In the

Supreme Court of the United States

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, PETITIONER,	)	
V.	)	No. 76-1058
UNITED STATES OF AMERICA, RESPONDENT	)	

Washington, D. C.
October 12, 1977

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IN THE SUPREME COURT OF THE UNITED STATES

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, Petitioner,	
v.	No. 76-1058
UNITED STATES OF AMERICA, Respondent	

Washington, D. C.

Wednesday, October 12, 1977

The above-entitled matter came on for argument at 1:55 o'clock p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

MISS SHARON L. KING, One First National Plaza, Suite 4200, Chicago, Illinois 60603 For Petitioner

STUART A. SMITH, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C. 20530
For Respondent

C O N T E N T S

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in No. 76-1058, Central Illinois Public Service Company versus the United States.

Miss King, I think you may proceed whenever you are ready.

ORAL ARGUMENT OF MISS SHARON L. KING

ON BEHALF OF PETITIONER

MIS KING: Mr. Chief Justice and may it please the Court:

This case, unlike the prior case, does not present an income tax question. It is a withholding tax case. It involves the scope of the withholding tax provisions and primarily the definition of the term "wages."

An item is not subject to withholding unless it is a wage within the meaning of the statute.

The facts in this case are basically agreed upon. The Petitioner, a public utility company, reimbursed its employees in the Year 1963 for expenses which they incurred in traveling on required trips on the company's business.

The Petitioner used the same method of reimbursement. It reimbursed on the same basis for overnight and non-overnight trips.

The Government's contention is that Petitioner should have withheld on the reimbursement payments which were

made to employees for meal expenses incurred on non-overnight trips.

There is no question that withholding is required on any of the other reimbursement payments.

QUESTION: There is no question it is not required.

MISS KING: That is correct, yes.

The district court held for Petitioner. It concluded that the Government's requirement of withholding on the non-overnight trip reimbursements was a departure from the realities of business life and a vigorous stretching of the statute.

The Seventh Circuit reversed and in reversing held in effect that virtually every item arising out of the employment relationship should be included in the withholding base and should be subject to withholding.

QUESTION: Miss King, let me ask a question or two, if I may. We are concerned here with 1963 liability, are we not?

MISS KING: Yes, that is correct.

QUESTION: Does that mean that we have the same issue up for every year since that time, 14 years?

MISS KING: There are prospective years. They are not before the Court.

QUESTION: Is there any claimed element of bad

faith in this case?

MISS KING: No.

QUESTION: Has the Government attempted tax these items to the individual employees as far as you know?

MISS KING: Yes, it has.

QUESTION: Successfully?

MISS KING: Yes. As a matter of fact, the Ahrens case is a case which involves one of the Petitioners' employees. The employee, Ahrens, paid the tax and then sued for a refund, questioning whether he had an offsetting income tax deduction.

In the years prior to this case, the government did pursue the employees but it is obviously much easier to pursue the employer so that is why the change in 1963.

QUESTION: Well, is judicial reaction uniformly that it is income subject to tax to the employee?

MISS KING: Every item of reimbursement is deemed to fall within the broad definition of gross income but there is an offsetting deduction for these items so that the effect is -- and it is generally considered that these items are not income but they are treated as taxable income and then subject to an offsetting income tax deduction.

QUESTION: Under Illinois law, if you lose here, would your client have a claim for restitution against the employees from whose wages it did not deduct these amounts?

MISS KING: I suppose it would have a claim, but as a practical matter, it would just --

QUESTION: Be kind of a theoretical matter.

MISS KING: -- be impossible to pursue all these people.

If the withholding statute is interpreted as the Seventh Circuit interpreted it and as the Government contends here, to include every economic benefit arising out of the employment relationship, the effect will be that almost every employer in this country will be in violation of the withholding tax provisions.

QUESTION: Do you understand the Government's claim to be as broad as you just characterized it?

MISS KING: Yes, I do. As a matter of fact, on page 20 of their brief in the second full paragraph, the last full sentence, the Government says, "The statutory 'concept' of wages is not tied to the performance of any particular service, but includes any personal economic benefit given by an employer to his employee as a result of the employment relationship.

QUESTION: Do you think that would mean that employees who worked in an office and that office was heated, would have to pay for their share of the heat?

MISS KING: That is a possible interpretation if we are talking about every economic benefit.

If every economic benefit is included, the problems are enormous; first of all, identifying what is in the withholding base such as heating and air conditioning and comofrtable offices --

QUESTION: Telephones.

