

MEMORANDUM TO CLIENTS

June 15, 2009

RE: Cell Phone Substantiation

The Internal Revenue Service (the "Service") recently issued Notice 2009-46 (attached), requesting comments on several proposals to "simplify" the rules requiring substantiation of the business-use of cell phones provided to employees. The Service's proposals would provide several alternative substantiation methods that would be more easily enforceable than the current rules requiring substantiation of business use (Code sec. 274(d)). Friday's Wall Street Journal featured a front-page article about the proposals, which have attracted considerable public attention.

In general, employers are permitted to take deductions for certain "listed property" provided to employees (which, since 1989, has included cell phones and similar devices) only if the employee provides adequate documentation of the business use of such property. Similarly, use of listed property results in taxable income to the employee unless the employee adequately documents that the property was used only for business purposes. Currently, the substantiation requirements are generally satisfied if an employee provides the employer with a log or diary tracking any personal use of an employer-provided cell phone (a practice that is, apparently, rarely honored).

Notice 2009-46 includes three possible proposals:

- a "minimal personal use" method whereby an employer-provided cell phone is deemed to be used exclusively for business purposes if the employee demonstrates to the employer that the employee uses a personal (non-employer-provided) cell phone for personal purposes during working hours (alternatively, the Service is considering defining a specified amount of personal use that would be disregarded, though it's not clear how and whether this "minimal" use would be documented);
- a "safe harbor" method whereby 25% of an employee's use of an employer-provided cell phone would be deemed to be for personal purposes; and
- a "statistical sampling method" (similar to the methods already used with respect to meal and entertainment expenses) whereby the employer would presumably measure the percentage of personal use of employer-provided cell phones from a sample group of employees and apply this percentage to each employee provided with a cell phone.

The Service also requests comments regarding possible methods to determine the fair market value to the employee of personal use of an employer-provided cell phone. In this regard, as is

the case with fringe benefits generally, the Service notes that the cost to the employer is not determinative of value.

The proposals indicate that the Service intends to crack down on the use of employer-provided cell phones for personal purposes. Although not mentioned in the Notice, it is quite possible that this would lay the foundation for future guidance on laptops, blackberries, and similar items.

In view of the potential wide spread impact of the proposal, we are considering preparing a comment letter for interested clients to recommend substantiation methods that would minimize the burden of compliance (including payroll administration costs) as much as possible. Comments are due to the IRS by September 4, 2009, so if you are interested, please let either Liz Dold (202-861-5406, edold@groom.com) or Lou Mazawey (202-861-6608, lmazawey@groom.com) know.

Notice 2009-46, Internal Revenue Service, (Jun. 8, 2009)

<http://prod.resource.cch.com/resource/scion/document/default/%28%40%40RCB02+IRB2009-231068%29rcb0209013e2c856e3715?cfu=Legal>

Federal Tax > Federal Tax Primary Sources > IRS Administrative Rulings > Rulings & Other Documents (2002-Current) > Notice 2009-46, Internal Revenue Service, (Jun. 8, 2009)

Notice 2009-46, I.R.B. 2009-23, 1068, June 8, 2009.

[[Code Sec. 274](#)]

Business expenses: Gross income: Fringe benefits: Substantiation: Cell phones.–

The IRS is requesting public comments on several proposals to simplify the procedures under which employers substantiate an employee's business use of employer-provided cell phones or similar telecommunications equipment. Suggestions for alternative approaches to simplify these substantiation procedures are also being requested. The three alternative substantiation methods being considered by the IRS and Treasury Department are: (1) a minimal personal use method; (2) a safe harbor substantiation method; and (3) a statistical sampling method. The IRS is also soliciting comments as to whether a simplified valuation method would be helpful and appropriate to determine the fair market value of an employee's personal use of an employer-provided cell phone. Comments must be submitted to the IRS on or before September 4, 2009. Back references: [¶14,417.027](#) and [¶14,417.26](#).

PURPOSE

This notice requests comments from the public regarding several proposals to simplify the procedures under which employers substantiate an employee's business use of employer-provided cellular telephones or other similar telecommunications equipment (hereinafter collectively referred to as "cell phones"). This notice describes the proposals under consideration. The Internal Revenue Service (IRS) and Treasury Department are interested in considering other possible approaches. Therefore, this notice also requests suggestions for alternative approaches to simplify the procedures under which employers substantiate an employee's business use of employer-provided cell phones.

