation.

Notwithstanding, neither the Discussion Draft nor the proposed section 84 call for examination of de minimus fringes on an aggregate basis.49 Itemizations of comparatively nugatory fringe benefits by category may appear substantially different when aggregated on a per employee basis.50 Thus, where many benefits, all of them considered small, are provided to a single individual or group of individuals, it is possible that an unreasonable amount of paid-for personal consumption is being exempted from the tax base. When the recipient is a highly compensated employee, the potential for greater abuse exists. Therefore, some form of interrelationship between the aggregation/comparison test of proposed section 84(b) (3) and the de minimus rule is necessary.51

An overly liberal interpretation of this section could result in abuses unless workable standards are established. A subsidiary consideration is that workable standards will be needed to give the de minimus rule teeth that can bite if the need arises. If interpreted and/or enforced in an excessively liberal manner, significant amounts of income may thereby be exempted from the base. Hopefully, when the point is reached where aggregate de minimus exemption amounts have crossed the threshold into more substantial benefits, the reason for the rule would cease (because accounting for them would then be practical), and so too should the rule.

48. See Johnson, supra note 10, at 27. See also A.B.A. Evaluation, note 7 supra, at 582.
49. See text accompanying note 43 supra, discussing § 84. Note that § 84(b), last sentence, specifically exempts de minimus amounts (§ 84(c)(2)) from the aggregation/comparison test of § 84(b)(3). This is a loophole in utero.
51. For one such proposal, see A.B.A. Evaluation, supra note 7, at 582.
C. Treatment of High-Bracket Taxpayers

One of the persistent problems associated with fringe benefits is that they are worth more to the higher bracket taxpayer.\textsuperscript{52} The \textit{Discussion Draft} specifically addressed this problem by including a nondiscrimination requirement in the first element of the first tier of exclusion.\textsuperscript{53} However, proposed section 84 does not accomplish the same goal directly. Instead, it would attempt to obtain the approximate result in a more oblique manner, by relying upon the aggregation/comparison test.\textsuperscript{54}

One of the salutary features of proposed section 84 is that should the employee run afoul of this test, the total value of all fringe benefits received would be included, not just the excessive amounts. The potential harshness of this rule is mitigated by the requirement that the excessive benefits must first be “substantial.” That would appear to be a higher burden upon the government than, for example, an “unreasonable” standard would be. This may be playing with semantics, but the language used in proposed section 84(b)(3) is fairly vague in this respect. For example, it might be possible that a large fringe benefit that is an item of personal consumption may not be considered substantial under the facts if the recipient is a corporate executive with a huge salary, and the absolute value of the benefit is not deemed too substantial. In contrast, this same benefit could be included in the employee’s income were he not so highly paid or, were the standard lowered to one of reasonableness.

If proposed section 84 were enacted in its present form, resort would have to be made to the courts to clarify this issue, while the language of the \textit{Discussion Draft} and examples 5 and 9 therein provided clearer insight, despite their liberal tenor.

A nondiscriminatory requirement should be inserted into the first-tier test of section 84. This would provide that the classification of employees receiving benefits could not be a class primarily consisting of the most highly compensated.

D. Commitment to Business Purpose

In this area proposed section 84 is also less meritorious than the \textit{Discussion Draft} because the latter would have required a

\begin{footnotesize}
\begin{itemize}
\item[52.] See note 4 \textit{supra}; and text accompanying notes 73-83 \textit{infra}.
\item[53.] \textit{Discussion Draft}, supra note 2, at § 1.61-16(a)(1). See also Johnson, \textit{supra} note 10, at 24-26.
\item[54.] See note 43 \textit{supra}, text proposed § 84(b)(3). Thus, a very highly compensated employee would be able to receive large amounts of benefits in comparison to his total salary, but when such amounts became substantial in the aggregate, the employee would no longer be shielded by the proposed section 84.
\end{itemize}
\end{footnotesize}
commitment to business purpose if the fringe were to be excluded, while the former has no such requirement. If Congress is to define parameters for exclusion of fringe benefits, one of the theoretical underpinnings ought to be that the benefit provided has an independent, legitimate business purpose, so that it is not solely an item of personal consumption. The Draft would have provided that the benefit be properly related to the employer’s trade or business, and primarily unrelated to personal use or consumption. Any item of benefit that safely ties up at the first tier of section 84 is virtually immune from taxation.

