

EMPLOYER-PROVIDED CELLULAR TELEPHONES AND PAGERS AS TAXABLE FRINGE BENEFITS

State agencies may provide employees with cellular phones and pagers for use outside the agencies' premises in the performance of their duties. Any personal use of such employer-provided electronic devices is taxable/reportable income when certain Internal Revenue Service (IRS) exclusion criteria are not met.

When these devices are provided to employees, the IRS requirements listed below must be met to exclude business use from income. All personal use generally represents taxable/reportable income. When the employer reimburses for an employee's electronic device and personal use is allowed, the payment may represent taxable income provided under a non-accountable plan.

The IRS characterizes cellular phones and pagers as "listed property" which is susceptible to personal use and, therefore, increases the likelihood that employees receive taxable income. Employer-provided "listed property" subjects the employer and employee to strict IRS substantiation rules.

Taxable income generally includes all income; from whatever source it is derived. Any benefit furnished an employee in connection with the performance of services is considered income, unless a specific exclusion applies. An exclusion is allowed, however, for working condition fringe benefits.

Business use of listed property is excluded from the wages of the employee as a working condition fringe benefit. However, any personal use of these devices is taxable and included in the wages of the employee. If substantiation requirements are not met, all use of the device is taxable and included in the wages of the employee.

WORKING CONDITION FRINGE BENEFITS

Per IRS Regulation 1.132-5, a working condition fringe benefit is any property or service provided to an employee to the extent that, if the employee paid for such property or service, such payment could be claimed as a business deduction under IRC Section 162 or 167. For an employer provided cellular phone/pager to qualify as a working condition fringe benefit, three requirements must be satisfied:

- 1) The employee's use of the cellular phone/pager relates to the business of the agency (employer maintains a policy prohibiting personal use);
- 2) The employee would have been entitled to a business expense deduction if the employee purchased the cellular phone/pager; and
- 3) The employee maintains adequate records required with respect to the business use of the cellular phone/pager provided by the agency and the agency routinely validates these records to insure only business use occurs.

The IRS requires that adequate records, according to IRS Regulation 1.274-5T(c), includes written documentary evidence (account book, diary, log, expense report, billing statement, etc) sufficient to establish each element of business use.

To the extent that the IRS substantiation rules are satisfied, the exclusion for a working condition fringe benefit shields the employee from taxable income, but only from the business use portion of the employer-provided cellular phone/pager. The employee's personal use of employer-provided cellular phone/pager falls outside of the working condition fringe benefit exclusion and is taxable income.

The employee's taxable income from personal use of the cellular phone/pager equals the Fair Market Value (FMV) of the equipment attributable to personal use. The FMV is the amount that an individual would pay for the cellular phone/pager, not necessarily what the agency paid for the device(s).

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Generally, if the working condition fringe benefit exclusion is not met, the personal use of an employer-provided cellular phone/pager is considered wages and subject to the withholding of federal employment taxes. Social security and/or medicare withholding depends on the applicable coverage for the employee.

EXAMPLES

- An agency provides an employee a cellular phone for business purposes. The agency's written policy prohibits personal use of the phone. The agency routinely audits the employee's phone billings to confirm that personal calls were not made. No personal calls were actually made by the employee. The business use of the phone is not taxable to the employee.
- An agency provides an employee a cellular phone for business purposes. The agency's written policy states that the phone is not intended for personal use, and requires reimbursement from the employee for any personal calls. The agency routinely audits the employee's phone billings to ascertain personal calls made. The employee reimburses for all personal calls made. The business use of the phone is not taxable to the employee.
- An agency provides an employee a cellular phone for business purposes. The agency's written policy prohibits personal use of the phone. The agency does not, however, audit the employee's phone billings to confirm only business use. The Fair Market Value (FMV) of the phone (one time value) plus the monthly phone service charge (on going) are taxable, reportable income.
- An agency gives an employee an electronic pager for business purposes plus pays the monthly service charge for its employee. The agency does not audit pager billing records. The FMV of the pager (one time value) plus the monthly pager service charge (on going) are taxable, reportable income.
- An agency provides an employee with a cellular phone and pays the monthly charges. The agency requires the employee to highlight personal calls on the monthly bill. The agency includes the direct charges for personal use and a pro rata share of monthly fees in the wages of the employee. The business use portion of the phone is not taxable to the employee.
- An agency allows an employee to use a personally owned cellular phone for state business. The agency has established a written policy on the use and manner of reimbursement for such phones. The employee submits a signed copy of the employee's cellular bill highlighting work-related calls for which the employee is requesting reimbursement. The agency reimburses the identified work calls on a pro rata share of the monthly fees after auditing the bill. The reimbursement of business related calls is not taxable to the employee.
- An agency allows an employee to use a personally owned cellular phone for state business. The agency has established a written policy on the use and manner of reimbursement for such phones. The agency pays a flat rate monthly allowance to the employee for the use of the phone. The agency does not require documentation identifying the personal and business use of the phone. The entire amount of the monthly allowance is taxable, reportable income.

This fact sheet was designed to provide awareness of social security coverage and reporting responsibilities for Kentucky state agencies. This fact sheet should not be cited or used as authority with respect to federal employment taxes. The Internal Revenue Code and the Social Security Act, along with the associated regulations, rulings and case law, are the only valid citations of authority.