

APPENDIX

A

TAX RESEARCH WORKING PAPER FILE

INDEX TO TAX RESEARCH FILE*

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*Most accounting firms maintain a client file for each of their clients. Typically, this file contains copies of client letters, memoranda-to-the-file, relevant primary and secondary authorities, and billing information. In our case, the client file for Mercy Hospital would include copies of the following: (1) the September 12 letter to Elizabeth Feghali, (2) the September 9 memorandum-to-the-file, (3) Sec. 119, (4) Reg. Sec. 1.119-1, (5) the Kowalski opinion, (6) the *Standard Federal Tax Reporter* annotation, and (7) pertinent billing information.

TAX RESEARCH FILE

As mentioned in Chapter C:1 the tax research process entails six steps.

1. Determine the facts
2. Identify the issues
3. Locate applicable authorities
4. Evaluate these authorities
5. Analyze the facts in terms of applicable authorities
6. Communicate conclusions and recommendations to others.

Let us walk through each of these steps.

Determine the Facts Assume that we have determined the facts to be as follows:

Mercy Hospital maintains a cafeteria on its premises. In addition, it rents space to MacDougal's, a privately owned sandwich shop. The cafeteria closes at 8:00 p.m. MacDougal's is open 24 hours. Mercy provides meal vouchers to each of its 240 medical employees to enable them to remain on call in case of emergency. The vouchers are redeemable either at the cafeteria or at MacDougal's. Although the employees are not required to remain on or near the premises during meal hours, they generally do. Elizabeth Fegali, Mercy's Chief Administrator, has approached you with the following question: Is the value of a meal voucher includible in the employees' gross income?

At this juncture, be sure you understand the facts before proceeding further. Remember, researching the wrong facts could produce the wrong results.

Identify the Issues Identifying the issues presupposes a minimum level of proficiency in tax accounting. This proficiency will come with time, effort, and perseverance. The central issue raised by the facts is the taxability of the meal vouchers. A resolution of this issue will hinge on the resolution of other issues raised in the course of the research.

Locate Applicable Authorities For some students, this step is the most difficult in the research process. It raises the perplexing question, "Where do I begin to look?" The answer depends on the tax resources at one's disposal, as well as one's research preferences. Four rules of thumb apply:

1. Adopt an approach with which you are comfortable, and that you are confident will produce reliable results.
2. Always consult the IRC and other primary authorities.
3. Be as thorough as possible, taking into consideration time and billing constraints.
4. Make sure that the authorities you consult are current.

One approach is to conduct a topical search. Begin by consulting the index to the Internal Revenue Code (IRC). Then read the relevant IRC section(s). If the language of the IRC is vague or ambiguous, turn to the Treasury Regulations. Read the relevant regulation section that elaborates or expounds on the IRC provision. If the language of the regulation is confusing or unclear, go to a commercial tax service. Read the relevant tax service paragraphs that explain or analyze the statutory and regulatory provisions. For references to other authorities, browse through the footnotes and annotations of the service. Then, consult these authorities directly. Finally, check the currency of the authorities consulted, with the aid of a citator, or status (finding) list.

If a pertinent court decision or IRS ruling has been called to your attention, consult this authority directly. Alternatively, browse through the status (finding) list of a tax service for references to tax service paragraphs that discuss this authority. Better still, consult a citator or status list for references to court opinions or rulings that cite the authority. If you subscribe to a computerized tax service, conduct a keyword, citation, contents, or topical search. (For a discussion of these types of searches, see the computerized research supplement available for download at www.prenhall.com/phtax.) Then, hyperlink to the authorities cited within the text of the documents retrieved. So numerous are the

approaches to tax research that one is virtually free to pick and choose. All that is required of the researcher is a basic level of skill and some imagination.

Let us adopt a topical approach to the issue of the meal vouchers. If we consult an index to the IRC, we are likely to find the heading "Meals and Lodging." Below this heading are likely to be several subheadings, some pertaining to deductions, others to exclusions. Because the voucher issue pertains to an exclusion, let us browse through these subheadings. In so doing, we will notice that most of these subheadings refer to Sec. 119. If we look up this IRC section, we will see the following passage:

Sec. 119. Meals or lodging furnished for the convenience of the employer.