This creates a serious potential for misuse. For example, if an employer makes available on the weekends an automobile to an employee whose job does not otherwise (on business principles) merit the use of a car, then the rental value of the car would be excluded under proposed sections 84(b) or (c)(2). Yet, the primary purpose of such use is undeniably personal consumption. This is clearly an incorrect and improper result. If enacted in its present form, it might be fair to assume that a business requirement will be engrafted onto section 84 as judicial gloss. However, the courts may defer to Congress on this (as having spoken by silence), and decline to read such a requirement into the statute.

E. Cost Limitations

Both sets of proposed rules require that at the first tier of exclusion the provision of the benefit may not result in substantial additional costs to the employer. This limitation is designed to minimize the total amount on money expended on fringe benefits, as well as to avoid the concomitant economic dislocations should the total amount of goods and services utilized in providing these benefits be too substantial. In example 1 of the Discussion Draft, the use by a stewardess of a free stand-by flight is not an includable fringe benefit because the otherwise vacant seat has no substantial additional cost to the airline.

The examples provided in the Discussion Draft referred to direct, out-of-pocket costs as the standard of measurement. It has been urged that “opportunity costs” and other concepts imported from the field of economics might better assess the true cost of

55. See Wasserman, supra note 25, at 138; see also text accompanying notes 28-29 supra, and 94-95 infra.
56. However, resort might be made to I.R.C. § 262, to deny portions of the employer’s claimed deduction.
These costs are generally incapable of calculation with any degree of certainty, and because of their inherently speculative nature could lead to taxpayer confusion, noncompliance, and problems of equity in enforcement. There are, however, at least two areas where such costs are more susceptible of accurate measurement, and perhaps should be taken into account.

1. Bargain Sales

The cost to the provider can quite often be readily calculated when a bargain sale is made to an employee. Presently, when an employee receives goods or services from an employer in a discounted sale, the bargain element is includable in income with de minimus exceptions. Under the Discussion Draft (example 3) and proposed section 84, this rule would be changed because assuming the amount is not de minimus, the employer has merely foregone the additional income from a retail sale.

Economic distortions may occur under such a rule, as compensation is taken in-kind at no tax cost in the form of bargain purchases. A separate rule should be appended to section 84 so that when an employer provides goods or services at a discount, that he is in the trade or business of selling and the bargain element (with de minimus exceptions) will be included in gross income. As an example, employee discounts provided to reasonable classifications of employees as a statutorily fixed percentage of retail cost could be allowed free of inclusion. This should control foreseeable and undesirable excesses, and is reasonably consistent with existing law.

2. Interest-Free Loans

This type of benefit lends itself to a reasonably accurate determination of the bargain element: that being the difference between the interest paid (if any) and the prevailing interest rate for that type of loan in the area or community in which the borrower resides.

57. See, e.g., Johnson, supra note 10, at 23.
58. Id. Mr. Johnson propounds that free flights, even if no other ready and willing takers are available for the empty seats, have opportunity costs: attractive women are drawn away from other (perhaps more vital) industries to the airline industry because of such flights. This assertion may have some validity, but the question remains whether such a cost should be recognized by tax law.
60. See Johnson, supra note 10, at 23. See also text accompanying notes 87-93 infra.
VI. TAX POLICY CONSIDERATIONS

A. Fringes Are Income

1. Tax Definition

Under present law the general rule is that most nonstatutory fringe benefits are includable in the gross income of the employee who receives them.61 This is based upon the compensatory, personal nature of the economic benefit derived, as well as the clear realization of gain. The employee has received stock, transportation, food, lodging, goods, or other economic benefits at either no cost or at a reduced cost, and strict application of such cases as Glenshaw Glass62 and Fenstermaker63 would require that these items be included.

