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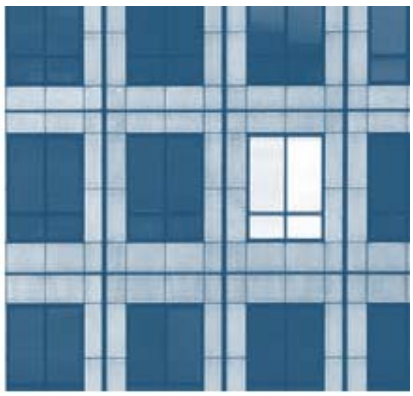
On the Subject



Employee Benefits

October 6, 2010

New legislation, which takes effect immediately, simplifies substantiation rules for employer-provided cell phones and other similar telecommunications equipment.

Small Business Jobs Act to Simplify Taxation of Cell Phone Usage

On Monday, September 27, 2010, President Obama signed the Small Business Jobs Act of 2010. The projected $42 billion measure passed by Congress simplifies substantiation rules for cell phones and other similar telecommunications equipment (*e.g.*, PDAs and Blackberries), an area of long-standing concern for employees and employers. Because it applies for tax years beginning after December 31, 2009, the act's relief takes effect immediately.

Legislative History and Background

Cellular phones have been "listed property" since 1989 under the Internal Revenue Code, as amended (the Code). Accordingly, more stringent substantiation rules had to be satisfied for an employer to fully deduct the costs of cell phones and for employees to fully exclude the value of cell phones from taxable income. Conflicting and confusing guidance did not provide clear rules for determining the taxation or deduction of an employee's personal cell phone usage. Coupled with inconsistent enforcement and a disproportionate strain on capital given the relative value of such benefits, employers have long requested that employer-provided cell-phones be delisted as property the personal use of which will be taxable to the employee.

The act was introduced in the U.S. House of Representatives May 13, 2009. Following various revisions, including a name change, it was approved by the U.S. Senate September 16, 2010, and referred back to the House of Representatives, which approved it September 23, 2010, by a vote of 237 to 187 (with nine abstentions). Included in the Small Business Jobs Act is language from the MOBILE Cell Phone Act of 2009, addressing the taxation of employer-provided cell phone usage by employees. While the principal purposes of the act are to address perceived needs of small businesses, many provisions apply to large employers including the act's relief for cell phone substantiation.

Delisting Cell Phones

Section 2043 of the act removes cellular telephones and similar telecommunications equipment from the Code's definition of "listed property." Therefore, cell phones are no longer subject to the Code's onerous substantiation requirements and special depreciation rules for listed property. According to the Senate Committee on Finance's summary, this provision is estimated to cost $410 million over 10 years.

Code Section 280F(d)(3) states that only to the extent that an item of listed property is provided for the exclusive benefit of the employer will it be eligible as a deductible expense to the employee. In other words, if the employee uses a portion of any item of listed property for his or her own benefit, the extent to which the item is used by the employee for personal reasons is taxable to the employee. Only the business usage of the item is deductible to the employee. Such business usage must be substantiated to qualify for deduction.

Cell phones' listed status resulted in significant consternation for employers and employees alike because it required some mechanism for charging back a portion of employer-provided technology to the employee for his or her personal use. Inadequate guidance in the area, coupled with intense Internal Revenue Service interest in the topic, often forced employers to develop their own means of either charging employees for personal use of cell phones or assigning an amount of taxable compensation for any personal use. The most draconian approaches required employees to keep detailed logs of their personal use, while even less intrusive measures, such as charges based on estimated use, still resulted in taxable income to the employee. Those who opposed these "charge backs" argued that employees were not charged to use their desk telephones for personal calls, so they should not be charged to use cell phones either.

Now employees will no longer need to keep detailed records to track their cell phone usage. This makes it easier for employees to exclude the value of employer-provided cell phones from their taxable income under the Code's working condition fringe benefit rules. Employees exclude working condition fringe benefits from their

personal income when they can personally deduct those benefits as "ordinary and necessary" business expenses under Section 162 of the Code.

By removing this category of items from the listed property definition, cell phones are no longer subject to Code Section 280F(d)(3). This means that limited personal usage of these employer-provided items is less likely to yield taxable income for employees, and that employees need not demonstrate their use is for the convenience of their employer and required as a condition of their employment. Presumably, if an employer gifted an employee a cell phone and cell phone service, with no expectation that the employee would use the phone for work, then the phone and the monthly charge for the phone would continue to be treated as a taxable item to the employee.

Lastly, according to the Joint Committee on Taxation's report, the act gives the U.S. Treasury Department discretion to determine whether personal use of cell phones that are provided primarily for business purposes may qualify as a *de minimis* fringe benefit under Section 132(e), the value of which is so small as to make accounting for it unreasonable or administratively impracticable.

What Should Employers Do Now?

Employers should review their current cell phone policies to determine whether any changes should be made to account for the act's stipulations. While employers could choose to charge employees some amount to reflect their personal use of an employer-provided cell phone, employers will no longer be required to treat an employee's personal use of the employer-provided cell phone as a taxable benefit.

Because this relief is retroactive to tax years beginning after December 31, 2009, employers may want to revisit their policies in light of this requirement and determine whether administrative considerations favor delaying changes to existing policies until another date. For example, an employer that has been imputing cell phone cost to employees during 2010 may elect to wait until 2011 to change its program so as not to affect current accounting requirements. Alternatively, the employer could reverse any charge or other impact on the employee, which would likely be welcome given the current economic environment.

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