(a) Meals and lodging furnished to employee, his spouse, and his dependents, pursuant to employment.

There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him . . . by, or on behalf of his employer for the convenience of the employer, but only if—

(1) in the case of meals, the meals are furnished on the business premises of the employer . . .

(b) Special rules. For purposes of subsection (a)—

(4) Meals furnished to employees on business premises where meals of most employees are otherwise excludable. All meals furnished on the business premises of an employer to such employer's employees shall be treated as furnished for the convenience of the employer if . . . more than half of the employees to whom such meals are furnished on such premises are furnished such meals for the convenience of the employer.

Section 119 appears to be applicable. It deals with meals furnished to an employee on the business premises of the employer. Our case deals with meal vouchers furnished to employees for redemption at employer-maintained and employer-rented-out facilities. But here, additional issues arise. For purposes of Sec. 119, are meal vouchers the same as "meals"? (Do not assume they are.) Are employer-maintained and employer-rented-out facilities the same as "the business premises of the employer"? (Again, do not assume they are.) And what does the IRC mean by "for the convenience of the employer"? Because the IRC offers no guidance in this respect, let us turn to the Treasury Regulations.

The applicable regulation is Reg. Sec. 1.119-1. How do we know this? Because Treasury Regulation section numbers track the IRC section numbers. Regulation Sec. 1.119-1 is the only regulation under Sec. 119. If we browse through this regulation, we will find the following provision:

(a) Meals . . .

(2) Meals furnished without a charge

(i) Meals furnished by an employer without charge to the employee will be regarded as furnished for the convenience of the employer if such meals are furnished for a substantial noncompensatory business reason of the employer . . .

(ii) (a) Meals will be regarded as furnished for a substantial noncompensatory business reason of the employer when the meals are furnished to the employee during his working hours to have the employee available for emergency call during his meal period . . .

(c) Business premises of the employer.

(1) In general. For purposes of this section, the term "business premises of the employer" generally means the place of employment of the employee . . .

Based on a reading of this provision, we might conclude that the hospital meals are furnished "for the convenience of the employer." Why? Because they are furnished for a "substantial noncompensatory business reason of the employer," namely, to have the employees available for emergency call during their meal periods. They also are furnished during the employees' working hours. Moreover, under Sec. 119(b)(4), if more than half the employees satisfy the "for the convenience of the employer" test, all employees will be regarded as satisfying the test. But are the meals furnished on "the business premises of the employer"? Under the regulation, the answer would depend. If the meals are furnished in the hospital cafeteria, they probably are furnished on "the business premises of the employer." The hospital is the place of employment of the medical employees. The cafeteria is part of the hospital. On the other hand, if the meals are furnished at MacDougal's, they probably are not

furnished on "the business premises of the employer." MacDougal's is not the place of employment of the medical employees. Nor is it a part of the hospital. Thus, Reg. Sec. 1.119-1 is enlightening with respect to two statutory terms: "for the convenience of the employer" and "the business premises of the employer." However, it is obscure with respect to the third term, "meals." Because of this obscurity, let us turn to a tax service.

Although the index to CCH's *Standard Federal Tax Reporter* does not list "meal vouchers," it does list "cash allowances in lieu of meals" as a subtopic under Meals and Lodging. Are meal vouchers the same as cash meal allowances?—perhaps so; let us see. Next to the heading "cash allowances in lieu of meals" is a reference to CCH ¶7222.59. If we look up this reference, we will find the following annotation:

¶7222.59 Meal allowances.—Cash meal allowances received by an employee (state trooper) from his employer were not excludible from income. *R.J. Kowalski*, SCt, 77-2 USTC ¶9748, 434 US 77.¹

Here we discover that, in the *Kowalski* case, the U.S. Supreme Court decided that cash meal allowances received by an employee were not excludible from the employee's income. Is the *Kowalski* case similar to our case? It might be. Let us find out. If we turn to paragraph 9748 of the second 1977 volume of *United States Tax Cases*, we will find the text of the *Kowalski* opinion. A synopsis of this opinion is present below.