2. Economic Definition

It is even clearer that under the well known Haig-Simons64 definition of income (adopted in the 1977 Treasury Blueprints65) a fringe is an item of “income.” This defines income as the sum of consumption during an accounting period plus increase in net worth during that same period. While generally irrelevant66 under the Internal Revenue Code, this definition further reinforces the view that such exclusions are impure deletions from a comprehensive tax base. It logically follows from this definition, that all of the currently excluded statutory fringe benefits are “income;” at least in the economic, if not tax sense, of the word.67

3. Initial Effects of Exclusion

There are many positive and negative effects of benefit exclusion with which Part VI of this article will be concerned. Two bear mentioning at the outset: erosion of the tax base and taxpayer uncertainty or noncompliance.

First, exclusion of fringe benefits significantly reduces the in-

61. See text accompanying notes 16-23 supra.
62. See note 17 supra.
63. See note 25 supra.
64. H. SIMONS, PERSONAL INCOME TAXATION 50 (1938).
65. Blueprints, supra note 7, at 3.
66. In criminal tax cases, however, this definition plays an important role in the “net worth” theory of prosecution. Holland v. United States, 348 U.S. 121, 125 (1954).
67. As mentioned before, an exploration of the wisdom of excluding these items is beyond the scope of this paper. See generally note 7 supra.
come tax base. This infers that (1) many people are not bearing their fair share of the tax burden, and (2) they are in effect shifting that burden to other taxpayers. This shift occurs as “income” is deleted from the base. If all nonstatutory fringes were taxed as income, this would broaden the base against which the section 1 rates are applied. Theoretically, higher rates are required when the base is narrowed, to generate the same amount of income as would be the result if lower rates had been applied against a larger base. Therefore, exclusion of fringe benefits necessitates higher rates for everyone, but the effect of this is that taxpayers who do not receive such benefits must generally make up the difference. It has been argued that by broadening the tax base, the government could reduce the rates while maintaining the same general level of revenue intake.

Second, there is considerable confusion among taxpayers and their counsel as to whether or not many of these items should be included. There is often a marked difference between the theory of Glenshaw Glass and the actual amounts put down on Form 1040. This frustrates several important goals of the tax system. The amount of tax cannot be determined under our system of self-assessment with a high degree of accuracy, thereby creating inefficiency and uncertainty. This is borne out by the fact that the ultimate resolution may turn, in individual cases, upon whether or not an audit is conducted. Fringes excluded on unaudited returns may be included in audited returns, thereby raising problems of equity in enforcement. Taxpayer morale is affected to the degree that lower and middle income taxpayers perceive that the highly compensated are given greater leeway with their fringes. Compliance is vitiated when “close calls,” or even clearly incorrect judgments are encouraged in the absence of reasonably defined rules.

An income tax that included the value of all fringe benefits, coupled with well defined exceptions justifiable on policy grounds, would significantly neutralize the above difficulties. However, to

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68. The A.B.A. Section on Taxation has put the present annual value of these statutory and nonstatutory benefits at $100,000,000,000. A.B.A. Evaluation, supra note 7, at 577.

69. Id., at 577-78. See also Blueprints, supra note 7, at 2; Blum, The Tax Expenditure Approach Seen Through Anthropological Eyes, Vol. 8 Tax Notes no. 23 at 699, 701 (1979).

70. This section assumes a good faith doubt as to inclusion, and cannot possibly be relevant to a taxpayer who “knows better.” For several excellent discussions and essays on the professional responsibility duties of tax counsel when rendering advice on such borderline questions, see Professional Responsibility in Federal Tax Practice (B. Bittker ed. 1970).

