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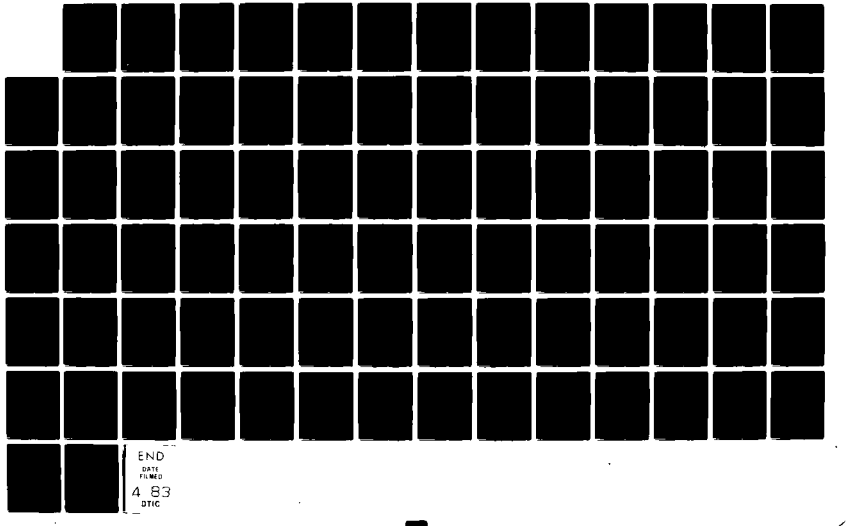

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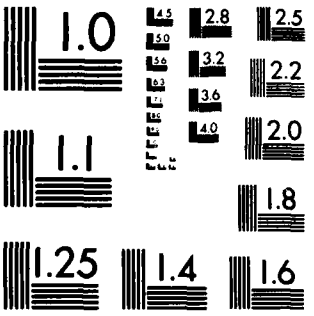

THE TAXATION OF MILITARY PAY AND ALLOWANCES: A VIEW FROM 1982

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A Thesis submitted to

The Faculty of

The National Law Center

of the George Washington University in partial satisfaction

of the requirements for the degree of Master of Laws

August 1982

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A

I. Introducticn.

The Federal income tax has not always been a part of the American way of life.[1] In fact, the first Federal income tax law was not adopted until 1861 as a measure calculated to meet the increased revenue needs of the nation due to the Civil War.[2] From the time that tax was allowed to expire in 1872 until 1913, only one short-lived and ineffective income tax was imposed in 1894.[3]

This latter tax was quickly disposed of by two Supreme Court decisions concerning the same case. In the first of those decisions[4], the Court held that, to the extent the Act taxed income from real estate, if was unconstitutional. Upon rehearing, the Court found all of the income taxes under the 1894 law to be unconstitutional.[5] It wasn't until after passage of the sixteenth amendment that Congress next passed a tax on individual incomes.[6]

These initial excursions into the taxation of individual incomes were generally marked by tax rates graduated by source of income and whether of not the taxpayer was living in the U.S. or abroad. From these early taxes, with their

primitive rate graduations and relatively high income requirement before the tax was applicable, the income tax has evolved into a highly complex system of income, exclusions, deductions and credits, with numerous "brackets" reaching even low income levels. Far from being solely an important source of revenue[7], the income tax now often serves a regulatory function, acting as an economic tool to encourage or discourage certain activities by either offering economic incentives or assessing penalties or additional taxes.[8]

Given the great complexities of the income tax today and the expanded purposes and objectives it attempts to accomplish, it is understandable that in many instances individuals will be treated differently depending upon their family and marital status, income, or type of job held. One area where this difference in tax treatment has been evident for many years is in the characterization of certain components of military compensation as compared with comparable elements of civilian compensation.

In general, regardless of the type of civilian worker in private enterprise, the compensation systems that have evolved have a common characteristic in that they provide a basic wage or salary which reimburses the individual for

services rendered. It is this basic wage or salary which determines the individual's standard of living and, together with bonuses, overtime pay and other income, is the basis upon which he computes the income tax owed. Similarly, the civilian employee of the Federal government depends upon his wage or salary to meet his needs and set his standard of living, and it is that amount upon which he bases his Federal tax calculations. Today's military compensation system is, however, enigmatic to this design.[9]

The military establishment is an institution rather than an occupation. Put more vividly: "A civilian works for General Motors; but a career soldier is in the Army."[10] It is this fundamental abstract distinction, perhaps more than any other, which is the basis for the unique nature of the system and the tax ramifications therefrom. The military member receives a basic pay, plus special allowances to meet his personal needs for quarters and subsistence;[11] and although he may set his standard of living by the sum of these compensation elements, it is only basic pay (with certain additions) upon which his Federal income tax is computed.[12] It is the purpose of this thesis to analyze and evaluate the major tax characteristics that help to set this system apart from the traditional civilian concept of basic

wage or salary, and to offer recommendations concerning existing laws and regulations dealing with the taxation of military pay and allowances.

II. The Military Compensation System-

A. Background:

Historically, members of armies and navies have been paid only comparatively small amounts in money but have been provided with food and shelter in kind. Success on the battlefield however meant possible great rewards for the victors since the spoils were often divided among them.[13] With the possible exception of the Revolutionary War, private monetary reward to the victors (i.e. a promise of a share of the spoils to the military members) has not been part of the American scene. The career American military was characterized from the beginning by small, relatively unskilled cadre-type combat forces before Pearl Harbor. With low cash pay as a hallmark of the fighting man, almost everyone in the military (the large majority of whom were single) was provided with free food, shelter and uniforms. Since very few exceptions were made to this method of paying military members, the system became one composed of low cash pay with in-kind benefits provided to care for the basic necessities of life.[14] This, then, marked the essential distinquishing characteristic between civilian pay systems

and the military compensation system: an historical reliance on substantial in-kind benefits with relatively low cash wages paid for services performed.

World War II brought about abrupt and significant changes in the U.S. military forces of the past. The rapid growth of technology and increases in size of the military, together with the significant effect of a military draft for many years, have changed the composition of the military from an unskilled career force to a highly skilled and necessarily competitive job alternative. White-collar occupations accounted for 46 percent of the total enlisted population in 1978 compared to 28 percent in 1945. Similarly, the percentage of craftsmen to total blue collar workers increased from 40 to 49 percent in the same period. In fact, the percentage of jobs in the armed services that require technical skills is almost twice as large as in the rest of the economy.[15] Despite this much-changed military, the pay system remains essentially the same with the addition of certain pays and bonuses for some of the more critically needed, highly skilled people.

A second important and conspicuous difference between the civilian and military systems is that the military pays its members principally on the basis of rank and years in service (both of which in part are dependent upon skill)

while civilian employers emphasize skill level and occupation in setting pay. Thus the focus is on the man, rather than his job of the moment. This "rank-in-the-man" concept enables the military to maintain the definite and indispensable chain of authority necessary in the peacetime environment as well as on the battlefield.[16] The concept also adds to the complexity of the nature of the system, however.

The basic issue arising from these historical and institutonal differences is that the military member computes his Federal income tax on his pay, excluding allowances for, or in-kind provision of quarters and subsistence.[17] Since quarters and subsistence allowances are not the only elements of compensation which are nontaxable, a review of the various pay and allowances is appropriate. The discussion which follows characterizes the elements of compensation into three basic categories depending on whether they are taxed or not and whether received in cash or in-kind.[18]

B. Taxable Cash Compensation:

The taxable component of the military compensation system is composed of a member's basic pay[19] plus other supplemental or special pays generally awarded for hazardous

duties or special skills.[20] Under this fragmented system, the single most important element is basic pay. It is given to all members for basic services rendered of a continuing nature and is the same for all members of equal rank or rate and longevity. To this basic figure is added any pay received for unusual or special additional services rendered of a continuing nature. With the exception of combat pay, little or no difference exists in the taxation of these payments as compared to pay received in the civilian sector for similar jobs except for the distinction made between the "rank-in-the-man versus rank-in-the-job" concept of paying for the services performed.[21] These supplemental pays can be categorized into the following groups:[22]

1. Hazardous Duty Pay, awarded to those who, due to the needs of the service, perform duties not directly related to combat and which involve a greater than normal degree of personal risk or injury, either mentally or physically. In this category are special pay for flight crews, diving duty, submarine duty, parachute duty, flight deck duty, demolitions and explosive ordinance duty.

2. Hardship Pay is awarded to those who, due to the needs of the service, perform duties which involve a greater than normal degree of discomfort or are particularly onerous. Such duty includes service in the polar regions, troop duty

in the field, sea duty, and isolated duty.

3. Combat pay[23] is paid to those who are subjected to the mental and physical stress occassioned by being in actual combat or in an area designated as a combat zone during a time of so-called peace. Although this special pay is a taxable item, section 112 of the Code exempts from inclusion in gross income of service personnel below the grade of commissioned officer all compensation received for active service in the U.S. military for any month during any part of which the member served in a combat zone or was hospitalized as a result of wounds, etc. received while serving in such a zone. Commissioned officers may, under similar circumstances exclude from gross income so much of their compensation as does not exceed $500. Hence, while combat pay is a taxable item under section 61, it is excluded in whole or in part under section 112.

4. Proficiency and Qualification Pays[24] are given to those members whose certain professional skills are urgently needed or whose particular technical skills will benefit the defense establishment. Proficiency Pay is provided to doctors, dentists, veterinarians and optometrists and is intended to help make up the difference between low military pay and the income which could be generated in the civilian community. It is readily apparent that such

compensation should be taxed.

5. Command Pay[25] is authorized for officers in certain critical positions in recognition of their increased responsibilities as compared with other officers of the same grade. First authorized in the Military Pay Act of 1958 (72 Stat. 122), it is now only used by the Navy to give monetary recognition to commanding officers.

6. Incentive and Continuation[26] pays are given to various groups such as pilots, nuclear qualified officers, doctors and dentists. These payments are given in great part to increase the ability of the military to attract and retain adequate trained personnel in fields of special need to the military.

7. Bonuses are awarded to cover gratuities, not of a continuing nature, offered by the government for specified items or acts. Enlistment and reenlistment bonuses comprise the most common payments in this category. Given their direct compensatory nature it is understandable they are taxed.

8. A final category bears recognition although it is not part of active duty compensation. This compensation deals with retirement pay and payments made to survivors. Military retirement pay is a form of deferred compensation as well as present compensation for preserving the government's right to

subject the retiree to recall to active 'uty, military discipline and justice, and various civilian and federal employment restrictions.[27] Retired pay is taxable although section 104 of the Code provides certain major exceptions to this general rule.[28] An exception also exists for the military retiree who is a participant in the Retired Serviceman's Family Protection Plan[29] (RSFPP) or the Survivor Benefit Plan[30] (SBP) or both, since the participant excludes from gross income the amount of any reduction in retired or retainer pay attributable to the cost of funding the plan.[31]

C. Non-Taxable Cash Compensation.

1. Individual Living Allowances-

These allowances are made to compensate the individual for food, shelter, and uniforms when not provided in kind by the military. The food (Basic Allowance for Subsistence/BAS) and shelter (Basic Allowance for Quarters/BAQ) allowances (together with their in-kind counterparts) comprise the largest tax-free allowances provided. Given this fact and their historical significance in the tax treatment of other military allowances and the development of the common law

convenience-of-the-employer-doctrine, these elements are addressed in a subsequent section.

