In the

Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE,

PETITIONER,

V.

ROBERT J. KOWALSKI, ET UX,

RESPONDENT.

No. 76-1095

Washington, D. C.
October 12, 1977

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COMMISSIONER OF INTERNAL REVENUE, Petitioner, v. ROBERT J. KOWALSKI, et ux, Respondents.	No. 76-1095

Washington, D. C.,

Wednesday, October 12, 1977.

The above-entitled matter came on for argument at 1:01 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:

STUART A. SMITH, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D. C. 20530; on behalf of the Petitioner.

CARL B. CORDES, ESQ., Battle, Fowler, Lidstone, Jaffin, Pierce & Kheel, 280 Park Avenue, New York, New York 10017; on behalf of the Respondents.

C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 76-1095, Commissioner of Internal Revenue against Kowalski.

Mr. Smith, you may proceed whenever you're ready.

ORAL ARGUMENT OF STUART A. SMITH, ESQ.,

ON BEHALF OF THE PETITIONER

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

This federal income tax case, Commissioner vs. Kowalski, is here on certiorari to the United States Court of Appeals for the Third Circuit. It presents a single question, with two sub parts: Whether cash payments to State police trooper, of whom Kowalski was one, which are designated as meal allowances, are includable in gross income under Section 61(a) of the Internal Revenue Code of 1954, and are not otherwise excludable from income under a special exclusion provision, Section 119, which came into the tax law at the time of the 1954 Codification.

In a brief per curiam opinion, the Third Circuit reversed a review decision of the Tax Court with respect to both Code sections, and held that the meal payments in question here were not gross income and, even if they were, they were excludable under Section 119.

We submit that the Court of Appeals erred as to both

points, that the cash payments are gross income as that fundamental term in the tax law is defined by Section 61(a), and that the cash payments here do not qualify for the limited exclusion provided by Section 119 of the Code, which briefly provides for an exclusion for meals furnished by employer to his employee for the convenience of the employer but only if the meals are furnished on the employer's business premises.

So, in this sense, the Section 61(a) aspect of the Court of Appeals decision is the most troublesome and extraordinary one, from our point of view, because it holds that a cash payment by an employer to his employee, to defray the cost of what is indisputably a personal expense, the cost of eating lunch during the day, does not fit within the statutory phrase "gross income from whatever source derived.

I think I can set forth the facts briefly there are undisputed.

QUESTION: Mr. Smith, before you do, in your brief on page 6 you say the "Tax Court unanimously held that the cash payments did not qualify for the exclusion from gross income under Section 119", is that correct?

MR. SMITH: I think that's correct. There were five or six dissents on the Section 61 point, but no one dissented on the Section 119 point. Judge Starrett wrote a dissenting opinion, joined by five judges, set forth at pages 32A to 37A of the Appendix A to the Petition, which said that -- which

concluded that the amounts were not gross income under Section 61.

He didn't reach the other -- I suppose one might say he didn't reach the other point, but there was no expression of disagreement in the Tax Court on the Section 119 point.

QUESTION: That sounds like the case we just heard.

QUESTION: Mr. Smith, while we have you there, you have in mind that when Judge -- when a federal judge is assigned to another Circuit or if, in his regular duties, a District Judge goes to another station to sit, he is given a $50-a-day allowance if he identifies the expenditures, so much for the room, and so much for meals and so on.

Now, since the judge presumably eats breakfast, lunch and dinner when he's home, bear in mind at some point, at your convenience, would you tell me what you think of that situation and under this provision or any one like it; would the judge be required to treat as income the breakfast, lunch and dinner?

MR. SMITH: Well, Mr. Chief Justice, the proper tax treatment, it would seem to me, of that situation would be as follows: The judge would -- unless it were a complete wash, I'm assuming -- well, let me back up for a moment. As a theoretical matter, all those payments are part of gross income.

Moreover, the amounts expended for meals, when away from home overnight, under this Court's Correll decision, are

a deductible business expense under Section 162 of the Code.

QUESTION: Well, but that's not true of a federal judge. He has no business expenses. In the sense that you are --

MR. SMITH: No, but he has employee business expenses. If an employee is away from home overnight and expends money in aid of his business, which is the business of being an employee, those expenses are deductible.

So, to follow through on your example, the judge would include all of this, per diem payments, in income and take corresponding deductions. It may well be, given the high cost of living these days and the particular plight that federal judges find themselves in, that there will be a net deficit, in which case that will be -- there will be a net reduction. It's possible, if the judge is frugal, that there may be a net amount of income.

Now, the Internal Revenue Service, by regulation, takes the position that if the employee is entitled -- if an employee must make an accounting to his employer and there is a complete wash, you don't have to report the actual items on the return, but you must append a statement to your return saying that you've had per diem payments, you've had business expenses, and that they net out against each other.

So this enables the Internal Revenue Service to be alerted to the fact that there are these items on the return,

and if they want to audit --

QUESTION: You mean all these years I've been misreporting?

MR. SMITH: What have you done --

QUESTION: When I go to the Judicial Conference --

MR. SMITH: Without making --

QUESTION: I never put this on my return.

MR. SMITH: You never put the statement on your return?