71. For a discussion of this, and the Commissioner’s position on abuse cases, see generally Fenstermaker, note 25 supra.
the extent that the allowed exceptions are either unjustifiably broad or unduly vague, successful correction of these problems will be substantially impaired. Proposed section 84 suffers, in part, from both of the above defects, as discussed earlier. It is not irretrievably defective, and hopefully can be rewritten in the legislative process to remove these objections.

B. The Problems of Equity

1. Vertical Equity

The attainment of vertical equity between taxpayers as a goal of tax policy requires that income attributable to taxpayers in the higher brackets should be taxed at progressively higher rates than income attributable to lower bracket taxpayers. This has generally worked in practice, so that in 1975 taxpayers in the highest quarter of adjusted gross income contributed 72% of all taxes paid, while those in the bottom 50% of adjusted gross income paid only 7% of all taxes.

Vertical equity may be frustrated when, for example, an employee in the 50% bracket receives a yearly free parking space with a fair market value of $600, and the employee’s secretary, who similarly parks next to him, is in the 25% bracket. If taxed to the boss, the fringe would cost him $300 in additional taxes, while the secretary would have a tax cost of only $150. Each has received an item that, under current law, probably ought to be included; and when excluded, this benefit has inured to each without being subjected to the applicable progressive rate. The boss has received the better deal, since his equivalent benefit would have had a higher tax cost if included.

It is submitted that undue attention has been given to this topic: it is a necessary corollary to the progressive rate structure that exclusions have greater tax significance as one ascends the brackets. The fact that both of the above-mentioned individuals have received the same in-hand economic benefit of $600 is frequently overlooked. Additionally, merely because a benefit has the indicia of income in the economic sense does not necessarily

72. See text accompanying notes 48-60 supra.
73. Roberts, Disguising the Tax Burden, HARPER'S, March 1978 at 32.
74. Of course, if the boss is a member of a suspect class, this benefit might disappear on audit.
mean that for tax purposes, it must be characterized as income.\textsuperscript{75}

Further, where similar benefits are received by two individuals with widely separated marginal rates, the benefit itself, and the tax that would be paid on it if included, are a larger percentage of normal compensation to the lower bracket taxpayer than they are to the higher bracket recipient. This serves to minimize the adverse effect on vertical equity, because the benefits received have a greater percentage value \textit{(vis a vis} salary) for those in the middle-to-lower brackets. Over-concentration on the tax benefit received by the highly compensated taxpayer does not adequately reveal that a greater percentage benefit has been conferred upon the secretary.

It is almost universally assumed that the preponderance of non-statutory benefits inure to the benefit of the highly compensated,\textsuperscript{76} thereby magnifying the apparent lack of vertical equity. The Discussion Draft was sensitive to this, and at the first tier, required that the fringe could not be one principally provided to such persons, prior to excluding the benefit.\textsuperscript{77} Proposed section 84, as noted above,\textsuperscript{78} probably does not go far enough in this regard because it would rely on the aggregation/comparison test to catch these abuses, and does not have a nondiscrimination provision.

Quite possibly, the magnitude of such abuses in the area of fringes provided to the highly compensated have been exaggerated. Many of the current statutory benefits are available in general terms to all employees regardless of their income level.\textsuperscript{79} Nonstatutory fringe benefits, such as employee discounts, daycare centers, supper monies, and cafeteria privileges, not exempt under section 119 are being received by many who are not in the higher brackets. In fact, most of the people who utilize these services and benefits are those in the middle and lower rungs of the income ladder.\textsuperscript{80} This is partially reinforced by the testimony of labor leaders before the House Task Force that examined proposed section 84: they regard non-cash compensatory benefits as

\textsuperscript{75} If the Haig-Simons definition of income is used, the boss still has an item of "income" which by exclusion has given him a tax benefit superior to the secretary's. See note 64 supra. See also Note, 89 HARV. L. REV. 1141, 1142-43 (1976).

\textsuperscript{76} Halperin, supra note 6, at 859; Johnson, supra note 10, at 24. See also Discussion Draft, note 2 supra.

