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Book Review (reviewing Hugh Holleman Macauley, Jr., Fringe Benefits and Their Federal Tax Treatment (1960))

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FRINGE BENEFITS AND THEIR FEDERAL TAX TREATMENT. By Hugh Holleman Macaulay, Jr. New York: Columbia University Press. 1959. x + 246 pages. $6.50.

As a useful generalization it can be said that the unevenness of our federal income tax base has drawn four kinds of reactions from tax specialists and students of taxation. One is that the many preferential provisions, in combination, are significant defects which seriously weaken the whole structure of the income tax. The numerous preferences, so it is thought, impair the equity of the tax, produce economic dislocations, magnify the administrative burden, render rate changes difficult to accomplish, and cause public suspicion and discontent. A second reaction is that, on the contrary, the preferential rules reflect reasonable legislative and judicial responses to important needs or grievances in the society. The preferences, in this view, are not deficiencies requiring repair, but rather are sound provisions carrying out fully justifiable economic or social policies. A third type of reaction is apathy or indifference. Confronted by a complex series of enactments, many highly technical, and a continuous crossfire of indictment and defense of them, there is understandable comfort in the position that preferences by and large are here to stay and that the range of politically possible change is so minor as not to be worth arguing over. A fourth reaction, seldom articulated for public consumption, is that the preferences are a blessing in almost transparent disguise. Whether or not the particular instances of special treatment are meritorious, the important thing is to have a great number of preferential provisions strategically placed throughout the law.

While I emphatically reject this last position, a few aspects of its strength might be noted since, for obvious reasons, the affirmative side has not been widely disseminated. A considerable number of lawyers experienced in tax matters seem to hold such a view, although not in the extreme form in which it is here stated. To some extent the attitude might derive from the professional habit of seeking to find ways for clients to accomplish their goals at minimum tax costs. Since it is the preferential rules which ultimately make tax planning a fruitful enterprise, preferences as a class may come to be looked upon by practitioners as the most promising road to tax reduction. Of probably greater weight in shaping this attitude is a feeling that preferences are an important protector of taxpayer morale in the face of high taxes. There is an observable

tendency of high income taxes to generate resistance and dissatisfaction on the part of taxpayers. When, however, one discovers or thinks that he is getting a special break under the law, his disposition is likely to improve (especially if he does not know that others are, on the average, getting an even better "bargain.") Of possibly greater importance in forming this attitude among lawyers is the impression that preferences constitute the most reliable vehicle yet devised for keeping the income tax burden from becoming unbearable—which usually means growing larger than it already is. If preferences make it difficult for Congress to raise rates, because of the imagined impact of higher rates on the man who fails to qualify for any special dispensations, or because preferences encased in technical detail are sticky to handle, so much the better. This thought is based not so much on cynicism but on an awareness, not to be dismissed lightly, that the graduated income tax is a formidable weapon in the hands of the government and if used unwisely could inflict damaging blows on our version of a private enterprise society. To the skeptic regarding power in government, an unwieldy and leaky tax is apt to appear safer than a watertight streamlined model. This attitude is also supported by a vague hunch among lawyers that a multitude of preferences in the law softens the clash between the various income classes in the society. Cohesiveness is not likely to be promoted if these classes feel that they are in direct opposition to one another in the voting of taxes. If only we have enough special dispensations in the law, the actual allocation of the tax burden will remain confused and unknown, and income taxes then can be levied with a minimum of friction.

Admittedly all this is the long way around in approaching *Fringe Benefits and Their Federal Tax Treatment.* However, so-called fringe benefits constitute a most important group of preferences under our present income tax, and although they most assuredly deserve study in themselves, the question whether to treat them in preferred fashion ultimately must come to grips with the case for preferences generally. To those who take refuge in apathy or who believe that a network of special treatments is an asset to be preserved, this recent study of fringe benefits will be of no interest. To those who are concerned over the impact of preferences on the health of our income tax, and to those who believe that any preference carries the burden of justifying its continuance, the study is of value in bringing together the many considerations bearing

on the taxation of fringe benefits and analyzing the problems encountered in integrating them into a general income tax.

At the outset the author, after noting that there are unavoidable difficulties in defining fringe benefits, reminds us that to a large extent their growth has been fostered by our individual and corporate income taxes and excess profits taxes. Indeed, the growth has been so rapid that any list of "new" fringe benefits soon gets out of date. For example, among those benefits "making their debut in the 1950's and achieving limited adoption have been Salk vaccine shots, influenza shots, legal advice and representation, company-financed vacation trips for all employees, a full year's vacation with pay for 10 years' service, medical diagnostic service, a car for every employee (including floorsweepers), eyeglasses, false teeth, meals for retired employees, and speed reading courses."[1] It is not obvious that all fringe benefits should be subject to income tax, or how they should be taxed. But we must beware of relying on "common sense" in deciding these questions, since there are already too many vested interests at large which generate a considerable bias in favor of exempting fringe benefits from tax. Moreover, as the author points out, we must be careful not to assume that the question of taxability can be soundly resolved by appealing to the distinction between "conditions of employment" and "compensation for work." While the former term "exists in our everyday vocabulary and is used in books dealing with labor economics and wage theory, the term, like fringe benefits, has no commonly accepted bounds, and, more important, it seems nowhere to be defined in relation to wages."[2] To avoid these traps, "a logical, consistent definition of income would appear to be the starting point in a search for tax treatment of fringe benefits."[3] The definition favored in the study is a broad one under which "any utility, satisfaction, or 'usance' which the employee enjoys because of expenditures of the employer would constitute consumption by the employee and so income to him."[4]

