

II. [Reserved]

III. Qualified Transportation Plans

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A. Introduction

The purpose of this Section III is to discuss the tax treatment of qualified transportation fringe benefit plans made available to employees by their employers under Code § 132(f)(4) (we call these “qualified transportation plans,” although a written plan is not always required).¹ Under general principles of taxation, all benefits provided to an employee by his or her employer (including transportation fringe benefits) are taxable to the employee unless the Code provides a specific exclusion for the benefit. Since 1985, when Code § 132 first became effective,² employers have been permitted to give the following transportation fringe benefits to employees on a tax-free basis:

- qualified parking;
- transit passes; and
- transportation in a commuter highway vehicle, if such transportation is in connection with travel between the employee’s residence and place of employment (also known as “vanpooling”).

¹ See subsection H.2.

² Pub. L. No. 98-369 (July 18, 1984).

The maximum amount of transportation fringe benefits that employees can exclude from income has varied from year to year. The limit for parking is \$220 per month for 2008 (\$215 for 2007), while the limit for combined vanpooling/transit pass expenses is \$115 per month for 2008 (\$110 for 2007).³

There are three primary types of qualified transportation plan designs, each of which represents a different employer choice about the method of funding:

- Giveaway plan, under which an employer “gives away” to its employees benefits up to specified maximum amounts. See subsection I for details. This was the only design available until 1997, when Congress created a safe harbor from the doctrine of constructive receipt (Code § 132(f)(4)) for qualified transportation benefits, opening the door for pre-tax compensation reduction plans. Consequently, the pure giveaway design is no longer very common.
- Pre-tax compensation reduction plan, under which employees pay all of the costs on a pre-tax basis through the use of compensation reduction agreements. See subsection J for details. This is probably the most popular plan design—employers are not required to make any employer contributions in order to let their employees save taxes.
- Giveaway plan with pre-tax compensation reductions, after-tax contributions and/or cash-outs. This variation on the above two designs allows employers to provide a subsidy while giving employees other options too. See subsection K for details.

If a plan fails to comply with the Code’s requirements, the employer and the employee may lose the favorable tax treatment—instead of being tax-free, the benefit will be treated as taxable wages. See subsection T. Consequently, this Section III addresses a wide range of questions that would interest an employer involved in establishing or administering a plan. These include eligibility to sponsor and to participate, the plan designs described above, funding, elections, benefit limits, expense substantiation, plan documentation, reporting, disclosure, effect on other benefits and additional sources of information. For those that sponsor or administer qualified transportation plans, we have also included a variety of practical tools including lots of Q&As, a checklist of plan design choices (see subsection H) and a table that compares qualified transportation plans with health FSAs and DCAPs (see subsection L).

³ Rev. Proc. 2007-66, 2007-45 I.R.B. 970. For the limits in other years, see the Table of Plan Limits behind Appendix Tab 11.

B. Who Can Sponsor and Who Can Participate in a Qualified Transportation Plan?

1. Any Type of Employer Can Sponsor

Any employer can sponsor a qualified transportation plan for its employees, no matter what the employer's size. Eligible employers include corporations (Subchapter S or Subchapter C), partnerships, non-profit organizations, government entities, limited liability companies (LLCs), limited liability partnerships (LLPs), and sole proprietorships. (Caution: Certain owners are ineligible for the Code § 132(f) tax exclusion, as discussed in subsection B.) Government employers can sponsor qualified transportation plans, as can companies in the private sector. For example, federal employees are allowed to exclude their mass transit and vanpooling commuting costs from taxable wages and to pay for those benefits through compensation reduction.⁴ Businesses that are under common control or are part of an affiliated service group (called controlled groups) may sponsor a single plan for all of their employees. All employees that are treated as employed by a single employer under Code § 414(b), (c), (m) or (o) (relating to controlled groups of corporations, trades or businesses under common control, or affiliated service groups) are also treated as employed by a single employer for this purpose.⁵

See subsection G for a discussion of how the statutory monthly limits apply when individual employees work for multiple related or unrelated employers.

