

## III. Qualified Transportation Plans

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### A. Overview

The purpose of this Section III is to discuss the tax treatment of qualified transportation fringe benefit plans that are made available to employees by their employers under Code § 132(f) (we call these “qualified transportation plans,” although a written plan is not always required).<sup>1</sup> 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.<sup>2</sup> Since 1985, when Code § 132 first became effective,<sup>3</sup> 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”).

For 2009 and later years, an amendment to Code § 132 also allows employers to reimburse certain bicycle commuting expenses on a tax-free basis.<sup>4</sup>

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<sup>1</sup> See subsection I.

<sup>2</sup> For more on the general tax principles that govern fringe benefits, see Section II.

<sup>3</sup> Pub. L. No. 98-369 (July 18, 1984).

<sup>4</sup> Pub. L. No. 110-343 (October 3, 2008).

For most transportation fringe benefits, the maximum amount that employees can exclude from income is subject to a statutory limit that is periodically adjusted for inflation. The limit for parking is \$230 per month for 2009 and 2010. The limit for transit pass and vanpooling expenses combined was \$120 per month for January and February of 2009. For the remainder of 2009 and for 2010, the combined limit is the same as the limit for parking (\$230 per month).<sup>5</sup> Bicycle commuting benefits are also subject to a statutory limit, but that limit is not adjusted for inflation. The limit equals the number of qualified bicycle commuting months during the calendar year times \$20 (resulting in a maximum benefit of \$240 per year). Unlike the monthly limit for other transportation fringe benefits, the limit for bicycle commuting benefits is applied on an annual basis.<sup>6</sup>

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 J for details. This was the only design available until 1998, when Congress created a safe harbor from the doctrine of constructive receipt (Code § 132(f)(4)) that opened the door for parking, vanpooling and transit pass benefits to be operated as pre-tax compensation reduction plans. As a result of that safe harbor, the pure giveaway design is no longer very common for those benefits, but it is the only design available for bicycle commuting benefits.
- 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 K 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. This design is not available for bicycle commuting benefits, though.
- Giveaway plan that also includes pre-tax compensation reductions, after-tax contributions, cash-outs, or a combination of those features. This variation on the above two designs allows employers to provide a subsidy while giving employees other options too. See subsection L 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 U. 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 I) and a table that compares qualified transportation plans with health FSAs and DCAPs (see subsection M).

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<sup>5</sup> Rev. Proc. 2008-66, 2008-45 I.R.B. 1107 (setting inflation-adjusted rates for parking, vanpooling and transit passes for 2009); Rev. Proc. 2009-21, 2009-16 I.R.B. 860 (revising the vanpooling and transit pass limits for months beginning after February 17, 2009 and before January 1, 2011); Rev. Proc. 2009-50, 2009-45 I.R.B. 617 (setting rate for 2010). The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 (Feb. 17, 2009), amended Code § 132(f)(2) to make the monthly limit for transit passes and vanpooling the same as the monthly limit for parking beginning March 2009. This parity rule expires at the end of 2010. While it remains in effect, the combined vanpooling/transit pass limit will automatically adjust to remain identical to the parking limit. For these limits in other years, see the Table of Plan Limits behind Appendix Tab 11.

<sup>6</sup> Code § 132(f).

**San Francisco Ordinance Requires Offer of Transportation Benefits.** Generally, employers who are eligible to sponsor qualified transportation plans (see subsection B for a discussion of who can sponsor a qualified transportation plan) can choose whether or not to implement such a plan. However, air quality concerns (and possibly also concerns about congestion and the long-term price of gas) spurred the City of San Francisco in 2008 to go a step further and adopt an ordinance requiring employers to provide their San Francisco employees with at least one of the following benefits:

- the opportunity to pay transit or vanpooling expenses on a pre-tax basis under a qualified transportation plan consistent with Code § 132(f);
- employer-supplied transit passes or reimbursement for equivalent vanpool charges, up to the value of an adult San Francisco MUNI fast pass (\$55 in 2009); or
- free employer-provided transportation in a multi-passenger vehicle, such as a vanpool or bus.

Only employers with an average of at least 20 employees per week (including temps) are subject to the ordinance, but employees are counted whether they work in or outside San Francisco. Employees who must be offered the benefit are limited to persons who performed an average of at least 10 hours of service per week within San Francisco for the same employer in the previous month and who are subject to California's minimum wage law. Violation of the ordinance is an infraction that may trigger fines ranging from \$100 for the first infraction in a year, up to \$500 per infraction for the third and all subsequent infractions in a year.\*

\* S.F., Cal., Ordinance 199-08 (Aug. 22, 2008), available at <http://www.sfbos.org/ftp/uploadedfiles/bdsupvrs/ordinances08/o0199-08.pdf> (as visited Dec. 7, 2009).

