MAYBE NOT

Earlier this year, the President proposed as part of his fiscal year 2010 budget request that ALL businesses should be required to issue Forms 1099, which report payments made for services rendered, to ALL their service vendors, including ALL corporations. The Department of Treasury estimated that over a ten year period, corporations would see the error of their ways and would stop underreporting their income and tax revenues would increase by at least $9 billion.

The Joint Committee on Taxation (JCT) has gotten around to estimating the revenue potential of the proposal. The JCT came up with a figure of just over $3 billion. I assume the state of the economy had something to do with it, but it could hardly explain a drop of nearly two-thirds. I suspect somebody figured out that the Form 1099 wallpaper was not going to generate much revenue because corporations are not underreporting income to the degree alleged.

I suspect this will take some of the gas out of this proposal. Most importantly, Congress follows the JCT estimate of revenues when considering tax legislation. However, I also believe we have made it clear that a) it would be an enormous burden for almost every business in America, most of whom are tax compliant and have nothing to do with the alleged problem and b) the revenue potential if any, is from all the penalties assessed against the innocent businesses that would be required to file the Form 1099s. If you cannot pick up much revenue, and the downsides are so obvious, one would have to have a strong desire to race into a headwind to keep pursuing this. But in Washington you know what they say ...“never say never.”

DON’T ANSWER THAT

Last week, the IRS issued a proposed rule to simplify the substantiation requirements regarding business use of a cell phone provided to an employee by an employer. “Hello, hello, what’s that you say? You did not know there WAS such a requirement in the first place? Your phone is ringing; it is the IRS calling.” Yes, the Blackberry and other PDAs too.

Because the IRS announced the rulemaking which, ironically, is designed to make life a little easier, it is getting a lot of play in the general media. The requirement has been in the law since 1989. The IRS decided to step up enforcement in 2005. Ask any professor at a major university about it. The audit activity began with universities. If you type in the topic in your favorite search engine, you will find dozens of university employee handbook policies on the subject.

Under the Internal Revenue Code (Code), there are some quirky rules for determining what is a fringe benefit to an employee and for determining what is included in a subset of fringe benefits known as “working condition fringe benefits.” While we suspect most employers and employees would not consider an employer-provided cell phone to be a “fringe benefit,” it is.

If an employer provides a cell phone to an employee (including the owner), and the employer acquires and pays the costs of using the cell phone, the assumption under the Code is that 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. As such, the cell phone expense is a...
deductible business expense for the employer, PROVIDED that the substantiation requirements of the 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.)

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.

What happens if the employee fails to substantiate the business use? The ramifications for the employee are income tax liability on the imputed income as well as FICA tax liability (7.15 percent). The ramification for the business is the additional FICA tax (7.15 percent) on the amount of imputed income. In addition, the business will lose of 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 share of the FICA tax on imputed income equivalent to those costs.

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

The section of the Code that defines the property for which substantiation is required includes the phrase: “any cellular telephone (or other similar telecommunications equipment).” Bills have been introduced to eliminate the recordkeeping requirement by eliminating that clause. Representative Sam Johnson (R-TX) and Earl Pomeroy (D-ND) have introduced H.R. 690, the Modernize Our Bookkeeping in the Law for Employees’ Cell Phone Act of 2009. In the Senate, Senators John Kerry (D-MA) and John Ensign (R-NV) have introduced the companion bill, S. 144.

The IRS has proposed three alternatives for substantiating the business use. They would be optional and the employee could still keep detailed records. The three options under consideration are:

1. Minimal Personal Use Method

The IRS is 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 usage 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 is 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 is proposing a business use percentage of 75 percent.

3. Statistical Sampling Method

The IRS is 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. 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.

The IRS is seeking comments on its suggestions for simplification. Comments are due in early September. The details can be found by typing in IRS Notice 2009-46 in the search window at www.irs.gov