

New rules for cell phones provided by employer

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Are you one of the employers that provide cell phones to your employees or reimburse them for use of their personal cell phones for business-related purpose?

Based on recent guidance issued by the Internal Revenue Service, you will be able to take a fringe-benefit business deduction for the value of the cell phones provided without requiring employees to keep extensive records of their personal use of cell phones as long as certain conditions are met. Under prior law, business use of employer-provided cell phones was deductible to the employer and excludable from an employee's income as a working-condition fringe only if the business use of the cell phones was substantiated in accordance with very strict rules that applied to "listed property."

If those rules were not met, the value of all business use and personal use of an employer-provided cell phone was included in an employee's taxable wage income, and subject to FICA, Medicare tax and income tax withholding.

The Small Business Jobs Act of 2010 removed cell phones from the definition of "listed property," but it did not provide complete relief. Employers and employee still had to keep records to indicate the extent of business use compared to personal use.

The new IRS guidance provides that business and personal use of a cell phone that an employer gives an employee primarily for noncompensatory business reasons is generally nontaxable to the employee. Noncompensatory business reasons are, for example, 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 or when the clients are in different time zones.

Providing a cell phone to an employee as a means to promote the morale or goodwill, to attract a prospective employee or as a means of providing additional compensation does not meet the noncompensatory business reason requirement. The IRS will treat the employee's use of an employer-provided cell phone for reasons related to the employer's trade or business as a working-condition fringe benefit and any personal use will be treated as a de minimis fringe benefit, the value of which is excluded from the employee's income.

An internal memorandum directs IRS field examiners to use a similar analysis for arrangements under which employees are reimbursed by their employers for the use of their personal cell phones. If audited, the IRS will examine on an individual basis the reimbursements received by employees and determine if the employer had a substantial business reason, other than providing additional compensation, for requiring the employee's use of personal cell phone in connection with the employer's trade or business.

For example, the type of cell phone coverage must be reasonable related to the needs of the employer's business, the reimbursement must be reasonably calculated not to exceed expenses the employee actually incurred in maintaining the cell phone, and the reimbursement must not be a substitute for a portion of the employee's regular wages.

The IRS provided the following examples of reimbursements that will be examined more closely: an employee's international or satellite phone coverage whose business clients are in the United States, or a pattern of reimbursements that deviates significantly from month to month (or quarter to quarter).

The relief applies to cell phones provided after Dec. 31, 2009, and gives employers certainty as to what they need to comply with in order to be able to take the fringe- benefit business deduction and answer questions in case of an IRS audit.

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