Internal Revenue Service

Number: **201005014**
Release Date: 2/5/2010

Index Number: 132.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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Refer Reply To:
CC:TEGE:EOEG:ET2
PLR-122803-09

Date:
October 28, 2009

<u>Legend</u>

Taxpayer =
State A =
Department A =
X =

Dear :

This is in response to a letter dated April 23, 2009, and supplemented by letters dated June 30, August 20, and September 15, 2009, submitted on behalf of Taxpayer by its authorized representative, requesting a ruling that the value of certain articles of clothing and accessories provided by Taxpayer to employees are excluded from gross income as de minimis fringe benefits under Internal Revenue Code (Code) section 132(a)(4). The ruling contained in this letter is based upon information and representations submitted by Taxpayer, and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request for ruling, such material is subject to verification upon examination. The information submitted in the request is substantially as set forth below.

FACTS

Taxpayer is a political subdivision in State A. It is divided into departments, several of which are further divided into divisions and sections (collectively, departments).

Taxpayer has over X employees, many of whom are eligible to receive work-related articles of clothing and accessories, including tee shirts, polo shirts, sweaters, jackets, swimsuits, socks, sweatshirts, coats, pants, jeans, shorts, gloves, hats, fanny packs, belts, clip-on ties, and equipment bags. Most of the items bear Taxpayer's logo or other information identifying the individual as an employee of Taxpayer. Employees are required to wear the clothing items while performing services for Taxpayer.

Taxpayer's departments may secure items annually under a contract system that begins when the City Council—which is Taxpayer's legislative branch that is responsible, in part, for adopting annual operating and capital budgets—appropriates an amount for Taxpayer to spend on clothing. Vendors then submit bids to provide particular items, such as tee shirts, that, if accepted, comprise contracts under which any department may order the item. These contracts rarely enumerate either the precise number of items that Taxpayer will collectively order, or the precise cost of each item, but do usually specify a maximum number of items that Taxpayer may order. Escalation clauses and variations in the material and size of an item can cause the cost of an item to vary, for example by allowing a vendor to charge one amount for a tee shirt in year one, but to charge a different amount for the same tee shirt in year two. Even within the same year, it is possible for a vendor to charge different amounts for a medium tee shirt as compared to an otherwise-identical large tee shirt, or for a medium tee shirt of one material grade and a medium tee shirt of a higher grade.

Once a vendor contract has been authorized, departments may secure items by ordering them directly from the vendors. The vendors submit invoices to the departments' fiscal officers, who forward them to the City Auditor after confirming that the goods were received. The City Auditor pays the invoice.

Storeroom supervisors issue items to employees in accordance with department policies. Department policies typically entitle employees to items both when they commence their employment and when they need replacements.

The exact frequencies with which the policies entitle new employees to receive items vary. Some, for example, limit new employees to a single provision of a particular item. Taxpayer provided the text of one collective bargaining agreement which requires the department to "provide an initial issue of rain jacket and rain pants to all [of its] refuse collectors." Other departments' policies, however, allow new employees to receive multiple provisions of particular items upon hiring. Replacement items are typically distributed on an "as" or "if" needed basis.

Additionally, different categories of employees may be entitled to different quantities of an item. Variables affecting the number of items any individual employee receives can include employment status (e.g., full-time, part-time, seasonal, volunteer, etc), job function, and department. For example, Department A's "Garment Distribution and Replacement" policy bases the number of tee shirts that it distributes to instructors on the number of hours that those instructors work—instructors who work twelve hours per week or more receive three tee shirts; those who work six to eleven hours receive two tee shirts, and those working one to five hours per week receive one tee shirt. As another example, Section A's policy categorically allows full-time, part-time, and seasonal employees to receive certain items, but allows other employees to receive them only "as established by the Director or designee." Finally, some departmental policies allow employees to wear appropriate personal clothing in lieu of the Taxpayer-provided clothing items to which they are entitled.

Because departments do not typically distribute every item ordered in a year, many store items for future use. Taxpayer cannot enumerate the particular number of items that each employee receives each year. However, it has represented "that the items generally are provided to employees no more frequently than annually," and, as part of its submission, has also provided copies of department polices and a table that are consistent with this representation. The table summarizes the number of items each department ordered, the number of items each department issued, and the number of employees entitled to receive the items. The table indicates that, in most instances, individual employees receive less than one item per year. That is, the number of employees eligible to receive a given item typically exceeded the number of items distributed by the department.

RULING REQUESTED

The values of articles of clothing and accessories provided by Taxpayer to employees (as specified in the table included as part of Taxpayer's submission) are excluded from gross income as de minimis fringe benefits under Code section 132(a)(4).

LAW

Code section 61(a)(1) provides that gross income means any income from whatever source derived, including, but not limited to, compensation for services including fringe benefits.

Code section 132(a)(4) states that gross income does not include the value of a de minimis fringe benefit provided to an employee. Code section 132(e)(1) states:

> The term "de minimis fringe" means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

Section 1.132-6(b)(1) of the Treasury Regulations states:

> Generally, the frequency with which similar fringes are provided by the employer to the employer's employees is determined by reference to the frequency with which the employer provides the fringes to each individual

> employee. For example, if an employer provides a free meal in kind to one employee on a daily basis, but not to any other employee, the value of the meals is not de minimis with respect to that one employee even though with respect to the employer's entire workforce the meals are provided “infrequently.”