Any changes to the substantiation procedures applicable to employer-provided cell phones will not become effective until the IRS and Treasury Department consider public comments and suggestions received in response to this notice and publish guidance announcing any simplified substantiation procedures.

BACKGROUND

Employers

[Section 162\(a\)](#) of the Internal Revenue Code provides that a deduction is allowed for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. However, [§ 262\(a\)](#) provides that, except as otherwise expressly provided, no deduction shall be allowed for personal, living, or family expenses.

[Section 274\(d\)\(4\)](#) provides that no deduction shall be allowed with respect to any listed property (as defined in [§ 280F\(d\)\(4\)](#)), unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the use of the property, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons using the property. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense that does not exceed an amount prescribed pursuant to such regulations.

[Section 280F\(d\)\(4\)\(A\)\(v\)](#) provides that "listed property" includes any cellular telephone (or other similar telecommunications equipment).

Section 1.274-5T(a) of the temporary Income Tax Regulations provides that no deduction or credit shall be allowed with respect to any listed property unless the taxpayer substantiates each element of the

expenditure or use. Section 1.274-5T(b)(6) provides that the elements to be proved with respect to any listed property are:

- (i) *Amount* — (A) The amount of each separate expenditure with respect to an item of listed property, such as the cost of acquisition, and (B) the amount of each business use based on the appropriate measure (that is, time) and the amount of total use of the listed property for the taxable period (see § 1.274-5T(e)(2));
- (ii) *Time* — The date of the expenditure or use with respect to the listed property; and
- (iii) *Business purpose* — The business purpose for an expenditure or use with respect to any listed property.

Employees

[Section 61\(a\)\(1\)](#) provides that, except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items. [Section 1.61-21\(b\)\(1\)](#) of the Income Tax Regulations requires that an employee generally must include in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of (i) the amount, if any, paid for the benefit by or on behalf of the employee, and (ii) the amount, if any, specifically excluded from gross income by some other section of the Code. The fair market value of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's length transaction. [Section 1.61-21\(b\)\(2\)](#). The cost incurred by an employer is not determinative of the fair market value of a fringe benefit. *Id.*

[Section 132\(a\)\(3\)](#) provides that gross income does not include any fringe benefit that qualifies as a working condition fringe. [Section 132\(d\)](#) provides that “working condition fringe” means any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under [§ 162](#) or [§ 167](#).

[Section 1.132-5\(a\)\(1\)\(ii\)](#) provides that if, under [§ 274](#) or any other section of the Code, certain substantiation requirements must be met in order for a deduction under [§ 162](#) or [§ 167](#) to be allowable, then those substantiation requirements apply in determining whether a property or service is excludable as a working condition fringe. See also [§ 1.132-5\(c\)\(1\)](#). The substantiation requirements of [§ 274\(d\)](#) are satisfied by adequate records or sufficient evidence corroborating the employee's own statement. [Section 1.132-5\(c\)\(2\)](#). Therefore, such records or evidence provided by the employee, and relied upon by the employer to the extent permitted by the regulations promulgated under [§ 274\(d\)](#), will be sufficient to substantiate a working condition fringe exclusion. *Id.*

DISCUSSION

If an employer provides a cell phone to an employee, and the employer acquires and pays the costs of using the cell phone, the employee receives a fringe benefit. To the extent that the employee uses the employer's cell phone for business purposes, the fair market value of such usage qualifies as a working condition fringe benefit excludable from the employee's gross income and the cell phone expense is a deductible business expense for the employer, provided that the substantiation requirements of [§ 274\(d\)](#) are met. However, to the extent the employee uses the employer's cell phone for personal purposes, the fair market value of such usage is includable in the employee's gross income. The employer's cost to provide the cell phone is not determinative of the fair market value of the benefit received by the employee.

PROPOSALS

The IRS and Treasury Department are considering the following proposals to simplify the [§ 274\(d\)](#) substantiation requirements applicable to employee usage of employer-provided cell phones.

A. Simplified Substantiation Methods

General Requirements

As discussed in greater detail below, the IRS and Treasury Department are considering three alternative methods to simplify the substantiation requirements applicable to employee usage of employer-provided cell phones: a minimal personal use method, a safe harbor substantiation method, and a statistical sampling method (or a combination of the foregoing). Any simplified cell phone substantiation method will be optional; taxpayers may continue to comply with current [§ 274\(d\)](#) substantiation requirements.