## 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.<sup>7</sup> 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.<sup>8</sup>

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

<sup>7</sup> 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](http://www.fta.dot.gov/about/about_FTA_4645.html) (as visited Dec. 9, 2009).

<sup>8</sup> Treas. Reg. § 1.132-9, Q/A-10. This regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits. For details about how to identify the members of a controlled group in the context of a cafeteria plan, see *Cafeteria Plans* (Thomson Reuters/EBIA, 1991-present, updated quarterly).

## 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.<sup>9</sup> As used in the regulations, the term “employee” includes only common-law employees and other statutory employees, such as officers of corporations.<sup>10</sup>

### 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 (i.e., the period after the close of a coverage period during which reimbursement claims may still be submitted) 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.<sup>11</sup>

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 condition and de minimis fringe provisions in Code §§ 132(a)(3) and (a)(4), even though they don’t qualify under Code § 132(f).<sup>12</sup>

**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).<sup>\*</sup> 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.<sup>†</sup> 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)), which is much less than the Code § 132(f) combined limit for transit passes and vanpooling.<sup>‡</sup> 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).

<sup>9</sup> Code § 132(f)(1); Treas. Reg. § 1.132-1(b)(2)(i); and Treas. Reg. § 1.132-9, Q/A-5. This regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits.

<sup>10</sup> Treas. Reg. § 1.132-9, Q/A-5.

<sup>11</sup> Code § 132(f)(5)(E); see also IRS Notice 94-3, 1994-3 I.R.B. 14 and Treas. Reg. § 1.132-9, Q/As-5 and -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).

<sup>12</sup> Treas. Reg. § 1.132-9, Q/A-24(a). This regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits.

### 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.<sup>13</sup> 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 whom they lease to recipient employers.<sup>14</sup> See subsection H 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.

### 3. Can Employers Further Limit Participation?

The preceding subsection explains that only individuals who are currently employed can be provided benefits under a qualified transportation plan.<sup>14.1</sup> But are plans required to cover all current employees? If not, are there any restrictions on employers' ability to limit participation by plan design?

The regulations governing qualified transportation plans do not impose any restrictions on the ability of employers to limit the employees who will be able to participate in a qualified transportation plan. And there are no nondiscrimination rules for qualified transportation plans. As a result, employers have considerable discretion to determine which employees will be able to participate. For example, participation could be limited to employees working in a certain location, to full-time employees, to a group of employees that is disproportionately highly compensated, or even to employees selected on a discretionary, case-by-case basis.

#### a. When Participation Begins

Implicit in employers' discretion to determine which employees can participate in a qualified transportation plan is substantial freedom to determine when an employee who is eligible to participate actually becomes a participant. In a pre-tax compensation reduction plan (described in subsection K), actual participation (i.e., the right to obtain benefits or incur expenses that can be reimbursed by the plan) will be contingent upon an employee's election to have amounts taken from his or her compensation that are then available either to pay for qualified benefits or to reimburse the employee for qualified expenses.<sup>14.2</sup> But in a giveaway plan (described in subsection J), where the employer pays the entire benefit, the plan might not require any employee election to commence participation.

**Example: Commencement of Participation in a Pre-Tax Compensation Reduction Plan.** Ellen is hired in mid-March as a full-time employee of Great River Ltd. Under the Great River Transportation Plan, all transportation benefits are funded by pre-tax compensation reductions. The Plan states that an eligible employee does not become a Plan participant until the first day of the first calendar month for which the eligible employee has a compensation reduction election in effect. It also states that compensation reductions cannot begin until after the employee has completed six consecutive full months of service. As a full-time employee, Ellen is an eligible employee. Ellen can submit a completed compensation reduction election by the deadline in September and become a participant as early as October 1st. If she does not submit her first compensation reduction election until the December deadline, she can begin participating on the following January 1st.

<sup>13</sup> Code § 414(n)(3)(C); Treas. Reg. § 1.132-9, Q/A-10. This regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits.

<sup>14</sup> 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* (Thomson Reuters/EBIA, 1991-present, updated quarterly).

<sup>14.1</sup> Treas. Reg. § 1.132-9, Q/A-5.

<sup>14.2</sup> Coverage in a pre-tax compensation reduction plan may begin immediately after the initial election is made, or—more commonly—it may wait until the beginning of the next regular (usually monthly) coverage period. Treas. Reg. § 1.132-9, Q/A-14(e) (Example 3 describes an employee who makes an election on February 27th and incurs reimbursable expenses on February 28th).

**b. When Participation Ends**

Do employers have similar freedom to determine when participation ends? We know that former employees cannot participate, but the regulations do not specify when participation ends for an individual who is still an employee but becomes ineligible to participate (e.g., because the plan is limited to full-time employees and the employee's hours are reduced). Plans typically provide a run-out period during which employees or even former employees can obtain reimbursement for expenses that were incurred during participation. But can an employee who is no longer eligible to participate continue to receive benefits or incur reimbursable expenses based on amounts that were taken from his or her compensation during participation, or that were credited to his or her account during participation?