The uniform allowance is provided to furnish enlisted members with the clothing they require in the performance of their duties. The obligation of the government to clothe (as well as feed and shelter) the enlisted member is firmly established in law. In hearings before the House Armed Services Committee, this fact was stressed as follows:

> Whenever an officer goes into the service, he does so knowing he will be required to subsist himself. Any time a man enlists in the service, the law requires that the Government subsist the man. And if the Government does not subsist that man, then we will have to reimburse him for that food. Under his contract, they agree to feed him, clothe him, and shelter him. But there is no contract with the officer.32

As so pointedly stressed, officers do not receive an ongoing uniform allowance.[33] Furthermore, while the allowance paid to enlisted members is excluded from gross income, military officers, (unlike police officers, nurses, letter carriers and others) are not even entitled to deduct

the cost of acquisition of basic uniform items since it is held the uniform is suitable for ordinary wear, and hence, not deductible under section 162 of the Code.[34]

2. Family Allowances have been given to partially compensate for the additional expenses (as compared with normal civilian employment) to which the service member with a spouse and/or other dependents is subjected because of the military way of life. By providing this extra payment, military life is arguably made more attractive to the married individual. The family separation allowance[35] is probably the most important special allowance in this category although the "dependent's differential", which is part of the quarters allowance, could also possibly be considered in this context.[36] The civilian community may approach the issue of family separation in at least two ways. One way might be for an employee to receive an expense account. Such funds would naturally be reportable by him but subject to possible deductions for business expense under section 162. Section 119 offers an alternate method whereby meals and lodging may be excluded from gross income if all the requirements of the section are met.

3. Area Cost-of-Living Allowance is similar and supplemental to the living and family allowances and is paid in many foreign countries to help meet the difference in cost

in living in such country. A second allowance, the Variable Housing Allowance (VHA),[37] authorized and begun to be paid in 1980, prescribed for service members entitled to BAQ, a supplemental allowance when living in an area of the United States which is a high housing cost area. The amount is based on the difference between the average monthly cost of housing in the area for members in the same pay grade and 115 percent of the amount of BAQ to which the member is entitled.[38]

4. Entertaining and Representation Allowances are intended to partially compensate the individual officer for special entertaining and added social expenses when dealing with foreign dignitaries as a representative of the government or as a Commander of a large command with required official or semi-official entertaining responsibilities.[39] While serving in diplomatic, foreign liaison and international billets the allowance is paid to maintain a high standard of living as a representative of the government. Such payments in the civilian community would certainly be taxable under section 61, but a corresponding deduction would be likely as a business expense under section 162.

5. Special Allowances are essentially intended to be reimbursements for specific costs of the individual member in carrying out his official duties. They include payments for

such items as travel and transportation, per diem, and dislocation allowance. Given their nature and basic purpose, similar payments in the civilian sector would be includable in gross income but deductible as business expenses under section 162 or moving expenses under section 217.[40]

Section 113 of the Code provides for exclusion from gross income of "mustering-out payments". These special termination allowances are ostensibly to assist the individual in his transition back to civilian life and to partially compensate him for the loss of opportunity to work with a profit motive during his military years.[41] While there are no equivalent civilian payments, some employers may provide termination payments to certain employees. Sports figures may be terminated yet continue to receive compensation. Section 61 would apply to all such payments.

Combat Pay, discussed above, may be taxable in part and excludable in part under 112, however a special section of the Code grants a total exemption from income tax in cases where an active service member dies if such death occurred while serving in a combat zone, or as a result of wounds, disease or injury incurred while so serving.[42] The exemption extends to any income tax with respect to the taxable year in which falls the date of death and to any prior taxable year ending on or after the first day he so

served in a combat zone after June 24, 1950. As with Section 112, there is no corresponding benefit extended to civilians who may be killed in a combat zone.

Section 112 also excludes from gross income compensation received for service for any month during any part of which the member was in a missing status (as defined in 37 U.S.C. of 551(2)) during the Vietnam conflict.[43] This exclusion applied as well to civilian employees of an Executive agency or military department, however.

D. Non-Taxable In-Kind Compensation.

Two (quarters and subsistence) of the four major in-kind elements of compensation will be discussed later. The third, the provision for uniforms to enlisted personnel has already been discussed relative to the cash allowance paid for uniforms. A fourth item, moving expenses received in-kind has also been mentioned earlier. Generally, gross income includes any reimbursement of expenses of moving.[44] Section 62(8) provides further that gross income is adjusted by the moving expense deductions allowed under section 217 of the Code. Section 217(g) establishes a special set of rules for members of the Armed Forces, however. In particular, any moving and storage expenses furnished in-kind or for which

reimbursement or allowance is provided, is not includible in gross income. Should the reimbursement or allowance be in excess of the expenses, then the excess is reportable as income.

E. Fringe Benefits.

The term "fringe benefit" as discussed here will cover those supplements, both cash and in-kind, that are not elements of basic compensation. Until approximately twenty or thirty years ago they were an attractive aspect of the military officer profession since they afforded many benefits in addition to basic compensation that were not generally available elsewhere. Today, however, industry has become the leader in the field of fringe benefits. In fact, the entire area of fringe benefits is so fraught with innovation, disarray and abuse that Congress has twice enacted legislation that temporarily prohibits the issuance of treasury regulations (pending legislative action).[45] The general feeling of Congress is that changes in the fringe benefit area involve tax policy considerations that would be more appropriately dealt with by legislation rather than regulations.[46]

Section 61 of the Code[47] and the Regulations[48] take an

"all inclusive" concept of income and seemingly tax all fringe benefits, but administrative rulings, case law, and the Code itself exclude benefits that could otherwise be taxed.[49] Furthermore, fringe benefits "vary from industry to industry, from employer to employer within industries, and from employee to employee in the case of a single employer."[50] The natural result is unequal taxes paid by taxpayers with equal incomes. The issue of tax-free employee fringe benefits is thus a significant tax equity problem.

The major military fringe benefits considered herein are commissary and exchange privileges, health and dental care for the member (including post-retirement care) plus health care for dependents, various entitlements from the Veterans Administration, life insurance at reduced costs, certain scholarship and other education assistance, and use of clubs, gymnasiums, golf courses and other facilities provided for the health and physical well-being of the active duty member.[51]

The issue generated by these benefits is not so much whether they should exist or not but whether they are items which should be subject to inclusion in gross income and taxable. It is especially relevant when compared to benefits of a similar nature in the civilian sector since many industries provide, in addition to family medical care plans and generous pensions, recreation facilities, scholarships

and tuition aid plans, stock options and "buy at cost" items manufactured by the company.

None of the items mentioned as military fringe benefits is included in gross income. In fact, some fringe benefits are excluded from gross income by statute or by comparison with statutes directly related to similar civilian benefits.[52] Of those benefits not specifically or inferentially covered by statute, the tax treatment in general does not differ distinguishably from their civilian counterparts given the non-discriminatory nature of the benefit. Shopping privileges, VA entitlements and facilities use is equally available to all employees and hence should be viewed in the nature of a generalized working condition providing for the proper conduct of the military rather than as items of personal use or consumption by the members.[53] Under the second Discussion Draft of Proposed Regulations issued in January 1981, it would seem continued exclusion of some of these benefits could be upheld strictly on a tax policy basis.[54]

F. State Taxation-

1. Income Tax

As the states have become increasingly pressed for funds they have become increasingly aggressive in the collection of state taxes.[55] Since an active duty member may be a legal resident of one state and reside in another due to military orders, a person in the military could be liable for income tax to two or possibly more states. The Soldiers' and Sailors' Civil Relief Act however, provides service members with relief from this possible double taxation.[56] The Act provides basically that a member of the Armed Forces who is a legal resident of one state but living in another solely by reason of military orders, is not liable to the second state for income taxes on his/her service pay.

Although saved from double taxation by the Soldiers' and Sailors' Civil Relief Act, members of the Armed Forces are not excused or exempt from state or local income and inheritance/estate taxes unless the law of the particular jurisdiction so provides. As with the federal government, many states have laws granting various exemptions which apply to active duty retired, disability and/or survivor pay.

Table 1 provides a ready comparison of the basic tax considerations given military compensation (including retirement and survivor annuities). It is readily apparent from that table that many states extend even greater tax benefits to the military member than does the federal government, although a few states tax some additional items not included in gross income on the federal tax return.

One element which bears special mention is the opportunity for military personnel to "domicile shop", that is, to select a state with favorable tax laws in order to escape significant state taxation anywhere. This opportunity exists because of the application of the Soldiers' and Sailors' Civil Relief Act,[57] and the wide variation in state taxes noted in Table 1. It has been said that the military man occupies a special niche in the law of domicile.[58] Since the typical military member's business affairs consist simply of his service career, domicile may be established and maintained with little effort by registering and voting in a given state, maintaining vehicle registrations and bank accounts in the same given jurisdiction and reciting the place in his will as his legal residence.[59] Given a set of military orders to a state such as Florida, therefore, a member of the military may effectively be able to escape almost all state taxes by merely taking appropriate steps to

show domiciliary intent. If such a move occurs at the beginning of a career the member will be able to avoid state taxes for the next thirty years.

III. Allowances for Subsistence and Quarters:

A. Historical Development of Non-Taxable Status- Jones v United States

The nontaxability of military quarters and subsistence allowances is not statutory in origin.[60] To the contrary, the earliest administrative regulations and rulings held such cash allowances to be subject to taxation. For example, an 1895 opinion of the Attorney General addressed the issue directly:

> "Paymasters and disbursing officers shall deduct the 2 percent income tax from all salaries and payments of every kind made in money to officers or other persons in the civil, military, naval and any other employment in the service of the United States upon the excess of said salaries over $4000. Commutation money received by an officer is be added to other income (including a salary of

> $4000 or less) in order to ascertain the total income, the excess of which over $4000 is subject to a tax of two percent"[61]

In an unpublished Treasury Decision in 1914 this same concept was extended to in-kind quarters.[62] After providing that officers' commutation of quarters, or their value if furnished in kind, should be taxable, it provided:

> When quarters are furnished in kind, of a greater number of rooms than the number allowed by law, it is to be assumed that the excess number is assigned for the convenience of the government, and the money equivalent only of the number of rooms allowed by law shall be returned as income."[63]

Subsequent rulings and decisions applied and elaborated on the convenience of the employer doctrine.[64] The specific issue first reached the Court of Claims in 1925 in the case of Jones v. United States.[65] The taxpayer in the Jones case was a commissioned Army officer who was funished quarters in kind for part of the taxable year while performing duties at the military post to which he was assigned. For the remainder of the year he was given a cash allowance in lieu

of quarters when his duties required him to be in Washington, D.C. away from his post where no quarters were available. Major Jones had been required to occupy public quarters while assigned at his post, and had in fact spent for quarters the cash allowance given him while away from his post in the District of Columbia. He included, under protest, both the rental value of the quarters assigned him on his post and the cash allowance received as commutation of quarters as items of gross income on his tax return. The court held both items to be nontaxable. In overturning both the 1895 Attorney General's opinion and the 1914 Treasury Decision (without referring to them in its opinion), the Court apparently relied on three rationales to sustain its holding.