MISS KING: Telephones. After identifying them, there are valuation problems where there are non-cash items involved and there are all sorts of problems in determining whether the regulations which exclude or exempt items from the definition of wages are still applicable.

QUESTION: Well, I suppose, since it would be pretty difficult to handle the accounting in charging people for the amount of heat that they absorb or light that they use, let me give you a more concrete one.

Do you suppose that it would include a Thanksgiving turkey -- if an employer gave a Thanksgiving turkey to every employee that was worth -- $20, I suppose, these days, he would have to withhold from their pay check whatever is the tax on $20?

MISS KING: That is right. There is an exemption or an exclusion under the regulations now for facilities and services -- that is, courtesy discounts or a medical center or related things, but of course, if every economic benefit is included, it does raise the question on what the effect of that regulation might be.

QUESTION: There are specific -- this is not a statute, but regulations with respect to bonuses, are there not?

MISS KING: Yes.

QUESTION: Yes. Of even greater significance, there is a regulation with respect to reimbursements for travel expenses and I would like to say that both the lower courts held that the amounts here involved are reimbursements for legitimate travel expenses. That is not a fact question and this regulation is so important to this case I would like to read it. It is on page 12 of our opening brief, which is the blue-covered brief. It is at the top of that page.

It says, "Traveling and other expenses. Amounts paid specifically -- either as advances or reimbursements -- for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding."

We think this regulation should dispose of this case.

The Government does not challenge the validity of the regulation.

QUESTION: They could not. It is the Government's regulation.

MISS KING: Yes, it is. And it has been in the regulations since the early 1940's when the present withholding tax provisions were adopted. The present withholding tax provisions were adopted in 1942 and 1943 and this came in in 1943 and it has been there ever since.

The Government contends, though, that this regulation should be read to apply only to reimbursements or allowances where the employee is not entitled to an offsetting business deduction but there is nothing in the regulation that says that.

The Government does point to the ordinary and necessary language which it says refers back to Section 162 and the employee's deductions but Section 162 applies to employers as well as it applies to employees and, further, these regulations are written for employers.

It is the employers' obligation to withhold which is involved and so they are in terms of, as this regulation says, "Amounts paid as advances or reimbursements, not amounts received and ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer, not the business of the employee and as Mr. Smith said earlier, those are two different things.

The Government in this case has essentially --

QUESTION: Miss King, may I interrupt, just to be sure I follow this argument?

MISS KING: Certainly.

QUESTION: Is this the regulation that provides the authority for excluding the amount paid on overnight trips from wages?

MISS KING: This regulation applies to exclude -- if you are talking about the Correll case, no, it is not.

QUESTION: I am talking about your company's practice of not including them in wages. You do not include them whehter they are overnight or not.

MISS KING: That is correct.

QUESTION: The Government agrees that you probably exclude the reimbursements insofar as they relate to overnight trips.

QUESTION: Correct.

MISS KING: Yes.

QUESTION: And is the reason they agree that it is proper based on this regulation?

MISS KING: Yes, that is correct.

QUESTION: And then, does not your questioning about the difference between employer and employee equally raise the question about that practice?

MISS KING: Well, I think -- if I understand your question correctly, this regulation is significant because it uses the word "traveling." It does not use the words, "Travel away from home." The employee's deduction, under

Section 162, is based on language allowing him a deduction for travel away from home and it --

QUESTION: The statute does not say anything about that.

MISS KING: No, the withholding statute says nothing.

QUESTION: No, nor does any other statute say it.

MISS KING: That is correct.

QUESTION: And 162 does not say anything about that.

MISS KING: Yes, it says "Travel away from home." Section 162 does.

QUESTION: Well, away from home, but nothing about overnight.

MISS KING: No. But this Court in Correll interpreted the "away from home" language to mean away from home overnight but the --

QUESTION: Over substantial dissent.

QUESTION: That is true of a large percentage of the decisions of this Court.

MISS KING: But the away from home concept is not incorporated in these regulations and this is, I think, of particular significance because the Government claims that its overnight theory was established just about the time -- about three years prior to the time this regulation was

issued.

QUESTION: Is not the issue whether the overnight concept is incorporated in this regulation? Is not that the very thing we have to decide here?

MISS KING: Well, I think the issue is -- that is what brings the case to this Court but I think the issue is broader than that and that is that if travel expense reimbursements are included in the withholding base because of the theory that every economic benefit arising out of the employment relationship should be treated as a wage subject to withholding, that that is really the question which is involved and that is the basis for the Seventh Circuit's holding.

