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IRS Provides Tax Relief for Employer - Provided Cell Phones—But Questions Remain

October 4, 2011

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Taxation of Cell Phones and “Other Similar Telecommunications Equipment”

- Always raised LOTS of questions
- Most recent IRS Guidance
 - Notice 2011-72
 - Field Exam Memorandum (SBSE-04-0911-083)
- Continues to raise LOTS of questions

Agenda

- How did we get here?
- IRS Notice 2011-72
- Unresolved issues
- Employer reimbursements
- Refund opportunities
- IRS audits
- Cell phone policies
- Recommended actions items
- Questions

How Did We Get Here?

- Cell phones and other similar telecommunications equipment were designated as “listed property” in 1989 – Code section 280F(d)(4)(A)(v)
 - Subject to heightened (widely ignored) substantiation rules
 - Notice 2009-46 – Substantiating Business Use of Employer-Provided Cell Phones
- Delisted in 2010 by the Small Business Jobs Act of 2010
 - Normal substantiation rules for business deductions still applied
- Notice 2011-72 – employer-provided cell phones
 - No substantiation required and *de minimis* exclusion applies if provided primarily for noncompensatory business reasons
- Field Exam Memorandum (SBSE-04-0911-083) – reimbursements and allowances
 - Guidance is unusual since cash reimbursements are NOT *de minimis* fringes
 - Costs must be shown to not exceed an employee’s expected expenses, plus other tests

Listed Property (Pre-2010)

- Working Condition Fringe Benefit Exclusion
 - The costs would have been deductible by the recipient if the recipient had paid for them
 - The costs relate to the employer's business
 - The employee has no choice between cash and the benefit
 - **Heightened recordkeeping rules for listed property applied**
- Business use excluded from income
- All personal use included in income – no *de minimis* rule
- If no substantiation, treated as 100% personal and included in income

Delisted in 2010 (Effective for years after 2009)

- Still had to qualify for the working condition fringe benefit exclusion
 - The costs would have been deductible by the recipient if the recipient had paid for them
 - The costs relate to the employer's business
 - The employee has no choice between cash and the benefit
 - **Normal tax recordkeeping rules for business deductions applied**
- Business use excluded from income
- Uncertain whether *de minimis* personal use could be excluded from income
- Still, if no substantiation, treated as 100% personal and included in income
- What type of policy and substantiation would be sufficient?

Notice 2011-72

- Employer-provided cell phones and “other similar telecommunications equipment”
- If provided primarily for noncompensatory business reasons, then:
 - Business Use – excludable as a working condition fringe benefit
 - Any Personal Use – excludable as a *de minimis* fringe benefit
- **Neither the business nor personal use is subject to recordkeeping**
- Retroactive to 2010

Notice 2011-72

- Does not apply to:
 - Reimbursements and allowances for business use of personal cell phones (Treas. Reg. § 1.132-6(c))
 - Cell phones used primarily for personal purposes
 - Personal computers
 - Other “listed property” under Code section 274
 - Other fringe benefits

Notice 2011-72

- What is “other similar telecommunications equipment”?
 - BlackBerry, smartphone, other PDA
 - Air cards
 - Other mobile broadband devices
 - Laptops, iPads, or tablet computers
- Where is the line between “other similar telecommunications equipment” and “computers and other peripheral equipment”?

Notice 2011-72

- What constitutes “provided primarily for noncompensatory business reasons”?
 - Substantial business reasons for providing a cell phone
 - *Employer’s need to contact employee at all times for work-related emergencies*
 - *Employee required to be available to speak with clients at times when employee is away from the office*
 - *Employee needs to speak with clients located in other time zones at times outside employee’s normal workday*

Notice 2011-72

- But not –
 - Promote the morale or goodwill of an employee
 - Attract a prospective employee
 - Means to furnish additional compensation

Field Exam Audit Guidance (SBSE-04-0911-083)

- Reimbursements for business use of personal cell phone
- “Not intended to be a technical position”
- “Analyze reimbursements in a manner that is similar to the approach described in Notice 2011-72”
- Field Exam Audit Guidance is not on the list of IRS guidance that qualifies as “substantial authority” (Treas. Reg. § 1.6662-4(d)(3)(iii))

Field Exam Audit Guidance (SBSE-04-0911-083)

- Examiners “should not necessarily assert” that reimbursements result in additional income
 - Where employers have substantial business reasons for requiring the employees’ use of personal cell phones in connection with the employers’ trade or business
- Provided that –
 - Cell phone plans should be reasonably related to the employers’ business needs
 - Reimbursements must be reasonably calculated so as not to exceed the employees’ actual cell phone expenses
 - Reimbursements are not substitutes for a portion of the employees’ regular wages