\textsuperscript{77} See text accompanying note 40 supra. However, some of the examples provided in the Draft that excluded certain benefits dealt with highly compensated individuals, and were severely criticized in Johnson, note 10 supra, at 25, as being unnecessarily liberal.

\textsuperscript{78} See text accompanying notes 52-54 supra.

\textsuperscript{79} See note 7 supra.

\textsuperscript{80} Roberts, supra note 73, at 32.
an important and substantial benefit to their rank and file members.\textsuperscript{81}

The question as to whether or not lower-paid workers prefer cash compensation to non-cash benefits is in dispute.\textsuperscript{82} In any event, if such benefits were required to be included in their income under either section 61 or under a too-restrictive fringe benefit section, they would probably find it more difficult to pay the additional tax due. Non-cash benefits generally do not increase ability-to-pay,\textsuperscript{83} and these workers may find that inclusion works to their detriment. On the other hand, the highly compensated will not have had their ability to pay significantly reduced by inclusion. This should be kept in mind because a dramatic shift in the tax treatment of the benefits that are currently being received by wage earners may have a dislocative effect.

In summary, the cumulative impact of exclusion on vertical equity has probably been exaggerated. If proposed section 84 is amended to be nondiscriminatory, and the aggregation/comparison test is lowered to a standard of "reasonableness," so that disproportionate benefits will not redound to the highly compensated, then the remaining incidental effects on vertical equity may well be acceptable.

2. Horizontal Equity

Horizontal equity postulates that two individuals with equal incomes should be taxed in a similar manner. The exclusion of fringe benefits contributes to varying degrees of horizontal inequity. Consider the case of A and B: A has earned income of $20,000; and B has earned income of $15,000, but has additional economic income consisting of fringe benefits (nontaxable, or not taxed) totalling $5,000. Both A and B have "income" of $20,000, yet A will calculate his rate on the full $20,000, while B will apply a lower marginal rate to only $15,000.\textsuperscript{84}

Were all benefits required to be included, this inequity would

\textsuperscript{81} Task Force Hearings, note 13 supra (statement of Louis B. Knecht, Secretary-Treasurer of the Communications Workers of America, Sept. 20, 1978). They are also important and substantial benefits to the labor bosses.

\textsuperscript{82} Johnson, supra note 10, at 24.

\textsuperscript{83} Except, of course, to the extent that personal expenditures that would be incurred anyway are paid for by the fringe benefit, which might then free other income for payment of the additional tax.

\textsuperscript{84} This creates an overlap with vertical inequity, because with the same total amount of income, B is now in a lower marginal bracket than A.
not have occurred, since all income would have been fully taxed. As exceptions are made to this strict rule, it is inevitable that certain amounts of inequity will result. However, under a program of partial exclusion, more employees will demand more fringe benefits, with the result that a gradual leveling may take place. Just as exempt pension plans (and other benefits excluded by statute) have played an increasingly important role in compensation, so too would non-cash benefits. When and if Congress acts to settle the current dust storm surrounding fringe benefit taxation, then laborers can be expected to call for a more broadly based extension of these benefits, thereby reducing both the incidence and severity of horizontal inequity.

C. Tax Neutrality

In an idyllic, tax-free world, economic decisions would be made in disregard of the oddities and vagaries of the Internal Revenue Code. To the extent that the inclusion/exclusion of fringe benefits has a direct impact on decision making, the goal of tax neutrality is proportionately sacrificed. It is argued that if proposed section 84 is enacted, the law may move closer to the attainment of tax neutrality than the present, jumbled state of affairs allows.

1. Benefit vs. Compensation

Wages paid, and most non-cash benefits are expenditures deductible by the employer; generally the employer has no substantial tax incentive for providing one or the other. Employees, however, must include cash compensation in income, and, as discussed above, many items of non-cash remuneration. Since most nonstatutory fringe benefits are not included in practice (and no withholding is made at the source), employees will opt in many circumstances for such benefits. This is of course aggravated when the employee is in a high tax bracket.