QUESTION: Perhaps they should have written a narrower opinion but perhaps that is not really dispositive of the question of how you decide the case.

MISS KING: I think that is the Seventh Circuit's view and that is the view which the Government is espousing here but there is nothing in the withholding provision which draws a distinction between overnight and nonovernight and I would like to go on and say that the Government arrives at its theory by attempting an equivalence between the broad definition of gross income in the income tax provisions and the more narrow term, "wages" in the withholding tax provision. It does this although the word "income" does not

appear in the withholding tax statute.

At one time many years ago, when one of the initial withholding tax statutes was adopted, this was in the tariff of 1913, Congress did try for an all-inclusive withholding provision and in that provision, among other things, they included all annual gains, profits and income.

As it turned out, the Department of the Treasury was soon back to Congress saying, "We are having difficulty with collections and furthermore, those that are made are erroneous and excessive and it is causing us a great burden."

So in 1942, when the present withholding system was adopted, Congress still had the option to go to income but it did not, it went to the term, "wages."

QUESTION: Miss King, at the outset you made a point of emphasizing that, unlike the previous case, this was not an income tax case but a withholding tax case.

MISS KING: Yes.

QUESTION: Does that -- may I properly infer from that point that you so emphasized that even if you prevailed and even, therefore, if your client need not withhold these payments, they may nonetheless be income to the employees?

MISS KING: Yes. Yes, that is correct.

QUESTION: Or put another way, wages may not mean the same as income from a job.

MISS KING: That is correct and as a matter of

fact, the Government's own rulings have so said.

QUESTION: Well, the statute says so.

MISS KING: The statute so says.

QUESTION: Income includes wages, among many other things.

MISS KING: Yes, they are not synonymous terms. The Government, in a number of rulings, has found in various situations that an employee may have an income result from a payment he receives but the employer does not have a withholding obligation and the uniform decided cases, up to the Seventh Circuit's decision below, in the Court of Claims and two circuit courts have held that the income tax treatment to the employee is immaterial in determining the scope of the withholding tax provisions.

And I think it is also significant that, while the Government places considerable emphasis on this Court's decision in the LoBue case in 1956, which was a gross income case. It did not consider withholding.

The rulings which the Government issued, saying that just because it is an item of income does not mean that an employer must withhold came, for the most part, after that decision was issued so that they are obviously well-aware that what the gross income sections say does not influence what the withholding tax provisions are.

The Government does cite a decision of this Court

the Nierotko case in 1946 which does involve withholding and I think it deserves special mention. That case involved the question of whether social security tax withholding was required on an award of back pay to improperly-discharged employees and the Court held that it was but back pay is not the same as remuneration for a travel expense or as a payment of a travel expense reimbursement and as a matter of fact, in the social security regulations, there is a provision, such as the one I read earlier on travel expense reimbursements. It is identical today. It was substantially the same in 1946, saying that reimbursements are not wages subject to withholding.

Obviously, this Court's decision on the back pay question was not intended to overrule that regulation and did not do so. That regulation continues to have force and effect.

The Government has somewhat modified its pure equivalence argument between income and wages by contending that the equivalence does not apply if the employee is entitled to an offsetting income tax deduction.

It is not clear how the Government finds support for this in its withholding provision. It is not there.

It is also not clear how the Government thinks this system would work. It suggests that every employee would take on the burden of determining what the income tax

deductions of each of its employees is likely to be and not on a payment-by-payment basis, but it would look on an aggregate basis for the entire year and/try to take into account trips which might arise based on unforeseeable events in the company's business, it might have to take in all sorts of considerations but the point is that it would be up to the employer to somehow decide what the income tax deductions would be for each of its many employees and for an employer such as the Petitioner with thousands of employees, this is simply an administrative nightmare.

So basically, the point we want to make is that the Government, in arguing the income tax cases, has confused the issue here. It is not an income tax case. It is a withholding tax case and the withholding tax provisions must govern. And we believe that the withholding tax provisions are quite clear, that Congress intended that wages be a narrow term and furthermore, that the regulations which have been on the books since the very outset of the withholding provisions preclude the inclusion in the withholding base of reimbursements for legitimate travel expenses.

There is a second issue in this case which involves the question of whether the -- a change in an administrative view about the withholding tax provisions can be imposed retroactively against an employer.

In 1963, when these payments were made, there was

not one regulation or ruling or court case which would have suggested that these reimbursement payments were subject to the withholding tax and as a matter of fact, the regulations said quite the contrary.

