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Congress "De-Lists" Cell Phones:
What Does That Mean for Employer-Provided Cell Phones?

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On September 27, President Obama signed into law the Small Business Jobs Act (H.R. 5297) (SBJA). Hidden in this legislation is much-needed relief to *all* businesses (small or large) and their employees concerning the business and personal use of employer-provided cell phones, including personal digital assistants (PDAs) with mobile communication features[1] and smartphones (collectively, cell phones).[2] This provision removes cell phones from the Internal Revenue Code's definition of "listed property" for taxable years beginning after December 31, 2009. Many employers and tax practitioners, however, are left with questions regarding the proper tax treatment of these fundamental business tools in the practical world. Until the IRS provides guidance and discontinues its ongoing audit efforts, this is an issue with a number of potential solutions but without a definitive answer.

What We Do Know

The SBJA provides significant relief to businesses by allowing them to exclude the value of employer-provided cell phones from employee wages without having to comply with the onerous recordkeeping requirements that apply to listed property. The relief, while consistent with the relief Morgan Lewis requested in our comment letter submitted to Commissioner Shulman of the Internal Revenue Service (IRS), does not go as far as was hoped. [3]

Although employees are no longer required to maintain logs of their business and personal use of cell phones (a requirement that few, if any, employers implemented—including federal agencies), the SBJA does not provide complete relief from recordkeeping for employer-provided cell phones. Employers can

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[1] The IRS might argue that PDAs on which the mobile communications feature is not activated is a computer subject to the onerous substantiation rules for listed property, as opposed to a cell phone. However, because PDAs today are generally all manufactured with mobile communications features, such devices should arguably be treated as cell phones, regardless of whether the mobile communication feature is activated.

[2] Employer-provided cell phone benefits can take various forms. For example, this benefit may be a cell phone that the employer provides to an employee who maintains a personal cell phone for personal use, reimbursement for an employee-owned cell phone and business usage, or a cell phone and/or usage costs covered by any of the policies outlined herein.

[3] See Morgan Lewis's comment letter to the IRS Commissioner, available at http://payrollperks.morganlewis.com/wp-content/uploads/2010/03/PPBB_MorganLewisCommentLetterToTheIRS.pdf. Additional information about the IRS's position on employer-provided cell phones is available in the Morgan Lewis LawFlash, "IRS 'Crackdown' on the Taxation of Business Cell Phones and PDAs: IRS Commissioner Clarifies and Softens the IRS's Stance" (June 17, 2009), available at http://www.morganlewis.com/pubs/EB_BusinessCellPhones+PDAs_LF_17jun09.pdf.

substantially loosen (but technically cannot eliminate) their recordkeeping and tax policies associated with the cell phones provided to employees.

What We Do Not Know

While the SBJA removes cell phones from the definition of listed property retroactive to the beginning of 2010, the new law does not provide that an employee's limited or *de minimis* personal use of employer-provided cell phones is nontaxable. The IRS and the Treasury Department have authority to promulgate regulations, issue other guidance, or adopt a nonenforcement position (all of which Morgan Lewis advocated as potential positions in our comment letter to the IRS). Conversely, the IRS retains the authority to continue to tax employer-provided cell phones on audit. Analogies to the IRS's well-known position on frequent flyer miles can be immediately drawn since tracking, valuing, and reporting cell phone costs and frequent flyer miles are equally administratively burdensome. The administrative efforts required to tax such benefits—and the loss of productivity that results—greatly outweigh the tax revenues generated. Whether the IRS ultimately extends the same nonenforcement approach to cell phones that it did to frequent flyer miles remains to be seen.[4]

Possible IRS Action

In the SBJA's legislative history, Congress explained that the SBJA does not affect the IRS's authority to determine the appropriate characterization of cell phones as a working condition fringe benefit or a *de minimis* fringe benefit. Pursuant to this authority and because Congress specifically acknowledged that business cell phones may constitute a *de minimis* fringe benefit, employers and tax practitioners should encourage IRS efforts to extend *de minimis* treatment to business cell phones or the adoption of a nonenforcement position consistent with the frequent flyer approach.

Interestingly, the Joint Committee on Taxation estimates that removing cell phones from the listed property definition will cost $410 million over 10 years—a very low number considering the wide proliferation of cell phones. Some believe this raises questions as to how far Congress intended that the IRS extend tax relief given the widespread prevalence of business cell phones. Conversely, perhaps this revenue estimate merely confirms Congress's belief that most employer-provided cell phones were already nontaxable consistent with most business practices.

The SBJA failed to delist other common business devices such as laptop computers that employees occasionally use for personal purposes. The IRS maintains that the business use of an employer-provided laptop cannot be excluded as a working condition fringe unless the employee substantiates business use of the computer by adequate records. One IRS tax allocation method is to divide the number of hours the computer is used for business purposes during the year by the total number of hours that the computer is used during the year. The IRS maintains that the value of personal use is includible in employee income and subject to withholding, unless it is excludable as a *de minimis* fringe benefit. Thus, employers must still grapple with recordkeeping, use restrictions, and income-reporting issues associated with laptops due to their ongoing status as listed property.

What Employers Should Do

Employers should review their existing cell phone policies. Several alternative tax positions are under consideration by employers pending formal or informal IRS guidance on this topic. While some have

[4] "Frequent Flyer Miles Attributable to Business or Official Travel," IRS Announcement 2002-18 (available at http://www.irs.gov/pub/irs-drop/a-02-18.pdf).

more merit than others, the first is likely the safest tax position—and ignoring the cell phone issue altogether the least advisable:

- Model the cell phone policy after the policies that the IRS and other federal agencies develop for their own employees.
- Limit the personal use of cell phones to occasional personal use during business and peak hours, and exclude the personal use as a *de minimis* fringe benefit.
- Limit the use of business cell phones to general business use and require year-end compliance certifications and tax accordingly.
- Issue cell phones only to employees for whom a cell phone is necessary to "properly perform their duties," and tax consistent with the legislative history applicable to the personal use of automobiles.
- Adopt and enforce a policy of no personal use (and possibly require the employee to show that the employee has another cell phone for personal use).
- Allow personal use, deem a certain amount of the cost of the cell phone and usage as personal, and include a specified dollar amount in every employee's wages.
- Limit personal use and only tax those employees who certify at year-end that their personal use exceeds a stated percentage.
- Have no policy and ignore the tax issues (similar to how taxpayers treated the frequent flyer mile issue prior to the IRS issuing its nonenforcement position).

Employers should carefully consider how to proceed with their cell phone policies. In addition, due to the failure to delist laptop computers, employers should consider how to address employees' use of such devices. Hopefully, the IRS will soon issue meaningful and practical guidance that recognizes that the personal use of employer-provided cell phones satisfies the *de minimis* fringe provisions of the Internal Revenue Code and the regulations. Until such guidance is issued, however, employers should expect that IRS agents will continue their audit efforts to generate tax dollars on this issue even though the administrative and financial costs of compliance far outweigh any tax dollars generated and hinders positive business development.

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