

NONPROFIT ALERT

JUNE 2008

Introduction

On May 5, 2004 IRS issued Letter Ruling 200435020 in response to a charitable organization's treatment of certain real estate transactions, credit cards, meals, gasoline, miscellaneous charges and cell phones. This letter ruling has been cited as the basis for the IRS's current thinking regarding the treatment of not only cell phones but communication devices in general. This category includes not only cell phones, but Blackberries, and laptops. During the course of the examination, the Service asked the organization to provide a copy of its policy statement ensuring that personal use of organization paid home phones, cellular phones and calling cards would be reimbursed to the organization. In response, the organization took from the policy manual – "The policy of X regarding personal use of telephone is that personal telephone calls should not be charged to any X paid telephone line. Any personal calls should be reimbursed 100% to X." The same basic response was given for the other categories. The issue became one of "excess benefit" since the personal use was not picked up by the organization.

IRS Perspective

From the IRS's point of view this is an "excess benefit" transaction. Letter Ruling 200435020 has often been cited as causing the problem. The actual culprit is Treasury Decision 8061 (Substantiation requirements) issued January 1, 1985.

To address the Intermediate Sanctions excess benefit issue first, Code section 4958(c)(1)(A) defines an excess benefit transaction in general "as any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. An economic benefit shall not be treated as consideration for the performance of services unless such organization clearly indicated its intent to do so." While the excess benefit issue may be of interest to exempt organizations, the only connection is the discussion of the "punishment" for not adhering to the rules concerning "communication devices." Keep in mind that in 1985 (22 years ago) Blackberries, cell phones and laptops as we use them today, were not as prevalent, or non-existent.

Unfortunately, the cell phone answer does not rest in a single code section or regulation. The analysis is progressive. First of all, the regulations state that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. This narrows the field insofar as we are now addressing expenses directly connected to the trade or business. This would eliminate personal use items[1]. Organizations have often referred to de minimis fringe benefits[2] as the reason for not including these items. In and of themselves, they probably would be de minimis if it were not for the reference to listed property[3]. This section states, in part, ". . . . that no deduction or credit shall be allowed...with respect to any listed property[4] (as defined in Code Section 280F(d)(4) unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement regarding amount, time and place, business purpose and business relationship. This is where the accountable aspect comes into play. Each employee is required to provide substantiation of the business purpose of each expense, generally in writing.

The requirements as to what is needed for substantiation, is quite specific for "listed property". These include: (1) the amount of each business/investment use; (2) the date of the expenditure or use; and, (3) and the business or investment purpose. Again, in each case the interest is in the

business use.

In regard to cell phones, the combination of Code sections 274 and 280F provide that cellular telephones are listed property. Strict substantiation requirements have to be in place, otherwise the use of the cell phones is taxable to the employee. Organizations appear to be taking one of three approaches:

- Develop a strict cell phone policy prohibiting personal use of these devices;
- Audit the cell phone bills to determine personal use which in most cases is impractical; or,
- Gross up the employees pay and have them pay for the cell phone and put in for the business use as an expense under an accountable plan.

In the event that the decision is made to continue with cell phones for key individuals, standardized procedures need to be developed and applied on a consistent basis. For example, the organization could decide to randomly pick three months during the previous year, do a detailed analysis of the cell phone charges, and create a monthly disallowance portion of cell phone usage. The portion determined to be personal should be added to the individual's compensation, however reported. Alternatively, if the decision is made to do away with cell phones on behalf of the organization, key employees should be instructed to submit the bills on an accountable basis, accounting for business use and requesting a reimbursement.

Conclusion

IRS has a renewed interest in accountability which is obvious from the new Form 990. In order to avoid Intermediate Sanctions under Code section 4958, a cell phone (communication device) policy should be developed and monitored.

For Further Information

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[1] Reg. section 1.162-1(a)

[2] Code section 132(e)

[3] Code section 274(d)

[4] Code section 280F(d)(4) defines listed property as any passenger automobile, or the property used as a means of transportation, and, any computer or peripheral equipment, and any cellular telephone (or other similar telecommunications equipment)

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