QUESTION: No, neither. Neither statement nor --

MR. SMITH: Well, I have -- in preparing for this case, I have been advised that there is such a requirement.

QUESTION: Do you think maybe I should disqualify myself?

MR. SMITH: Absolutely not.

I think it's -- I don't think it's a mandatory requirement; it's a permissive requirement.

QUESTION: Mr. Smith, your answer to the Chief Justice's question that these allowances, in any event, are gross income leads me to this question which may be of the very outer bounds of relevancy, but that won't stop me from asking it: As I understand the past three or four Presidents of the country have received what are called tax-free expense allowances in addition to their salaries.

Now, are those gross income for those persons?

MR. SMITH: Well, I suspect probably not, if they are tax-free, and that's -- I'm not familiar with that, but that may well be by special statute that, you know, the statute authorizing the President's salary may provide for a tax-free allowance.

Very much like the military has certain tax-free allowances which --

QUESTION: So that simply depends on the wording of the particular statute.

MR. SMITH: Yes. Right.

Getting back to the more mundane factual context in which this case arose, --

QUESTION: And the mundane factor of federal judges too.

[Laughter.]

QUESTION: You don't distinguish them, do you? You don't distinguish federal judges from State highway patrolmen, do you, for these purposes?

MR. SMITH: For these purposes, we are all taxpayers. I don't even exclude myself from the surface of taxpayers.

This respondent is a New Jersey State police trooper, and in 1970 he had a base salary $8739. He received an additional amount which the State designated as a meal allowance, which, for 1970, was $1697. This meal allowance was, like the salary, paid biweekly, but unlike the salary it was paid

in advance, and the salary was paid for prior periods.

QUESTION: Is there any significance in that payment in advance?

MR. SMITH: I don't think so.

QUESTION: Somewhere in your argument, would you differentiate in the Service's treatment of military allowances of this kind and --

MR. SMITH: I shall.

QUESTION: -- the State trooper's allowance, and tell us precisely why one is in and one is out?

MR. SMITH: I shall.

QUESTION: Thank you.

MR. SMITH: This meal allowance is described on a New Jersey Police recruitment brochure as an item to be received in addition to salary. It's clearly an important aspect of the trooper's compensation.

The amount of the meal allowance is a subject of negotiations between the Police Troopers Union and the State, and in fact has gone up over the years; it used to be $70 a month and now it ranges from $1740 for troopers like respondent Kowalski, $1776 for lieutenants and captains, and $2136 for the commander of the New Jersey State Police, the Superintendent Colonel.

So there is a variation in amount depending upon your rank.

The meal allowances are also significantly included in the compensation base on which the trooper's pension benefits are computed.

Now, under the cash meal allowance system, the troopers are expected to eat within their assigned patrol area. And what they have to do is, when they are going to go to lunch -- when I use "lunch" I'm really talking about a mid-shift meal, and just using "lunch" as an example -- they have to check in with the officer in charge and tell them they will be at such-and-such a restaurant, and they will be there for lunch.

Now, there's no restrictions on the cash payments, because the troopers can eat at home if they wish, if they live within their assigned duty area; they can eat in a public restaurant, as I suggested, or they can even take their lunch, take a sandwich from home and eat in their patrol cars, if they so desire.

The amount of the meal allowance is not calculated at all to provide any kind of reimbursement for any specific amount of meals, it's simply a flat amount per year, in this case $1740.

On his 1970 return, respondent Kowalski reported his $9,000-or-so in wages, which included a base salary of $8739 and cash meal allowances of $326. Now, the reason he reported part of this cash meal allowance on his 1970 return is,

I think, significant. He reported it because the State of New Jersey, in October 1970 -- that is, for the final quarter of this taxable year -- changed its policy and began to include the cash meal allowances on the Form W-2 of their troopers.

So the Internal Revenue Service began to be advised formally of the fact that these troopers were receiving these additional amounts.

But the respondent Kowalski did not report the remaining $1371 portion for the first nine months of 1970 because that wasn't included on his Form W-2. So the only reason this sort of came to the Internal Revenue Service's attention -- and in one respect this aspect of the case is really significant for purposes of the second case, because it shows the importance of the need for the Internal Revenue Service to withhold on cash payments from an employer to an employee at the source.

But the reason the Internal Revenue Service found out about it is because they disallowed respondent Kowalski's travel expenses, and after respondent Kowalski filed a petition in the Tax Court and the Service filed its answer, it began to engage in a more -- in a deeper kind of discovery, they discovered the fact that he had this additional $1371, by happenstance of this litigation, and then filed an amended answer which raised the issue which is before the Court.

QUESTION: Mr. Smith, you're not suggesting the

Internal Revenue Service is ignorant of this kind of practice among every --

MR. SMITH: No, I'm not suggesting --

QUESTION: These cases have been kicking around here for over a decade.

MR. SMITH: Oh, for more than a decade, Mr. Justice Blackmun, actually --

QUESTION: I said, "for over a decade".