The Government seems to concede in its brief that if there is a factual or legal basis on which an employer may decide that withholding was not required, it is then an abuse of discretion to retroactively impose withholding on the employer and we believe this is clearly this case. It would be an abuse to retroactively impose a withholding requirement.

The employer, after all, acts only as an agent for the Government. This does not involve the employer's tax. It is merely collecting taxes to assist the Government.

QUESTION: May I ask when you think the Government put taxpayers fairly on notice as to its policy? What year?

MISS KING: Well, I think that probably the first published announcement came in 1969 in its revenue ruling 69 592 and in that revenue ruling, the Government said that if an employer reasonably believes at the time he makes a payment that the employee's offsetting deduction will equal or exceed for the entire year, the amount of the reimbursements which he will receive, then withholding is not required.

QUESTION: It would take a pretty good tax lawyer to understand what that means.

MISS KING: Yes, it does.

QUESTION: Do you think the small businessman, with no tax lawyer, would ever understand that?

MISS KING: I think it would be very difficult for any small business without having sophisticated tax advice to know what that means.

QUESTION: What about Correll? Do you think that constituted notice in this way?

MISS KING: No, I do not. The Correll case was specifically an income tax case and given the fact that -- and I might say that Correll was never asked to consider the withholding tax provision. It never came up. But given the fact that even at the time the Correll case was decided, that there were these regulations, there were the Government's rulings, most of which were issued in the 1950's and at the time of -- well, shortly after Correll, there were a number of cases saying that the income tax treatment to the employee is immaterial.

I think given all of that, that even sophisticated tax counsel would have been hardpressed to have found a withholding obligation.

QUESTION: Until when? At least, learned the Government's position until when?

MISS KING: Well, until, they learned the Government's position, I suppose when this case began to come to

to come to the forefront, particularly the District Court decided for the Petitioner, so it was really not till the Seventh Circuit decision came up.

QUESTION: It was no later than the decision of the Court of Appeals for the Seventh Circuit.

MISS KING: Yes. But even then it is such a broad opinion that I expect that not --

QUESTION: Well, it gives plenty of notice to at least the people in the Seventh Circuit, does it not?

MISS KING: Yes, but I do not know that every employer is out withholding on the air conditioning and the heating and so on. That is just impossible to administer.

QUESTION: Miss King, but would not the 1969 ruling have given notice to those who really understood it and read it carefully that there was this problem in this area?

MISS KING: All right, the 1969 ruling never mentions wages. It does not talk in those times. It is clearly an administrative convenience-type ruling and it --

QUESTION: But it is talking about the obligation to withhold.

MISS KING: And it does talk about the obligation to withhold on travel reimbursements.

QUESTION: That applies to wages.

MISS KING: And that -- they do not talk about

wages but they just say --

QUESTION: That obligation only applies to wages.

MISS KING: That is correct.

QUESTION: To statutory obligation.

MISS KING: Yes.

QUESTION: And does it not seem reasonable if they say you do not have to withhold if you expect the employee to have an offsetting deduction that the converse is that we do expect you to withhold if you do not think he does have an offsetting deduction?

MISS KING: Well, they did not put it on a payment by payment basis. They said, when you look at the aggregate of the payments which you think you might make to the employee over the period of a year, if you reasonably believe-- for example, if you, as an employer, reimburse on the basis of ten cents per mile for mileage and the deduction is fifteen, now gone to seventeen cents a mile, then obviously, there would be some excess deduction there which the employee would deduct against other items but it puts an enormous administrative burden on employers to try to guess each of these --

QUESTION: I am not talking about the merits of whether it is wise. I understand your argument there. But just in terms of the notice point. Your strongest argument, is it not, is for the period from 1963 to 1969. And of

course, we have 1963 here.

MISS KING: 1963 is the year before the Court, yes.

QUESTION: Yes. But it seems to me, after 1969 you may or may not be able to make the same argument, is all I was suggesting.

MISS KING: Well, we are addressing our argument to 1963 here.

QUESTION: Right.

MISS KING: Thank you.

MR. CHIEF JUSTICE BURGER: Mr. Smith.

ORAL ARGUMENT OF STUART A. SMITH, ESQ.,

ON BEHALF OF RESPONDENT

MR. SMITH: Mr. Chief Justice and may it please the Court:

I think I would like to begin by referring the Court to the pertinent statutory provision in this case, which is set forth at page 1A of the Appendix to our brief. That is, the statutory definition of wages in Section 3401A of the Code. It says that "The term 'wages' means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash."