Section 1.132-6(b)(2) of the Treasury Regulations states:

> Notwithstanding the rule of paragraph (b)(1) of this section . . . where it would be administratively difficult to determine frequency with respect to individual employees, the frequency with which similar fringes are provided by the employer to the employer's employees is determined by reference to the frequency with which the employer provides the fringes to the workforce as a whole. Therefore, under this rule, the frequency with which any individual employee receives such a fringe benefit is not relevant and in some circumstances, the de minimis fringe exclusion may apply with respect to a benefit even though a particular employee receives the benefit frequently. For example, if an employer exercises sufficient control and imposes significant restrictions on the personal use of a company copying machine so that at least 85 percent of the use of the machine is for business purposes, any personal use of the copying machine by particular employees is considered to be a de minimis fringe.

Section 1.132-6(c) of the Treasury Regulations states:

> Unless excluded by a provision of chapter 1 of the Internal Revenue Code of 1986 other than section 132(a)(4), the value of any fringe benefit that would not be unreasonable or administratively impracticable to account for is includible in the employee's gross income. Thus . . . the provision of any cash fringe benefit is never excludable under section 132(a) as a de minimis fringe benefit. Similarly . . . a cash equivalent fringe benefit (such as a fringe benefit provided to an employee through the use of a gift certificate or charge or credit card) is generally not excludable under section 132(a) even if the same property or service acquired (if provided in kind) would be excludable as a de minimis fringe benefit. For example, the provision of cash to an employee for a theatre ticket that would itself be excludable as a de minimis fringe . . . is not excludable as a de minimis fringe.

ANALYSIS

The Code and Regulations require Taxpayer to establish that the value of the items it seeks to exclude as de minimis fringes is so low as to make accounting for them administratively impracticable. Neither the Code nor the Regulations specify a particular value above which an item can no longer be considered a de minimis fringe.

Even an item with a low value may not be a de minimis fringe if an individual receives it too frequently. Code section 132(e) therefore requires Taxpayer to establish that it does not provide items so frequently that the aggregate value is not de minimis. Section 1.132-6(b)(1) of the Treasury Regulations generally requires taxpayers to establish this frequency by referencing the frequency with which the employer provides the fringes to each individual employee (the “employee-measured” frequency standard). If the taxpayer can establish that it would be administratively difficult to determine such employee-measured frequency, it may instead reference the frequency with which the employer provides the fringes to the workforce as a whole, under section 1.132-6(b)(2) of the Treasury Regulations (the “employer-measured” frequency standard).

Finally, Taxpayer must establish that it would be unreasonable or administratively impracticable to account for the value of the items. It is for this reason that section 1.132-6(c) of the Treasury Regulations specifies that employer provisions of cash or equivalents are generally not excludable under Code section 132(c), even if the same property or service acquired (if provided in kind) would be excludable as a de minimis fringe—there are little-to-no administrative costs associated with accounting for the fair market value of a cash-denominated item.

Applying the facts to these standards, the items that Taxpayer has provided to its employees qualify as de minimis fringe benefits under Code section 132(e). Taxpayer has provided evidence objectively demonstrating that the items are of low value, were not distributed too frequently, and it would be administratively impracticable to account for the value of the items.

Value of Benefits

The items identified by Taxpayer are of low value. Using the cost of the items as an approximation of their values, it is reasonable to conclude that the items listed in Taxpayer’s ruling request are de minimis fringes if Taxpayer can also establish both that the frequency with which the items were distributed does not preclude such a finding, and that it would be administratively impracticable to account for each item’s value.

Frequency with which Taxpayer Distributed Benefits

It is appropriate for Taxpayer to use the employer-measured frequency standard. As discussed earlier, section 1.132-6(b)(2) of the Treasury Regulations states that the employer-measured frequency standard is available to Taxpayer if it can establish that it would be administratively difficult for it to use the employee-measured frequency standard. Whether the frequency determination is administratively difficult is based on an objective demonstration of difficulty, not an unsupported assertion. Further, an employer cannot tailor its procedures to make accounting for fringe benefits administratively difficult for the purpose of achieving de minimis fringe benefit treatment. American Airlines v. United States, 40 Fed. Cl. 712, 725 (Ct. Cl. 1998), aff'd, 204 F.3d 1103, 1112 (Fed. Cir. 2000) (stating that "difficulty caused by the employer's chosen accounting system . . . does not constitute administrative impracticability"). In this case, Taxpayer has established administrative difficulty by providing objective evidence that the costs associated with determining employee-measured frequency would exceed the nominal tax revenue generated by including the value of the benefits in income.