In the mid-1970s, the State of New Jersey provided cash meal allowances to its state troopers. The state did not require the troopers to use the allowances exclusively for meals. Nor did it require them to consume their meals on its business premises. One trooper, Robert J. Kowalski, failed to report a portion of his allowance on his tax return. The IRS assessed a deficiency, and Kowalski took the IRS to court. In court, Kowalski argued that the meal allowances were excludible, because they were furnished "for the convenience of the employer." The IRS contended that the allowances were taxable because they amounted to compensation. The Supreme Court took up the case and sided with the IRS. The Court held that the Sec. 119 income exclusion does not apply to cash payments; it applies only to meals in kind.²

For the sake of illustration, let us assume that Sec. 119, Reg. Sec. 1.119-1, and the *Kowalski* case are the *only* authorities "on point." How should we evaluate them?

Evaluate Authorities Section 119 is the key authority applicable to our case. It supplies the operative rule for resolving the issue of the meal vouchers. It is vague, however, with respect to three terms: "meals," "business premises of the employer," and "for the convenience of the employer." The principal judicial authority is the *Kowalski* case. It provides an official interpretation of the term "meals." Because the U.S. Supreme Court decided *Kowalski*, the case should be assigned considerable weight. The relevant administrative authority is Reg. Sec. 1.119-1. It expounds on the terms "business premises of the employer" and "for the convenience of the employer." Because neither the IRC nor *Kowalski* explain these terms, Reg. Sec. 1.119-1 should be accorded great weight. But what if *Kowalski* had conflicted with Reg. Sec. 1.119-1? Which should be considered more authoritative? As a general rule, high court decisions "trump" the Treasury Regulations (and all IRS pronouncements for that matter). The more recent the decision, the greater its precedential weight. Had there been no Supreme Court decision and a division of appellate authority, equal weight should have been assigned to each of the appellate court decisions.

Analyze the Facts in Terms of Applicable Authorities Analyzing the facts in terms of applicable authorities involves applying the abstraction of the law to the concreteness of the facts. It entails expressing the generalities of the law in terms of the specifics of the facts. In this process, every legal condition must be satisfied for the result implied by the

researcher also might read the main *Standard Federal Tax Reporter* uph that discusses meals and lodging furnished by the employer (CCH 01). Within this paragraph are likely to be references to other primary ries.

² At this juncture, the researcher should consult a citator to determine whether *Kowalski* is still "good law," and to locate other authorities that cite *Kowalski*.

general rule to ensue. Thus, in our case, the conditions of furnishing "meals," "on the business premises of the employer," and "for the convenience of the employer" must be satisfied for the value of the "meals" to be excluded from the employee's income.

When analyzing the facts in terms of case law, the researcher should always draw an *analogy* between case facts and client facts. Likewise, he or she should always draw a *distinction* between case facts and client facts. Remember, under the rule of precedent, a court deciding the client's case will be bound by the precedent of cases involving *similar* facts and issues. By the same token, it will *not* be bound by the precedent of cases involving *dissimilar* facts and issues.

The most useful vehicle for analyzing client facts is the memorandum-to-the-file (see page A-6). The purpose of this document is threefold: first, it assists the researcher in recollecting transactions long transpired; second, it appries colleagues and supervisors of the nature of one's research; third, it provides "substantial authority" for the tax treatment of a particular item. Let us analyze the facts of our case by way of a memorandum-to-the-file. Notice the format of this document; it generally tracks the steps in the research process itself.

Communicate Conclusions and Recommendations to Others For three practical reasons, research results always should be communicated to the client *in writing*. First, a written communication can be made after extensive revisions. An oral communication cannot. Second, in a written communication, the researcher can delve into the intricacies of tax law. Often, in an oral communication, he or she cannot. Third, a written communication reinforces an oral understanding. Alternatively, it brings to light an oral misunderstanding.

The written communication usually takes the form of a client letter (see page A-7). The purpose of this letter is two-fold: first, it appries the client of the results of one's research and, second, it recommends to the client a course of action based on these results. A sample client letter is presented below. Notice the organization of this document; it is similar to that of the memorandum-to-the-file.

