

Office of the President

TO MEMBERS OF THE COMMITTEE ON COMPENSATION:

ACTION ITEM

For Meeting of May 7, 2009

CASH ALLOWANCE FOR CERTAIN EMPLOYEES FURNISHED WITH A UNIVERSITY-PROVIDED CELLULAR PHONE

The President recommends that the Committee on Compensation recommend to the Regents that for each Senior Management Group (SMG) member or other employee whose salary exceeds the indexed compensation level, which requires Regental approval, that:

Such employees receive a monthly cash allowance reimbursing them for the tax on the imputed income added to their taxable earnings for the value of a University-provided cellular phone or a cell phone-enabled personal digital assistant (PDA) and service plan. Since the cash allowance itself is taxable, it would be increased in accordance with the Internal Revenue Service (IRS) formula for grossing up such payments in order to reimburse the employee for applicable payroll taxes related to the payment.

In addition to SMG members, employees eligible to receive a cell phone or PDA include faculty, staff, and collective bargaining unit employees. These employees would also receive a cash allowance reimbursing them for the taxes associated with their University-provided cell phone or PDA.

BACKGROUND

In 2008, the IRS concluded two employment tax audits at UCLA and UCSD. As part of the settlement of the exams, UCLA and UCSD paid tax assessments of \$238,474 and \$186,471, respectively, related to the personal use of cell phones and PDAs furnished by the campuses to their employees. In addition to paying the tax assessments, the University entered into a closing agreement with the IRS to change its policy to bring all campuses into compliance with the income tax regulations governing employer-provided cell phones.

IRS Regulations Governing Cell Phones

Employer-provided cell phones are subject to special substantiation rules set forth in the same regulations that cover automobiles, computers, and other “listed property” items that lend themselves to personal use. In 1989, the listed property law was amended to add cell phones to

this category of items. The law has not been updated in the last 20 years even though cell phones are more widespread and economical to purchase today.

Under the current regulations, unless an employer has a policy requiring employees to keep detailed records of their cell phone usage, distinguishing between business and personal calls, the value of the phone and service plan will be treated as additional wages paid to the employee. "At a minimum," the IRS says "the employee should keep a record of each call and its business purpose. If calls are itemized on a monthly statement, they should be identifiable as personal or business and the employee should retain any supporting evidence of the business calls. This information should be submitted to the employer, who must maintain these records to support the exclusion of the phone from the employee's wages." Any personal calls must be reimbursed or the value of the calls will be treated as wages subject to withholding and reportable on the employee's Form W-2.

Because the special substantiation rules are extremely antiquated and burdensome for both employees and employers, legislation was reintroduced earlier this year in the House (H.R. 690) and Senate (S. 144) to modernize the tax treatment of employer-provided cell phones, BlackBerrys, and similar devices. Although the bills have strong bipartisan support, it is not known when, or if, Congress will take action to pass these measures into law.

The University's existing policy allows employees to make incidental personal calls using a University-provided cell phone. As long as the employee does not exceed his or her package minutes, such personal calls are not reimbursable. However, in accordance with the closing agreement with the IRS, the University must change its cell phone policy in order to comply with the special substantiation rules contained in the current regulations.

Cell Phone Policy Change

In response to the IRS audits, the President proposes to treat the value of a University-provided cell phone as a taxable fringe benefit. The cost of the monthly service plan, including the cost of the device, would be added to the employee's taxable earnings as imputed income. These employees would receive a cash allowance reimbursing them for the tax on the imputed income and the additional taxes associated with the payment itself.

As a result of this change, the detailed substantiation rules applicable to cell phones would not apply since the University would essentially be paying the taxes on cell phone equipment furnished to its employees. Employees would be relieved of complying with the burdensome and outdated substantiation rules and the University's exposure to future IRS assessment related to cell phone use would be eliminated.

The imputed income and cash allowance received by such employees would not be included in their compensation for purposes of determining University retirement coverage or other benefits.