

IRS Issues Guidance Permitting Tax-Free Treatment of Employer-Provided Cell Phones and PDAs

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The Internal Revenue Service (IRS) provided welcome and practical relief to businesses with the September 14 release of Notice 2011-72 (the Notice), which eliminates all recordkeeping requirements in connection with employer-provided cell phones and “other similar telecommunications equipment” that are provided to employees primarily for business purposes.

Pursuant to the Notice, for tax years after 2009, employee use of cell phones and other similar telecommunications equipment (such as PDAs, BlackBerrys, smart phones, and the like) and their related calling/data plans (collectively referred to as “cell phones” in this LawFlash) provided primarily for “non-compensatory business purposes” is treated as follows:

1. The business use is excludable from the employee’s income as a working condition fringe benefit.
2. **Any** personal use is excludable as a de minimis fringe benefit.

Neither the business or personal use is subject to recordkeeping.

The IRS also released a Field Exam Memorandum (Control No. SBSE-04-0911-083) to its examiners regarding the proper treatment of employer reimbursements for personal cell phone usage, described below.

Background

The Notice was issued in response to the Small Business Jobs Act of 2010 (SBJA), which removed cell phones and “other similar telecommunications equipment” from the “listed property” provisions of Code section 274(d). (Notably, the legislative history of the SBJA specifically includes both cell phones and BlackBerrys.) The delisting of cell phones by the SBJA relieved employers of the onerous recordkeeping requirements that normally apply to listed property, but it did not go so far as to eliminate the recordkeeping required to prove business use.¹

1. Additional background information is available in the Morgan Lewis LawFlash, “Congress ‘De-Lists’ Cell Phones: What Does That Mean for Employer-Provided Cell Phones?” (September 29, 2010), available at http://www.morganlewis.com/pubs/EB_CongressDeListsCellPhones_LF_29sept10.pdf, and Morgan Lewis’s September 4, 2009 comment letter to the IRS Commissioner, available at http://payrollperks.morganlewis.com/wp-content/uploads/2010/03/PPBB_MorganLewisCommentLetterToTheIRS.pdf.

Overview of Notice 2011-72

Notice 2011-72 further removes any recordkeeping requirements for the business and personal use of employer-provided cell phones after December 31, 2009 so long as the employer can demonstrate that the cell phones are provided primarily for “non-compensatory business purposes.” Once an employer satisfies the business purpose standard, the recordkeeping requirements are “deemed satisfied” and employees’ use of cell phones for business purposes will be excludable from employees’ income as a working condition fringe benefit and any personal use will be excludable as a de minimis fringe benefit.

The Notice provides the following examples of what qualifies as a non-compensatory business purpose:

- The employer’s need to contact the employee at all times for work-related emergencies.
- The employer’s requirement that the employee be available to speak with clients at times when the employee is away from the office.
- The employee’s need to speak with clients at times outside the employee’s normal work schedule (i.e., when clients are in different time zones).

Pursuant to the Notice, cell phones provided to increase morale or good will of an employee, to attract potential employees, or as a means of furnishing additional compensation are not considered to be provided for qualifying business purposes.

This relief only applies to cell phone use that is primarily business related. Cell phones provided for personal reasons (or that are primarily used for personal reasons) are **not** exempt from the recordkeeping requirements. Records must be kept to exclude any business-related use of a primarily personal cell phone from the employee’s income as a working condition fringe benefit. To the extent no records are kept, such arrangements are generally taxable.

Cash Allowance and Reimbursement Issue

The IRS also released a Field Exam Memorandum to its examiners regarding the proper treatment of employer reimbursements for personal cell phone usage. Additional guidance was necessary as the “de minimis exclusion” applied to cell phone personal usage by Notice 2011-72 is technically not applicable to employers’ cash reimbursements paid to employees for use of their own phones. Unfortunately, instead of stating in the Notice that its relief is extended to cash reimbursements, the IRS has announced this rule in the form of internal guidance. (We plan to submit comments on the Notice requesting that the Notice be technically corrected to reference cash reimbursements.)

According to this Field Exam Memorandum, in order for cell phone reimbursements for business use of a personal cell phone to be excludable from an employee’s income, the employer must have substantial non-compensatory business reasons for requiring the employee to use his or her personal cell phone for work-related purposes, the employee must maintain the type of cell phone coverage that is “reasonably related to the needs of the employer’s business,” and the reimbursement must not exceed the expenses actually incurred. The Field Exam Memorandum points out that the reimbursement for business use must not be a substitute for a portion of the employee’s regular wages, and that examiners should be cautious of arrangements that allow for the reimbursement of unusual or excessive cell phone expenses.

Key Takeaways

- **The Notice applies only to cell phones and “other similar telecommunications equipment” provided primarily for non-compensatory business purposes.** Accordingly, employers should review their current cell phone policies to determine whether the policy qualifies for the relief in the Notice, and if it does not, consider amending its policy to qualify for the relief. This may be more difficult than it appears at first glance because what constitutes non-compensatory business purposes depends on the particular facts and circumstances, and “other similar telecommunications equipment” is not well defined. Confusion around the definitions of these terms could potentially subject an employer’s treatment of cell phones to challenge by the IRS.

Additionally, employers should consider incorporating into their cell phone policies the key provisions of the IRS’s own business and personal use policy for cell phones and other telecommunications equipment issued to its employees.

- **Employers who provide cash allowances and reimbursements to employees for the business use of their personal cell phones must understand that the IRS Field Exam Memorandum is not the equivalent of an IRS ruling or notice for reliance purposes.** Accordingly, such employers should consider whether or how the Field Exam Memorandum can be used to create a reasonable belief that the allowance or reimbursement is not taxable.
- **The Notice is effective for tax years beginning in 2010.** Accordingly, employers should consider correcting any taxation after 2009 of cell phones provided to employees primarily for business purposes. In doing so, employers should consider whether the administrative challenges of filing refund claims (and processing Forms W-2c) outweigh the refund potential and whether refund claims should instead be pursued by affected employees. Also, any employer that implemented a deduction disallowance for cell phone expenses should consider filing a refund claim.
- **Cell phones provided for personal reasons (or that are primarily used for personal reasons) are not exempt from the normal recordkeeping requirements necessary to exclude business-related use from the employee’s income as a working condition fringe benefit.** To the extent no records are kept, such employer-provided cell phones are generally taxable.

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