



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF THE CHIEF COUNSEL

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The Honorable Rich Nugent
Member, U.S. House of Representatives
16224 Spring Hill Drive
Brooksville, FL 34604

Attention:

Dear Congressman Nugent :

I am responding to your inquiry of April 5, 2011, on behalf of your constituent, . asked why reimbursement of phone concession for post-divestiture retirees who reside outside of the former company's local service area is subject to Federal Insurance Contribution Act taxes (FICA) while reimbursement of phone concession for pre-divestiture retirees is not.

FICA taxes consist of the old-age survivors and disability (OASDI) portion and the hospital insurance portion (Medicare tax). Employers compute these taxes as a percentage of wages they pay to an employee (sections 3101, 3111, 3121 of the Internal Revenue Code (the Code)). Wages for FICA purposes are defined as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. However, any fringe benefit which is excludable under section 132 of the Code is not wages for FICA purposes (section 3121(a)(20) of the Code).

An employee's gross income does not include any fringe benefit that qualifies as a no-additional-cost service (section 132(a)(1) of the Code). The law defines a no-additional-cost service as a service that (section 132(b) of the Code):

- Is for the employee's use
- Is for sale to customers in the ordinary course of the employer's business
- Is for sale in the line of business in which the employee works
- Does not cause the employer to incur any substantial additional cost (including forgone revenue) in providing the service

With respect to no-additional-cost services, the term “employee” includes any individual who the employer formerly employed in that line of business and who separated from service due to retirement (section 132(h)(1)(A) of the Code).

Prior to the divestiture of the Bell System, retired Bell System employees receiving free telephone service could exclude the value of the service from income as a no-additional-cost service under section 132(b) of the Code. However, after the divestiture, the System changed and a single provider no longer provided telephone services throughout the United States. Instead, several Regional Bell Operating Companies (RBOCs) were created to provide telephone services in different regions of the country. Each of these RBOCs is a different employer for purposes of the no-additional-cost fringe benefit provisions. The exclusion from income for no-additional-cost services only applies to services an employer provides to its own employees or retired employees. Thus, employees who had retired from the Bell System prior to divestiture risked losing eligibility to exclude the value of free telephone service from their income because an entity other than their employer (i.e., an RBOC) had become the provider of the benefit.

The Congress took action to enable employees who had retired from the Bell System prior to its divestiture to continue excluding the value of their free telephone service from income. The Congress accomplished this by revising the law to allow pre-divestiture retirees to treat telephone service an RBOC provided as a no-additional-cost service (Section 1853(d) of the Tax Reform Act of 1986 (Pub. L. No. 99-514), revising section 559 of the Tax Reform Act of 1984 (Pub. L. No. 98-369)). As a result, for employees who retired before January 1, 1984, the law treats all RBOCs as a single employer in the same line of business. It also treats payment an RBOC makes of all or part of the cost of local telephone service that a person other than an RBOC provides to the retiree (including a rebate of the amount the retiree paid for the service and payment to the person providing the service) as telephone service a single employer provided.

The Senate Report on the Tax Reform Act of 1986 (S. Rep. No.99-313, at 1024-25 (1986)) stated that the purpose of this provision was to apply an “intended transitional rule under which the fair market value of free telephone service provided to employees of the Bell System, who had retired prior to divestiture of the system on January 1, 1984 is excluded from income and wages of such pre-divestiture retired employees.” The Senate Report further stated that this provision does not apply to any employee who separated from service on or after January 1, 1984.

Unfortunately, the Congress enacted these special rules to apply only to pre-divestiture retirees. The normal rules for no-additional-cost services apply to post-divestiture retirees. To exclude the value of free telephone service from income as a no-additional-cost service, the employer or former employer must provide the service to its own employee or retired employee. If a post-divestiture retiree receives telephone service

(or a reimbursement for payment for telephone services) from an entity other than that retiree's former employer, the retiree must include the value of the service or the amount of the reimbursement in income. Additionally, the payment constitutes wages for FICA purposes because it represents remuneration for past services.

I hope this information is helpful. If you have any questions, please contact me or
at .

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2
(Exempt Organizations/ Employment Tax/
Government Entities)
(Tax Exempt and Government Entities)