Field Exam Audit Guidance (SBSE-04-0911-083)

- Example – No additional income or wages
 - Employee uses personal cell phone to communicate with employer's clients outside normal office hours
 - Employee maintains a basic coverage plan (i.e., the plan charges a flat rate for a certain number of minutes for domestic calls)
 - Employer reimburses employee for monthly basic plan to enable employee to maintain contact with business clients throughout the U.S. after hours

Field Exam Audit Guidance (SBSE-04-0911-083)

- Examine more closely:
 - Reimbursement replaces a portion of an employee's previous wages
 - Reimbursement covers unusual or excessive expenses
 - *International or satellite cell phone coverage where business clients and other business contacts are all local*
 - A pattern of reimbursements that deviates significantly from normal business use
 - *Reimbursed for \$100/quarter in Q1, Q2, and Q3, but reimbursed \$500 in Q4*

Why the Notice and the Field Exam Memorandum?

- Notice 2011-72
 - If satisfied, then employer has a reasonable basis for not taxing without the need for any records
- Field Exam Memorandum
 - “Not intended to be a technical position”
 - Is not substantial authority
- Impact on audits and refunds

Refund Opportunities for 2010 and 2011

- Some employers and employees maybe entitled to refunds
 - FICA taxes
 - Income taxes
 - Deduction disallowances
 - Procedures
 - Issues

Audit Risks to Employer – Failure to Treat Taxable Benefits as Wages

- Employer is directly liable for employee's taxes that should have been withheld
 - 25% federal income tax withholding exposure
 - 15.3% employer and employee FICA (Social Security and Medicare)
 - *Note: the employee Social Security tax rate is reduced from 6.2% to 4.2% for wages paid during 2011*
 - Social Security taxable wage base (\$106,800 for 2009, 2010, and 2011)
- Potential penalties
- More likely that employer will be audited than the employee

Sample IDR

- How many employees had company-provided BlackBerrys with phone service in 2008?
- Did the company include a personal-use component for these BlackBerrys with phone service in wages reported on each affected employee's Form W-2 for 2008?
- If yes, please provide computation.

Sample IDR

- Please provide the corporate policy/written guidelines for each item below and indicate how the item is reported for tax purposes (i.e., W-2 or 1099)
 - Communications equipment (identify equipment provided to each section 16, describe ongoing service cost for the equipment, and how both aspects of the fringe benefit are treated for tax purposes)

Audit Environment

- Coordination with corporate tax exams of deductions
 - No more trading payroll tax assessments for deduction disallowances
- More frequently require Forms W-2c (where deficiencies are assessed)
 - Harder to talk IRS out of this; employee refiles return and pays taxes
 - If employer pays payroll taxes, and is required to file Form W-2c, employer should also request a refund of its payment, if any employees are required to pay income taxes, because such a refund is allowed, upon production of a Form 4669 proving employees paid the income taxes

Policies to Help Avoid and/or Resolve IRS Audits Going Forward

- Do companies need to have a policy?
- Should the policy require employees to have a second/personal phone?
- Should the policy restrict or prohibit personal use?
- Are year-end compliance certifications required?
- What if the cell phone is used primarily for personal reasons?
 - Can we deduct the cell phone expense?
 - Can we exclude any portion used for business reasons from the employee's taxes?

Action Items

- Review existing cell phone/PDA policies for compliance
- Identify issues that are not answered by the IRS Guidance
- Revise or adopt compliant cell phone/PDA policies
- Incorporate key provisions from IRS's own business/personal use policy on cell phones
- Consider potential refund claims/adjustments for 2010 and 2011 tax years (or deduction disallowance)
- Consider alerting affected employees about any potential refund opportunities
- Determine whether laptops, iPads, and tablet computers qualify

Appendix – “Computer or Peripheral Equipment” (I.R.C. § 168(i)(2)(B))

- (ii) Computer—the term “computer” means a programmable electronically activated device which—
 - (I) is capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention, and
 - (II) consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities.
 - (III) Related peripheral equipment. The term “related peripheral equipment” means any auxiliary machine (whether on-line or off-line) which is designed to be placed under the control of the central processing unit of a computer.

Appendix – “Computed or Peripheral Equipment” (I.R.C. § 168(i)(2)(B)) (cont’d)

- (IV) Exceptions. The term “computer or peripheral equipment” shall not include—
- (I) any equipment which is an integral part of other property which is not a computer,
 - (II) typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, and
 - (III) equipment of a kind used primarily for amusement or entertainment of the user.

Questions?

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