An employer that is providing transportation benefits under a giveaway plan will want to clarify in the plan documents exactly when an employee's participation ends. Nothing in the qualified transportation plan regulations prevents unused employer-paid benefits from being forfeited immediately when an employee loses eligibility to participate in the plan.

In the case of a compensation reduction plan, however, the ability to forfeit unused balances is less certain. While the regulations do not specifically provide for participation after compensation reductions are stopped (or some other event has occurred that would ordinarily make an employee ineligible), neither do the regulations specifically permit a forfeiture to the employer of compensation reduction amounts set aside by an individual who is still an employee.<sup>14.3</sup> As a result, pre-tax compensation reduction plans may want to allow a "spend-down" of accounts—both for employees who have discontinued compensation reductions and for employees who are no longer eligible to make compensation reductions and otherwise participate in the plan—so long as the spend-down does not occur after termination of employment.

**Example: Termination of Participation in a Pre-Tax Compensation Reduction Plan.**

Assume the same facts as in the preceding example, except that after participating in the Great River Transportation Plan for four years, Ellen ceases to be an eligible employee because she changes to part-time status. Because she overestimated her expenses, Ellen has an unused balance of \$450 to her credit under the Plan after reimbursement of all of the qualifying transportation expenses she incurred before becoming a part-time employee.

Ellen cannot make any additional pre-tax compensation reduction contributions because she is no longer an eligible employee. Ellen does not immediately cease to be a participant, however, because under the terms of the Plan, any employee of Great River with an outstanding Transportation Plan balance can incur qualifying expenses and be reimbursed for those expenses until the balance to the employee's credit under the Plan is exhausted or the employee terminates employment. Ellen will therefore remain a participant, and will be able to spend down her account balance, unless she terminates employment before incurring sufficient reimbursable expenses. According to the Plan, after her termination of employment, Ellen will have a limited time to request reimbursement for qualifying expenses incurred as a participant before her employment termination. Any balance remaining in Ellen's account after that run-out period ends will be forfeited.

<sup>14.3</sup> Even if such forfeitures are permissible, they may be hard to explain, discourage participation, and invite disputes.

The following table summarizes when participation will end in a variety of circumstances.

Event	When Participation Ends*
Participant in a giveaway plan remains an employee, but ceases to be the kind of employee who is ordinarily eligible for employer-provided benefits	Determined by plan design; typically immediate
Participant in a pre-tax compensation reduction plan remains an employee but ceases to be the kind of employee who is eligible to elect compensation reductions	Uncertain; cautious employers may prefer to delay until exhaustion of participant's unused compensation reduction amounts (or earlier termination of employment), but some plans end participation immediately
Participant ceases to be an employee	Determined by law; immediate upon termination of employment

\* Note, in any of these situations, the plan may offer a run-out period during which qualified expenses incurred or paid during participation may still be submitted for reimbursement.

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

Under Code § 132(f)(1), four types of benefits can be qualified transportation fringes:

- parking;
- transit passes;
- 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); and
- bicycle commuting expense reimbursements.

Employers should consider the unique characteristics of their location to 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 to get a feel for how their employees are commuting to work and what other options they would consider. For example, it would be pointless to include transit passes under a qualified transportation plan if mass transit is virtually nonexistent in a particular city.

After deciding which types of benefits should be offered, the employer will need to set the benefit amounts within certain statutory limits. Congress has limited the favorable tax treatment available by setting maximum limits for each type of benefit. Those limits are sometimes referred to as "exclusion amounts" because 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 2010 expenses, the statutory limits (i.e., the exclusion amounts) are:

- \$230 per month for parking;
- for transit passes and vanpooling combined, \$230 per month (i.e., the same as the limit for parking); and
- for bicycle commuting expense reimbursements, an amount per calendar year equal to the number of qualified bicycle commuting months during the calendar year times \$20 (up to a maximum of \$240 per calendar year).<sup>15</sup>

The limits for parking, transit and vanpooling (but not bicycle commuting) are subject to cost-of-living adjustments (if any) for future years, which are announced by the IRS before the beginning of each calendar year. Special issues that arise in connection with the administration of these limits are addressed in detail in subsection H.

**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.

<sup>15</sup> Rev. Proc. 2009-50, 2009-45 I.R.B. 617 (setting rate for 2010). The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 (Feb. 17, 2009) amended Code § 132(f)(2) to make the monthly limit for transit passes and vanpooling temporarily the same as the monthly limit for parking. This change is effective only through December 2010. For these limits in other years, see the Table of Plan Limits behind Appendix Tab 11.