



RING-A-DINGY REDUX

REIMBURSEMENT FOR CELL PHONE BILLS, AND IRS TIPS TO EXAMINING AGENTS

BY: GEORGE L. CHIMENTO

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MORE INFORMATION

We recently reported on the new IRS position that incidental personal use of employer cell phones will no longer be taxable. Good news. This eliminated the need for detailed recordkeeping to distinguish calls to mom (taxable) and those to good customers (non-taxable). However, the official Notice only dealt with employer-owned phones. What if the employer — often a small employer — reimburses an employee for personal cell phone bills for a cell phone needed in business? To address that concern, IRS has issued a one year Field Directive to agents. It instructs them to apply the new rules in reimbursement cases, too.

THE REQUIREMENTS FOR TAX-FREE TREATMENT

The Directive is most instructive for its examples of employer cell phone programs which will, and will not, pass muster under the new regime. READ CAREFULLY, because a Field Directive gives tips to agents on how to collect taxes.

As previously reported, a cell phone program will not be tax-free to employees unless (1) there is a business reason for it, and (2) it is not just a substitute for compensation.

Basic Principle #1: Business Reason

A reimbursing employer, just like the employer who provides a phone, should be prepared to show that (1) it has need to contact the employee at all times for work-related emergencies; or (2) the employee needs to speak with clients when away from the office or outside the normal work schedule.

Observation: Paying the cell bills for employees who do not need to be contacted in emergencies or who do not have after-hours and external client responsibilities is still a taxable benefit.

Basic Principle #2: Not Just a Substitute for Compensation

The Directive gives three examples of programs that may be taxable.

1. Swapping Pay for Cell Phone Reimbursement

Agents are told to look for arrangements that replace a portion of an employee's previous wages with a reimbursement for the employee's cell phone bills.

Translation: If the employer gives its employees a choice between taxable pay or a phone, the phone probably isn't necessary for business, so the employee should be taxed.

2. Service Beyond the Basic Geographic Area of the Business

Agents are told to be on the alert for international and satellite coverage for employees who only need to contact clients in a local area. So let's modify that observation that calls to Mom are non-taxable. If the only overseas calls are to Mom who lives in Asia, the reimbursement of fees for international service which is not covered within the basic domestic package is taxable.

Recommendation: In most cases, employers should just reimburse the employee for a basic fee which covers a reasonable allotment of domestic minutes. If the employee has an extra international package which is not needed for business, don't reimburse that.

3. Unusual Reimbursement Patterns

Agents are told to watch for "a pattern of reimbursements that deviates significantly from a normal course of cell phone use in the employer's business," i.e. reimbursements normally in the range of \$100/quarter which jump to \$500 for a single quarter.

Observation: This portion of the Directive poses a concern mainly for those who intentionally try to game the system. If the excess charge simply occurs because of a rare transaction that overwhelms a basic subscription plan, that can be explained to the agent.

THE BASIC PLAN: A SAFE HARBOR FROM IRS

Provided that the employer has a "substantial noncompensatory business reason" the Directive tells agents they can breathe easy if the employer is only paying for a basic monthly cell phone plan.

If employers pay for more, they should realize that the IRS could still want the employees to pay tax. In addition to unnecessary international plans, consider the following (not mentioned in the Directive):

- ▶ excessive plans, with minutes way beyond those ever used for business calls,
- ▶ heavy duty instant messaging and web access packages not needed for business and not provided as part of a basic plan,
- ▶ other supplemental services and products not needed for business.

CONCLUSION

For those who keep it simple, the new policy is a welcome change. However, IRS will still be alert for programs which it considers excessive.

The [September 14 Directive to IRS agents](#) and [IRS Notice 2011-72](#) have more detail.

Signing off now. It's time to call Mom, tax-free.

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