

Internet Service Reimbursements

Q: Is it appropriate to reimburse an employee for Internet service in their home? If so, what recordkeeping is required?

A: In today's digitally-connected world, many employers want to communicate with their employees via email during non-working hours. Other organizations may require employees to submit expense reports electronically, or communicate digitally with customers across the globe and across different time zones. To facilitate these tasks, the employees will need Internet access, and using Internet access in their home will oftentimes be the most logical and effective method.

Business Connection

Internet expenses, if incurred for a bona fide business need, can be reimbursed by an employer. Like any business expense reimbursement, the reimbursement must comply with an accountable reimbursement plan in order to be non-taxable to the employee. The IRS requires the following for an accountable reimbursement:

- The expense must have a business connection (i.e., a valid business expense incurred as part of an employee's job requirement).
- The employee must provide documents such as receipts or invoices to support the expense in a timely manner.

Internet service is often billed one month at a time; are employers able to reimburse the entire monthly bill?

According to the IRS, only the costs associated with the business connection can be

reimbursed under an accountable reimbursement plan. Undoubtedly, some portion of the Internet service will be used for personal purposes. Therefore, the use of the Internet service must be allocated between business and personal use.

Some employees will want to compare their home Internet service to a cell phone plan that is fully reimbursed by the employer. In recent years, the IRS reduced the recordkeeping requirements for employer-provided cell phones, and in 2011, the IRS issued Notice 2011-72 which clarified that when an employer-provided cell phone complied with a few important guidelines, any personal use of that cell phone would be considered *de minimis* and non-taxable to the employee.

However, the IRS has not classified the reimbursement of Internet service in a similar manner. In fact, the notice states that the *de minimis* exclusion for cell phones should not be interpreted as applying to other fringe benefits. Therefore, in order for Internet access reimbursements to be non-taxable to the employee, only the business portion should be reimbursed. If expenses allocable to personal use are reimbursed, they should be included as taxable income for the employee. IRS Publication 535, Business Expenses, specifically states personal use of reimbursed Internet service is taxable to the employee.

Substantiating Business Use

The IRS Tax Court provided an example of how Internet expenses could be substantiated. In *Verma v. Commissioner*, T.C. Memo 2001-132, the court characterized Internet expenses

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as utility expenses. This court case and a few others indicate that an employer could reimburse an employee's home Internet expense using a reasonable allocation or percentage of business use.

The following guidelines should be used:

- Document the business justification for the Internet use.
- Agree on a reasonable allocation or percentage of Internet expense that will be reimbursed. A formal agreement with the employee may be helpful to avoid any confusion.
- Require employees to provide a copy of their monthly service statement.
- Any reimbursement that exceeds the business portion of the expense should be included as taxable income for the employee.
- The reimbursement should never be more than the actual cost of the Internet service.
- The business allocation and reimbursement amount should be reviewed annually to account for any changes in business need or amount.

If Internet expenses are reimbursed *without* an accountable plan or reasonable allocation, the

reimbursements will be taxable compensation and should be reported as such to the employee.

Current Business Practices

According to the U.S. Census Bureau, almost 72% of households had Internet access in 2011. Access increased to 82% if the household included individuals between the ages of 18 and 34. Based on these statistics, it is safe to say that most employees have Internet access in their home.

Because most individuals already have home Internet service for personal reasons, and due to the administrative work in complying with an accountable reimbursement plan, many companies appear to be moving away from reimbursing Internet access as a business expense.

If an organization chooses not to reimburse home Internet expenses, employees may still be able to deduct unreimbursed business expenses on their individual taxes.

Note about employees who are ministers: Ministers who are eligible for a housing allowance can choose to list home Internet expenses as a housing allowance expense along with other utilities. When reporting housing allowance expenses, ministers should not report any portion of home Internet expenses that were reimbursed by their employer.

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