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Tax Treatment of Transit Passes and Qualified Parking Provided by Smartcards

In IRS Information Letter 2010-0146, the IRS provides an overview of the tax treatment of employer-provided transportation benefits and then answers specific questions about transit passes and qualified parking, which are the two types of qualified transportation fringes employers frequently provide through the use of smartcards.

Practice Pointer. Note that the IRS uses Information Letters to explain basic principles of tax law. The letters do not address specific fact patterns; they are advisory only and have no binding effect.

Background

Employers that provide their employees with transportation benefits can exclude those benefits from their employees' gross incomes if the benefits are "qualified transportation fringes" [Code Sec. 132(a)(5)]. An employer may provide both transit passes and qualified parking on a tax-favored

basis to an employee in a given month, as long as each benefit separately meets the requirements described below.

Transit Passes

A "transit pass" is any pass, token, farecard, voucher or similar item (including an item exchangeable for fare media) that entitles a person to transportation on mass transit facilities [Code Sec. 132(f)(5)(A)]. Transportation benefits employers provide through smartcards, debit or credit cards, or other electronic media are considered "transit passes" only if the fare media value stored on the cards is useable only as fare media for a mass transit system and the amount allocated to the cards each month does not exceed the maximum amount that may be excluded from gross income and wages. In 2010, an employer is entitled to exclude up to \$230 per month of such benefits from an employee's gross income and wages. Substantiation of the

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use of these transit passes is not a requirement for receiving the tax-favored treatment [Reg. §1.132-9, Q&A 18-19]. Therefore, employers may credit up to \$230 in transit pass benefits to their employees' smartcards each month on a tax-free basis without requiring the employees to show how they use the transit benefits.

Qualified Parking

"Qualified parking" is parking that is located on or near the employer's business premises or on or near a location from which the employee commutes to work *via* mass transit or commuter highway vehicle [Code Sec. 132(f)(5)(C)]. In 2010, an employer is entitled to exclude up to \$230 per month of such benefits from an employee's gross income and wages. Employers may provide parking benefits only by reimbursing their employees for "qualified parking" expenses that they in fact incurred. Rather than reimbursing their employees in actual cash, some employers may choose to make "cash" reimbursements by crediting the reimbursed amounts onto employees' smartcards. Employers that make cash reimbursements must establish a "bona fide reimbursement arrangement" that is reasonably calculated to ensure that the employee in fact incurred expenses in an amount equal to the reimbursement [Reg. §1.132-9, Q&A 16(c)]. Common characteristics of such arrangements include requirements that employees provide employers with receipts or other records substantiating the parking costs that they incurred.

Salary Reduction and Salary Supplement Arrangements

Employers may provide employees with transit passes or parking benefits either (1) in addition to employees' stated compensation (salary supplement), or (2) by reducing employees' stated compensation (salary reduction). In a salary supplement arrangement, an employer offers to fund the cost of a qualified transportation fringe benefit over and above the amount the employer pays to the employee in salary. In a salary reduction arrangement, the employee is allowed to designate a portion of the amount he would otherwise receive as salary to be set aside to fund qualified transportation fringe benefits that he then receives from the employer. The amount of the salary supplement or salary reduction is excluded from the employee's income and wages if the salary supplement or salary reduction is used exclusively to fund qualified transportation fringes.

Rollover Allowed

Employers may "roll over" excess salary reduction amounts. That is, when an employee elects to reduce her compensation for a month by an amount that exceeds the transportation expenses that she receives either in the form of transit passes or as reimbursements for qualified parking expenses actually incurred for that month, the employer may apply this excess toward qualified transportation fringes in subsequent months, as long as the employee does not receive an amount in excess of the maximum excludible amount in any month [Reg. §1.132-9,

Q&A 15]. For example, if an employee elects a monthly salary reduction of \$200 to be used to reimburse qualified parking expenses, and the employee incurs only \$150 in qualified parking expenses for that month, the \$50 in salary reduction that exceeds the expenses can be rolled over and made available to reimburse parking expenses incurred in a future month. The employer may not provide a refund of the amount by which the employee's salary reduction amounts exceed the actual qualified transportation fringes provided to the employee by the employer [Reg. §1.132-9, Q&A 14].

Can the Combination of Rolled Over Funds Plus New Month Funds Exceed Current Monthly Limits?

The IRS provides that the sum of rolled over credits that an employee has accumulated on a smartcard from a prior month plus new month funds that are credited to the employee's smartcard in the current month may exceed the maximum monthly excludible amount. Because the regulations do not require employers to distribute transit passes pursuant to *bona fide* reimbursement arrangements, it is possible for the value of the transit passes that employees receive to exceed

the actual costs that they incur for transportation on mass transit facilities. Therefore, the sum of any excess transit passes that an employee accumulates from prior months and transit passes that an employer makes available in the current month may exceed the monthly limit. The IRS points out that because the regulations do not permit employers to provide employees with parking benefits that exceed parking costs that the employees actually incur, there can be no roll over of these funds.

Are Transit and Parking Benefits for the Exclusive Use by the Employee Between Home and Work Travel?

The regulations state that an employer may provide transit passes only to those individuals who are "currently employees of the employer at the time the qualified transportation fringe is provided" [Reg. §1.132-9, Q&A 18]. The IRS explains that the regulations do not prohibit employers from independently requiring employees to certify, for example, that they used such transit passes only in connection with their own commutes from their residences to their workplaces [Reg. §1.132-9, Q&A 19].

Like transit passes, an employer may provide quali-

fied parking only to those individuals who are "currently employees of the employer at the time the qualified transportation fringe is provided." However, unlike transit passes, parking benefits may be used only by the employees themselves, and only in connection with their commutes to their places of employment. Reg. §1.132-9, Q&A 19 limits the exclusion to parking provided to an employee by an employer "[o]n or near the employer's business premises," or "[a]t a location from which the employee commutes to work." The regulations also require employers who provide parking benefits to establish *bona fide* substantiation arrangements, under which employers verify that the employees have incurred the costs themselves in connection with their travel between home and work [Reg. §1.132-9, Q&A 16(c)].

May Employers Require Unused Transit Passes from a Salary Supplement Arrangement to Be Refunded?

The IRS provides that the nothing in either the Code or Regulations prohibits an employer that provides its employees with transit passes as salary supplements from requiring employees to return unused transit passes. ■