Now, this broad statutory definition of wages -- talking about "all remuneration," is in our view, consistent with the congressional design in setting up the withholding

tax system in 1943 to collect income taxes at their source and thereby prevent what had theretofore been the losses of large amounts of revenue to the Internal REvenue Service and the inconvenience of taxpayers having to come up with a large lump sum payment at what was then March 15th and which is now April 15th at the time of the filing of the return.

Now, the regulations which we set forth at page 3A of the Appendix similarly reflect this broad congressional design because they provide respectively that the name that you call remuneration, that is immaterial, that is salaries, fees, bonuses, commissions and the like and it also says that it is the basis on which the remuneration is paid.

That is, it could be paid on the basis of piecework, percentage of profits, et cetera -- all of that is irrelevant. The question is, is this remuneration for services by an employee for his employer.

Now, the Petitioner in this case has suggested that what we have done is to fix up things because this is not an income tax case, it is a withholding tax case.

But necessarily, the Code has to be read as an integrated whole and we do not suggest that all items of income are wages. We are not suggesting that the gamut of receipts set forth in Section 61, which is set forth at page 1A of the Appendix, all 15 items which is not an exhaustive list, is wages.

But we do suggest that the appropriate focus of this case is on Section 61A1 of that definition which provides that gross income include compensation for services including fees, commissions and similar items.

Now, there is no question, it seems to us, that these lunch payments here, really, for the same reasons I have pointed out --

QUESTION: Why do you focus on gross income when you have got a specific statutory definition of wages?

MR. SMITH: Well, we focus on gross income, Mr. Justice Rehnquist, simply because we think that the statutes dovetail each other.

In other words, when we are talking about compensation or remuneration for services and we are talking about compensation, those are really the same things and what they do, in our view, is to emphasize the purpose of the withholding definition.

That is, the purpose was to collect taxes on what is the employee's taxable base.

In other words, that is why, in our view, the question of whether these items are -- the relevance of the Correll decision -- the question of whether some of these items are deductible and the fact that nonovernight lunch payments are not deductible is important because what it demonstrates to us is that if the withholding tax system is

to work coherently, it has to be a rough measure of the employee's taxable base and in this --

QUESTION: That would be fine if you were drafting the thing yourself but Congress has already spoken and am I not right in thinking that all wages is income is gross --

MR. SMITH: All wages are income but not all income is wages but this a particular kind of income here that is compensation for services and it seems to us that under Section 3401 we are talking about with remuneration for services, you have to ask the question, you know, whether these people got these payments for services and that really corresponds, you know, to the Section 61A1 category of gross income.

QUESTION: Well, why do you have --

MR. SMITH: I do not mean to belabor the point but it seems to me that the two provisions work in a harmonious way.

QUESTION: You do not really need to make the point.

MR. SMITH: No, you do not need to make the point but I think the Code attempts to be coherent and that really is the point I wanted to make.

Well, in any event, so we have here -- in order for the Petitioner to prevail here, he has to demonstrate that these payments were not compensatory remuneration for services. It seems to us that the facts of this case

demonstrate the correctness of the Court of Appeals conclusion that the payments were compensatory remuneration for services.

First of all, these are employees, these people who work for the public utilities. They were required to perform services. In exchange for the services that they performed, they became elegible for certain agreed-upon employee benefits, pursuant to a union contract, much like the union contract in the Kowalski case.

If they worked at their normal duty station, they got their wages. No doubt about it that those are subject to withholding and the Petitioner does not contend otherwise.

If they went on non-overnight travel, they got their wages plus the $1.40 a day meal payment. If they did not work for the day [sic], they performed those services -- they got no wages and they got no meal payment. It seems to us that there is an inescapable causal connection between the receipt of the meal allowance, the $1.40 per day and the performance of services and in fact, there really is no qualitative difference between the meal allowance and any other element of the employee's compensation.

That is, it is simply comparable to any other kind of economic benefit provided by an employer in order to get better services.

QUESTION: You can say the same thing about

somebody that goes to a heated office on a cold day and works. There is an inescapable connection between working in that office and getting heat but that does not necessarily make the heat a part of the wages.

MR. SMITH: No, it does not necessarily make the heat a part of the wages but I would suggest that when we are talking about items like that, we are really talking about questions that are impossible to value. I mean, that is just not part of the compensation scheme in the way that wages of normal salary plus lunch payment is for the day, any more than light or a pencil.

QUESTION: Then you are drawing a distinction between that which is capable easily of valuation and that which is not.

MR. SMITH: Well, it seems to me that the withholding system has to be a practical system and I am not -- I would think that perhaps the value of heat -- if the value of heat went into the withholding taxable base, I suppose that it might come out as a deductible employee business expense because the employee has to have heat to perform his functions properly.