2. Only Current Employees Can Participate

Only individuals who are "currently employees at the time the qualified transportation fringe is provided" are eligible to participate.⁶ As used in the regulations, the term "employee" includes only common-law employees and other statutory employees, such as officers of corporations.⁷

a. Former Employees Cannot Participate

Former employees cannot participate in a qualified transportation fringe benefit plan. Consequently, an employer cannot reimburse otherwise qualified transportation expenses that are neither incurred nor paid by former employees *before* their employment termination date. However, this "no former-employee participants" rule does not prevent an employer from reimbursing a claim for an expense submitted by a former employee within the plan's applicable run-out period if the claim is for qualified transportation expenses that were incurred or paid *before* the employee's termination date, including expenses that were incurred *before* but paid *after* the termination date.

b. Self-Employed Individuals Cannot Participate

Self-employed individuals (partners, sole proprietors, more-than-2% Subchapter S shareholders, and independent contractors) are ineligible for the income exclusion.⁸

Can self-employed individuals obtain any favorable tax treatment for transportation expenses, even though they are ineligible for a qualified transportation plan? Yes. Individuals who are partners, more-than-2% shareholders and independent contractors may still obtain income exclusions under the working

⁴ Executive Order 13150 (Apr. 21, 2000). The President also announced a qualified transportation fringe benefit program under which federal employees working in Washington, D.C. and the surrounding area would receive transit passes on a tax-free basis. A three-year transit pass program was also adopted for three federal agencies in the National Capital Region (NCR). Subsequently, it was expanded to all federal employees as a three-year pilot program. Federal employees in the NCR, Departments of Transportation (DOT) and Energy (DOE) and the Environmental Protection Agency (EPA) receive a transit or vanpool pass equal to their actual commuting costs, up to \$100 per month. Outside the NCR, federal employees may elect to reduce their pre-tax income by an amount equal to their transit or vanpool expenses up to \$100 per month. Executive Order 13150 Federal Workforce Transportation (Frequently Asked Questions), http://www.fta.dot.gov/about/about_FTA_4645.html (as visited Feb. 22, 2008).

⁵ Treas. Reg. § 1.132-9, Q/A-10. For details about how to identify the members of a controlled group in the context of a cafeteria plan, see *Cafeteria Plans* (EBIA, 1991-present, updated quarterly).

⁶ Code § 132(f)(1); Treas. Reg. § 1.132-1(b)(2)(i); and Treas. Reg. § 1.132-9, Q/A-5.

⁷ Treas. Reg. § 1.132-9, Q/A-5.

⁸ Code § 132(f)(5)(E); see also IRS Notice 94-3, 1994-3 I.R.B. 14 and Treas. Reg. § 1.132-9, Q/A-5 and Q/A-24. See also IRS Information Letter 2001-0050 (Jan. 28, 2001); and IRS Publication 15-B (Employer's Tax Guide to Fringe Benefits) (noting that more-than-2% shareholders should be treated in the same way as partners in a partnership for fringe benefit purposes, but that the benefit should not be treated as a reduction in distributions to the more-than-2% shareholder).

condition and de minimis fringe provisions in Code §§ 132(a)(3) and (a)(4), even though they don't qualify under Code § 132(f).⁹

Example: Other Fringe Benefit Exclusions May Be Available to Self-Employed Individuals. Deanna is a partner in Prime Partnership. She commutes to and from her office every day and parks free of charge in Prime's parking lot. Deanna can't exclude the value of her parking under Code § 132(f) because she is self-employed, but she can exclude it if it qualifies as a de minimis fringe under Code § 132(a)(4).^{*} Also, any tokens or farecards provided to her by Prime that enable her to commute on a public transit system are excludable if the value of the tokens and farecards in any month doesn't exceed the limits in that regulation.[†] The de minimis fringe benefit exclusions are more limited than the qualified transportation fringe benefits limits, however. For example, a partner receiving a farecard from the partnership can only exclude its value up to \$21 per month (the limit for a de minimis fringe under Treas. Reg. § 1.132-6(d)(1)), not \$115 per month under the Code § 132(f) combined transit/vanpooling limit for 2008.[‡] Moreover, if amounts in excess of \$21 are provided, then under Treas. Reg. § 1.132-6(d)(1), the entire amount is taxable.

* See also Treas. Reg. § 1.132-9, Q/A-24(d).

† Treas. Reg. § 1.132-9, Q/A-24(b).

‡ IRS Information Letter 2001-0050 (Jan. 28, 2001).

c. Leased Employees and PEOs

In addition, an individual who is treated as a leased employee of a recipient-employer under Code § 414(n) is treated as an employee of the recipient-employer for purposes of Code § 132.¹⁰ Some employers have contracts with employee leasing firms or professional employer organizations (PEOs) under which the leasing firm or PEO fulfills the employer's staffing needs and handles payroll. It is unclear whether such leasing firms or PEOs can maintain a qualified transportation plan for the individuals who they lease to recipient employers.¹¹ See subsection G.2 for a discussion of how the statutory monthly limits apply when individual employees work for related or unrelated multiple employers.

For sample language describing which employees are—and are not—eligible to participate in a qualified transportation plan, see the sample transportation plan document behind Appendix Tab 10.