It is widely assumed that employers always provide non-cash compensation in response to employee demands for tax-free benefits. However, it may be too broad of an assertion to state that

85. See note 81 supra.
86. The problems that are connected with this are discussed in the text accompanying notes 87-97 infra.
87. However, see MACAULEY, supra note 50, at 56, for an example of how “gain” is sometimes accrued by the employer as non-cash compensation is gradually increased.
88. The point at which this theoretically becomes desirable is when “the reduction in utility from consuming [non-cash items of compensation] rather than other goods does not exceed the increase in utility available from using the tax saving to purchase additional quantities of these or other goods and services.” Id. at 55.
all benefits are in lieu of compensation, so that addition of the value of the benefit to the employee's actual wage would be an amount equal to what the true wage would be in all cases. The employer receives definite benefits from an enhanced physical plant that includes free parking, cafeteria, daycare centers, and ultimately, contented employees. To this extent, benefits are not invariably in lieu of cash compensation.

Nevertheless, the tax temptation is strong. The Discussion Draft had this in mind and would have required that the item had no substantial additional cost to the employer. Proposed section 84 retains this test, and has added the aggregation/comparison test. Where the benefit received rises to the level of (1) resulting in substantial incremental costs to the employer, or (2) being substantial on an absolute basis, or in comparison to the employee's salary, then inclusion would be required.

Once this segment of section 84 has been embellished with judicial and administrative interpretation, it is quite possible that the current trend away from cash compensation to benefit compensation will be checked. Primarily this would result from the fact that the section does not merely tax the excess of a substantial fringe over a reasonable fringe, but instead includes the whole value of all nonqualified benefits. This would operate to place an upper limit on benefits that can be received tax-free, whereas no such limits presently exist. It would be in the employee's self-interest to see that the benefits he or she is to receive will not run afoul of the enumerated tests. A lower level of tax-free benefits is superior to a higher level that runs the risk of sweeping all benefits into income. When wages and salaries are increased, benefits may also be raised, but not to the point where they are too substantial in the aggregate.

In this article, it has been recommended that Congress consider lowering the proposed standard of substantiality to one of unreasonableness, for purposes of the aggregation/comparison test. This would create a stronger incentive to design a fringe benefit program with a lower benefit-to-compensation ratio than present

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89. See Discussion Draft, supra note 2, at § 1.61-16(a)(1)-(2).
90. See text accompanying notes 52-60 supra.
91. See text accompanying note 54 supra. This penalty feature is harsh, but may serve as an excellent deterrent to widespread abuse. Prior to the promulgation of regulations and/or the addition of judicial interpretation, though, it would present a real planning headache for the tax lawyer or accountant.
language allows, thereby minimizing invasions on tax neutrality principles. Furthermore, the incorporation of a business purpose requirement into the first tier of section 84 will establish another disincentive to the shift away from cash to benefit compensation.

2. Misallocation of Goods and Services

Derivative of the “benefit vs. compensation” issue above is the effect of exclusion on the allocation of goods and services. Those that have a tax savings attached, as do fringe benefits, are presumably more attractive than others which the employee must purchase with previously taxed income. This may be an interference with the “normal functioning of the economic system,” since the employer has provided goods and services to employees rather than on the open market, and the employee’s decision to avail himself of these items is motivated, in part, by the low tax cost associated with them, rather than by normative economic decisions. However, this is not always the case.

Neutrality is materially violated only where (1) the benefit received would not have been ordinarily purchased by the employee absent tax savings, and (2) the employer could have made an alternative disposition in the marketplace. First, even with the tax savings attached, employees as a practical matter are not going to accept benefits they would not purchase generally. Self-interest alone dictates that to the extent employees and employers “collude” to avoid taxable compensation, the employees will desire goods and services such as meals, parking, daycare centers, and retail discount items that they truly want. Tax savings may be a factor entering into the decision, but it is rarely, if ever, the dispositive factor. The second objection can be met by refining proposed section 84 so that this instance of non-neutrality will be minimized by toughening up the cost to the employer test, and by a special provision governing bargain sales.