The court first examined at length the historical characterization of quarters in the overall pay structure of the military to decide if the allowances were "compensation" under the statute defining gross income.[66] Army regulations from as early as 1813 were reviewed, with the court noting the regulations continually provided for quarters in-kind for officers. Later regulations provided for the mandatory use of government quarters "unless none were available," in which case either rented quarters or commutation in money would be provided. Such commutation was limited to the lesser of a set dollar amount or actual expenditure for the allowed

services.[67] Built into the system of total compensation was a ceiling on total pay and allowances, necessitating the amount of cash allowances to which an officer was entitled to be reduced by the amount of excess above the pay ceiling.[68] Hence, by the time the Jones case was decided it was clear that, "in addition to his pay", an officer was entitled to public quarters if available, or if not, a money allowance for rental of quarters. The regulations were seen to constitute a kind of employer's characterization and demonstrated the military necesity of providing quarters. The Jones court therefore concluded that congressional intent would be thwarted were it to hold quarters taxable.

Second, the court noted that the income of certain federal officials[69] had been exempt from taxation under several earlier revenue acts, and decided that it was well within Congress' power to exclude others. Once again, the historical characterization of a hundred years of regulations was used as an indication of the intent of Congress.

In its final rationale, the court held that the allowances were not income within the definition enunciated five years earlier in Eisner v. Macomber,[70] and therefore could not be taxed. In reaching this conclusion the court questioned whether an officer, as remuneration for his services, was not only paid a salary but in addition

furnished a house to live in as part thereof. The reply was clearly, "the officer is not paid a salary and furnished a house to live in for his services; he is, on the contrary, paid a salary to live in the quarters furnished."[71]

The Bureau of Internal Revenue (forerunner of the Internal Revenue Service and hereinafter, the "Service") acquiesced in the Jones decision and promulgated in 1926 Treasury Regulation 69, Article 33.[72] Present regulations extend the exemptions to include both cash and in-kind subsistence, quarters and uniform allowances.[73] Given the Services's acquiescence, no further cases have been decided on the point.[74]

B. Meals and Lodging in the Civilian Setting.

1. Section 119 - Convenience of the Employer:

Subsequent to Jones, judicial development of the convenience-of-the-employer doctrine centered primarily in the Tax Court.[75] In Beneglia v. Commissioner,[76] one of the initial cases to clearly delineate the factual situations which lend themselves to a finding that certain benefits are provided for the convenience of the employer, the court concluded the lodgings and meals provided the petitioner were

imposed upon him for the convenience of his employer since absent them, the petitioner could not otherwise perform his managerial duties. The taxpayer, a manager of several resort hotels, and his wife occupied a suite in one of the hotels and received their meals there. His residence in the hotel was a specific condition of his employment. Important to the court's decision was the fact the employer did not view the benefit as part of the compensation paid for the taxpayer's services.

Fourteen years later, however, in Van Rosen v. Commissioner,[77] the Tax Court expressly rejected any notion that would make the tax consequences of such "benefits" turn on the intent of the employer. Van Rosen is especially noteworthy since the employer was the United States and the subsistence payments involved in the litigation were provided by military regulations, both elements similar to the Jones facts.[78] The court chose to settle on the business-necessity rationale for its holding in disallowing most of the exclusion claimed by the taxpayer.[79]

In 1950 the Service, in an attempt to give more definitive guidance on the doctrine, issued Mim. 6472:

> The "convenience of the employer" rule is simply an administrative test to be applied only in cases in which the compensatory character of

> such benefit is not otherwise determinable. It follows that the rule should not be applied in any case in which it is evident from the other circumstances involved that the receit of quarters or meals by the employee represents compensation for services rendered."[80]

Three years later, the Tax Court in Doran v. Commissioner,[81] partially returned to the employer's characterization rationale rejected in Van Rosen. There, the taxpayer was furnished lodging at a state school, the value of which was included in his compensation as required by state law. The court required the value to be included in reportable income on the basis of the characterization of the lodgings as compensation by the employer, even though the lodging was otherwise furnished to allow the taxpayer to be on 24-hour call. Although the Tax Court in Doran gave credence to the philosophy of Mim. 6472, some other courts were less receptive.[82]

By 1954 Congress felt compelled to act to "end the confusion as to the tax status of meals and lodging furnished an employee by the employer."[83] As a result, Section 119 of the Code was enacted to exclude from gross income of an employee the value of meals and lodging furnished for the convenience of the employer. Then, after more than two

decades of litigation, the Supreme Court had occassion in Commissioner v. Kowalski[84] to clearly rule on the new section and its relationship to sections 61 and 162 of the Code.

Kowalski is the apex in a line of cases dealing with meal allowances provided to state police officers. Officer Kowalski had received a cash meal allowance from the State of New Jersey and had not reported most of it as income since the State considered the allowance to be noncompensatory. In trying to settle the confusion created by the Third Circuit and Tax Court decisions,[85] the Supreme Court clearly ruled on the taxpayer's contentions that the allowance was not income under section 61, and that even if it were, it could be excluded under section 119. The Supreme Court held that Section 119 (1) codified the rationale that the convenience-of-the-employer doctrine required a "business necessity"; (2) limited the doctrine to in-kind meals and lodging on the employer's business premises,[86] ; and (3) preempted the field so that noncompensatory, non-income arguments under Sections 119 and 61 are not viable.

Important in the discussion of the Kowalski case is yet anther issue dealing with Congressional intent. The taxpayer argued that it was unfair that members of the military may exclude their subsistence allowances, both cash and in-kind, from income while he could not. The Court responded by

reviewing the fact that section 120 of the Code[87] had at one time allowed police officers to exclude from income subsistence allowances of up to $5 per day, but that Congress had expressly rejected the equity argument when the section was repealed.[88] Hence it is clear the Court has "allowed" Congress the right to determine what is inequitable and therefore not excluded, and what is possibly inequitable yet allowed to be excluded.

Application of section 119 in deciding convenience-of the-employer issues is now the rule for all but those individuals covered by the "military exception" stemming from the Jones decision and Treasury Regulation §1.61-(2)(b).

The section maintains a long-standing rule that the employee must be required to accept the lodging as a condition of employment to be excluded from gross income.[89] A similar requirement does not exist however, relative to the provision of meals furnished for the employer's convenience. As to meals, the regulations add that the employer's convenience is met if the meals "are furnished for a substantial noncompensatory business reason of the employer."[90]

Such reasons include (1) the employee being available for emergency calls during the meal period; (2) a business need which restricts the employee to a short meal period; and (3) the absence of sufficient eating facilities near the business

premises.[91] Exception is made for remaining employees to take the exclusion if a noncompensatory reason applies to substantially all of the employees receiving meals,[92] and a special exception applies to employees of restaurants and other food service establishments.[93]

2. Section 162: Trade and Business Expenses.

Section 162 of the Code does not find general applicability to the central issue since that section allows the only deduction of certain trade and business expenses from income rather than providing an exclusion from gross income. It therefore is mentioned only as an alternative solution to exclusions under sections 61 and 119. As it pertains to the discussion at hand, the statute provides in part:

> "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including...(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagent under the circumstances) while away from

home in the pursuit of a trade or business..."[94]

One of the major limitations to application of this section is found in United States v. Correll,[95] wherein the Supreme Court upheld the Service's interpretation of "away from home" by holding that the travel away from home must include an overnight stay before the expense for meals could be deducted. In a dissenting opinion in Kowalski, Justice Blackman (joined by Chief Justice Burger) argued in part that section 162 should allow a deduction of the meal allowance as an ordinary and necessary expense of trade or business.[96] Faced with Correll however, Officer Kowalski had understandably not pressed the issue in presenting his case to the Court.

Section 162 does have general application to the comparison of civilian trade and business expenses with certain travel, per diem and other allowances received in the military.[97] In general, three basic tests must be met by a given expense in order to be properly deductible under 162: (1) the expense must be for the purpose of carrying on a trade or business rather than for personal use; (2) it must be ordinary and necessary; and (3) it must be a current expense rather than a capital expenditure.[98]

C. Jones v. United States - Revisited

1. Employer's Characterization.

The historical significance of Jones cannot be overemphasized. By drawing the fundamental distinction between pay and allowances, and in deciding that neither the provision of government quarters nor the commutation thereof was an allowance of a "compensatory" nature, the court in effect established the precedent for the exemption of other military allowances from taxation.[99]

As already discussed, the court went to great lengths to review the history of the quarters allowance in arriving at its conclusion that the congressional purpose would be severely thwarted were the court to hold quarters taxable. Although the specific purpose was ambiguous, it was made clear that since a definite and fundamental distinction had always existed between "pay" and "allowances", it was only natural the two concepts should be treated differently for tax purposes.

The court concluded its historical review of military allowances by examining the Pay Readjustment Act of June 10, 1922.[100]. Under the provisions of section 6, commissioned officers below the grade of brigadier general or its equivalent, "if public quarters (were) not available, (would)

be entitled at all times, in addition to (their) pay, to a monthly allowance for rental quarters."[101] (Emphasis added.) The act further allowed the money value of commutation of quarters to be fixed each year by the President. The court then stated that if quarters, or the commutation thereof, were compensation (as argued by the Service), then the obvious effect of the statute was "to allow the President, in part at least, to fix the compensation of Army officers."[102] To reach that conclusion, in the court's view, was contrary to Congress' intent. If such were the case the purpose of the statute to assimilate pay of officers in keeping with their rank and duties would be thwarted since the officer without dependents would be required to pay less from his pay proper in income taxes than the officer with dependents if both occupied quarters in-kind.[103]

The congressional purpose in differentiating between pay and allowances was expanded from a mere characterization by the employer to include the concept that the provision of"public quarters was as much a military necessity as the procurement of implements of warfare or the training of troops."[104] Given the conclusion that such facilities were an integral part of the organization itself and indispensible for keeping the Army intact, it was an easy step to say the allowance for quarters or the commutation thereof was not

compensatory in nature. Since in the court's opinion it was not compensatory, it could not be taxed.

If the rationale for not taxing the quarters allowance were based solely on characterizing it as non-compensatory, then the doctrine created by the court would simply have been that whether an item is included in income or not depends on the intent of the employer.[105] The court's rationale, however, did not rest on characterization alone. A thread of exceptional strength was woven throughout the opinion, without which the court would have found great difficulty in deciding as it did. In an opinion less than twenty-seven pages in length, reference was made in at least twenty-two places to the fact that commutation of quarters was allowed only where no public quarters were available. Indeed, the court drove home its holding by emphasizing this very point when it emphatically stated just prior to the order:

> "Situations must be faced as they exist; rights are not to be determined upon a hypothetical basis in the face of facts. The Army officer may not provide himself with his own quarters. No such regulation or law has ever prevailed. Congress has never accorded the privilege, and the provision for commutation emphasizes the fact. On the contrary, the Government furnishes the

quarters as a part of the military establishment itself."[106]

Elsewhere in the opinion the same concept was presented in terms of "choice":

> "If it is meant to assert that an officer may choose between an acceptance of commutation or quarters in kind, the error is obvious. The officer has no such choice. In no single provision, however, in either the law or regulations, are we able to discover the long established and firmly adhered to principle that in no case may an officer receive commutation of quarters save he is denied the right and privilege accorded him by the acts of public quarters."[107]

Army Regulations, relating to the pay and allowances of the Army, provided in part:

> "14. ....Conditions essential to receipt (of rental allowance). There are two essential conditions necessary to the receipt of the rental allowance: (1) That public quarters are not available, and (2) That the officer occupies a duty status that would entitle him to quarters in kind."[108]

Thus, while the court emphasized the non-compensatory

nature of the allowance, the characterization seems to have been greatly dependent upon the fact that occupancy of public quarters was mandatory when they were available.

