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Employer-Provided Cell Phones May Generally Be Treated as Nontaxable Fringe

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The Internal Revenue Service recently issued a notice specifying that the business and personal use of an employer-provided cell phone, or other similar telecommunications equipment (*e.g.*, PDAs and BlackBerrys), will generally be treated as nontaxable to the employee, if the employer has provided the cell phone primarily for noncompensatory business reasons. The tax relief takes effect immediately.

On September 14, 2011, the Internal Revenue Service (IRS) issued Notice 2011-72 (Notice), which provides long-awaited relief concerning the tax treatment for employee use of employer-provided cellular telephones or other similar telecommunications equipment (*e.g.*, PDAs and BlackBerrys). The Notice provides that:

1. The IRS will generally treat an employee's business use of an employer-provided cell phone as a nontaxable working condition fringe benefit, without the need to meet onerous substantiation requirements.

2. The IRS will generally treat the value of any personal use of an employer-provided cell phone as a nontaxable *de minimis* fringe benefit.

The IRS guidance specifies that the business and personal use of an employer-provided cell phone will generally be treated as nontaxable to the employee, if the employer has provided the cell phone primarily for noncompensatory business reasons. Because it applies for taxable years beginning after December 31, 2009, the tax relief provided under the IRS Notice takes effect immediately.

Background

Under prior law, cell phones were treated as "listed property" for purposes of Internal Revenue Code Section 280F. As a result, cell phones were generally required to be provided for the "exclusive benefit" of the employer, and the employer deduction for the cost of any business use was subject to onerous substantiation requirements. Further, any personal use of an employer-provided cell phone was previously treated as a taxable benefit to employees.

During fall of 2010, cell phones were removed from the Code's definition of "listed property," as part of the Small Business Jobs Act of 2010. This change eliminated the onerous substantiation requirements for employers to be entitled to deduct the costs associated with employer-provided cell phones. However, until Notice 2011-72, employers were left to draw inferences regarding the corresponding tax treatment to employees in connection with either their business use, or limited personal use of employer-provided cell phones.

For further discussion on the removal of cellular telephones or other similar telecommunications equipment from the Code's definition of "listed property," see Small Business Jobs Act to Simplify Taxation of Cell Phone Usage.

The Guidance

The Notice makes it clear that when an employer provides an employee with a cell phone primarily for noncompensatory business reasons, the IRS will deem the employee to have satisfied the substantiation requirements for any business-related use to be excludable from compensation as a working condition fringe benefit. In addition, the Notice provides that the IRS will also treat any personal use of an employer-provided cell phone as a nontaxable *de minimis* fringe benefit. (This position is consistent with the long-standing tax treatment of occasional personal telephone calls from an employee's desk phone as a nontaxable, *de minimis* fringe benefit.)

Concurrent with the release of Notice 2011-72, the IRS has also issued a memo that provides audit guidance to its examiners for addressing the tax treatment of the employer reimbursement for the business use of an employee's personal cell phones on audit. The memorandum provides examples of "substantial noncompensatory business reasons" for reimbursing employees for the business use of their personal cell phones. The memorandum also provides examples to help evaluate whether employee cell phone reimbursement arrangements are in excess of the cellular communication needs of the employer's business and, thus, triggering additional taxable wages to the employee.

What Should Employers Do Now?

Employers that provide or pay for cell phones or other telecommunications equipment for employees should be sure to document the substantial business reasons for providing doing so. That rationale should be assessed to ensure it makes it sufficiently clear that the telecommunications equipment is provided primarily for noncompensatory business purposes.