

Handling Employee Use of Employer-provided Computers and Cell Phones

An emerging issue for many employers is how to treat an employee's personal use of an employer-provided computer or cell phone. In a recent IRS Information Letter addressed to U.S. Representative Dennis Moore, IRS Branch Chief Lynne Camillo outlined the tax consequences of employer-provided cell phones (INFO 2007-0030). The Branch Chief noted that cell phones raise special tax issues because they are considered to be "listed property" under IRC Sec. 280F(d)(4)(A). Congress expanded the definition of listed property in 1989 to include cell phones on the belief that they are "often used primarily for personal or investment use rather than in the conduct of a trade or business."

The letter adds that employers can exclude the value of an employee's use of an employer-provided cell phone from the employee's income "if the employer has some method of requiring the employee to keep records that distinguish business from personal phone charges." If the employee uses the phone exclusively for business, the value of all use is excluded from the employee's income as a working condition fringe benefit. On the other hand, employers must include the value of any personal use of the cell phone in the employee's wages. Personal use includes individual personal calls as well as a pro rata share of monthly service charges.

According to the Branch Chief, IRC Sec. 274(d) requires the employee "to keep a record of each call and its business purpose. If the employee receives a monthly statement, the employee should identify each call as personal or business." If the employee does not use the cell phone to make personal calls or only has minimal personal use of the cell phone, the business use of the phone is not taxable to the employee.

While INFO 2007-0030 provides a glimpse of the IRS's thinking on this topic, until the IRS directly addresses the issue, employers can look to the general principles found in the Section 132 fringe benefit provisions for guidance on the matter.

Fringe Benefit Rules

A working condition fringe includes property or services provided to an employee that meet the following requirements: (1) the employee could have deducted the property or services as a trade or business expense or a depreciable asset if he or she had personally incurred the cost; (2) the employee's use of the property or services is substantiated by adequate records or other sufficient evidence; and (3) the employee's use is related to the employer's trade or business, or the employee's trade or business of being an employee of the employer [IRC Sec. 132(d); Reg. 1.132-5(a)].

The fair market value (FMV) of a working condition fringe benefit is excluded from the employee's income [IRC Sec. 132(a)]. Examples of excludable working condition fringe benefits include business-related magazine subscriptions, professional dues, job-related education, outplacement services, business travel and entertainment, and business use of a company car. Nondeductible club dues and spousal travel may also qualify as working condition fringe benefits under certain circumstances.

De minimis fringe benefits are also excluded from income and employment taxes [IRC Sec. 132(e); Reg. 1.132-6(a)]. They include property or services provided by an employer for an employee that have such a small (nominal) value that accounting for them would be unreasonable or administratively impractical. Examples include [Reg. 1.132-6(e)(1)]:

1. Occasional typing of personal letters by a company secretary.
2. Occasional cocktail parties, meals, or picnics for employees and their guests.
3. Traditional birthday or holiday gifts of property (not cash) with a low FMV.
4. Occasional theater or sporting event tickets, coffee, doughnuts, soft drinks, and local phone calls.
5. Flowers, fruits, books, or similar property provided to employees under special circumstances (e.g., outstanding performance, illness, or family crisis).
6. Occasional personal use of a copying machine, provided the employer exercises

sufficient control and imposes significant restrictions on the personal use of the copier so that at least 85% of the use is for business purposes. As discussed below, employers may be able to apply this rule to treat employee's personal use of computers maintained exclusively on company premises as *de minimis*.

Computers Maintained on Company Premises

Employee use of a computer maintained exclusively on the employer's business premises is an excludable working condition fringe if the use relates to the employer's trade or business. But if employers allow employees to use company computers for personal purposes, the FMV of the employee's unreimbursed personal use is a taxable fringe benefit unless the use qualifies as a *de minimis* fringe benefit.

The unreimbursed personal use will qualify as an excludable *de minimis* fringe benefit if the use's value is so small that accounting for it would be unreasonable or impractical. As already noted, the regulations include a safe harbor for copying machines where the employer exercises sufficient control and imposes significant restrictions. As long as 85% of the copying machine's use is for business, the remaining use will be considered *de minimis*. Employers may be able to apply a similar rule to computers that are maintained on company premises. However, it is unlikely that an employer can exercise the required control unless the computer is maintained on its premises.

Cell Phones and Computers Not Maintained on Company Premises

Tax-free working condition fringe treatment is harder to achieve with laptop computers allowed off company premises, desktop computers provided to employees for their use at home, and cell phones. Since these items are listed property under IRC Sec. 280F(d)(4), an employee's business use will qualify as an excludable working condition fringe only if the substantiation requirements of IRC Sec. 274(d) (i.e., amount of use, date, place, and business reason) are met. Employers should require employees to maintain and provide logs of the business and personal use of the equipment.

Observation: Cell phone use documented only through approximation or unsupported testimony of the taxpayer does not qualify as business use [*Fabian Vaksman*, TC Memo 2001-165 (2001), *aff'd*. 90 AFTR 2d 2002-7639 (5th Cir. 2002).].

Valuing Personal Use

Unsubstantiated (personal) use by an employee of a company computer or cell phone is a taxable fringe benefit. The employer includes in the employee's income the amount by which the FMV of the fringe benefit exceeds the amount the employee pays for the fringe benefit plus the amount that is excluded from income under IRC Sec. 132 or other Code section (e.g., qualifies as a *de minimis* fringe benefit). This taxable fringe benefit is employee compensation subject to income tax withholding and payroll taxes.

Generally, the FMV of a taxable noncash fringe benefit is based on the facts and circumstances. This means the FMV of the fringe benefit is the amount an individual would pay for it in an independent arm's-length transaction.

When the employer pays a flat monthly cell phone rate, the business usage presumably can be based on the percentage of minutes spent on business calls. This percentage should be based on the time the cell phone is actually used, as opposed to calculating the percentage based on the time the phone is available for use [Reg. 1.280F-6(e)(3)]. If the employer pays for each call, the business usage presumably can be based on actual charges for business calls.

Concluding Thought

Employers may attempt to avoid the personal use issue by forbidding employee personal use of employer-provided computers or cell phones similar to the policy the IRS allows for automobiles. However, the IRS's Executive Fringe Benefits Audit Techniques Guide indicates that there are no recordkeeping exceptions like "no personal use" available for computers. Therefore, detailed records

are required to establish business use of computers that can be taken home or are kept at home by employees. The guide indicates that similar recordkeeping problems exist for cell phones.

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