Although the conclusion was clear, the Congressional purpose in authorizing the quarters allowance may have been somewhat obscure in Jones. That purpose has been ellucidated by the Court and Congress since then, however. In 1973, the Supreme Court decided Frontiero v. Richardson,[109] a sex discrimination case brought by a married female Air Force officer seeking increased quarters allowance and medical benefits for her husband as a "dependent" under 37 U.S.C. 401, 403, and 10 U.S.C. 1072, 1076. En route to holding for the appellant officer, the Court stated the congressional purpose in authorizing the military quarters allowance was "to attract career personnel through enlistments (by means of) a scheme for the provision of fringe benefits to members of the uniformed services on a competitive basis with business and industry."[110] Hence, instead of a noncompensatory system intended to mitigate the hardships of military life and make the servicemember readily available to the call of duty, the system has evolved into a complex compensatory system on a par with competitive industrial and business employers.[111]

Further evidence of the compensatory character of these

allowances is seen in legislative action taken since Jones. The Jones ruling created, at least conceptually, one of the fringe benefits referred to above. That benefit, in existence because of the tax-free status of BAQ and BAS, is referred to as the "Federal income tax advantage."[112] (hereinafter also referred to as the "tax advantage"). Prior to World War II, however, the tax advantage was of little significance since tax rates and the level of military pay and allowances were such that most military personnel would have had to pay little or no income tax even if the allowances were included in gross income. Likewise, the emergency tax relief legislation enacted during the war essentially negated any taxes which would otherwise have been owed due to concurrent increases in tax rates and military pay and allowances. Hence, not until 1948 did the tax advantage become a significant and increasingly more important element in military compensation.[113]

The first formal recognition of the tax advantage as an element of compensation was made when the House Armed Services Committee stated in its report on the Uniformed Services Pay Act of 1965:

> The committee wishes to emphasize that, in the development of the proposed new basic pay scales, reflected in charts 3, 4, and 5, it has attempted

> to give appropriate and full consideration to both the tax advantage, which accrues to military personnel because of the tax-free nature of the quarters and subsistence allowances....
>
> After determination was made of the level of pay (including allowances) considered appropriate for each military grade, account was taken of... the amount of the estimated Federal income tax advantage (using 1965 tax rates) on the basic allowances for quarters and subsistence. The importance of this step is that it would set out "in the record" the actual amounts by which military pay scales are lower because of the military "noncontributory" retirement system and the tax-free status of the basic allowances for quarters and subsistence. In the history of all previous military pay legislation, no documentation of such adjustment has been provided for the record.[114]

Public Law 90-207[115] followed, providing that whenever the General Schedule of compensation for Federal classified employees was increased, a comparable increase was to be effected by Executive Order in the basic pay of members of

the uniformed services. Public Law 90-207 specified that the comparable increase in raises was to be determined by equating regular military compensation (RMC) to General Schedule salaries. The use of RMC was important since RMC was defined at that time as the sum of basic pay, quarters and subsistence allowances (both in-cash and in-kind), and the tax advantage of those allowances. The effect of the law was to consider BAQ and BAS as compensation, but to apply the intire increase to basic pay only.

In 1974, Congress acted to retain the principle of linking basic pay to civil service increases, however the method was changed by requiring military raise to be distributed to basic pay, BAQ, and BAS by the same percentage as General Schedule salaries.[116] The same law added section 101(25) to Title 37, United States Code, formally defining "regular compensation" or RMC as meaning:

> " 'Regular compensation' or 'regular military compensation' means the total of the following elements that a member of a uniformed service accrues or receives, directly or indirectly, in cash or in kind every pay day: basic pay, basic allowance for quarters (including any variable housing allowance or station housing allowance), basic allowance for subsistence; and any Federal tax advantage accruing to the aforementioned allowances because they are not subject to Federal income tax." [117]

The development of the law, together with continued Congressional recognition of the tax advantage, thus makes it clear that BAQ and BAS are compensation, and that the Federal government, as the employer, has so characterized them.

Remembering the Jones court's rationale that Congress surely would not intend the President to participate in the fixing of compensation of an Army officer, [118] further evidence of Congress' real intent was manifest in 1976 when Congress explicitly gave the President authority to allocate the "overall average percentage of any increase (in military pay) among the elements of compensation...." [119]

2. Availability of Public Quarters

The law has not only changed relevant to the compensatory nature of BAQ and BAS, but it has also changed regarding mandatory non-availability of public quarters as a prerequisite to receipt of the in-cash allowance. The first hint that such was the case can be seen as early as the Pay Readjustment Act of 1942.[120] Section 6 of that Act begins essentially as did the 1922 Act.[121] Conspicuously absent though, is the phrase, "if public guarters are not available." The legislative history of Public Law 77-607 is silent as to the reason the explicit requirement is omitted. In discussing the high cost of rental housing for military officers, especially in the large cities where many bases were located, the Senate Report accompanying the bill stated the following, however:

> "When an officer is assigned to a city where no government quarters are available (and the for whom such quarters are available now is almost negligible) he must provide them for himself within a limited distance from his post of duty...." [122]

Hence, although the explicit requirement was omitted from the statute there remained authority in the legislative history for its continued viability.

Similarly, the Career Compensation Act of October 12, 1949 was silent on the requirement.[123] That Act revamped the entire military compensation structure, replacing the old rental allowance with the existing basic allowance for quarters. The only reference to the obligatory requirement of non-availability of public quarters came during the hearings on the bill wherein Rep. Kilday stated:

> "I am afraid that many members of this committee do not agree with it, but I would like to say this for the record. Of course no one can draw commutations for quarters unless his commanding officer certifies that no suitable government quarters are available."[124]

So while the provision was not explicitly in the law, nor was it considered a requirement by many on the Armed Services Committee, for the record it was still alive and well in the mind of the subcommittee chairman.

It wasn't until 1963 that Congress finally stated what

many of Chairman Kilday's committee members felt in 1949. Section 10 of the Uniformed Services Pay Act of 1963 amended Section 403(b) of title 37, United States Code, by adding the following:

> "However, except as provided by regulations prescribed under subsection (g) of this section, a commissioned officer without dependents who is in a pay grade above pay grade O-3 and who is assigned to quarters... appropriate to his grade or rank and adequate for himself, may elect not to occupy those quarters and instead to receive the basic allowance for quarters prescribed for his pay grade by this section."[126]

The above amendment was not found in the House report sent to the Senate on April 11, but found its way into the Senate report without comment. It seems clear form this fact and the comment of Congressman Kilday in 1949, that the requirement for non-availability of public quarters had lost its practical application long before 1963. Current law maintains that all members without dependents who are in a pay grade above E-6 and who are assigned housing "may elect

not to occupy those quarters and instead receive the basic allowance for quarters prescribed by his pay grade...."[127]

Finally, the Department of Defense has published specfic policy relative to the provision of family housing. While Defense maintains its objective to assure members of the Armed forces with dependents have suitable housing in which to house their dependents, the "policy is to rely on the local housing market in communities near military installations as the primary source of family housing for military personnel....Family housing is built only in those locations where civilian housing in the surrounding area is not adequate to meet the needs of the local military community."[128]

From the above it can no longer by said that, "(no) question as to the discontinuance of the requirment (to be compelled to occupy public quarters when available) has ever been the subject of agitation...."[129] To the contrary, Congress hesitates greatly today to provide public quarters except to the extent needed to meet minimum requirements.[130]

3. Exemptions of Certain Federal Officials.

The authority "to lay and collect taxes on incomes, from whatever source derived,"[131] has seldom been exercised with a great degree of specificity; rather, Congress has chosen to provide broad language "leaving to (administrative) and judicial determination the inclusion or exclusion of unspecified items."[132] The use of such language is equally applicable to the subjects of taxation as it is to the objects of taxation. Hence the second rationale of the Jones court is as valid today as it was fifty-seven years ago. Congress may in fact choose to exempt from taxation "income" of certain individuals. While it has not specifically exempted from inclusion in gross income the allowances of military members, neither has it chosen to act affirmatively to disaffirm Treasury Regulation section §§ 1.61-2(b) which grants the exemption.[133]

It has been argued that the use by Congress of its power to exclude the allowances of members of the military is unfair when similar application of that power is withheld from other identifiable groups. The Supreme Court has noted however, that "arguments of equity have little force in construing the boundaries of exclusions and deductions from

income, many of which, to be administrable, must be arbitrary."[134] While the special application of the exclusion only to certain readily identifiable groups may be unfair, it is therefore certainly within Congress' power to do so if it chooses.

4. Income Defined.

It will be recalled the Court of Claims asked whether the allowances should be considered income under Eisner v. Macomber.[135] In response the court focused on whether the gain was derived from labor, that is, were the quarters and commutation thereof provided to Major Jones as remuneration for his services, in addition to his salary. If so, then income accrued under Eisner.

The courts today do not labor under the same constraint as did the Jones court. The Supreme Court in 1955 put an end to much of the uncertainty generated by Eisner by discarding the labor/capital formulation in favor of a broader and simpler concept of income. In a case involving treble damages under the antitrust laws, the Court held in Commissioner v. Glenshaw Glass,[136] even the punitive damages to be taxable since they were "undeniable accessions to wealth, clearly realized...." That concept made "source"

irrelevant and substituted enrichment realized as the basis for decision. The Court stated that Congress intended to use "the full measure of its taxing powers" when it drafted section 61, applying "no limitations as to the source of taxable receipts, nor restrictive labels as to their nature...(in order) to tax all gains except those specifically exempted."[137] Section 61 of the Code now includes in gross income all income from whatever source derived, and provides numerous examples.

The regulations are especially helpful since they state income may be realized "in the form of ... meals, accomodations...."[138] and includes "pay of persons in the military or naval forces of the United States...."[139]

In the landmark case of Commissioner v. Kawalski,[140] the Court was presented the issue of whether the cash meals allowance received by New Jersey state troopers was "income" as defined by section 61. The Court recognized that Jones rested on the proposition that the convenience of the employer can be inferred from the characterization given the cash payments by the employer but indicated the heart of that"proposition was undercut by both the language of 119 and the Senate Report (No. 1622, 830 Cong., 2D Sess. 19(1954))."[141] The Court further stressed that Jones also rested on Eisner V. Macomber, but emphatically rejected any

notion that Eisner's definition of income was read into section 61 by Congress. The short shrift given the section 61 argument by the Court in Kowalski inevitably leads to the conclusion that it would be difficult to argue successfully that a benefit rendered to the taxpayer by his or her employer would not be considered income, particularly when the payment is in cash, which is presumptively compensatory.[142]

Absent the exclusion expressly provided by Treasury Regulation § 1.61-2(b), and given the numerous Congressional and court statements on the compensatory nature of military allowances, were the issue raised today under section 61, the conclusion would necessarily be contrary to that in Jones.