QUESTION: Well, the employer deducts it anyway.

MR. SMITH: Yes, the employer does.

QUESTION: Mr. Smith?

MR. SMITH: Yes.

QUESTION: In today's life, have you not heard, secretaries want to know, "Before I work, do I have an electric typewriter, air conditioning, heat, et cetera."

Do they not all say that?

MR. SMITH: Of course, and those are --

QUESTION: Are those a part of their salary?

MR. SMITH: I would not think so. It seems to me part of the gamut of fringe benefits that an employer provides his employee in order to --

QUESTION: I would not put it on grounds that you cannot calculate it. I think you have to find another ground for it.

QUESTION: All those things do fall within the literal meaning of this sentence on page 20 that was called to our attention by your sister on the other side.

MR. SMITH: Well --

QUESTION: The water in the men's and ladies' rooms and everything.

MR. SMITH: I suspect that as a technical matter, they do fall within the sentence but I am not standing on that sentence. I think what we are talking about in this case is $1.40 a day cash payment --

QUESTION: Well, this is your brief trying to prevail on that theory and this is what you tell us.

MR. SMITH: Well, okay, it seems to me -- well, I

think that sentence in the brief was addressed to refute the point made by the Royster decision in the Fourth Circuit and which the Petitioner has advanced here, that somehow, when you have a payment that is not tied to a particular service, that it is not compensation for services -- it is not remuneration for services -- what the Fourth Circuit in Royster said, on comparable facts, is when the sailors ate lunch, they were not working but that cannot possibly make any sense because vacation pay -- people are at leisure during vacation pay. They are not working and that is plainly wages, subject to withholding and I do not think that Petitioner would content to the contrary. And this Court --

QUESTION: Let me ask you about one more concrete and readily-measurable thing, the 15-minute coffee break with unlimited coffee. Today it is 25 cents, is it not, for a cup of coffee. The average employee might readily have two cups of coffee. Would you charge him 50 cents wages for that?

MR. SMITH: I suppose, as a theoretical matter but again, I point out that, you know, the withholding system is a practical system.

You asked, I think, earlier in the argument about the Christmas turkey. The service has ruled that items like that, while technically income and quite properly also fitting within the statutory definition of wages, are simply eliminated from both tax bases as a practical matter in order to --

for ease of tax administration.

QUESTION: What about the western and southern states and the logging operations where lumberjacks do not usually live right at the site of the work? The general practice is that a bus comes around to the dormitory barracks where the lumberjacks stay, picks them all up at the same time, takes them out and drops them off at the various work sites.

Now, they get their travel to and from work and, of course, they get all their meals included, too. Are the meals taxable? Is the bus ride taxable?

MR. SMITH: I would think that, as a theoretical matter, they are all taxable.

QUESTION: Do you know what IRS is, in fact, doing on that?

MR. SMITH: These are some of the problems that the Treasury is now considering in terms of -- there have been studies of the taxability of fringe benefits and one of the things that the Treasury has to strike a balance between is sensible tax administration -- which I would suggest, I cannot predict how the study would come out but I would suggest that it would exclude cups of coffee on a coffee break consumed by employees but at the same time, include an income or substantial items which are more easily susceptible to valuation and which are more regularly provided across the

board on an industry-wide basis.

Here you have a large public utility which simply decides that if a person is going to leave his normal duty-station for the day, he is going to get $1.40 to eat lunch and if he did not get that $1.40, presumably he would have to pay for the lunch himself.

That, from the Treasurer's point of view, is a valuable economic benefit. So is heat, I suppose, but you know, one has to allocate one's resources regarding what one is going to subject to tax and withholding and what one is not.

QUESTION: Mr. Smith, I think you have already answered the question I am going to ask but I do not have it quite clearly in mind.

Let us assume that one of these employees drove his car 50 miles for his job site on a particular day and was provided reimbursement for his lunch and for his mileage. I recognize that Regulation 340 1(a) et cetera refers to travel expenses explicitly. Is that the basis for a distinction between the two?

MR. SMITH: No, because -- well, in order to -- I mean that is the real hypothetical of day work, going back and forth and not going overnight. The way we read that regulation, the only way to have -- what the Petitioners tried to do is to turn their lunch, what we regard as a lunch

case into a travel case.

QUESTION: But if you had the travel facts I stated, what is the position?