While a definition of income is the proper starting place, it is only that. Since "the tax treatment of fringe benefits entails one set of difficulties if the benefits are taxed and a different set of

1. P. 15.
2. P. 31.
3. P. 32.
4. *Ibid.*

difficulties if they are not taxed,"[5] the author advocates that "an attempt should be made to choose that course of action which would entail minimum aggregate difficulty."[6] His term "difficulty" embraces not only matters of administration but "problems in equity, tax rates, incentives, resource allocation, business fluctuations, and many other fields as well as administration."[7] He recognizes that because "these fields of difficulty have no common unit of measurement, the minimization of these difficulties or problems will largely rest on the relative values assigned to them by each individual."[8] This consideration establishes the main guideline for the first half of the study: "What should be attempted, then, is a discussion or description of the difficulties likely to be encountered in each of these areas, first, under the assumption that fringe benefits are not taxed and, second, under the assumption that fringe benefits are taxed. The individual, having the sum of these difficulties laid before him, is then in a better position to decide on their tax treatment."[9]

In the ensuing analysis, by far the most prominent concern is with the economic effects of the tax treatment of fringe benefits. Perhaps the explanation for this emphasis is that more can be said about economic effects than about other considerations; or possibly it is attributable to the special training and interests of the author. Considerable attention is devoted to investigating the effects of fringe benefits in general on the allocation of resources, on the mobility of labor in our society, and on the so-called cyclical stability of the economy. The conclusions are not very startling: "the introduction of fringe benefits into the economic system will lead to a lower level of consumption from given expenditures made on behalf of lower income employees; will . . . introduce an element of automatic wage flexibility since wages are paid to some extent in kind; will make it necessary to have larger changes in tax rates to achieve a given effect on economic stabilization; will lead to . . . a lower level of consumer satisfaction from given expenditures on employees; has . . . reduced the mobility of labor in many cases . . . ."[10]

5. P. 33.
6. *Ibid.*
7. *Ibid.*
8. *Ibid.*
9. *Ibid.*
10. P. 85.

While the first half of the study deals with fringe benefits "as though they were a homogeneous mass," the second half proceeds on the assumption that it "is safer to subject the individual fringe benefits to examination one at a time and then to try to reach a decision on each one of these as to effects of the present tax treatment and possible alternative forms of tax treatment."[11] Successive chapters take up retirement benefits, including pension and profit sharing plans; life insurance and death benefits, including social security and widow's benefits; unemployment and health insurance; and fringe benefits in kind, including meals, housing and medical care for employees and their families. In the case of each benefit the analysis follows the directional lines developed in the first half of the study, accompanied by some descriptive material regarding the existing tax treatment and the extent to which it constitutes a preferred position.

To the lawyer seeking guidance in advising clients on the legal status of fringe benefits, the study is not intended to be useful. The description of the existing law is too superficial for that purpose. It is to the lawyer interested in the policy aspects of taxing fringe benefits that the study should appeal. Unfortunately this appeal might suffer somewhat from the literary style of the book. In what apparently is the vogue in social science manuscripts, authors of other works are referred to in the text by last name alone, as though the reader of course were acquainted with the whole fraternity. For an outlander it is a bit annoying to read: "Pigou, while not mentioning the difference between [something] . . . and [something] . . . notes that the tax gatherer will have to be content with [something else] . . . . Vickrey notes [something] . . . . Simons in discussing taxation of compensation in kind, is no more optimistic."[12] The annoyance becomes stronger when the sentence begins with "Due argues that . . . ."[13] Not until the next sentence did I realize that no typesetting error had occurred but that the reference was to a man named Due, who I happily was then able to identify as John Due, an economist. Another manifestation of the academic style which presumes familiarity with the literature is nicely illustrated by a quotation in the text which reads: "The problem of Kleinwachter's *Flugeladjutant* is insoluble and certainly is not amenable

11. P. 89.
12. Pp. 29–30.
13. P. 65.

to reasonable solution on the basis of simple rules which could be administered by revenue agents."[14] Largely by happenstance I was in the fortunate position of not having to look at the footnotes to learn what the insiders presumably already know: "Kleinwachter's *Flugeladjutant* is a fictional character who is traditionally used to emphasize the problems connected with the taxation of income in kind. . . . In [the] . . . capacity [of flugeladjutant] he enjoys quarters at the royal palace . . . and attends the theater and opera with the sovereign . . . [but] he dislikes palace living, the theater, and the opera."[15] The academic tradition comes out in force in another respect when we read in the text, "This can be stated in simple algebraic terms as $n = y - ty$ or $n = y\ (1 - t)$."[16] At this point my luck ran out, and I was left with a faint wish that all algebraic formulations had been relegated to the footnotes. These, however are scattered items, and it would be wrong to generalize from them that, to accommodate lawyers, the places of the footnotes and the text might better have been reversed.

Despite these small detractions (and I admittedly overplay them), the study provides both a good survey and a thoughtful analysis of one of the hardest territories in the province of income taxation. I would endorse most of the conclusions about the handling of particular fringe benefits. In reaching them, however, I would in general place less weight on economic considerations and more on basic notions of equity. But since this is a period in which our policy makers like to talk a good deal about economic consequences, in this respect it is not the author of the study but I who seem to be out of step.

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THE LAW OF CONFLICT OF LAWS. By Robert A. Leflar. Indianapolis: Bobbs-Merrill Co. 1959. lxxii + 467 pages. $9.50.

In the 1930's Professor Robert Leflar of the University of Arkansas found that the conflict of laws of that state could not be adequately treated by simply annotating the state's appellate cases

14. P. 30.
15. Pp. 200–201.
16. P. 40.

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