5. Section 119.

The Tax Court in Kowalski v. Commissioner[143] did not follow the common law convenience of the employer rule which excluded cash payments from income.[144] Instead, it reasoned that enactment of section 119 of the Code limited availability of the exclusion to cases meeting the tests of 119. Since cash allowances did not fall under the rule, the exclusion was denied. The Supreme Court concurred in this reasoning, holding that section 119, as the exclusive

authority for allowing exclusion of meals, does not cover cash payments of any kind.[145] Hence, were Jones to be decided today under section 119, commutation of quarters and subsistence would not be excludable.

Whether in-kind subsistence (rations in-kind) would be excludable depends on compliance with the section 119 requirements of (1) on the business premise, and (2) for the convenience of the employer. The first of these is generally met in the military without question since the member receiving rations consumes them in a government mess on a base or post, aboard ship, or simply enjoys his meal from a can in the field. As to the second requirement, the regulations require an examination of all the surrounding facts and circumstances in determing the reason of an employer for furnishing meals. In this instance however, unlike the state of the law prior to 1954, if the test is met the exclusion applies irrespective of whether such meals are furnished for compensation.[146] The main question which must be answered is, "Are the meals furnished for a substantial noncompensatory business reason? If so, they will be regarded as furnished for the convenience of the employer, even though they are furnished for a compensatory reason.

It has already been seen that BAS is considered part of the compensation provided a member of the military. There is

no argument that the Government has a substantial non-compensatory reason for subsisting military members in the field or at sea. Similarly, given the basic and important role of defense, it is logical to argue that an equally strong reason exists simply to ensure a healthy, well-maintained fighting force at all times. While there has been no deviation from the concept that the government is obligated to subsist enlisted personnel,[147] the basis for officer subsistence is less clear, yet at least in those situations mentioned, the employer's need to subsist even officers is obvious and should be determinative.

Similar section 119 requirements exist for exclusion of housing provided by the employer with the additional test that the member must accept the housing as a condition of his employment. Because military members above pay grade E-6 now have the option to elect not to accept public quarters, this test would be failed by all such individuals despite any personal need to live in such quarters if available.

D. Policy

1. Tax

Central to the discussion of military compensation today is the previously noted concept of the federal income tax advantage. A great many factors influence the actual tax advantage of a given member, so the government uses a concept of "formal" tax advantage in determining the aggregate tax advantage accruing to service members. Basically, only four parameters are considered: (1) basic pay of the member; (2) whether BAQ and BAS are received in-kind or cash; (3) the member's marital status; and (4) his/her number of personal tax exemptions. Not considered in the computation are such factors as:(1) other pay received (eg. incentive, hazardous duty, etc.); (2) non-military income; (3) spousal income; (4) filing status; (5) other tax exclusion; and (6) use of itemized versus standard deductions. Since these factors all impact on taxable income, the result of not considering them in the formal tax advantage adds an element of raggedly uneven compensation distributed among military personal.

The tax advantage, as a Federal tax expenditure item, reflects the loss to the Federal treasury of revenue that

would be collected if military quarters and subsistence, both cash and in-kind, were subject to income taxation.[149] By choosing not to tax those allowances however, the government effectively saves the amount it would otherwise have to pay the member in order to leave him with the same after-tax income as under the present system. This additional amount, together with an amount reflecting difficulties of an administrative nature in classifying and valuing presently non-taxable benefits, would probably offset the overall gain to be recognized by the government should all pay and allowances be taxed.

A second policy consideration exists in that the allowance of tax-free fringe benefits to lower paid employees may be an equitable solution to the fact that many perquisites are usually associated only with highly-compensated executives.[150] Table 3 provides insight to the distribution of adjusted gross income for military members, indicating that in 1972 (the only year for which figures are available), 81 percent of the military reported less than $10,000 adjusted gross income, with 55.6 percent reporting less than $6,000. If equity is an objective, the argument exists that the provision of an exclusion for allowances to the military as a class is equitable because of their otherwise low pay.

It remains to be noted, however, that a certain inequity exists among service members themselves, as well as when compared to the civilian sector. Any system of exclusions for certain kinds of compensation produces unequal benefits among the recipients. The dollar value of the exclusion to each recipient depends upon the tax saved by the exclusion, a reflection of the individual's own marginal tax rate. See Table 4. Since there are both comparatively high and low income military personnel, it may be argued the exclusion is of greater advantage to those who need it least. The significance of such an argument is minimal, however, since the tax advantage is in essence used as one element in establishing pay for the military.[151] In other words, the fact that the average tax advantage for an officer in pay grade O-5 is approximately 4.2 times that of an enlisted member in pay grade E-5, simply reflects the Congressional intent in setting the pay of both.

2. Non-Tax.

Only mentioned by a few of the commentators on the convenience-of-the-employer doctrine is the reference in Jones to the fact that the military member is governed by a

set of stringent military laws which are inapplicable to civilians.[152] The importance of this concept is highlighted by the Tax Court decision in Van Rosen v. Commissioner[153] and by the Service in Revenue Ruling 60-66.[154] The petitioner in Van Rosen was a civilian employee of the Army Transportation Corps who, as a result of his duties as ship's master, was required to eat some of his meals away from home.

He received a cash allowance for subsistence and quarters in addition to his regular salary. The court noted that the only case to conclude such cash allowances were not income was the Jones decision. Then, in support of its holding that the allowances were taxable in this instance, it distinguished Jones by observing that, "(Jones) was a Army officer and that the terms and conditions of his service were much more rigid and his freedom of action much more restricted than in the case of a civilian employee...."

In Revenue Ruling 60-66, the Service held that the subsistence and quarters allowances paid in cash to a contract surgeon by the Department of the Army constituted wages which were includable in gross income. The ruling cited Van Rosen and section 1.61-2(b) of the regulations and simply stated the surgeon was not a member of the uniformed services and hence, not enitiled to the exclusion.

These two holdings, when viewed together with the Court

of Claims' recognition of the unique status of military service, seem to hint at a non-tax, non-economic decision to exclude the allowances from taxation as a matter of public policy based on the unique circumstances of military service.

IV. Conclusion

Although the principle of exemption of armed forces benefits and allowances appeared early in the history of the income tax, it has evolved through subsequent statutes, regulations, revenue rulings and court decisions. For some benefits, the rationale was a specific desire to reduce tax burdens of military personnel during wartime (such as combat pay provisions); other preferences have been based on the belief that certain benefits were intrinsic elements of the military structure and not compensatory in nature.

Whatever may have been the validity of the Jones rationale for excluding BAQ in 1925, subsequent fundamental changes in the structure of the military compensation system have seemingly rendered that decision an anachronism. While the Treasury regulations continue to exempt quarters and subsistence allowances from taxation under the income tax, the practice is best explained not as the result of a well-reasoned conclusion that some legal tax doctrine dictates such treatment, but as a product of a non-tax, non-economic policy decision on the part of the government to grant a special tax advantage to the nation's military personnel.[155]

Recognition of this fact in no way demands however, that the system be changed to equitably conform to the modern tax treatment accorded similar compensation among all other taxpayers of the country. Rather, it creates a more well-informed basis from which policy makers may rationally, and more freely, examine the validity and scope of tax benefits extended to the military.

Three options among many exist: (1) convert the military pay and allowance system to a gross salary system[156] similar to the civilian sector, making it more responsive to equitable treatment under the Code; (2) retain a system of pay and allowances but let each case rest on the requirements of section 119 to determine whether the allowance benefits are excludable (thereby terminating all exclusions for cash allowances); or (3) retain the current system of pay and allowances, including the exclusion provided by Jones and Treasury regulation section 1.61-2(b).

Acceptance of either of the first two proposals, while theoretically reducing some inequities both among individuals in the service as well as between service members and civilians, would necessitate a charge system for all members using public quarters. This would include not only families in government housing, but single personnel occupying barracks, bunks on ships or foxholes in the field.[157] Such

action logically leads to especially difficult guestions and logistic considerations in trying to meet the needs of the services since each requires the physical presence of certain individuals. Equally difficult would be the proper provision for communal facilities in which to house and feed single enlisted personnel. Furthermore, an appropriate upward adjustment in current pay scales would also be required to compensate for the loss of the tax advantage. This could be especially difficult to administer equitably under the second proposal.

These quickly identifiable military problems only support the conclusion that the tax-free nature of allowances is not strictly a legal tax issue. The issue is truly one of military necessity. It is that necessity which has spawned the long-standing and unchanged usage upon which servicemen and Congress have relied. Once seen in this light, the wisdom of the Jones decision is evident. Since the basic needs and customs of the military remain unchanged.

Should change in the method of taxing military pay and allowances by made, thefore, it should only be done on the basis of assessment of overall military necessity and readiness, not on the basis of strict tax policy or theoretical economic principles.

FOOTNOTES

1. Article I, Section 8 of the United States Constitution confers upon Congress the power to tax "to pay the debts and provide for the common defense and general welfare of the United States", but it wasn't until the 16th Amendment became effective on February 25, 1913, that Congress was given the express" power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI.

2. Act of August 5, 1861, 12 Stat. 309 (expired 1872).

3. Act of August 27, 1894, 28 Stat. 509.

4. Pollock v. Farmers Loan and Trust Company, 157 U.S. 429 (1895).

5. Pollock v. Farmers Loan and Trust Company, 158 U.S. 601 (1895). The Court expressly held that taxes on personal property, or on the income of personal property, as well as taxes on real estate or the income therefrom, were direct taxes and thereby unconstitutional.

6. Act of October 3, 1913, Pub.L.No. 37-16, 38 Stat. 166 (1913).

7. For the fiscal year ending September 30, 1980, the federal income tax was estimated to produce $298.3 billion, or approximately 60 percent of the total federal receits (and over 90 percent of the general tax revenues). Of that figure, approximately 77 percent was from individual income taxes. See B. Bittker and L. Stone, Federal Income Taxation 1(1980).

8. For example, compare the tax credits available under IRC §§ 36-45 with the penalties provided in IRC §§ 4940-48 dealing with penalties imposed on certain activities of private foundations or their managers.

9. For a thorough discussion of this point, see text accompanying notes 13-18 infra.

10. 1 Modernizing Military Pay, U.S. Department of Defense, Active Duty Compensation, Report of the First Quadrennial Review of Military Compensation, at 101(1967).

11. Quarters is the term commonly used to refer to the

residence or barracks housing military personnel, or the monetary allowance given for such use in lieu of the actual housing. Subsistence refers to the provision of meals for military personnel, or the monetary allowance given in lieu of the food actually being provided.

12. Treas. Regs. § 1.61-2(b), specifically provides, "Subsistence and uniform allowances granted (members) of the Armed Forces..., and amounts received by them as commutation of quarters, are to be excluded from gross income. Similarly, the value of quarters or subsistence furnished to such persons is to be excluded from gross income."