MR. SMITH: Well, if I had the travel facts you stated and there was no overnight travel, those amounts of reimbursements would be remuneration for services because the fellow's total package of compensation -- there would not be any offset under the regulation because --

QUESTION: The mileage? The mileage would be compensation?

MR. SMITH: Sure, because of the computing expenses. When you go -- when one goes from home to the office and goes back at night, that, under the Court's decision, I think, in Commissioner versus Flowers, would be held to be --

QUESTION: If you sent him down to Fredericksburg today, would that be analagous to commuting from Chevy Chase?

MR. SMITH: Well, I suppose it would be different. If you sent him down to Fredericksburg on a mission for his employer, those travel expenses, if he got reimbursed for them, they would go in and out.

QUESTION: But not the meal he ate in Fredericksburg.

MR. SMITH: Not the meal he ate in Fredericksburg because that comes under the Commissioner's overnight rule

and in other words, you have to eat your lunch anyway. The theory of the overnight rule, and it is a line drawing which the Court approved back in 1969 --

QUESTION: Well, he is not overnight. He is going down in the day.

MR. SMITH: Well, that is right, Mr. Justice Marshall. If you travel in a not-overnight capacity, you do not get to deduct the cost of your meals consumed. That was what the Court considered in Correll. In other words, if a lawyer leaves his office in New York, comes down to Washington for the day, spends the day debating with the IRS about a technical tax matter and eats lunch, that lunch is not a deductible business expense.

QUESTION: Mr. Smith, for the benefit of my brother Stevens, is there any place in the record a list of the places in Chicago that you can get lunch for $1.40?

MR. SMITH: Mr. Justice Marshall, I have two answers to that. To begin with, this case came from the Southern District of Illinois where I hope that costs are cheaper. I think the District Court sat in Peoria that decided this case -- or Springfield.

QUESTION: I can tell you that the judges on the Seventh Circuit have found all those places.

MR. SMITH: And secondly, this was 1970. Now, I know that does not seem that long ago, but it was seven years

ago and I suspect seven years ago, one could get a modest lunch and, in fact, the trial transcript talks about --

QUESTION: Well, do you remember when you could get one for $1.40?

MR. SMITH: Yes, but it is shrouded in mists of time.

QUESTION: Well, I do, but I do not think you do.

MR. SMITH: In any event, we think that these were payments to enlist better services. They were payments to defray a personal expense. They do not come under the regulation that the taxpayer relies upon because they are non-overnight travel and they do fit properly within the statutory definition of wages. Now, to the extent that --

QUESTION: Of course, the regulation does not say non-overnight travel.

MR. SMITH: No, it does not say non-overnight travel, Mr. Justice White, but the regulation, I think, was issued in 1943, shortly after Congress enacted the withholding provisions.

The Commissioner announced his overnight rule in 1940 and this sort of brings up the question of no.

QUESTION: Is this about the same -- Correll did not involve wages. It involved income tax.

MR. SMITH: Correll involved deductions.

QUESTION: And that was a long-standing Treasury

practice that Correll --

MR. SMITH: Exactly. The Court in Correll said that the Commissioner had consistently adhered to this position since 1940.

QUESTION: And is that the same time -- is the source of it the same time --

MR. SMITH: And that predated these regulations by quite a few years, these withholding tax regulations. The Commissioner --

QUESTION: Well, you just mentioned 1940 awhile ago, though, as to --

MR. SMITH: Oh, well, I think the withholding tax provisions came in in 1943 in the war and the Commissioner's overnight rule antedated those and that --

QUESTION: And you think, as soon as this regulation came out, he said it only covered overnight?

MR. SMITH: Well, I think that that -- it seems to me that is the purport of the phrase, "ordinary and necessary expenses."

QUESTION: But did he say -- did he have some rulings expressly?

MR. SMITH: The real express rulings -- the point is that the Commission --

QUESTION: This is an awfully poor way of saying "overnight," just to say, "All travelling expenses," you know.

MR. SMITH: Well, the point is that the Comissioner had announced -- you know, the overnight rule is 37 years old. Now --

QUESTION: The overnight rule for what? Not for this purpose?

MR. SMITH: No, for employee deduction purposes. That brings up the point that I started with and that is --

QUESTION: If that is 37 years old, it looks like he could have incorporated it in his regulations.

MR. SMITH: I suppose he could have. That brings up the point I mentioned earlier.

QUESTION: Well, if he did not, I would think he meant not to.

MR. SMITH: No, I do not think you can -- I would draw exactly the contrary inference, that since the overnight rule --

QUESTION: So you are entitled to it?