MR. SMITH: Yes. No, I'm not suggesting that, but what I was trying to emphasize is the fact that the withholding requirements are very important, and I will address this in greater detail in the Central Illinois case, but I wanted to simply say that the withholding requirements are very important to the Service in terms of insuring that taxes are collected on employee compensation. Because basically the Service is set up, on its computers, that it would treat items on Form W-2s as the basic compensation of an employee, and it's only when matters go into audit, like this case, that you have the happenstance of discovering an additional amount that may not -- that are not reported on a Form W-2.

QUESTION: But you're not suggesting that what the employer thinks that it ought to do governs his tax consequences, necessarily?

MR. SMITH: Absolutely not. Absolutely not. In fact, he --

QUESTION: He has to explain it in some way if it's on the W-2 form, and hence it's perfectly natural for him to report it, or make some reference to it on his return.

MR. SMITH: Absolutely not. The point I was simply making is that when something isn't on a Form W-2, it is more than likely that the Service, in the normal kind of tax administration, absent a deep audit, is not going to be aware of a payment, of a cash payment made by an employer to his employees.

QUESTION: Let me try this hypothetical on you. I suppose in a State trooper situation they have a base somewhere with the radio dispatcher that communicates with all the cars. Now, let's assume also the dispatcher is on duty nine hours a day. That's the term of his employment. And he is required, by the terms of the employment, to eat on the premises and go down to the cafeteria and pick up a tray and bring it back to the, to his gear, his broadcasting gear, and remain on duty throughout the lunch period in order to handle calls to and from troopers in the field.

Would you say that that was deductible, that that was gross income?

MR. SMITH: Well, Mr. Chief Justice, is this a meal in kind that's provided --

QUESTION: What they do, to save bookkeeping, they just allow him to go down and get a free meal.

MR. SMITH: But it's a meal provided in kind by the employer, to be eaten on the employer's business premises.

QUESTION: Right at the Switchboard.

MR. SMITH: I would think that that would be covered by Section -- by the exclusion of Section 119.

QUESTION: That is, the question is, would it be gross income?

MR. SMITH: Oh, it would be gross -- no, no, no, no. Because Section 119 says it's not gross. In other words --

QUESTION: Except for 119 it would be, right.

MR. SMITH: Except for 119, it would be gross income, because Section 61(a) begins "except as otherwise provided in this subtitle" and this subtitle includes Section 119.

QUESTION: Now, suppose the rules of the State troopers required them, at meal time, to drive to a restaurant, get the food in the restaurant and then bring it into the car and eat it in the car, so they would be within reach of their radio at all times. Would you say that was --

MR. SMITH: That would not be -- that would not be a "meal in kind" provided by the employer. They would be paying --

QUESTION: What do you mean, "in kind"?

MR. SMITH: -- they would be paying cash for this meal. In other words, Section 119 clearly and by legislative history and the regulations provides -- you've got to meet three requirements. No. 1, it must be a meal in kind provided

by the employer; No. 2, it must be for the convenience of the employer; and No. 3, it must be furnished on the business premises.

Now, in your example --

QUESTION: Well, two of those requirements are clearly met, aren't they, in my last hypothesis?

MR. SMITH: Well, I suppose it would be for the convenience of the employer that --

QUESTION: And it's on the premises, if he's eating in the car, isn't it?

MR. SMITH: Although I suppose it would be a debatable question whether the meal were furnished on the business premises if you had to go to a public restaurant to get it. But I think you wouldn't meet the question of "meal in kind" if, in effect, you're getting a cash payment to go buy a meal in a restaurant and eat it. That would -- and the statute clearly provides you've got to meet all three requirements under Section 119, otherwise you flunk the test.

QUESTION: Well, then let's back up to my radio dispatcher again, and State authorities decide it's too expensive to maintain a barracks cafeteria, and so they dispense with it, but say to the radio operator: "You must be on duty". And he sends across the street to MacDonald's or some place.

MR. SMITH: That would be gross income, because it would not be a "meal in kind furnished by the employer".

QUESTION: In other words, the key to it is they've got to furnish the food?

MR. SMITH: Exactly. And, in fact, that's really what happened in this case, and that's what the respondents have argued. Because the State of New Jersey used to havea kind of meal station system, which they abandoned in favor of this cash allowance. The respondents have argued here that -- and throughout this case -- that because it was done on a meal station basis before, that makes the cash payments non-taxable.

We have basically -- have two answers to this: First, item -- there's nothing in the record that permits an inference that the meal station allowance, this meal station system of former days would have been non-taxable. In fact, it really turned out to be for the inconvenience of the employer. Because the State of New Jersey found that people were driving all around the State, to eat their meals, and which actually turned out to be quite far from their duty stations.

Our second answer to this is --

QUESTION: How does that bear on the tax question?

MR. SMITH: Well, it bears on the tax question --

QUESTION: They can deal with that sort of a problem by disallowing --

MR. SMITH: No, no, it does bear on the tax question, Mr. Chief Justice, because Section 119, one of its

requirements is that the meals be furnished for the convenience of the employer. And if it turns out, as I'm suggesting, that the meal -- it turned out to be inconvenient to the employer, I would suggest that you don't meet the statutory test.

