

IRS Notice Provides Tax Favorable Treatment for Employer Provided Cell Phones

The IRS, in a recently issued notice, has presented the possibility of an employer providing cell phones and cell service to employees, as a tax free fringe benefit. The ruling applies to cell phones and other similar telecommunication equipment. The ruling, which on its face applies only to employees, also applies to cell phones provided by partnerships to partners if the partner provides services to the partnership.

As long as the phone and service are not provided as a form of compensation, the personal use, as well as the business use of the phone, will not be included in the recipient's taxable income. In addition, the substantiation requirements of the regulations that would ordinarily apply have been eliminated.

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The ruling is contingent on the phone not being provided for compensatory purposes. The notice gives a few examples of what would qualify as noncompensatory purposes. These include the need of the business to contact the employee for work-related emergencies, the requirement that the employee be available to speak with clients or customers when the employee is away from the office and the need to speak to clients and customers in other time zones outside of the employee's normal work day. The notice says, however, that providing a cell phone for morale or just as a part of compensation package would not qualify.

One final complexity is that the notice implies that a cash fringe benefit would not be excludable. This means that reimbursing an employee for a phone or service that the employee has would not be excluded. It is unclear what this position means when the IRS, in a separate document, has said that "agents should not necessarily" assert that the employer's reimbursement results in income to the employee. Reading the two publications together one could take the position that reimbursement of cell phone expenses that were incurred personally should also not be taxable to the employee. That seems to contradict the language of the notice authorizing the tax free treatment, however. To be on the safe side, the company should provide the phones and the service to the employees. For the more adventurous, until the conflict is clarified, they could take the position that a reimbursement of those expenses is still tax free.

Companies may want to consider whether their employees will qualify for the tax free treatment. The notice is welcome expansion of the benefits that can be provided tax free to employees.

