

Working Condition Fringe Benefit: Cell Phones

The IRS is looking for input on several proposals regarding the procedures used by employers to account for employees' use of employer-provided cell phones. Whichever proposal is chosen could have significant ramifications.

On June 8, 2009, the IRS issued Notice 2009-46 (IRB, 2009-23, 1068) requesting public comments on several proposals to simplify the procedures under which employers substantiate an employee's business use of employer-provided cell phones or similar telecommunications equipment. In essence, the IRS (the "Service") and Treasury Department are considering three alternative substantiation methods to determine the fair market value (FMV) of an employee's personal use of an employer-provided cell phone. Since comments are due to the IRS on or before Sept. 4, 2009, time is of the essence.

IRC §61 broadly defines gross income to include all income from whatever source, including fringe benefits, unless specifically excluded by another IRC section. IRC §132 provides relief from IRC §61 for eight incidental fringe benefits, including the working condition fringe benefit. A working condi-

tion fringe benefit is defined in Regulation §1.132-5(a)(1) as "...any property or service provided to an employee of an employer to the extent that, if the employee paid for the property or service, the amount paid would be allowable as a deduction under section 162 or 167."

IRC §1.132-5(a)(1)(ii) also provides that if, under IRC §274 or any other section of the Code, certain substantiation requirements must be met in order for a deduction under IRC §162 or §167 to be allowable, then those substantia-



tion requirements apply in determining whether a property or service is excludable as a working condition fringe. The substantiation requirements of IRC §274(d) are satisfied by adequate records or sufficient evidence corroborat-

ing the employee's own statement. Therefore, such records or evidence provided by the employee, and relied upon by the employer to the extent permitted by the regulations promulgated under IRC §274(d), will be sufficient to substantiate a working condition fringe benefit exclusion.

IRC §162(a) provides that a business deduction is allowed for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. There are exceptions to the general rules. IRC §274(d)(4) provides that no deduction is allowed for listed property (as defined in IRC §280F(d)(4)) unless the taxpayer substantiates the amount of such expense or other item, the use of the property, the business purpose of the expense or other item, and the business relationship to the taxpayer of persons using the property. Listed property under IRC §280F(d)(4) includes any cellular telephone (or similar telecommunications equipment).

Therefore, an employee can exclude from gross income the cost of the cell phone that is associated with business use but not with any personal use. Furthermore, Temp. Reg. §1.274-5T(a)

provides that no deduction or credit is allowed with respect to any listed property unless the taxpayer substantiates each element of the expenditure or use. Thus, the employee must maintain records or logs substantiating the business and personal usage of any employer-provided cell phone.

Notice 2009-46

The IRS has recognized the complexity with the record-keeping process associated with cell phone usage for both the employer and employee. As a result, it is looking to simplify the process.

Within Notice 2009-46, the Service has proposed three alternative simplification methods: a minimal personal use method, a safe harbor substantiation method, and a statistical sampling method (or a combination of the foregoing). Regardless of which method or methods it adopts, the IRS has indicated that an employer will have the option of adopting that method or continuing the use of the current method.

The minimal personal use method would treat the total usage of an employer-provided cell phone as business related under certain conditions. Therefore, none of the value would be included in the employee's gross income. There are two proposals being considered under this method. The first requires the employee to account to his or her employer with sufficient records to establish that the employee maintains and uses a personal (nonemployer-provided) cell phone for personal purposes

during the employee's work hours. The second proposal defines a specified amount or type of "minimal" personal use that would be disregarded in determining the amount of personal use of an employer-provided cell phone. Pursuant to the notice, "minimal" could be defined by reference to a particular number of minutes of use or for certain personal purposes. It should be noted that the Service anticipates requiring that the employer must reasonably

believe that the cell phone

isn't used for personal purposes except for minimal personal use.

The second method being considered is a safe harbor

method. This

method would treat a certain percentage of use of an employer-provided cell phone as business usage. Hence, the remaining percentage of use would be deemed to be for personal purposes. The Notice includes an example of 75% business use, which means 25% of the value would be included in the employee's gross income.

The final method under consideration is the statistical sampling method. The IRS sees this method as one that would allow employers to use statistical sampling techniques to measure an employee's personal use of an employer-provided cell phone. In general, an employer could use an approved statistical sampling methodology similar to that provided in Rev. Proc. 2004-29 (2004-1 C.B. 918) to determine

the percentage of personal use of employer-provided cell phones. The employer would multiply that percentage times the value of each employee's total usage to determine the value of personal usage. The remaining portion of the employee's usage would be deemed to be for business purposes. Obviously, this is the most complex method.

The final issue that needs addressing is the FMV determination of the cell phone usage. As stated in Notice 2009-46, the IRS is interested in understanding the methods employers currently use to arrive at the FMV of the taxable fringe benefit and whether a simplified valuation method would be helpful and appropriate to determine such FMV. This subtle statement suggests that employers are treating the personal usage as a taxable fringe benefit.

As mentioned earlier, the deadline for submitting comments or thoughts on this proposal is Sept. 4, 2009, which is quickly approaching. More than likely, most companies won't respond. If your company provides cell phones to employees, however, the final decision made by the Service on this issue will affect you and your employees. It may be wise to consider the issues and voice your thoughts. The IRS is particularly interested in the following issues:

- ◆ The specific provisions that should be required to be included in an employer's written policy prohibiting personal use of employer-provided cell phones;
- ◆ The types of employee records sufficient to establish that

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the employee maintains and uses a personal (nonemployer-provided) cell phone for purposes of the first proposed minimum personal use method;

- ◆ How to define a specified amount or type of “minimal” personal use (e.g., a maximum number of minutes of use or a list of acceptable personal uses) that should be disregarded in determining the amount of personal use of an employer-provided cell phone for purposes of the second proposed minimum personal use method;

- ◆ The business-use percentage that should be applied in the proposed safe harbor substantiation method, and the data and rationale upon which it is based;

- ◆ The methods currently used by employers to determine the FMV of an employee’s use of an employer-provided cell phone; and

- ◆ Whether a simplified method of determining the FMV of an employee’s use of an employer-provided cell phone would be appropriate, and, if so, suggested simplified methodologies for determining such FMV.

This comment period is your chance. Speak now or forever hold your peace. **SF**

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