But putting that aside for a moment, I think that the Court has said on a number of instances, in National Alfalfa and Central Tablet Manufacturing Company, simply the fact that you could do it one way and achieve a particular tax result doesn't mean that if you do it another way, which may be virtually equivalent from a surface point of view, that that will achieve the same tax result. Each case has to be judged on its facts.

Now, I do want to talk --

QUESTION: One point, Mr. Smith, I don't know, but were these men working eight-hour shifts?

MR. SMITH: I think so.

QUESTION: Where do you eat lunch during an eight-hour shift?

MR. SMITH: I think they get an hour off for -- time off for lunch within that eight-hour shift. Now, it's possible it may be a nine-hour shift with an hour for lunch.

QUESTION: Yes. Well, the other point is, is there anything in the record to show that they need special food or anything like that?

MR. SMITH: No. No.

QUESTION: This is just a run-of-the-mill lunch, and --

MR. SMITH: No, they're allowed -- they can go wherever they want to eat lunch. Essentially it's just as if my employer, or anyone's employer, simply said: Here's, we're going to give you two dollars more a day to eat lunch.

And we submit that those cash payments are tax -- are compensation for services under Section 61(a)(1), and that they don't meet any -- that the special limited exclusion of Section 119, which Congress channeled in these three requirements. And they have all got to be met.

QUESTION: So -- what I mean is, it had nothing to do with overtime?

MR. SMITH: Nothing to do with overtime at all.

QUESTION: Mr. Smith, suppose your employer, in the case you put, said: You may leave the factory premises during lunch. Would that make a difference?

MR. SMITH: That would not make a difference in our view, because that restriction might -- and that basically is this case, because that restriction might be for the convenience of the employer, but the cash payment doesn't serve the convenience of the employer.

The employer must provide the meals. And Congress said so specifically, that -- in the Committee Report on Section 119, in reporting it out -- that this provision only

applies to "meals in kind", it's not a --

QUESTION: So that your case really comes down to whether the refund is in cash or whether there is a --

MR. SMITH: Absolutely. That's critical. The cash aspect of it is critical to the eligibility under Section 119. And we submit that cash payments are never eligible for exclusion under Section 119.

I don't want to forget to turn to the tax treatment of the military, as Justice Blackmun asked.

The military have always been a special case under the tax laws, as well as generally -- I think this Court's decisions indicate that the military have been treated differently.

Now, the origin of the treatment of the military arose in the Jones case, which the Court of Claims decided in the 1920s, and the Court of Claims decided that tax -- that cash allowances, housing allowances, to the military would not be taxable income.

Well, the Service had resisted it at the time; after the Jones decision, the Service changed its position, that cash subsistence payments to military personnel were includable in gross income, and ruled that such allowances are -- were not includable in gross income.

Now, after that, that position of the Internal Revenue Service was -- ultimately found its way into the

regulations -- I think it's 1.61-2(b) of the regulations.

So, following the Jones decision, the Service, the Treasury has, for the last 50 years, treated the military quite differently.

Now, during this last 50 years, the Code has -- the Internal -- the tax law has been codified twice, in 1939 and in 1954. And Congress was aware of the Treasury regulations providing for this special treatment to what turned out to be not just the military but the uniformed services, which [sic] includes the Coastal and Geodetic Survey and Public Health Service as well, and Congress never expressed any opinion that this was not to be the governing rule. And, in fact, in 37 U.S.C. 101, which we quote at page 19 of our brief, Congress explicitly confirmed the understanding that regular military compensation include "federal tax advantages accruing to aforementioned quarters and subsistence allowances."

Now, the respondents in this case have tried to make much of the fact that there are analogies between the State police and the military. But, quite frankly, we think that Congress and the courts and the Treasury have, for the last half-century, treated them as a very special case. And, in fact, the legislative evidence is all to the contrary, because Congress, in 1954, enacted Section 120 of the Code, which we refer to briefly in our brief, which basically provided a five-dollar-a-day exclusion for State police troopers for a

subsistence allowance. And then in 1958 Congress repealed it, for very much the same reason that sort of underlies our position in this case, is that after they enacted the provision, many States simply said -- allocated part of the compensation of State police interest to subsistence allowances, even though that was not the intent of what Congress was trying to do, and they said it basically worked an inequity: that it gave the State police troopers something that other people didn't have, so it repealed 120 in 1958.

Now, if, somehow, there's an exclusion from gross income, as respondents contend, to these cash payments, then the whole congressional exercise between 1954 and 1958 is really a nullity. And we submit that Congress knew what it was doing, the military were spacial, and, to the extent it addressed the problem in this case, it focused on the fact that -- and ultimately concluded that these cash payments to State police troopers were not to be excluded from gross income, but were to be includable.

Now, if there are no further questions, --

QUESTION: I have one, Mr. Smith. What is the government's position with respect to Section 162? Does it have any bearing on this case at all?

MR. SMITH: It doesn't have any bearing on this case, Mr. Justice Blackmun, it has more bearing in the next case. But let me simply say, for purposes of this case, Section 162

dropped out of this case by the time the tax -- after the Tax Court. Because the Tax Court had held that part of these cash payments to respondent Kowalski turned out to be deductible by him, because some of the time he was away from home overnight. And to that extent, under the Court's Correll decision, the Tax Court afforded him a Section 162 deduction. And we have not appealed that aspect of this decision to the Court of Appeals, and it is, accordingly, not before the Court.