The problem is far less severe when the benefits provided are not goods or services that are an integral part (or product) of the employer’s trade or business. In these situations, there is little significant competition with other providers of such goods and services, and accordingly, special notice should be taken of this fact. For example, if an employer erects an office building and provides for underground parking, the employer is normally not in the trade or business of renting parking spaces. When spaces

92. See Macaulay, supra note 50, at 54. See also Johnson, supra note 10, at 22.
93. But see Johnson, supra note 10, at 24. His rather dim view of human nature held that employees will “consume a lot of junk,” if fringes are excluded; and the higher the employee’s tax bracket is, the more “junk,” naturally, he will consume because the tax benefits keep increasing.
are allocated to employees at either no cost or at a reduced cost, the employer is merely acting as a conduit in providing the service. It was never the primary intention of the employer to provide spaces for anyone other than his employees, so that he has not really lost any retail sales. Second, while the cost to the employee may be quite lower than that which could be had at comparable commercial garages, convenience alone, and not tax savings, would be the deciding factor in the decision by the employee to utilize the parking provided by the employer.

The issue of neutrality has been encountered before when Congress exempted the current statutory fringe benefits from the income tax. Policy arguments outweighed the perceived intrusion on neutrality in each of those instances, and the same arguments can be applied by analogy to the nonstatutory benefits.

D. The Personal Element

One of the more important policy issues is that personal expenses ought to be paid by taxpayers with after-tax earnings, and should not therefore have the cost of their acquisition excluded from the tax base. This is a concept related to the rule of nondeductibility of personal expenses contained in section 262. Many of the fringe benefits discussed in this comment can be characterized as items of personal expenditure. When coupled with the fact that they are paid in lieu of compensation to a certain extent, policy reasons argue strongly for inclusion of their value in gross income.

One answer to this problem is that most, if not all, of the present statutory benefits are in reality personal expenditures.\(^9\) Thus, addition of another, albeit large, category of excluded items is not totally inconsistent with the present policy of liberalizing employer-provided benefits. Another answer is that conditioning exclusion on the existence of a bona fide business purpose (which proposed section 84 does not require) may partially satisfy this objection.\(^9\)

\(^{9}\) They are also “tax expenditures” as exclusions or deductions from the normative rate of income tax.

\(^{95}\) See text accompanying notes 55-56 supra.
VII. CONCLUSION

A. The Case for Partial Exclusion

1. Certainty and Compliance

If proposed section 84 is adopted by Congress and is amended to include reasonably clear standards and guidelines regarding the permissible boundaries of exclusion (consonant with maximizing equity and neutrality), taxpayers and their counsel will have a greater degree of certainty in the planning and reporting of fringe benefits than under present law. This should increase taxpayer morale and improve compliance, and will be distinctly superior to the present congressional policy of repeatedly deferring resolution of this important question.96

2. Simplicity

Obviously, the easiest route to attainment of simplification would be to enforce the strict language of section 61 and case law and to include all benefits. However, to the extent that Congress makes a determination that exclusion of certain benefits advances other policies, pure simplicity will have to be proportionately abandoned. The countervailing policies of equity and neutrality will necessitate some degree of complexity in any exclusion section, as this article has noted in detail. To curb certain abuses, and to forestall effects that are perceived to be dislocative and inequitable, special rules, exceptions, and defined parameters will be needed. Invariably, time will add a significant body of case law to embellish these rules. The benefits yielded by such an approach will outweigh the detriments, and can certainly be no worse than the present, haphazard system of taxation.

Proposed section 84 is, with regard to the policy goal of simplification, superior to the Discussion Draft. It will be recalled that at the second tier of exclusion, the Draft resorted to a vague standard of "all the facts and circumstances." Proposed section 84 thankfully lacks such a subjective and fluid test, and has adopted instead a modified "brightline" concept, whereby benefit inclusion or exclusion is more clearly determinable, depending upon which side of the statutory line the fringe falls. Tax planning, administration, and enforcement will be facilitated by such a comparatively measurable standard.

