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IRS Retreats on Employer-Provided Cell Phones

October 14, 2011 by Steven M. Saraisky

This post should provide fodder for all the tax reformers out there who want to simplify the tax code. Employers, employees take note: the IRS has simplified the recordkeeping requirements for employer-provided cell phones! Uh, sort of.

Let us explain: the Internal Revenue Code defines gross income as all income from whatever source derived. Gross income of course includes things like compensation for services, but it also includes fringe benefits received by employees from their employers, such as car services, nonqualified moving expenses, etc.

There are exceptions to the fringe benefit rule. For example, Code §132(a)(3) provides that gross income does not include any fringe benefit which qualifies as a "working condition fringe," that is, a work-related benefit that would be deductible if the employee had to pay for it. Code §132(a)(4) provides that gross income does not include any fringe benefit which qualifies as a "de minimis fringe," that is, property or a service so small as to make accounting for it unreasonable or administratively impracticable. There are substantiation requirements for these fringe benefits. In addition, there are "heightened substantiation rules" for property specifically listed by Congress because it is subject to "abuse."

Prior to the Small Business Jobs Act of 2010 (the "Act"), employer-provided cell phones were listed property and subject to the aforementioned heightened substantiation rules. But the Act, among other things, removed employer-provided cell phones from the heightened substantiation list.

The IRS has now come out with its own guidance, clarifying its position on whether employer-provided cell phones are taxable fringe benefits. The IRS takes the following position: although

an employee's use of an employer-provided cell phone is a fringe benefit and generally includible in income, if the employee's use of the phone is for business purposes such that it would be deductible by the employer, then the business use of the cell phone qualifies as a working condition fringe and is excludible from the employee's income. Furthermore, if an employer provides a cell phone to an employee for business reasons (the "business reason cell phone"), then the employee's use of the cell phone for personal calls is a de minimis fringe and also is excludible from income. Notice 2011-72. Employers no longer have to record which of the employees' calls are business and which are personal. Employees no longer have to report the cost of those personal calls (paid by the employer) as income.

On the other hand, if the employer provides the cell phone to the employee only to promote morale or goodwill (the "non-business reason cell phone"), then the value of the phone and service is a taxable fringe benefit.

So, are the rules simplified, still overly complex, or both? Is the IRS' position on employer-provided cell phones sound tax policy that gets to the core principle of taxing income in any form, or does it represent everything that is wrong with America today (is this really what Congress does)? We leave these questions for our readers to answer.

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