32 T.C. 839 (1959)

Cost-of-living allowances received by civilian employees of the U.S. Government stationed outside the continental United States are excludable from gross income only if paid in accordance with regulations approved by the President.

Summary

The case concerns whether cost-of-living allowances received by George R. Bell, an employee of the Government of American Samoa, were excludable from his gross income. The Tax Court held that the allowances were not excludable because, although Bell received payments designated as cost-of-living allowances, these were not paid in accordance with regulations approved by the President as required by the Internal Revenue Code. The Court found that while regulations authorized territorial post differentials in American Samoa, they did not designate the area for cost-of-living allowances, a prerequisite for exclusion under the statute.

Facts

George R. Bell was employed by the Government of American Samoa in 1952 and 1953. His employment contracts stated that he was to receive a salary plus a 25% cost-of-living allowance. He excluded these allowances from his gross income when filing his taxes. The IRS challenged this exclusion, arguing that the allowances were taxable income. The Civil Service Commission had issued regulations to provide for territorial post differentials and territorial cost-of-living allowances, but the Government of American Samoa was only designated for the former, not the latter. The relevant statute, I.R.C. 1939 § 116(j), allowed the exclusion of cost-of-living allowances for employees stationed outside the continental United States only if the allowances were paid "in accordance with regulations approved by the President."

Procedural History

Initially, the Tax Court ruled against Bell, holding that his entire compensation was taxable. Bell filed a motion for a rehearing, arguing that a portion of his compensation was a cost-of-living allowance and, therefore, potentially excludable under I.R.C. 1939 § 116(j). The court granted the motion and reopened the case to determine the nature of the payments. Following a supplemental hearing and the submission of a stipulation of facts, the court issued its final decision.

Issue(s)

1. Whether the cost-of-living allowances received by Bell from the Government of American Samoa were excludable from his gross income under I.R.C. 1939 § 116(j).

Holding

1. No, because the cost-of-living allowances were not paid in accordance with

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regulations approved by the President.

Court’s Reasoning

The court’s decision hinged on the interpretation of I.R.C. 1939 § 116(j), which allowed for the exclusion of cost-of-living allowances for certain government employees stationed outside the continental United States but only if the allowances were paid “in accordance with regulations approved by the President.” The court found that Executive Order 10,000 authorized the Civil Service Commission to establish territorial post differentials and cost-of-living allowances. While American Samoa was designated for the former, it was not specifically designated as an area where territorial cost-of-living allowances were payable. The court emphasized that “the cost-of-living allowances were not paid petitioner in accordance with regulations approved by the President” and that it was this factor that determined excludability. The court found that the Civil Service Commission’s regulations did not permit the payment of cost-of-living allowances in American Samoa. Therefore, the 25% of Bell’s pay that represented cost of living allowance was not excludable.

Practical Implications

This case underscores the importance of adhering precisely to the requirements of tax statutes and regulations. It emphasizes that even if an employee receives payments labeled as cost-of-living allowances, those payments are not excludable unless they are authorized under regulations approved by the President. Lawyers advising clients in similar situations must meticulously examine the governing regulations to determine if an area has been officially designated for such allowances. The case also clarifies that reliance on general descriptions of payments is insufficient; the specific regulatory framework must authorize the payments’ exclusion. This case informs the analysis of similar tax matters. The principle that specific regulatory authorization is required for exclusion continues to guide interpretations of tax law related to employee compensation. The case is relevant to any situation involving employee compensation and the excludability of allowances based on the location of their work.

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