3. Economic Incentives

As a substituted form of tax cut (to the limited extent nonstatu-

96. See note 5 supra; see also text accompanying notes 70-71 supra.
tory benefits are included presently), the partial exclusion of certain fringes will, in varying degrees, lower the tax cost of the consumption of the goods and services provided by employers. Due to the consumer nature of many of these items, this will partially offset the effects of inflation, which most severely burdens the lower and middle classes. A partial shift from cash to non-cash compensation, if effected within reasonably prudent boundaries, will additionally lower the overall tax burden of workers.\textsuperscript{97}

To the extent that after-tax income is thereby increased, capital formation will be encouraged because more money will be available for savings and other productive investments. This should result in a more generalized economic stimulus, based upon the principle that money in the hands of private citizens is better spent than that which the government has and then spends.

4. Advancement of Equity

It has been argued\textsuperscript{98} that a tailored, partial exclusion of fringe benefits will have a positive effect on both vertical and horizontal equity. The tandem reasoning is that (1) a greater than imagined participation by taxpayers of divergent backgrounds now exists, and (2) that persons of middle-to-lower income can be expected to receive more of these benefits in the future. To curb excesses and abuses with the highly compensated, existing tools\textsuperscript{99} would be augmented by the proposed rules in section 84 (hopefully toughened prior to enactment).

5. The Political Question

It has been observed that fringe benefits on an aggregate basis play an important role in the current practice of employee compensation. If, under a mandate of full inclusion or of a too narrowly drafted exclusion statute, significant amounts of previously untaxed income were suddenly taxed, Congress would be deafened by the resultant outcry. Therefore, it is politically inconceivable that Congress will not pass on proposed section 84, or on

\textsuperscript{97} This is accomplished since benefit compensation includes items of personal expense, thereby releasing for use in other areas an equivalent amount of after-tax income that otherwise would have been spent on such expenses.

\textsuperscript{98} See text accompanying notes 73-86 supra.

\textsuperscript{99} Denial of deductions: under I.R.C. § 162 as lavish, extravagant, or unreasonable; under § 274 as non-qualified and/or unsubstantiated; and under § 262 as personal. Inclusion in income under Fenstermaker v. Commissioner, T.C. Memo 1978-210, and Armantrout v. Commissioner, 78-1 U.S.T.C. ¶ 9232 (7th Cir. 1978).
substantially similar legislation, and exempt many of the present programs from taxation. Unfortunately, this same political pressure may severely hamper efforts to amend section 84 in the legislative process.

Parenthetically, it should be noted that at the very time when the political community is discussing “tax reform” the searching out of new items to be included into the base receives little comment; whereas the academic reformers generally speak in these terms. If the fringe benefit rules in section 84 are enacted with a bias against the highly compensated and with safeguards against economic distortions, academic reformers will have been left arguing for a tax increase—a singularly insular position.

B. Summary

Proposed section 84 is a step in the proper direction toward a more coherent, equitable, and practical policy in the taxation of fringe benefits. If amended to cover some of the contingencies and problems mentioned in this paper, it will be a welcome and settling addition to the Code. By placing flexible limits upon the maximum amount permitted to be received without inclusion, in income, it will provide for a more ordered development in the extension of such benefits by employers, rather than the current pattern of unchecked growth. This may also mitigate the occurrence of tax neutrality violations, and eliminate clearly excessive abuses by the highly compensated. Clearly, if Congress seeks to stem the currents of controversy that surround these particular fringe benefit policies, proposed section 84 should be given serious consideration.

GREGORY M. FOWLER*

100. See text accompanying notes 70-71 supra.
* B.A. California Polytechnic State University, 1976; J.D. Pepperdine University, 1979; LL.M. George Washington University, 1980; Scottish Rite Fellow; member of California Bar.