In particular, Taxpayer's submission indicates that the administrative costs it would have to incur to establish employee-measured frequency include requiring department storerooms to track the number of items that each employee received, maintaining records for each employee, and routinely transmiting the records to fiscal officers. These records would also have to be provided for payroll departments and the City's auditor. Adding additional difficulty are the facts that (1) many departments—particularly those that provide the items on an "as-needed" basis—do not distribute items at regular intervals; (2) Taxpayer provides many items to volunteers, a population whose receipt of employer-provided items is inherently difficult to track; and (3) Not all employees opt to receive all items which they are entitled to receive under departmental policies.

The relevant inquiry for purposes of determining employer-measured frequency is not the frequency with which each individual employee actually received the benefits, but the frequency with which all employees collectively received the benefits. Section 1.132-6(b)(2) of the Treasury Regulations. Generally, this analysis requires determining the number of times particular or similar benefits were provided to the work force as a whole.

Taxpayer's submission summarizes departmental policies that enumerate the maximum number of items that employees may receive in a given year. These policies typically entitle employees to items when hired and replacements on an as needed basis. We do not consider the provision of the items once, or perhaps twice, annually as so frequent that, given the low value of each item, the provision could not properly be characterized as de minimis.

Administratively Impracticable to require Taxpayer to Account

Although the determination of administrative impracticability is inherently a function of facts and circumstances, one objective guidepost exists where the administrative costs associated with determining the value of the benefit and accounting for it may be more expensive than providing the benefit.

As shown above, neither the values of the items, nor the frequencies with which Taxpayer provides these items to employees, independently prevent these items from qualifying as de minimis fringes. These items will, therefore, fail to qualify as de minimis fringe benefits only if the administrative costs of accounting for their fair market values is so low that requiring Taxpayer to make such an accounting is not unreasonable or administratively impracticable. Taxpayer's submission, however, demonstrates based on objective data that Taxpayer would have to incur substantial administrative costs to account for the fair market value of each item.

Establishing a system to track each individual item's cost would be expensive. Such accounting would be impossible unless vendors provided invoices detailing the particular types and amounts of clothing that each department purchased. Taxpayer has indicated that vendors do not presently provide such detailed invoices, and do not possess the resources to provide such invoices. Vendors would undoubtedly pass at least some portion of the recordkeeping costs associated with establishing such a system to Taxpayer.

And it would be even more burdensome to require Taxpayer to account for each item's fair market value, as the Code and Regulations require. Simply requiring Taxpayer to pinpoint each item's fair market value would be difficult, as the variables discussed above—such as escalation clauses and variations in clothing sizes and materials—which cause items' costs to vary, would also cause items' fair market values to vary. Because most of the items bear Taxpayer's insignia or other writing, there may not be a readily ascertainable fair market value for the items, making it even more difficult for Taxpayer to determine fair market value. Complicating matters even further is the fact that Taxpayer cannot measure administrative impracticability—and thus each item's fair market value—until it actually provides the benefits. Thus, although it would likely be most efficient for Taxpayer to determine these items' values when it received large quantities of them, Taxpayer would have to forgo making this determination until the time at which it actually distributed the items. This would be the only way for Taxpayer to ensure that employees' Forms W-2, Wage and Tax Statements, accurately reflected the items' values.

Taxpayer would also have to incur costs to maintain records of the fair market value of each item that each employee received. Its necessarily large and bureaucratic structure would, however, make this process costly. Taxpayer has determined that this tracking process would require a storeroom worker to complete a form every time an employee received an item. This form would have to identify the employee, the item received, the date received, and the item's fair market value. Storerooms would have to maintain these records, and routinely (which Taxpayer defines as most likely weekly) prepare reports and transmit copies of the records to their department's fiscal officer. The fiscal officer would have to transfer the forms to the payroll department for a preliminary calculation of the taxable amount to be added to each employee's wages. Taxpayer would ultimately have to transfer all information—including copies of each paper form—to its Auditor's office for a final review. The Auditor's office would have to add the appropriate amount to each employee's wages. Each department would have to maintain copies of associated forms and records for many years.

Although many of the administrative costs discussed above are a result of Taxpayer's large and decentralized structure, it is notable for the purposes of a de minimis fringe analysis that there is no indication that Taxpayer designed this system with an intent to make it administratively impracticable to track the items' values. Rather, the size and nature of Taxpayer's operations necessitates such an administrative structure. This objectively supports Taxpayer affirmative representation that "the difficulty in accounting for the provision of the items at issue herein is not of [Taxpayer's] own making."

To summarize, Taxpayer has demonstrated that it is unreasonable to account for the value of the items because it would have to incur substantial administrative costs to track the fair market value of each item it provides to its employees. The information it has provided objectively supports the notion that these items' values—while taking into consideration the frequency with which employees receive them—are so small that the administrative costs that would be associated with accounting for them would make such an accounting administratively impracticable.

RULING

Based on the information submitted and the representations made, we rule that the values of articles of clothing and accessories provided by Taxpayer to employees (as specified in the table included as part of Taxpayer's submission) are excluded from gross income as de minimis fringe benefits under Code section 132(a)(4).

This private letter ruling is directed only to Taxpayer, who requested it. Code section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant.

Sincerely,

Paul Carlino
Senior Technician Reviewer, Employment
Tax Branch 2
Tax Exempt and Government Entities