

New Rules on Cell Phones

On September 14, 2011, the IRS issued rules that ease - but do not eliminate - concerns over the taxation of cell phones provided by employers. As a practical matter, most cell phones should not be taxed, but employers should keep records for each cell phone provided to ensure that (i) the employer is not subject to penalties for under-withholding of income tax and (ii) employees are not subject inadvertently to tax. IRS did not clear up the rules on iPads or laptops.

The Rules

Cell phones (the value of the phone and cell service) are not taxable income if the phone is provided for a "noncompensatory business purpose". If the employer provides the phone as part of the employee's compensation, it is taxable income subject to the usual rules.

What is "noncompensatory"? The IRS gave these examples:

- The employer needs to contact the employee at all times for emergencies.
- The employee must be available to talk with clients at all times while away from the office.
- The employee must be available to talk with clients in other time zones outside the normal working day.

These are quite limited situations, of course, but other situations may also qualify as noncompensatory business purposes.

Some Questions

What about cell phones that are needed only during the working day? Cell phones often are the standard form of communication for employees in the field during the work day, but are not needed at other times. The new rules are silent about that situation.

What about cell phones for employees who sometimes must be available on non-regular workday hours? There are no answers for this situation either.

Recordkeeping



by Judith W. Boyette

What records should be kept or other steps taken to avoid or reduce problems?

1. To demonstrate that cell phones are provided for "noncompensatory" business purposes, for each employee with a cell phone, the employer should record the noncompensatory reason for providing the cell phone. This record should be updated on a regular basis, probably at least once a year.

2. Where "noncompensatory" is during the work day only, the conservative approach is to maintain a record for the noncompensatory need as in item 1 above, and either (i) establish a written policy that prohibits the use of the cell phone for personal purposes, and do periodic audits to enforce that policy, (ii) use a reasonable rule of thumb for use that is not noncompensatory and impute the fair market value of cell use for that period of time based on valid data regarding use, or (iii) require employees to keep a log of personal and business use.

Is all of this recordkeeping really necessary? The answer is that as far as we can tell from recent experience, the IRS is generally not eager to audit cell phone use. But individual auditors may go after cell phones, especially in situations where there are no records at all.

iPads and Laptops

In a recent audit, the IRS made clear that these are still "listed property". This means that detailed records of use must be kept to avoid income taxation to the employee and to avoid employment tax penalties on the employer. Based on our recent experience, the IRS will still require employees to track personal versus business use of an employer-provided laptop and include the value of any personal use in income unless that use is de minimis. Of course, the rules are unclear about how much personal use of a laptop qualifies as "de minimis". The same options set out in item 2 above should work for recordkeeping. But for these machines, only those options work; it is not enough that the individual receives the iPad/laptop for noncompensatory purposes.

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