QUESTION: Do you think your opponent can rely on 162 in any respect?

MR. SMITH: I don't think so.

QUESTION: Because?

MR. SMITH: It doesn't seem to me that -- we're talking about what's left in the case is non-overnight meals, and non-overnight meals are not deductible under the Court's Correll decision which approved the Commissioner's overnight rule.

QUESTION: Mr. Smith, I gather from your answer to Justice Blackmun's question about the treatment of military meals, in lieu payments, the Congress -- there is no express statutory authority for treating them differently from State troopers. You refer to the Court of Claims, Treasury regulations, and to a Committee Report, but there's no express statutory basis?

MR. SMITH: Yes, there was -- there is. I alluded to

it briefly. It's on page 19 of our brief. 37 U.S.C.101(25) defines regular military compensation as including the federal tax advantages accruing to the aforementioned allowances, because they are not subject to federal income tax.

Congress -- to the extent that Congress has addressed the problem, it confirmed what we -- what was the general understanding of the courts and the pertinent administrative agency that these amounts were not -- the subsistance allowance to the military were not taxable.

And I suppose, in setting military compensation, Congress takes that federal tax advantage into account.

QUESTION: And I suppose that statute on Uniformed Personnel, you are bound to read as limited to federal personnel?

MR. SMITH: Absolutely. Absolutely.

Thank you.

MR. CHIEF JUSTICE BURGER: Mr. Cordes.

ORAL ARGUMENT OF CARL B. CORDES, ESQ.,

ON BEHALF OF THE RESPONDENTS

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

May I first say that my name is pronounced "Cord-es" sir.

MR. CHIEF JUSTICE BURGER: Mr. Cordes. We weren't given that phonetic aid today.

MR. CORDES: Before I start my main argument, I would like to correct two factual problems that I have with Mr. Smith's statement.

In response to a question from Mr. Justice Marshall, Mr. Smith stated that these troopers work an eight-hour day, and have a lunch break. That is not the case with respect to the New Jersey State troopers.

In 1970 they slept in barracks for much of the year that they were on duty, not under all assignments, but on -- Kowalski himself spent eight months of the twelve in barracks.

The second thing I'd like to say about Mr. Smith's presentation is with respect to the initiation of withholding --

QUESTION: Is that in this case?

MR. CORDES: Yes, sir. It is.

QUESTION: Whether or not that lodging is income, it's not in this case.

MR. CORDES: Oh, no. That's not. That is not at issue in the case.

QUESTION: That's what I thought.

MR. CORDES: No.

Mr. Smith stated that the withholding began in 1970. That's correct. The State of New Jersey started withholding on the trooper's meal allowances in response to pressure from the Internal Revenue Service, which had been going on by

correspondence over a period of several years.

The petitioner's argument basically comes down to the point that the meal allowance is income because there is no statutory exclusion. And in order to understand how this case fits within the long history of exceptions from gross income, several crucial facts must be emphasized.

New Jersey State Police is organized along military lines, and it has unlimitedStatewide jurisdiction for all police functions; it is not merely a highway patrol.

For more than 25 years, prior to July 1, 1949, the State of New Jersey fed its troopers at meal stations, located throughout the State, at the expense of the State. By 1949, the State had found that the meal station system was no longer acceptable, because it took the troopers away from their police duties for too much time.

Therefore, in 1949, the State abandoned the meal station system and instituted the meal allowance system, in issue in this case. The meal allowance system was instituted by the State for the benefit of the State, and the meal allowance system has worked well for the State. Not only has it provided the State and public with better police protection, but it also has been proven less expensive than the meal station system.

QUESTION: So, do you say that adds up to the convenience of the State?

MR. CORDES: Yes, Mr. Chief Justice.

And just as the State's furnishing of meals was not intended to represent additional compensation, the meal allowance, as the Tax Court found, is "not intended to represent additional compensation".

The State's accounting for salaries is strictly separated from its accounting for meal allowances, and the two funds are never mingled.

Moreover, just --

QUESTION: Mr. Cordes, on your first point, that the substitution of the meal allowance for the meal station system was more convenient for the State than the prior system, but that's enough to satisfy the test of convenience of the State. Does that mean any time you have a very inefficient system, you change to something better, that that would satisfy the test?

MR. CORDES: It seems to me, Mr. Justice Stevens, that if you have a system that, itself, satisfies the test, and you switch to a system --

QUESTION: But, by definition, your system did not satisfy the test, because you found it inconvenient.

MR. CORDES: It satisfied the test in the beginning. The State had this system going for -- from 1929 to --

QUESTION: But at the time of the change, it apparently didn't.

At the time -- one day before you made the change, it

was obviously inconvenient to the State.

MR. CORDES: Not inconvenient, Mr. Justice, less convenient.

QUESTION: Well, then, the test is more convenient than the predecessor system?

MR. CORDES: Which was also convenient.

QUESTION: Okay.

QUESTION: Well, the ultimate objective was to keep these men on the job 60 minutes out of every hour, at all times when they were on duty; is that not so?