Memorandum-to-the-File

Date: December 9, 20X1

From: Rosina Havacek

Re: The taxability of meal vouchers furnished by Mercy Hospital to its medical staff.

Facts

[State only the facts that are relevant to the Issue(s) and necessary for the Analysis.] Our client, Mercy Hospital ("Mercy"), provides meal vouchers to its medical employees to enable them to remain on emergency call. The vouchers are redeemable at Mercy's onsite cafeteria and at MacDougal's, a privately owned sandwich shop. MacDougal's rents business space from the hospital. Although Mercy does not require its employees to remain on or near its premises during their meal hours, the employees generally do. Elizabeth Fegali, Mercy's Chief Administrator, has asked us to research whether the value of the meal vouchers is taxable to the employees.

Issues

[Identify the issue(s) raised by the Facts. Be specific.] The taxability of the meal vouchers depends on three issues: first, whether the meals are furnished "for the convenience of the employer"; second, whether they are furnished "on the business premises of the employer"; and third, whether the vouchers are equivalent to cash.

Applicable Law

[Discuss those legal principles that both strengthen and weaken the client's case. Because the primary authority for tax law is the IRC, begin with the IRC.] Section 119 provides that the value of meals is excludible from an employee's income if the meals are furnished for the convenience of, and on the business premises of the employer. [Discuss how administrative and/or judicial authorities expound on statutory terms.] Under Reg. Sec. 1.119-1, a meal is furnished "for the convenience of the employer" if it is furnished for a "substantial noncompensatory business reason." A "substantial noncompensatory business reason" includes the need to have the employee available for emergency calls during his or her meal period. Under Sec. 119(b)(4), if more than half the employees satisfy the "for the convenience of the employer" test, all employees will be regarded as satisfying the test. Regulation Sec. 1.119-1 defines "business premises of the employer" as the place of employment of the employee.

[When discussing court cases, present case facts in such a way as to enable the reader to draw an analogy with client facts.] A Supreme Court case, *Kowalski v. CIR*, 434 U.S. 77, 77-2 USTC ¶9748, discusses what constitutes "meals" for purposes of Sec. 119. In *Kowalski*, the State of New Jersey furnished cash meal allowances to its state troopers to enable them to eat while on duty. It did not require the troopers to use the allowances exclusively for meals. Nor did it require them to consume their meals on its business premises. One trooper, R.J. Kowalski, excluded the value of his allowances from his income. The IRS disputed this treatment, and Kowalski took the IRS to Court. In Court, Kowalski argued that the allowances were excludible because they were furnished "for the convenience of the employer." The IRS contended that the allowances were taxable because they amounted to compensation. The U.S. Supreme Court took up the case and decided for the IRS. The Court held that the Sec. 119 income exclusion does not apply to payments in cash.

Analysis

[The Analysis should (a) apply Applicable Law to the Facts and (b) address the Issue(s). In this section, every proposition should be supported by either authority, logic, or plausible assumptions.]

Issue 1: The meals provided by Mercy seem to be furnished "for the convenience of the employer." They are furnished to have employees available for emergency call during their meal breaks. This is a "substantial noncompensatory reason" within the meaning of Reg. sec. 1.119-1.

Issue 2: Although the hospital cafeteria appears to be the "business premises of the employer," MacDougal's does not appear to be. The hospital is the place of employment of the medical employees. MacDougal's is not.

Issue 3: [In applying case law to the Facts, indicate how case facts are similar to/dissimilar from client facts. If the analysis does not support a "yes-no" answer, do not give one.] Based on the foregoing authorities, it is unclear whether the vouchers are equivalent to cash. On the one hand, they are redeemable only in meals. Thus, they resemble meals-in-kind. On the other hand, they are redeemable at more than one institution. Thus, they resemble cash. Nor is it clear whether a court deciding this case would reach the same conclusion as the Supreme Court did in *Kowalski*. In the latter case, the State of New Jersey provided its meal allowances in the form of cash. It did not require its employees to use the allowances exclusively for meals. Nor did it require them to consume their meals on its business premises. In our case, Mercy provides its meal allowances in the form of vouchers. Thus, it indirectly requires its employees to use the allowances exclusively for meals. On the other hand, it does not require them to consume their meals on its business premises.