C. What Types of Transportation Fringe Benefits May Be Offered in General?

Under Code § 132(f)(1), three types of benefits meet the definition of qualified transportation fringes: parking, transit passes, and vanpooling (i.e., transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment). Separate monthly dollar limitations apply to each of these qualified transportation benefits. See subsections D through F.

Employers will need to consider the unique characteristics of the mass transit and parking situations in their particular metropolitan area and determine what benefits they believe actually would be used by employees. Many employers have taken surveys of their employees prior to implementing a qualified transportation plan so that they have a feel for how their employees are commuting to work. In other words, it would be pointless to include transit passes under a qualified transportation plan when mass transit is virtually nonexistent or not well used in a particular city.

After deciding which types of benefits should be offered, the employer will need to set the applicable amounts, within certain statutory limits. Congress has limited the favorable tax treatment available by setting maximum limits, applied on a monthly basis, for each type of benefit. Employees who receive benefits in excess of those statutory limits will lose the income exclusion and employers will have new withholding and reporting obligations. For 2008 expenses, the statutory limit is \$220 per month for parking and \$115 per month for transit passes and vanpooling combined (for the limits in other years, see the Table of Plan Limits behind Appendix Tab 11). These limits are subject to cost-of-living adjustments (if any) for future years, which are

⁹ Treas. Reg. § 1.132-9, Q/A-24(a).

¹⁰ Code § 414(n)(3)(C); Treas. Reg. § 1.132-9, Q/A-10.

¹¹ For details about how to identify leased employees in the context of a cafeteria plan and for other issues raised by PEOs, see *Cafeteria Plans* (EBIA, 1991-present, updated quarterly).

announced by the IRS before the beginning of each calendar year. Special issues arise in connection with administration of these limits—these are addressed in detail in subsection G.

Can an Employee Receive All Three Types of Benefits During the Same Month?

Yes, so long as he or she receives no more than the applicable statutory limit for each type of benefit, calculated on the basis of a calendar month or substantially equivalent period consistently applied (see subsection J). For purposes of the statutory limitations, the limitation for vanpooling and transit passes is a combined \$110 (for 2007).*

* For the limits in other years, see the Table of Plan Limits behind Appendix Tab 11.

Example: Combined Limit for Vanpooling and Transit Passes. Mika lives on Heavenly Island. She parks her car at a lot near the ferry terminal on the island (which costs \$215 per month), rides the ferry to downtown Emerald City (which costs \$110 per month), and then joins a vanpool to travel to her work in a distant city suburb (which costs \$110 per month). For 2007, she can exclude \$215 per month for parking and \$110 for the ferry transit passes and vanpooling expenses combined (a total of \$325 in tax-free benefits per month). (Note: She cannot exclude both \$110 per month for transit passes and \$110 per month for vanpooling because the statutory limit on mass transit benefits applies to transit passes and vanpooling combined.)*

* Code § 132(f)(2)(A); Treas. Reg. § 1.132-9, Q/A-7(a) and -7(c).

Caution: E-Z Pass Use Is Not a Qualified Transportation Fringe Benefit. E-Z Pass is an electronic toll collection system that is common on the East Coast and in parts of the Midwest. It is often used by commuters to pay their daily tolls for bridges, tunnels, turnpikes, etc. Although expenses paid with E-Z Pass may be related to commuting, they do not fall within the definition of qualified parking, transit passes, or vanpooling under Code § 132. Thus, expenses paid through E-Z Pass should not be reimbursed under a qualified transportation plan, nor should the use of electronic payment cards be permitted for E-Z Pass expenses under a qualified transportation plan.

The three types of transportation fringe benefits—parking, transit passes, and commuter highway vehicle transportation (also known as vanpooling)—are discussed in detail below, together with special rules regarding the limitations on the amounts that may be provided.

D. Qualified Parking (Benefit Type #1)

1. *Qualified Parking Defined*

“Qualified parking” includes the following types of parking:

- parking provided to an employee at or near the business premises of the employer;
- parking provided to an employee at or near a location from which the employee commutes to work by mass transit, by vanpooling, in a commuter highway vehicle, by carpool, or by any other means; and
- parking provided to an employee for which an employer pays (directly to a parking lot operator or by reimbursement to the employee), or parking that an employer provides on premises that it owns or leases.¹²

Qualified parking does not include parking on or near an employee’s residence.¹³ How near is “near” for purposes of the above requirements is a facts-and-circumstances question, so employers should be

¹² Treas. Reg. § 1.132-9, Q/A-4.

¹³ Treas. Reg. § 1.132-9, Q/A-4.