MR. CORDES: That is so.

QUESTION: And your position is that either of them would satisfy the statute?

MR. CORDES: Definitely. Either of them would satisfy the statute.

QUESTION: No, which statute? 61 or 119?

MR. CORDES: 61.

QUESTION: It would not be within 61?

MR. CORDES: Would not be within 61.

QUESTION: Neither one would be. And you're not relying at the moment at all on 119?

MR. CORDES: Correct.

QUESTION: Mr. Cordes, as I understand the SG's position, it's quite immaterial whether the meals were being furnished for the convenience of the State or not. The issue

is reduced, as I understand it, quite simply to whether or not they were paid in cash or the meals were furnished in kind.

QUESTION: That's for 119, but you're --

MR. CORDES: That's for 119.

QUESTION: Well, I understood the Solicitor General to make that broad generalization. Now, 119 is quite explicit in that respect.

Now, the Saunders case reached a different result, it said that it was immaterial whether they were paid in cash or were provided in kind.

Is that the only case that would reach that conclusion, attached only to Section 61, before 119 was enacted?

MR. CORDES: Yes, it is, it's the only case that reached that conclusion with respect to State police troopers.

QUESTION: A cash payment.

MR. CORDES: Cash payment. There was only one other cases involving the State police trooper, a cash payment to a State police trooper, prior to the '54 Code, and that was the Hyslope case, which was decidedby the Tax Court in very brief opinion, and never appealed beyond that point.

The Jones case, to which the SG referred, held that cash payments in commutation of meals and quarters to an Army officer were excluded under the prior version of Section 61.

And in that connection, the fact that a payment is

made in cash rather than kind should not be crucial for federal income tax purposes. The Internal Revenue Code, or the tax law, rather, provides an exclusion from gross income for a number of different types of cash payments without any specific statutory exclusion in the Code. The meal allowances to the Armed Services is authorized for tax purposes only by Reg. Section 1.61-2(b). Supper money paid to employees who work overtime is excluded from gross income by a ruling that was issued by the Internal Revenue Bureau in 1920 and has not been modified since.

Social Security benefits are excluded from gross income without any specific statutory section. Welfare benefits are excluded from gross income without any specific statutory section. And Unemployment Compensation itself is excluded from gross income without any specific statutory section.

QUESTION: Some of those exclusions from gross income are the result of court decisions, aren't they?

MR. CORDES: They are, as --

QUESTION: I mean, this wasn't a voluntary act of grace on the part of Internal Revenue Service?

MR. CORDES: That's correct. And as was the case with the military pay exclusion. That originated with a court decision.

QUESTION: Yes.

MR. CORDES: The state provides the same -- the

troopers with the same meal allowance, exactly the same meal allowance, every trooper gets the same regardless of his length of service and regardless of his salary. Their salaries do increase with length of service.

QUESTION: And regardless of whether he eats or not.

MR. CORDES: And regardless of whether he eats or not. However, we have a stipulation in this case, and a finding by the Tax Court that the taxpayer spent at least the amount of his meal allowance for meals while in uniform on active duty.

QUESTION: But do you also have a stipulation that says no two people eat the exact amount of food?

MR. CORDES: [Laughing] I don't think we need a stipulation on that.

QUESTION: Well --.

MR. CORDES: The meal allowance is not calculated to provide reimbursement for any specific number of meals, but is rather an averaging device appropriate to the policy of the State of New Jersey of rotating its troopers among various assignments, to give each trooper a broad range of experience.

QUESTION: Now, it's true, is it not, that lieutenants receive a larger meal allowance than troopers, and captains receive a larger meal allowance than lieutenants?

MR. CORDES: That is true.

QUESTION: And majors a larger one than captains.

MR. CORDES: That is true.

QUESTION: And the superintendent, the largest of all?

MR. CORDES: That is true.

QUESTION: And no claim that they have different appetites, as a class, is there?

MR. CORDES: No claim that they have different appetites. However, I have no doubt in my mind that meal allowances in the military services also increase with rank.

And, appropriately, the nature of the duties of the higher officers may well be such as to require them to eat at more expensive places than the troopers have to eat in, and the higher officers also get a higher uniform alloance because their uniforms are more elaborate.

QUESTION: Well, now, wait a minute. The superintendent is driven by a trooper, isn't he? Most of the time.

MR. CORDES: Well, I would assume so.

QUESTION: Well, they both stop and eat lunch. Why did the superintendent get more? Couldn't the trooper eat the same place he eats, and eat the same food he eats?

MR. CORDES: May I say, Mr. Justice, it's not crucial to my case that the meal allowances that are paid to the superintendents and the officers are excluded from gross income.

QUESTION: But I think involved in your case is the

fact that, for some reason which, up till now, has not been explained, at least to me, a superintendent, sitting behind a desk, needs more food than a trooper running up and down the road.

MR. CORDES: I can only ascribe it to custom, just as in the military.

QUESTION: Well, these men aren't in -- some of them never have been near the military.

MR. CORDES: What I am saying is that this is a military type organization, it's very similarly patterned to the military, as you can tell from the titles of the ranks themselves, and if they are following military practice, they probably naturally assume that officers get more than the men do.