MR. SMITH: Well, yes, since the overnight rule involves Section -- centers on Section 162 using the phrase "ordinary and necessary," it seems to us that the Commissioner incorporated his position in these regulations.

In fact, since these things are not deductible, they do not fall out of the employee's tax base and they are necessarily included in this definition of wages and subject to withholding. I do not think that the taxpayer can argue

here that they were not on notice that the Commissioner was taking this position.

QUESTION: On the purpose of this regulation and the Correll case, is there anything before 1969 that would reasonably put companies like this on notice as to wages, that you are going to apply an overnight rule on withholding wages?

MR. SMITH: Well, actually, I do not think the 1969 ruling -- the 1969 ruling said that if your reimbursements did not exceed your deductible expenses, then you had to withhold them or conversely, if they did, that is what the 1969 ruling says.

Well, what I want to say -- in terms of the taxpayer's notice position, they have been arguing all along here that somehow there is a universe of wages and then there is a universe of income and that they have nothing to do with each other and that somehow this stuff, while it may be -- these payments, while they may be income, are not wages but when they come to their notice provision, they shift grounds and talk about the fact that they rely on the Hanson case and the Hanson case is an income tax case. It was one of the pre-Correll, one of the appeals decisions of -- I think of the Eighth Circuit which had rejected the Commissioner's overnight ruling so the issue, basically, they are coming back to the very position that we are taking on the merits

and that is, that the withholding tax -- that the employee's tax base is very important, that in trying --

QUESTION: That does not follow, because if there was an old case holding it was not income, a fortiorari, it would not be wages. That does not follow -- because the change of the law on income is made, it does not follow that also --

MR. SMITH: There was an old case holding that --

QUESTION: It is not deductible.

MR. SMITH: That it was deductible.

QUESTION: Well, it was deductible and therefore, it could be excluded from income.

MR. SMITH: Right.

QUESTION: But the fact that that was the law -- the change in that rule would not necessarily also require a change in the rule applicable to wages.

MR. SMITH: No. I am simply making a point that -- my point is simply that the positions are inconsistent.

QUESTION: Well, no, they could rely on that because if it was deductible and therefore, not includable as income, surely it would not be subject to withholding, would it?

QUESTION: It is includable as income, but it is deductible.

MR. SMITH: It is includable in income.

QUESTION: There is no point in deducting -- you do not deduct something that you do not first report as income, gross income.

MR. SMITH: Oh, absolutely. I understand.

Well, the point of the matter is, old case or not, I do not think that the taxpayer -- I mean, the Commissioner has taken this position since 1940 and the fact that the courts are in disarray on this question of the deductibility of employee business expenses, I do not think that it is reasonable to rely on a single court decision. I think, as we pointed out in our brief, it seems to me --

QUESTION: The other side of it, realistically, is that you have large companies all over the country with problems like this and they have no motivation not to withhold if they understand the Government's position, do they?

MR. SMITH: But it seems to me, when we are talking about an announced position of non-deductibility on the overnight and you have these non-overnight payments and you have this statutory definition of wages and these items are plainly compensation or remuneration for services within Section 3401a, it would seem to me that a prudent employer and a large employer, like a large public utility, if they had any question about whether or whether or not to withhold, the prudent thing to do is to ask the Internal Revenue Service.

QUESTION: What, in fact, did the large companies do, prior to 1969?

MR. SMITH: I am not aware of any practice. I cannot answer that question because there is nothing in the record and I am not --

QUESTION: Is there any litigation instituted by the Commissioner?

MR. SMITH: The only litigation instituted by the Commissioner prior to this case was on the withholding point, was the Royster case in the Fourth Circuit. To that extent, I cannot tell you when the Royster case --

QUESTION: And that went the other way.

MR. SMITH: That went the other way but it also signalled to the Tax Bar that the Commissioner was taking the position that these items were subject to withholding and we would submit that the announcement of the Commissioner's overnight rule indicated that these matters would not come out of the tax base and that there was no limit to withholding.

QUESTION: Excuse me, what is the date of Royster? It is in the brief but I do not have it before me.

QUESTION: 1973.

MR. SMITH: 1973. No, that is the date of the Court of Appeals decision. I assume that the Royster case began quite a good deal earlier than 1973.

If the Court has no further questions, I --

MR. CHIEF JUSTICE BURGER: Do you have anything further, Miss King?

MISS KING: I have nothing further.

MR. CHIEF JUSTICE BURGER: Thank you, Counsel. The case is submitted.

[Whereupon, at 2:46 o'clock p.m., the case was submitted.]