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August 10, 2009

The Honorable Douglas H. Shulman  
Commissioner of Internal Revenue  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

Dear Commissioner Shulman:

I am writing to request your assistance in granting the University of California a temporary waiver of compliance with the "listed property" substantiation rules applicable to employer-provided cell phones. We request that this waiver be in effect only until such time as the Internal Revenue Service (IRS) or Congress changes these substantiation rules.

By way of background, the IRS concluded an employment tax audit of the University's Los Angeles and San Diego campuses in 2008. One of the issues raised by the examining agent involved the University's practice of requiring employees to identify only their personal cell phone calls without also requiring employees to substantiate all of their business calls. As part of the resolution of this issue, the University made payments to the IRS totaling \$424,945. The University also entered into closing agreements covering both the Los Angeles and San Diego campuses, as well as the University's other eight campuses. Under these closing agreements, the University agreed to comply beginning January 1, 2009, with the listed property substantiation rules as they apply to employer-provided cell phones.

On November 7, 2008, Nanette H. Downing, Acting Director for Federal, State and Local Governments (FSLG), agreed to extend the compliance date to June 1, 2009, because of additional time needed by the University to establish internal systems to track cell phone usage. Although legislation was pending in Congress that, if enacted, would have changed the cell phone substantiation rules, the legislation was not considered in granting the extension, according to Ms. Downing. During the five-month period from January 1 – May 31, 2009, the University continued to follow its practice of permitting *de minimis* personal use of the cell phones.

The University came into compliance on June 1, 2009, by treating the total value of the monthly cell phone service charges, handset, and any accessories as a taxable noncash fringe benefit subject to withholding for payroll taxes. In addition, the University paid employees provided with such equipment a monthly cash allowance reimbursing them for the tax on this fringe benefit. Because the cash allowance is taxable, it is grossed up to include the taxes associated with the payment. As you can imagine, making this change was extraordinarily expensive for the University given that over 13,000 employees, out of more than 121,000 full-time faculty and staff, have a University-provided cell phone or personal digital assistant (PDA). The cost of the monthly cell phone cash allowances alone is \$4-5 million annually. In addition, there are significant administrative costs associated with this policy change.

It is important to note that since the entire cost of the cell phones and PDAs furnished to our employees and the payment of the cash allowances are being treated as additional taxable income, the tax revenue received by the IRS far exceeds the taxes that would have been due related to any personal benefits employees may realize in connection with the use of this equipment. However, we believe that these costs, while extraordinary, would not exceed the costs to comply with the outdated cell phone substantiation rules and the potential costs of future audit assessments given that the rules are so burdensome and unworkable as to make compliance impractical over the long-term.

It now appears that the IRS will issue new guidance simplifying the cell phone substantiation rules. As you know, IRS Notice 2009-46 sets forth a set of proposed liberalized substantiation rules, which were recently published for comment. On June 16, 2009, you also asked Congress to change the "listed property" substantiation rules as they apply to employer-provided cell phones. For these reasons, we requested permission to operate under our prior cell phone policies until such time as the new rules are finalized, but on July 16, 2009, we were advised by Cheryl J. Mares, Manager, FSLG, Pacific Coast Area, that our request would not be granted because of the requirements set forth in our closing agreements.

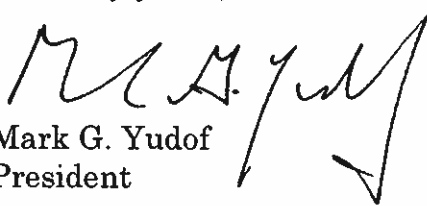
My purpose in writing is to request that you allow the University to revert to its pre-June 1, 2009 cell phone substantiation practices until the new rules are promulgated either by the IRS or Congress. If and when the IRS issues liberalized substantiation rules, or Congress changes the law in this area, the University will quickly come into compliance with whatever the new rules may be. But the current cost to the University to comply with rules, which you have stated are "obsolete" and asked Congress to change, is prohibitive, particularly in the face of the University's current and well-publicized budgetary problems.

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The fact that I choose to be in touch with you directly on this issue reflects its extreme importance to the University, and I very much appreciate any assistance you can provide in this matter.

With best wishes, I am,

Sincerely yours,

  
Mark G. Yudof  
President

cc: Executive Vice President Lapp  
Executive Vice President Taylor  
Senior Vice President Dooley  
Vice President Broome  
Associate Vice President Falle  
✓ Assistant Vice President Plotts