QUESTION: Well, maybe we should adopt that in the Court.

MR. CORDES: The meal allowances for meals, troopers are required to eat while they are on active duty. They are on active duty when they are in uniform, performing their official duties. They are on active duty in uniform when they eat the meals for which the meal allowance is paid. They must obtain permission to eat, and their meals are frequently interrupted by the demands of their duties, and, Mr. Chief Justice, they carry radios on their persons, which enables them to be summoned by headquarters when they are eating their

meal. They don't have to go out to the car to be at the radio.

QUESTION: Mr. Cordes, supposing you had all the same regulations about what they had to do during the lunch hour, carry a radio, and where they eat, and all the rest, and they did not get a meal allowance, but instead they were paid an extra $15 a day or whatever it might be -- they had a little higher salary. How would one system serve the convenience of the employer more than the other?

MR. CORDES: I think the reason that the meal allowance is paid is that they are on duty and expected to be functioning when they are eating their meals. They eat on the run. They don't have a lunch hour.

QUESTION: May I suggest, that's not responsive to my question.

MR. CORDES: Then perhaps I didn't understand the question.

QUESTION: How does one system serve the convenience of the employer more than the other, of the two alternatives I gave you?

MR. CORDES: It doesn't, but this raises a question that the government has raised. They say it may well be convenient for the troopers to have their meals under these circumstances, but it's not convenient for the State to have to pay for the meals.

If that's the case, it seems to me there is no

convenience of the employer doctrine at all, even within the context of Section 119, because for any employer it's more convenient to have something done the way he wants it and not have to pay for it.

QUESTION: Does this not come back to what Mr. Smith himself suggested, that sometimes calling a thing by a name makes it one way or the other under tax law, as distinguished from the law generally?

MR. CORDES: That does happen sometimes. But not in this case. I don't think what it's called -- I don't want to get into --

QUESTION: They didn't call it "pay" here, they --

MR. CORDES: They didn't call it "pay", they called it a meal allowance because it replaced the system providing meals in kind.

QUESTION: Which the government, as I understand it, concedes was not taxable.

MR. CORDES: I would assume so.

QUESTION: This is a subject of collective bargaining, and has been, between the Troopers Union and the State?

MR. CORDES: It has. The Troopers Union was organized in 1968, and the meal allowance system was instituted in 1949, and the mere fact that it's a part of the collective bargaining negotiations, I don't think affects the outcome, because --

QUESTION: No, I didn't -- I just asked the question

whether or not it is.

MR. CORDES: Certainly. Like other conditions of employment.

QUESTION: I suppose it's higher now than it was in 1970?

MR. CORDES: It is.

QUESTION: As a result of --

MR. CORDES: As a result of inflation.

QUESTION: -- collective bargaining.

MR. CORDES: And collective bargaining, too, yes.

QUESTION: And the economy.

MR. CORDES: And the economy. And the salaries are higher now, too.

Almost immediately after the State instituted the meal allowance system in 1949, the Revenue Service challenged it in the Saunders case, a 1950 case, where the facts were, in the words of the Tax Court in this case, not substantially different from those in this case.

Saunders excluded the meal allowance under the predecessor of Section 61, under the convenience of the employer doctrine. And this has been the law for the New Jersey State troopers' meal allowances always, under the meal station system they didn't pay tax on it, under the meal allowance system they never paid tax on it, as a result of Saunders, until this case has been brought again by the government.

One point I'd like to emphasize in reaching your decision is the equity argument. That is, equal treatment among taxpayers who are similarly situated. I, myself, find it very difficult to draw a distinction between military officers and State police officers who are working in a State police department which functions under this system, with barracks and long hours, uniforms, and not being a mere highway patrol.

If there is a convenience of the employer doctrine, as there must be, if the military pay exclusion -- the military meal allowance exclusion is to be a valid regulation, Judge Sterrett here in the Tax Court found that it's difficult to conceive of a situation where an employee must so clearly take his meals at the convenience ofthe employer, as is the case with the New Jersey State troopers.

QUESTION: But if Congress has recognized the meal allowance and so forth for military by separate statute, doesn't that remove some of the necessity for bringing it under the convenience of the employer doctrine?

MR. CORDES: Mr. Justice, I think in the statute that Mr. Smith cited, I think all that Congress has done is to recognize that there is a well-recognized exclusion.

QUESTION: Yes, I checked and that came out of the Armed Services Committee rather than the Ways and Means Committee.

MR. CORDES: Right. That is not a tax statute. That statute just says, "Look, the revenue boys have decided this, and so that's the way we'll treat this." It's not part of the tax law.

QUESTION: It's still a congressional recognition.

MR. CORDES: It's a congressional recognition, but it --

QUESTION: You don't suppose that the Revenue people could go on and tax if, in a military bill, it said they won't be taxed.

MR. CORDES: I suppose that if --

QUESTION: You couldn't believe that they would.

MR. CORDES: I think they would be out of their minds if they tried to do it at this point.

QUESTION: Exactly.

MR. CORDES: Yes.