13. See generally 1 Department of Defense Study of Military Compensation 1-3, Vol. 1, pp. 1-3, 1962, for a discussion of the historical aspects of war for profit. The Mexican Wars and Indian Wars certainly had profit incentives since Texas and half the continent were involved. However, the military man did not share in those profits without getting out of the military to attain it. Similarly, there were no profits taken by the military man after the Spanish-American War. By the end of World War II, profit was so eliminated as a motive that the U.S. actually helped rehabilitate its former enemies back to financial stability.

14. Binkin, M., The Military Pay Muddle 2 (1975).

15. See M. Binkin and I. Kyriakopoulos, Paying the Modern Military 6 (1980). The need for the military to be competetive in the job market place has been further heightened by the end of the draft. Given the highly skilled requirements of many of the billets in the armed services, and the dollar value of those skills in the civilian sector, a promised pension after twenty-years service is insufficient to compete effectively to obtain and retain those skilled personnel.

16. U.S. Department of Defense, Study of Military Compensation 4-3 through 4-5 (1964).

17. See text accompanying notes 11 and 12 supra.

18. Although characterization of military pay and allowances in this manner is relevant to the discussion of the tax issues involved, it must appear stilted to the non-lawyer military reader. To those of us in the military, compensation is more readily viewed in terms of what is being paid for rather than how the element/benefit is taxed and in what form it is received. A more familiar

categorization would include: Basic Pay, Special or Supplemental Pays, and Allowances. It is of interest to note that the United States is not alone in compensating its military with these different components. A 1962 study indicated that of all thirteen countries considered (among them, the U.S., Russia, France, Great Brittain and Canada), all had a system of various pays and allowances. See 4 Department of Defense Study of Military Compensation 9, 1962, (available in Dept. of Def., Office of the Ass't Sec'y. of Def. for Manpower and Reserve Affairs).

19. The term, "basic pay", was initiated by the Career Compensation Act of October 12, 1949, Pub.L.Ch. 681, 81st Cong., 1st Sess., 63 Stat. 802. Prior to that time the primary compensation element was known as "base" pay (1922-1949) and "pay proper","pay of the troops" or "pay" (prior to 1922).

20. These supplementary pays are paid only for that period of time when the individual is engaged in the particular duty. Since they are earned by only a small percentage of the active duty force at any one time, they are not added to all salaries across the board. They would lose their identity, and with it their incentive value, should everyone receive the pay regardless of duty.

21. Supra note 16.

22. Implementing regulations for each of the pays, allowances and bonuses mentioned may be found in Department of Defense Military Pay and Allowances Entitlements Manual, March 22, 1982 (as updated through change 67). Hereinafter DODPAM.

23. 37 U.S.C. 310. This entitlement, known also as hostile fire duty pay, was first authorized by the Combat Duty Pay Act of 1952, 66 Stat. 538. See also Rev. Rule. 71-343, 1971 -2 C.B.92.

24. 37 U.S.C. §§ 302, 303 and 307.

25. 37 U.S.C. § 306.

26. 37 U.S.C. §§ 301 (b), 311 and 312.

27. The Supreme Court has held that retired pay is "compensation" ... continued at a reduced rate, and the connection is continued, with a retirement from active service only." United States v. Taylor, 105 U.S. 244 (1881). In holding that Federal law precludes a state

court from dividing military retired pay pursuant to community property laws, the Court recently reiterated this conclusion without deciding whether federal law prohibits a State from characterizing retired pay as deferred compensation. McCarty v. McCarty, 453 U.S. 210, 69 L.Ed.2d 589 (1981).

28. One of the reforms undertaken by the Tax Reform Act of 1976 (94th Cong. 2d Sess.) make a prospective change in the exclusion of disability payments for members of the armed forces and certain other government services. The exclusion continues to exist for those entitled to receive such payments on or before September 24, 1975; or for those who, such date, were a member of any of the specified organizations or under a binding written committment to become such a member. It further applies if the individual receives payments by reason of combat-related injuries (broadly defined to include many injuries other than just those received as a direct result of armed conflict). In addition, if he would be entitled to receive disability compensation from the Veteran's Administration, the payments will continue to be excludable. See S. Rep. No. 94-938, 94th Cong. 2d Sess. 138(1976). For a satirical comment on what was (or was not) accomplished by the 1976 change, see Bittker, Tax Reform and Disability Pensions - The Equal Treatment of Equals, 55 Taxes 363(1977).

29. 10 U.S.C. §§ 1431-46.

30. 10 U.S.C. §§ 1447-55.

31. I.R.C. § 122. Under the RSFPP as originally enacted, the characterization of the plan as an annuity necessitated the participant including in his gross pay the amount deducted from his retired pay as the cost of participation. Then, when a surviving spouse began receiving the benefits, she/he was required to include only a proportionate amount as gross income under Section 72 of the Internal Revenue Code. Section 72(n) of the Code now makes the payments to the beneficiary fully taxable as ordinary income. This treatment is consistent with that given to civilians who participate in similar qualified plans under the rules outlined in Chapter 1, Subchapter D of the Code.

32. The Career Compensation Act of 1949: Hearings on H.R. 5007 Before Subcommittee No. 2 of the House Armed Services Committee, 81st Cong., 1st Sess. (1949). Current applicable legislation is codified at 37 U.S.C. §§ 415-418.

33. 37 U.S.C.§ 415 provides only for an initial uniform allowance of not more than $200 as reimbursement for the purchase of required uniforms and equipment.

34. I.T. 3988, 1950-1 C.B.28, and Mim. 6463, 1950- 1 C.B.29 superceded by Rev. Rul. 70-474, 1970-2 C.B. 34, restating the holding that the cost of acquisition and maintenance of military uniforms is not deductible under IRC 162 because they are of a nature adjustable to general or continued useage to the extent they may take the place of regular clothing. Where, however, local regulations require the working-type uniforms (such as fatigues, wash khaki or dungarees) be worn, the cost of such uniforms and their maintenance is deductible to the extent it exceeds any uniform allowance received. Similarly, the cost of items or equipment required by the particular service which does not take the place of civilian clothes (such as shoulder boards, gold braid, sword, etc.) is deductible.

35. 37 U.S.C.§ 427. Implementing regulations may be found in DODPAY and corresponding service directives.

36. Uniformed Services Pay Act of 1981, Pub.L.No. 97-60. 95 Stat. 989 (1981). Current BAQ rates for members with dependents differ by as much as $64.20 to $122.70 more depending upon pay grade when compared with the BAQ rate for members of similar pay grade but without dependents. While this difference does not necessarily reflect the true difference in quarters living expense between the two groups, the arguement is clearly made that it does reflect a concern by Congress to recognize the additional needs of the member with a family and to encourage him/her to stay in the military. This allowance "differential" has been the subject of numerous discussions and comments by many single members of the military in calling for "equal pay for equal work." Such comments when applied to this allowance only tend to highlight the view of many members regarding the compensatory nature of all pay and allowances.

37. Military Personnel and Compensation Amendments of 1980, Pub.L.No. 96-343, 96th Cong. 2d Sess, 94 Stat. 1123 (1980).

38. Ibid.,§ 4(B).

39. Supra note 10, at 16.

40. IRC§ 117(g) provides the special rules for members of the Armed Forces who move pursuant to military orders and incident to a permanent change of station. It is this

subsection that excludes from gross income in-kind moving and storage expenses as well as reimbursements and allowances relative to such a move. See also Rev. Rul. 71-343, 1971 -2C.B.92, (dislocation allowance is part of compensation excludable from gross income).

41. Supra note 13, at 17. 37 U.S.C.§§ 404 and 406 provide for separation travel entitlements including transportation of the member and his dependents and household goods, or reimbursement for such transportation, from the place of separation to his home. The "policy demonstrates the intent of the Congress to defray the expenses encountered by a service man in returning to his home or to the place where he entered the service from civilian life." H.Rep.No. 93-1255, 93d Cong., 2d Sess. 43(1974).

42. IRC§ 692(a).

43. IRC§ 112(d). For a complete discussion of the tax implications of this section see Gordon, H., The Federal Income Tax Significance of Being a POW or MIA, 53 Taxes 551(1975).

44. IRC§ 82.

45. See Economic Recovery Tax Act of 1981, Pub.L.No. 97-34, 801, 95 Stat 172 (1981), amending Sec. 1 of Pub.L. No. 95-427. The prohibition now extends until Dec. 31, 1983.

46. Comm. on Ways and Means, U.S. House of Rep., "Discussion Draft Bill and Report on Employee Fringe Benefits" 2, February 15, 1979.

47. IRC§ 61(a)(1).

48. Treas. Regs.§ 1.61-2(d).

49. See text accompanying notes 32-44 supra.

50. Task force on Employee Fringe Benefits, Comm. on Ways and Means, U.S. House of Representatives, 95th Cong. 2d Sess., Tax Treatment of Fringe Benefits 2,4 (Comm. Print 1978),(statement of Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy).

51. The list could also include payments for non-duty periods, enjoyment in retirement of numerous active duty benefits, availability of retirement homes, space available travel on certain military flights, legal assistance and various other minor benefits. The Dept. of Defense has opined that these benefits have been "seen by some of the extreme elements of the public and legislative bodies as a secret treasure of military personnel which the latter attempt to disguise, and through which real compensation is enormously enhanced." See note 13, at p. 63.

52. Cf. IRC§ 105(b), (amounts paid, directly or indirectly, to the taxpayer to reimburse him for expenses incurred for medical care);§ 117 (various scholarships and federal grants, but the difference between federal and non-federal employees regarding the requirement of future services);§ 79 (allowing for exclusion of cost of group-term life insurance to extent of $50,000 policy); 120, (group legal services plans); and§ 127 (educational assistance programs). Special legislation has excluded from income amounts received through 1984 by service members who started training under the Armed Forces Health Professions Scholarship Program before 1981. This includes stipends, tuitions, laboratory fees and books. It does not apply to regular pay and allowances received on active duty.

53. Department of the Treasury, Fringe Benefits; Notice of Publication of Discussion Draft of Regulations, 40 Fed. Reg. 41118(1975); withdrawn at 41 Fed. Reg. 56, 334 (1976). See also Phillips. L., The Taxation of Executive Perquisite in Light of Recent Developments, 12 Tax Advisor 607 (1981) (examining the current state of t xation of fringe benefits in view of the withdrawal by Treasury of the Discussion Draft of Proposed Regulations and the prohibition at note 44 against the issuance of Treasury regulations).

54. The 1981 draft would tax for example, such notable current exemptions (among others) as airline flights for employees, personal financial and tax counseling, and country club dues.

55. The following states have not enacted statutes permitting reciprocal enforcement of income taxes: Connecticut, Florida, Montana, Nevada, New Mexico, Texas, Utah, and Wyoming. Only Arizona and Nevada have not entered into agreements with the Internal Revenue Service for the exchange of tax data in order to make their tax collection more efficient.

56. Soldiers' and Sailors' Civil Relief Act of 1952, 50 USC § 574. Section 514 of the Act was specifically enacted to alleviate the hardship referred to in the text. As recently as 1976 however, the sanctity of that section was challenged and its repeal was recommended. See, Advisory Commission on Intergovernmental Relations Report, A-50, State Taxation of Military Income and Store Sales 4,5 (July 1976). See generally, Losey, F., Multiple State Taxation of Military Income, 19 A.F.L. Rev. 38 (1977).

