



SMALL BUSINESS
LEGISLATIVE
COUNCIL

SBLC WEEKLY

Via E-mail
April 19, 2010

Volume XII, Issue 13

IT MIGHT BE CHEAPER TO STAY OFF THE PHONE

The United States House of Representatives passed H.R. 4994, the Taxpayer Assistance Act, on April 14, 2010. It was the House's "thank-you" to taxpayers for Tax Day. Included in the bill is language to resolve a long-standing issue regarding the personal use of business cell phones.

To the extent that an employee uses her/his 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. Conversely, to the extent the employee uses the employer's cell phone for personal purposes (i.e., only a portion can be substantiated as business use), the fair market value of such personal use is includable in the employee's gross income.

The cell phone expense is a deductible business expense for the employer, PROVIDED that the substantiation requirements of the Internal Revenue Code are met. (The substantiation requirements are requirements that most small business owners are familiar with, since these are the same ones that

apply for documenting business use of cars and computers.)

The ramification for the employee is income tax liability on the imputed income as well as FICA taxes (7.15 percent). The ramification for the business is the additional FICA taxes (7.15 percent) on the amount of imputed income. In addition, the business will lose a portion (or all, if no substantiation) of the deduction for the cost of the purchase of the telephone (probably a Section 179 direct expensing deduction for the full amount, but a depreciation deduction over ten years otherwise) and lose a portion (or all, if no substantiation) of the deduction for the on-going service charges. Since some or all of those expenses will now be income to the employee, those expenses should still be deductible as wages, and the business exposure should be limited to the employer's FICA taxes on imputed income equivalent of those costs.

For the self-employed, it basically means paying for the cell phone with after-tax dollars.

While the requirement has been in the law for a long time, the issue was only recently raised in audits.

The bill resolves the problem by removing "any cellular telephone (or other similar telecommunications equipment)" from the list of items in the Code to which the substantiation rules apply.

Now with all things revenue related, what one hand giveth, the other hand taketh away. The revenue offset is to increase the various penalties for failing to issue timely information reports. "What, what, is that I hear you saying?" "John, didn't you report on something about information returns recently?" Well, as a matter of fact I did. As you may recall, the Patient Protection and Affordable Care Act (PPACA) changed the law for Form 1099s issued by businesses to other businesses. Information reports will have to be issued to all vendors (corporate and non-corporate) providing services OR goods for which the business has paid at least \$600 annually.

What a coincidence. Congress increases the number of 1099s by millions, and then weeks later, turns around and increases the penalties for failing to do so on a timely basis. Needless to say, the penalty increase revenue offset has nothing to do with the cell phone issue.

Here are the current penalties if the business taxpayer fails to file the information return:

- \$15 per information return if you correctly file within 30 days (by March 30 if the due date is February 28); maximum penalty is \$75,000 per year (\$25,000 for small businesses, defined below)
- \$30 per information return if you correctly file more than 30 days after the due date but by August 1; maximum penalty is \$150,000 per year (\$50,000 for small businesses)
- \$50 per information return if you file after August 1 or you do not file required information returns; maximum penalty is \$250,000 per year (\$100,000 for small businesses)

The definition of small business for this purpose is average annual gross receipts of \$5 million or less for the three most recent tax years (or for the period a business has been in existence, if shorter) ending before the calendar year in which the information returns were due.

The new penalties would be:

- \$30 per information return if you correctly file within 30 days (by March 30 if the due date is February 28); maximum penalty is \$250,000 per year (\$75,000 for small businesses)
- \$60 per information return if you correctly file more than 30 days after the due date but by August 1; maximum penalty is \$500,000 per year (\$200,000 for small businesses)
- \$100 per information return if you file after August 1 or you do not file required information returns; maximum penalty is \$1,500,000 per year (\$500,000 for small businesses)

Basically, the single report “inadvertent” penalties doubled and the aggregate amounts increased significantly.

At this time, I am not sure what the Senate will do. Using up revenue offsets is becoming an increasingly touchy topic as Congress runs out of them.