

AN OVERVIEW OF PRE-TAX COMMUTER BENEFITS FROM 1998 to 2002

On June 9, 1998 President Clinton signed the Transportation Equity Act for the 21st Century (TEA-21). Section 9010 of TEA-21 modified the "qualified transportation fringe benefits" (QTFBs) under Internal Revenue Code (Code) §132(f)(4) so employees can use pre-tax salary to pay for their mass transit expenses when commuting to work. Pre-tax parking was enacted by the Taxpayer Relief Act of 1997; both laws were effective January 1, 1998.

Employees using pre-tax salary for commuting expenses create TAX-FREE savings of 27.65% or more by not paying FICA, state or federal income taxes. The higher their tax rate, the more they save. Employers save from 8% to 10% on their payroll costs by lowering their FICA match along with savings from FUTA and workers' compensation. The FICA limit for 2002 is \$89,400 (\$80,400 for 2001).

FUNDING THE BENEFITS

Commuter benefits may be paid by the: (1) employer; (2) employee; or (3) shared. Amounts exceeding the QTFB limits are taxed as ordinary income if paid by the employer.

MASS TRANSIT UP TO \$100 PER MONTH FOR 2002

For calendar years 1998-2001 employees were able to deduct up to \$65 per month from their salary (\$780 per year) on a pre-tax basis to cover transit and vanpool expenses. The limit increases to \$100 per month beginning January 1, 2002 and is indexed for inflation thereafter.

Mass transit includes: Trains, buses, subways, ferries and vanpools (see definition below).

Ineligible expenses: Bicycling, walking, roller blading, tolls, parking and carpools that do not meet the vanpool definition. Also, spouse's transit expenses may not be included; each employer must establish separate QTFBs.

- A vanpool or "commuter highway vehicle" must have a seating capacity of at least 6 adults (not including the driver) and at least 80% of the mileage must be used for transporting employees between their homes and places of employment. For these commuting trips, the number of employees transported must be at least one-half of the adult seating capacity of the vehicle, excluding the driver. Carpools that do not satisfy the vanpool definition noted above are not eligible for the Program.

- The term "transit pass" means any pass, token, farecard, voucher or similar item entitling a person to use mass transit (whether or not publicly owned) or provided by a person in the business of transporting persons in a vehicle meeting the commuter highway vehicle definition. That means transit passes can be used for commercial vehicles such as limousines, jitneys and vans meeting the vanpool definition.

PARKING UP TO \$185 PER MONTH FOR 2002

From 1998-2000, the benefit limit was \$175 per month for parking expenses at or near an employer's worksite or to a location from which employees commute to work by carpool, vanpool or mass transit. This limit is also indexed for inflation and was increased to \$180 per month for calendar year 2001 and \$185 for 2002.

Ineligible Expenses: Bridge tolls, gasoline, residence or spouse's parking expenses. General transportation allowances, not specific to a QTFB, would be taxed as ordinary income.

NOTES: (1) Sole proprietors, partnerships, 2% or more shareholders of S corporations, or owners of LLPs or LLCs may not participate in any pre-tax commuter benefits.

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However, such persons may be able to deduct travel costs as "business-related" expenses under Code section 162. (2) The amount to be reimbursed to an employee under an accountable plan is not subject to monthly limits like commuter benefits (e.g. employee uses personal vehicle to pick up supplies for employer each morning and is reimbursed for mileage).

IMPLEMENTING A COMMUTER BENEFITS PLAN (Plan)

Because the Plan is not subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), no plan document, summary plan description (SPD), nondiscrimination test or Form 5500 is required. However, if the Plan is to be successful, it must be communicated, be easy to use, be financially accountability to participants and managed prudently (same principles as ERISA).

Plan Design: Employers may offer one or both commuter benefit options. For employers that are "socially-minded" and want to promote mass transit, they can do so by not offering pre-tax parking. As a practical matter, mass transit is not available to all employees. Some employees must drive to a parking lot and then transfer to a bus or train. Thus, the majority of employers implement the parking benefit.

Communication: It is highly recommended that a summary be prepared covering: monthly limits, tax benefits, modifications, filing claims, reimbursement, etc.

NEW RULES FOR CALENDAR YEAR 2002

(1) WRITTEN ELECTIONS AND AUTOMATIC RENEWALS: For calendar year 2002 and thereafter, written and signed election agreements from employees is required. Final regulations specify that such elections may be in electronic format so long as it is maintained in a permanent and verifiable form. In addition, the election must specify the amount to be deducted and the time period. Elections can also be automatically renewed (or automatically accomplished by the employer on behalf of employees) if adequate notice is provided to employees and they have an opportunity to receive salary in lieu of the transportation benefit. [Reg §1.132-9\(b\)](#), [Q&A 12\(a\)](#) and [\(b\)](#) .

(2) ISSUING TRANSIT TICKETS IN ADVANCE OF EXPENSES: (a) The value of transit passes provided in advance to an employee for a month in which the individual is not an employee is included in the employee's wages for *income tax* purposes. [Reg §1.132-9\(b\)](#), [Q&A 9\(c\)\(1\)](#). (b) Whether transit passes provided in advance are excludable from wages for *employment tax purposes* (including FICA, FUTA, and income tax withholding) will depend in part on whether transit passes are distributed for more than three months. If the passes are distributed for no more than three months, *and no employment termination date is established for an employee when he first received the passes*, then the value of the passes will not be subject to employment taxes even if the employee is no longer an employee for one or all of the months for which the passes relate. But if the passes are distributed for more than three months, then the value of the passes for the months during which the employee is not employed by the employer will be includable in wages for employment tax purposes (regardless of whether an employment termination date was established when the passes were distributed). [Reg §1.132-9\(b\)](#), [Q&A 9\(c\)\(2\)](#).

(3) CARRY-OVER RULE: Commuter benefits are not subject to the "use-it or lose-it" rule like flexible spending accounts. At each employer's discretion, the Plan can allow unclaimed contributions to be carried forward for future monthly expenses, including the next plan year. However, monthly reimbursements can never exceed the federal limits for mass transit or parking expenses. [Reg §1.132-9\(b\)](#), [Q&A 15](#).

At TAI, we have many ways to handle employee expenses, including "smart" card technology, which eliminates the entire claim process for employees (also works with our section 125 FSA administration). For more information about a pre-tax commuter plan for your company, contact us via email or call us toll-free at the number below.

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