The statutory definition of income itself is not particularly helpful. The Section 61 of the Code simply says gross income means all income, from whatever source derived. So it's defining itself within itself. And, as a definition, therefore, the language is defective; and therefore these glosses have grown up on the statute over a period of time, judicially, administratively, and, of course, legislatively.

Convenience of the employer doctrine is one of them. It's not the only one. It's not the most well-known one. But

it's there, and it has been there for a long time. And counsel for the government is saying that if you have a cash payment you can't possibly come under the convenience of the employer doctrine. And, to reach that finding, you have to decide that all cash payments are income and it's clear that, under our tax system, all cash payments are not income.

QUESTION: Mr. Cordes, I take it, you are placing no reliance on 162?

MR. CORDES: Let me give you the context of 162 in this case. In the Tax Court we briefed the 162 question; we lost the case in the Tax Court on a very close decision. On appeal we briefed all three questions, Section 61, Section 119 and Section 162.

The Court of Appeals, in reversing the Tax Court on the basis of Saunders, in Judge Starrett's dissenting opinion under Section 61, did not, in my opinion at least, reach the 119 question, and did not at all reach the 162 question.

QUESTION: And 162 provides what?

MR. CORDES: 162 provides a deduction, whereas the other two provide an exclusion from income; 162 provides --

QUESTION: Is a deduction.

MR. CORDES: Is a deduction, right.

QUESTION: My question is, are you relying on it?

MR. CORDES: To keep my judgment below, I certainly

would rely on it.

QUESTION: Despite Correll?

MR. CORDES: I must say, to rely on it, the limitations would have to be put on the scope of the Correll test.

QUESTION: So you do not agree with Mr. Smith that it just has faded back --

MR. CORDES: I don't agree with Mr. Smith that it's faded, because, although the government -- what the Tax Court did was to allow a deduction for two-thirds of the meal allowance, because he was away from home two-thirds of the time.

The government did not appeal from the allowance of the two-thirds deduction. We did appeal from the disallowance of the one-third deduction.

Mr. Chief Justice, unless there are further questions, I have completed my presentation.

MR. CHIEF JUSTICE BURGER: Very well, thank you.

Mr. Smith, do you have anything further?

REBUTTAL ARGUMENT OF STUART A. SMITH, ESQ.,

ON BEHALF OF THE PETITIONER

MR. SMITH: I have a couple of points, Mr. Chief Justice.

The respondent has suggested that there is this non-statutory convenience of the employer test, which somehow suffuses Section 61 of the Code, and enables him to exclude

these cash payments from gross income.

But even assuming, as we point out in our brief, that there is such a test, and we don't think that there -- we think that that test has never been channeled exclusively into Section 119; but even assuming that he's right, that there is such a test, under that test he has to meet two qualifications, by his own analysis.

He has to demonstrate that these amounts were non-compensatory, and he has to demonstrate that the cash payments were for the convenience of the employer.

We submit that he meets none of those tests with respect to Section -- with respect to his own analysis.

First of all, with respect to Section -- with respect to whether the amounts were compensatory, he relies on a finding of the Tax Court that the meal allowance was not intended to represent additional compensation.

But, as I pointed out, in my opening argument, that is a slender read. That finding of the Tax Court does not say that they were not compenations, it simply said what the State hoped that they would be; and this Court has said, in Commissioner vs. Duberstein, that what the parties hope, labels put on things, what they hope the tax effect will be is irrelevant for purposes of what the objective circumstances are.

And, in fact, later on in the Tax Court's opinion,

on page 13A, they say: Even though we have found that the meal allowance was not intended as additional compensation, it was obviously compensatory to a trooper, to the extent that it paid for food which he otherwise would have had to pay from some other source.

We conclude, under Section 61, that, except as otherwise provided in the income tax law, the meal allowance received by petitioner [sic] is includable in its gross income.

Now, with respect to the convenience of the employer, we submit that cash payments do not serve the convenience of the employer, because what the respondent has done is to confuse the issue by attempting to talk about all these meal restrictions. That is, you have to eat it within the patrol area, you have to eat within a certain area. But the point is, he hasn't explained why those restrictions have anything to do with the convenience of the employer. All they have done is -- in other words, if, as Mr. Justice Stevens has suggested, they simply paid cash, as they did, and didn't call it a meal allowance --

QUESTION: But doesn't it serve the convenience of the employer, that is, the State of New Jersey, that they have this man on duty and on call for 60 minutes of the entire lunch hour?

MR. SMITH: Mr. Chief Justice, the meal restrictions serve the convenience of the employer, but the fact that the

State of New Jersey paid cash does not serve the convenience of the employer. And we submit that that is the critical question.

QUESTION: I go back to my hypothetical I put to you: if they gave him a box lunch before he left the barracks, then you'd say that that's not taxable?

MR. SMITH: That would qualify under Section 119, as meals in kind. That's the distinction --

QUESTION: Well, it wouldn't be on the premises of the employer, though, would it?

MR. SMITH: Well, assuming that quickly and implicitly -- assume that the patrol car would be the --

QUESTION: If he eats it in the car.

MR. SMITH: If he eats it in the car.

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

[Whereupon, at 1:54 o'clock, p.m., the case in the above-entitled matter was submitted.]

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