The IRS and Treasury Department contemplate that any taxpayer who wishes to use a simplified cell phone substantiation method will be required to implement a written policy that requires employees to carry and use the employer-provided cell phones in connection with the employer's trade or business and that prohibits personal use of employer-provided cell phones, except for minimal personal use, similar to the requirements currently applicable to employer-provided automobiles in § 1.274-6T. In addition, the IRS and Treasury Department anticipate requiring that the employer must reasonably believe that the cell phone is not used for personal purposes except for minimal personal use.

1. Minimal Personal Use Method

The IRS and Treasury Department are considering two proposals that would allow an employer to deem all of an employee's usage of an employer-provided cell phone as business usage. Under the first proposal, the entire amount of an employee's use of an employer-provided cell phone would be deemed to be for business purposes if the employee can account to his or her employer with sufficient records to establish that the employee maintains and uses a personal (non-employer-provided) cell phone for personal purposes during the employee's work hours.

Alternatively, the second proposal would define a specified amount or type of "minimal" personal use that would be disregarded in determining the amount of personal use of an employer-provided cell phone. For example, "minimal" could be defined by reference to a particular number of minutes of use or for certain personal purposes.

2. Safe Harbor Substantiation Method

The IRS and Treasury Department are considering a safe harbor method under which an employer would treat a certain percentage of each employee's use of an employer-provided cell phone as business usage. The remaining percentage of use would be deemed to be for personal purposes. For this proposal, the IRS and Treasury Department propose a business use percentage of 75 percent.

3. Statistical Sampling Method

The IRS and Treasury Department are considering a proposal that would allow employers to use statistical sampling techniques to measure an employee's personal use of an employer-provided cell phone. In general, an employer could use an approved statistical sampling methodology similar to that provided in [Rev. Proc. 2004-29](#), 2004-1 C.B. 918, to determine the percentage of personal use of employer-provided cell phones. The employer would multiply that percentage times the value of each employee's total usage to determine the value of personal usage. The remaining portion of the employee's usage would be deemed to be for business purposes.

B. Simplified Fair Market Value Determination

To the extent that an employee's use of an employer-provided cell phone does not qualify as a working condition fringe benefit (because the employer does not satisfy [§ 274\(d\)](#) or the cell phone is used partially for personal purposes), the fair market value of an employee's use of the employer-provided cell phone is a taxable fringe benefit that is includable in the employee's gross income. An employer's cost to provide the cell phone is not determinative of the fair market value of an employee's fringe benefit. The IRS and Treasury Department are interested in understanding the methods employers currently use to arrive at the fair market value to an employee of an employer-provided cell phone. The IRS and Treasury Department are considering whether a simplified valuation method would be helpful and appropriate to determine such fair market value.

REQUEST FOR COMMENTS

The IRS and Treasury Department request public comments on the proposals contained in this notice and suggestions for other approaches for modifying and simplifying the substantiation requirements applicable to employee usage of employer-provided cell phones. The IRS and Treasury Department are particularly interested in any comments regarding:

- The specific provisions that should be required to be included in an employer's written policy prohibiting personal use of employer-provided cell phones;
- The types of employee records sufficient to establish that the employee maintains and uses a personal (nonemployer-provided) cell phone for purposes of the first proposed minimum personal use method contained in this notice;
- How to define a specified amount or type of "minimal" personal use (e.g., a maximum number of minutes of use or a list of acceptable personal uses) that should be disregarded in determining the amount of personal use of an employer-provided cell phone for purposes of the second proposed minimum personal use method contained in this notice.
- The business use percentage that should be applied in the proposed safe harbor substantiation method contained in this notice and the data and rationale upon which it is based;
- The methods currently used by employers to determine the fair market value of an employee's use of an employer-provided cell phone; and
- Whether a simplified method of determining the fair market value of an employee's use of an employer-provided cell phone would be appropriate, and, if so, suggested simplified methodologies for determining such fair market value.

Comments must be submitted in writing on or before September 4, 2009, and should include a reference to Notice 2009-46. Submissions should be sent to:

Internal Revenue Service

Attn: CC:PA:LPD:PR

(Notice 2009-46), Room 5203P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Notice 2009-46), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC. Alternatively, comments may be submitted electronically directly to the IRS via the following e-mail address: *Notice.comments@irs.counsel.treas.gov*. Please include " Notice 2009-46" in the subject line of any electronic communication. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Jeffrey T. Rodrick of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Mr. Rodrick at (202) 622-4930 (not a toll-free call).