Conclusion

[The Conclusion should (a) logically flow from the Analysis, and (b) address the Issue(s).] Although it appears that the meals acquired by voucher in the hospital cafeteria are furnished "for the convenience of the employer" and "on the business premises of the employer," it is unclear whether the vouchers are equivalent to cash. If they are equivalent to cash, or if they are redeemed at MacDougal's, their value is likely to be taxable to the employees. On the other hand, if they are not equivalent to cash, and they are redeemed only in the hospital cafeteria, their value is likely to be excludible.

Professional Accounting Associates
2701 First City Plaza
Suite 905
Dallas, Texas 75019

December 12, 20X1

Elizabeth Feghali, Chief Administrator
Mercy Hospital
22650 West Haven Drive
Arlington, Texas 75527

Dear Ms. Feghali:

[Introduction. Set a cordial tone.] It was great to see you at last Thursday's football game. If not for that last minute fumble, the Longhorns might have taken the Big 12 Conference championship!

[Issue/Purpose.] In our meeting of December 6, you asked us to research whether the value of the meal vouchers that Mercy provides to its medical employees is taxable to the employees. *[Short Answer.]* I regret to inform you that if the vouchers are redeemed at MacDougal's, their value is likely to be taxable to the employees. On the other hand, if the vouchers are redeemed in the hospital cafeteria, their value is likely to be excludible from the employee's income. *[The remainder of the letter should elaborate, support, and qualify this answer.]*

[Steps Taken in Deriving Conclusion.] In reaching this conclusion, we consulted relevant provisions of the Internal Revenue Code ("IRC"), applicable Treasury Regulations under the IRC, and a pertinent Supreme Court case. In addition, we reviewed the documents on employee benefits that you submitted to us at our earlier meeting.

[Facts. State only the facts that are relevant to the Issue and necessary for the Analysis.] The facts as we understand them are as follows: Mercy provides meal vouchers to its medical employees to enable them to eat while on emergency call. The vouchers are redeemable either in the hospital cafeteria or at MacDougal's. MacDougal's is a privately owned institution that rents business space from the hospital. Although Mercy's employees are not required to remain on or near the premises during their meal hours, they generally do.

Applicable Law. State, do not interpret. Under the IRC, the value of meals is excludible from an employee's income if two conditions are met: first, the meals are furnished "for the convenience of the employer" and second, they are provided "on the business premises of the employer." Although the IRC does not explain what is meant by "for the convenience of the employer," "business premises of the employer," and "meals," other authorities do. Specifically, the Treasury Regulations define "business premises of the employer" to be the place of employment of the employees. The regulations state that providing meals during work hours to have an employee available for emergency calls is "for the convenience of the employer." Moreover, under the IRC, if more than half the employees satisfy the "for the convenience of the employer" test, all the employees will be regarded as satisfying the test. The Supreme Court has interpreted "meals" to mean food-in-kind. The Court has held that cash allowances do not qualify as "meals."

[Analysis. Express the generalities of Applicable Law in terms of the specifics of the Facts.] Clearly, the meals furnished by Mercy are "for the convenience of the employer." They are furnished during the employees' work hours to have the employees available for emergency call. Although the meals provided in the hospital cafeteria appear to be furnished "on the business premises of the employer," the meals provided at MacDougal's do not appear to be. The hospital is the place of employment of the medical employees. MacDougal's is not. What is unclear is whether the meal vouchers are equivalent to food-in-kind. On the one hand, they are redeemable at more than one institution and thus resemble cash allowances. On the other hand, they are redeemable only in meals and thus resemble food-in-kind.

[Conclusion/Recommendation.] Because of this lack of clarity, we suggest that you modify your employee benefits plan to allow for the provision of meals-in-kind exclusively in the hospital cafeteria. In this way, you will dispel any doubt that Mercy is furnishing "meals," "for the convenience of the employer," "on the premises of the employer."

[Closing/Follow Up.] Please call me at 475-2020 if you have any questions concerning this conclusion. May I suggest that we meet next week to discuss the possibility of revising your employee benefits plan.

Very truly yours,
Professional Accounting Associates

By: Rosina Havacek, Junior Associate