57. Id.

58. Sanftner, The Serviceman's Legal Residence: Some Practical Suggestions, 26 JAG J. 87, 106(1971).

59. Although domicile may be changed with relative ease, a problem arises when the member either scatters the indicia of domicile among several states or tries to make a change late in a career and only for a short period. To effect a bona fide change of domicile the member's actions must be positive and unequivocal.

60. As already indicated in the text, a few provisions of the Code prescribe special tax benefits to members of the uniformed services, taking account of the hazards, travel obligations and other special features of military life. The Code and Treasury regulations do not, however, contain all of the relevant rules since these provisions often turn on the status of the individual in his/her branch of service. It therefore becomes necessary to consult the regulations and legislation peculiar to the particular armed service to determine the tax application of an item as it relates to a specific individual.

61. 21 Op. Att'y Gen. 112(1895).

62. T.D. 2079 (Nov. 24, 1914).

63. This is apparently the first use of the expression, "convenience of the government," and precedes by four years the first use of the expression, "convenience of the employer" to explain the emerging doctrine with the same name. See comment, Tax Treatment of Compensation in Kind, 37 Calif. L.Rev. 628 (1949), and Art. 33, Regs. 45 under the Revenue Act of 1918.

64. Maintenance furnished Red Cross employees, O.D. 11,1 C.B. 66(1919); seamen, O.D. 265, 1 C.B. 71(1919); the receipt of "supper money", O.D. 514, 2 C.B. 90(1920); certain fishing and canning employees, O.D. 814, 4 C.B. 84 (1921); hospital employees on call, O.D. 915, 4 C.B.

85(1921).

65. 60 Ct. Cl. 552(1925), reprinted in T.D. 3724, IV-2 C.B. (1925). Despite the fact the Jones case is cited by numerous authors as being the first major case to examine the general problem of the exclusion of employer furnished meals and lodging, the doctrine is not mentioned by name in the opinion.

66. Section 213 of the Revenue Act of 1921 (42 Stat. 237), defined "gross income" as including, "gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and Interior Courts of the United States, and all other officers and employees, whether elected or appointed of the United States..., the compensation received as such) of whatever kind and in whatever form paid...."

67. Supra note 65, at 555-62.

68. Supra note 65, at 559.

69. The revenue acts prior to 1918 excluded from income taxation the compensation received by the President, Federal Judges, and officers and employees of a State, except as to the latter such as might be paid to them by the Federal Government. The revenue acts of 1918 and 1921 taxed the compensation of the President and Federal judges. The tax imposed on the Federal judiciary was declared constitutional in Evans v. Gore, 253 U.S. 245(1920).

70. Eisner v. Macomber, 252 U.S. 189(1920). Income was defined as "the gain derived from labor, from capital or from both combined." This construction gave rise to the argument that unless the factor of labor or capital were present, the definition did not encompass the item as income and the income tax would not apply.

71. Supra note 65, at 570.

72. The Service earlier had expanded the Jones exemption to include enlisted men and non-commissioned officers, I.T. 2219, IV-2C.B. 41(1925), and members of the Army, Navy, Marine Corps and Coast Guard, IT 2232, IV-2 C.B. 144(1925). The 1926 regulation cited pertained only to the value of quarters and the commutation of such.

73. Treas. Regs. § 1.61-2(b).

74. Connelly v. Cr, 8 T.C. 848(1947) dealt with the issue of

where none had existed before. H.R. Rep.No. 775, 85th Cong., 1st Sess. 7, reprinted in (1958) U.S. Code Cong. News 4791.

89. IRC§ 119(a)(2). For application and discussion of this rule see Olkjer v. CIR, 32 T.C. 464, 468(1959); Stone v. CIR, 32 T.C. 1021(1959); Rev.Rul. 71-267, 1971-1 C.B. 37; Rev.Rul. 68-354, 1968-2 C.B. 60; and Treas. Reg. § 1.119-1(d), Ex.5.

90. Treas. Regs.§ 1.119-1(a)(2)(i).

91. Id. at § 1.119-1(a)(2)(ii).

92. Id. at § 1.119-1(a)(2)(ii)(e).

93. Id. at § 1.119-1(a)(2)(ii)(d).

94. IRC § 162(a)(2).

95. 389 U.S. 299(1967).

96. Supra note 84, at 96. Prior to both Kowalski and Correll, in a case with facts similar to those in Kowalski, the EighthCircuit (with Justice Blackman then sitting as a Circuit Judge) had held in the alternative to exclusion that if the subsistence allowance were includable in gross income, it was deductible under section 162(a)(2). United States v. Morelan, 356 F. 2d 199 (8th Cir 1966).

97. See text accompanying notes 39 and 40 Supra.

98. A complete discussion of section 162 is beyond the scope of this thesis. See generally B. Bittker and L. Stone, Federal Income Taxation 282-371(1980).

99. Supra note 74 and accompanying text. See Rev.Rul. 70-281, 1970-1 C.B. 16 (family separation allowances): Rev.Rul. 61-5, 1961-1 C.B. 8 (Cost-of-living allowance to defray excess quarters costs).

100. Pay Readjustment Act of June 10, 1922, Pub. L. No. 67-235, 42 Stat. 625, 628 (1922).

101. Id. at 628.

102. Supra note 65, at 571.

whether the taxpayer was a commissioned officer in the Coast Guard and therefore entitled to the tax benefit.

75. See generally Comment, Cr. v. Kowalski; Cash Reimbursements to State Troopers for Meals Examined, 5 Ohio N.U.L. Rev. 495(1978), and Note, Dissection of a Malignancy; The Convenience of the Employer Doctrine, 44 Notre Dame Law. 1104(1969). For the history of the convenience of the employer doctine, see Cr v. Kowalski, 434 U.S. 77(1977).

76. Benaglia v. Commissioner, 36 B.T.A. 838(1937).

77. Van Rosen V. Commissioner, 17 T.C. 834(1951).

78. Van Rosen was a civilian ship captain employed by the U.S. Army Transportation Corps. Both his pay and subsistence allowances were determined by Marine Personnel Regulations of the Corps. His principal argument in the Tax Court was the factual similarity of his case to Jones v. United States, 60 Ct.Cl. 552(1925).

79. Supra note 77, at 838.

80. 1950-1 C.B. 15.

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

82. See, e.g. Saunders v. Commissioner, 215 F.2d 768, 773 (3d Cir. 1954); Gordon v. United States, 52 F. Supp. 427 (D.N.J. 1957).

83. H.R. Rep.No. 1337, 83d Cong., 2d Sess. 18(1954) reprinted in (1954) U.S. Code Cong. & Ad. News 4017, 4042; See also S. Rep.No. 1622, 83d Cong., 2d Sess. 19, 190-191(1954).

84. Cr. v. Kowalski, 434 U.S. 77, 54 L. Ed. 2d 252, 98 S. Ct. 315(1977).

85. Kowalski v. Commissioner, 65 T.C. 44(1975), rev'd, 544 F. 2d 686 (3rd Cir. 1976), rev'd, 434 U.S. 77(1977).

86. The 1978 amendments to the Code clarified § 119 by requiring the meals and lodging be furnished " by or on behalf of" the employer.

87. IRC § 120(1954)(repealed by the Technical Amendments Act of 1958, § 3, 72 Stat. 1607).

88. Congress repealed the provision because it was unfair to allow a few to deduct an expense common to so many, and because police departments were creating meal allowances

103. This would be true because the officer with dependents is given an allowance slightly greater than an officer without dependents. Hence, if both were to live in public quarters, the officer with dependents would be considered to receive quarters of greater value.

104. Supra note 65, at 569.

105. Both the Service and the Tax Court have, in the past, relied on the employer's characterization as the basic theory for employing the convenience of the employer doctrine. See Mim. 5023, 1940-1 C.B. 14, Mim. 6472, 1950-1 C.B. 15 (clarifying Mim. 5023), and Doran v. Commissioner, 21 T.C. 374(1953). Subsequently, the legislative history of Section 119 makes it clear that characterization of the employer is only one of the elements to consider when analyzing all the facts and circumstances of a case. See S.Rep.No. 1622, 83d Cong., 2d Sess. 190(1954); and Treas. Regs. § 1.119-1(a)(2).

106. Supra note 65, at 577-578.

107. Id., at 573. See text accompanying note 100 supra.

108. Army Regulations No. 35-4220 (promulgated September 21, 1922, pursuant to the authority contained in the Act of June 10, 1922)(cited in Jones at 558).

109. Frontiero v. Richardson, 411 U.S. 677, 93 S.Ct. 1764, 36 L.Ed.2d 583 (1973).

110. Id., at 679 and 1766.

111. Weaver v. Prince George's County, 281 Md. 349, 379 A. 2d 399, 409 (Ct. App 1977).

112. H.R. Rep. No. 549, 89th Cong., 1st Sess. 24 (1965). The Federal income tax advantage is, conceptually, the additional amount of taxable income a member of the armed service would have to receive under the given tax rates, in a system in which cash and in-kind BAQ and BAS were fully taxable to produce the same after-tax compensation the member now receives under the system where those allowances are tax-exempt.

113. See Department of Defense, Third Quadrennial Review of Military Compensation 45 (1976)(located Army Library, Pentagon).

114. Supra note 112.

115. Pub.L.No. 90-207, 81 Stat. 649 (1967).

116. Pub.L.No. 93-419, 88 Stat. 1152 (1974).

117. Pub.L.No. 96-579, 94 Stat. 3368, 3369 (1980) amended the 1974 definition by inserting the parenthetical phrase. The effect of this addition is to increase the tax advantage, and hence the RMC, above the level of any cash payments received because of the allowances.

118. See text accompanying note 102 supra.

119. Department of Defense Appropriation Act, 1977, of July 14, 1976, Pub.L.No. 94-361, 90 Stat. 923, 925 (1976).

120. Pub.L.No.77-607, 56 Stat. 359, 361(1942).

121. Supra notes 100 and 101 and accompanying text.

122. S. Rep.No. 1185, 77th Cong., 2d Sess. 9 (1942)(available in GSA Library, Washington, D.C.). See also H.Rep.No. 2080, 77th Cong., 2d Sess. 8 (1942); generally, Hearings on S. 2025 Before the Committee on Military Affairs, House of Representatives, 77th Cong., 2d Sess. 12 (1942)(noting the government's assumption of the obligation of providing an officer with a place to live).

123. Pub.L.No. 81-351, 63 Stat. 802, 812-813(1949).

124. Hearings on H.R. 2553 Before a Subcommittee of the Committee on Armed Services of the House of Representatives, 81st Cong., 1st Sess. 1678 (1949)(available in Army Library, Pentagon).

125. Pub.L.No. 88-132, 77 Stat. 210 (1963).

126. Id., at 216-217.

127. 37 U.S.C. 403(b)(enacted as Pub.L.No. 97-22, 95 Stat. 124, 138 (1981)).

128. Office of the Chief of Naval Operations, OPNAVINST 11101.13 G, Feb. 25, 1978 (citing DOD policy).

129. Supra note 65, at 568.

130. See S. 2586, 97th Cong., 2d Sess. (1982)(Military Construction Authorization Fiscal Year 1983) and S.Rep.No. 97-440, 97th Cong., 2d Sess. (1982).

131. U.S. Const. amend. XVI.

132. Rapp, Some Recent Developments in the Concept of Taxable

Income, 11 Tax L.Rev. 329 (1956).

133. Cf. White v. United States, 305 U.S. 281, 291 (1938)(Referring to sections 101 and 115 the Court said, "repeated enactment... is upon accepted principles a Congressional adoption of the regulation as correctly interpreting those sections...").

134. Supra note 84, at 95, 96.

135. Supra note 70.

136. Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955).

137. Id. at 429-30.

138. Treas. Regs. § 1.61-1(a).

139. Id., § 1.61-2(a)

140. Supra note 84.

141. Id. at 94.

142. Saunders v. Commissioner, 215 F. 2d 768, 771 (3d Cir. 1954).

143. Kowalski v. Commissioner, 65 T.C. 44 (1975), rev'd, 544 F. 2d 686 (3d Cir. 1976), rev'd 434 U.S. 77 (1977).

144. Supra note 142.

145. Supra note 84, at 94.

146. Treas. Regs § 1.119-1(a)(1).

147. Supra note 32.

148. See text accompanying notes 112 through 119 supra.

149. Table 2 lists an estimate of the annualized tax advantage for all military personnel from 1982 through 1987.

150. Supra notes 46 through 48 and accompanying text.

151. See text accompanying notes 114 through 117 supra.

152. Comment, Dissection of a Malignancy; The Convenience of the Employer Doctrine, 44 Notre Dame Law 1104, 1130 (1969). Since a member of the military is subject to all lawful orders, disobedience of the order to move to a certain post or station, or live on board the

installation, may result in criminal action against him, including court-martial and imprisonment.

153. Supra note 77, at 839.

154. Rev.Rul. 60-66, 1960-1 C.B. 21.

155. Compare the recent decision in United States v. County of Humboldt, Calif., 445 F. Supp. 852 (N.D.Cal. 1978), wherein the District Court for the Northern District of California seemingly took at face value the dicta of Jones that quarters furnished to the military were solely for the benefit of the United States, not for the benefit of the personnel. The court found no difficulty in distinguishing military personnel's occupancy of assigned quarters from the Forest Service employees' occupancy of dwelling units, stating, "... the business (of the Forest Service employees) was completely incidental to the main use of the property." By implication therefore, the court suggested that government business was not simply incidental to the serviceman's occupancy of quarters. Query if this applies to his receipt of an allowance for quarters in lieu thereof.

156. The Quadrennial Review of Military Compensation made such a recommendation in late 1967 (see note 10 supra). It was endorsed by the Gates Commission Report on an All-Volunteer Armed Force in 1970. Others have made similar recommendations.

157. Conceivably, an administrative nightmare could ensue not only over keeping track of all personnel, but in valuation of the various amenities.

Table 1

State Taxation of Military Income

	A State Inc. tax	B Acdu mil pay exempt	C Ret'd Pay exempt	D Dis. Ret'd Pay exempt	E Inherit/ tax on annuity	F Inc. tax on SBP annuity	G Cost of SBP txble
Alabama	yes 4/	no	8000	all	no	yes 1/	yes
Alaska	none 1/	-	-	-	"	-	
Arizona	yes	1st $1000	no	yes 1/	"	yes	no
Arkansas	yes	1st $6000	$6000	yes	"	yes	yes
California	yes	1st $1000	to $1000	yes	"	yes	no
Colorado	yes	no	age 2/	yes	"	yes 3/	"
Connecticut	none 2/	-	-	-	"	none 2/	no
Deleware	yes 3/	no	$2000 1st	yes	"	yes	"
Dist of Columbia	yes	no	no	yes 1/	"	yes	yes
Florida	none 1/	-	-	-	"	none 2/	no
Georgia	yes	no	1st $2000	yes	"	yes	"
Hawaii	yes 3/	no	yes 1/	yes 1/	"	no	"
Idaho	yes 3/	no	no	yes 1/	"	yes 4/	"
Illinois	yes 1/	yes 1/	yes 1/	yes	"	no	"
Indiana	yes	1st $2000	yes 1/	"	yes 5/	"	
Iowa	yes	no	no	yes 1/	"	yes	"
Kansas	yes 4/	no	1st $2000	yes 1/	"	yes	"
Kentucky	yes	no	>65 grad	yes 1/	"	yes	"
Louisiana	yes	no	no	yes 1/	"	yes	"
Maine	yes	no 2/	no 4/	yes 1/	"	yes	"
Maryland	yes	no	$7400 >65	yes 1/	"	yes	"

State Taxation of Military Income

	A State Inc. tax	B Actu mil pay exempt	C Ret'd Pay exempt	D Dis. Ret'd Pay exempt	E Inherit/ tax on annuity	F Inc. tax on SBP annuity	G Cost of SBP txble
Massachusetts	yes	no	no	yes 1/	"	yes	"
Michigan	yes	yes	yes 1/	yes	"	yes	"
Minnesota	yes	no	1st $1000	yes 1/	"	yes	"
Mississippi	yes	no	1st $5000	yes 1/	"	yes 6/	yes
Missouri	yes 3/	no	no	yes 1/	"	yes	no
Montana	yes	yes	1st $3600	yes	"	yes 7/	"
Nebraska	yes 4/	no	no	yes 1/	"	yes	"
Nevada	none 1/	-	-	-	none 2/	none 2/	no
New Hampshire	none 2/	-	-	-	no	none 2/	no
New Jersey	yes	no	no	yes 1/	"	yes	yes
New Mexico	yes	no 2/	no	yes 1/	no	yes 8/	no
New York	yes 3/	no	1st $20000	yes 1/	"	yes	"
North Carolina	yes	no	1st $3000	yes	"	yes	"
North Dakota	yes	1st $1000	1st $5000	yes 1/	"	yes 9/	"
Ohio	yes	no 2/	no	yes 2/	"	yes 10/	"
Oklahoma	yes 5/	no	1st $1500	yes	"	yes	"
Oregon	yes	1st $3000	yes 6/	yes 1/	yes 1/	yes	"
Pennsylvania	yes 3/	no	yes 1/	yes	no	no	"
Rhode Island	yes	no 2/	no 4/	yes 1/	"	yes	"
South Carolina	yes	no	1st $1200	yes 1/	"	yes	"
South Dakota	none 1/	-	-	-	"	none 2/	no
Tennessee	none 2/	-	-	-	"	none 2/	no
Texas	none 1/	-	-	-	"	none 2/	no
Utah	yes	no 2/	no	no	"	yes	"
Vermont	yes	yes 1/	no 4/	yes 1/	"	yes	"
Virginia	yes	no 2/	no 4/	yes 1/	"	yes	"
Washington	none 1/	-	-	-	"	none 2/	"
West Virginia	yes 3/	1st $4000	yes 1/	yes	"	no	"

NOTES FOR TABLE 1

1 - State Inc. Tax
2 - Inher/Est Tax on SBP/RSFPP annuities
3 - ACDU mil pay exempt
4 - Dis. Ret'd Pay Exempt

Notes Col A
1. No tax imposed
2. Inc. tax imposed on investment inc.
3. ACDU mil. legal residents maintain domicile outside state on PCS orders are not considered residents for inc. tax purposes.
4. Unless in combat zone.
5. ACDU out of state - 1st $1500 exempt.

Notes Col. B

1. All military ACDU pay exempt.
2. Exclusions same as federal.
3. Add'l $300/mo. exclusion for ea. month out of country.

Notes Col. C

1. All mil. ret'd pay exempt.
2. 1st $2000 if under age 55 $15,000 if over 55.
3. if over age 60 and not using tax credit for elderly
4. same as federal
5. reduced $ for $ by amnt fed. adj. gross inc. > $17,000
6. 1st $3400 > 65. If < 65, then red. $ for $ by earned inc.

Notes Col D

1. exemption is same as federal
2. to extent excluded fr. fed. adj. gr. inc.

Notes Col E

1. $100,000 exemption
2. no tax imposed

Notes Col F

1. $8,000 ann. exemption (Basis of annuity amnt contrib by member.
2. no tax imposed
3. $15,000 exemption if over 55
4. Variable exemption at age 60 (62 if disabled)
5. $2000 exemption at age 60 (if not claiming tax credit for

elderly)
6. $5000 annual exemption
7. $3600 annual exemption
8. $6000 exemption of age 65 or older. $3000 if under 65 and spouse age 62 or older. If not, exemption begin when dependent would have been 62
9. $5000 at age 60 (reduced by Soc Sec benefits)
10. $4000 annual exclusion

TABLE 2

Exclusion of Benefits and Allowances

to Armed Forces Personnel

Estimated Revenue Loss

(in Millions of dollars)

FISCAL YEAR	TOTAL
1982	1,885
1983	1,940
1984	2,025
1985	2,160
1986	2,310
1987	2,465

Committee on the Budget

United States Senate

97th Cong. 2D Sess., March 17, 1982

TABLE 3

1972 Adjusted Gross Income of Military Members*

ADJ. GROSS INCOME	PERCENT OF MILITARY POPULATION
$1,000-<$2,000	9.4
$2,000-<$4,000	19.6
$4,000-<$6,000	26.5
$6,000-<$8,000	15.0
$8,000-<$10,000	10.4
$10,000-<$12,000	6.6
$12,000-<$14,000	4.7
$14,000-<$17,000	3.7
$17,000-<$20,000	2.0
$20,000-<$25,000	1.4
$25,000 or more	0.7

Table from Sailer, P. and Vogel, L., Exploration of Differences Between Linked Current Population Survey and Internal Revenue Service Data for 1972, Proceedings of the American Statistical Society 130 (1975).

* Exclusive of those members overseas or living in public quarters.

TABLE 4

Annual "Formal" Tax Advantage by Pay Grade
(1981) Tax Rates -- 1 Oct 81 RMC Rates)

Pay Grade	Range of Tax Advantage Low	High	Average Tax Advantage
O-10	$6,828	$8,176	$8,153
O-9	6,828	8,176	8,154
O-8	6,828	8,176	8,146
O-7	6,828	8,080	8,021
O-6	4,164	6,901	6,341
O-5	3,080	5,747	4,725
O-4	1,818	4,772	3,411
O-3	1,560	3,710	2,650
O-2	1,266	2,754	2,073
O-1	956	1,947	1,340
W-4	2,058	4,335	2,984
W-3	1,638	3,278	2,128
W-2	1,252	2,490	1,701
W-1	1,002	2,105	1,439
W-9	1,971	3,307	2,523
W-8	1,523	2,734	1,944
E-7	1,255	1,255	1,579
E-6	989	1,652	1,324
E-5	950	1,381	1,149
E-4	831	1,064	1,003
E-3	745	1,028	871
E-2	733	1,178	792
E-1	703	1,262	738

Includes increases for pay grades O-7 through O-10 resulting from increase in Executive Level V rate from $50,112.50 to $57,500.00 on January 1, 1982.

Figures provided by Office of Assistant Secretary of Defense for Manpower, Reserve Affairs and Logistics.