

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Transportation Fringe Benefits

REG-113572-99

AGENCY: Internal Revenue Service

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to qualified transportation fringe benefits. These proposed regulations reflect changes to the law made by the Energy Policy Act of 1992, the Taxpayer Relief Act of 1997, and the Transportation Equity Act for the 21st Century. These proposed regulations affect employers that offer qualified transportation fringes and employees who receive these benefits. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by April 26, 2000. Outlines of topics to be discussed at the public hearing scheduled for June 1, 2000 at 10 a.m. must be received by May 10, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-113572-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-113572-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/reglist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, John Richards of the Office of Associate Chief Counsel (Employee

Benefits and Exempt Organizations), (202) 622-6040; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by March 27, 2000. Comments are specifically requested concerning: Whether the proposed collections of information are necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility; The accuracy of the estimated burden associated with the proposed collections of information (see below); How the quality, utility, and clarity of the information to be collected may be enhanced; How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this proposed regulation are in 26 CFR 1.132-9(b). This information is required by the Internal Revenue Service to implement section 132(f). This information will be used to verify compliance with section 132(f). Section 132(f)(3) provides that qualified transportation fringes can include cash reimbursement for qualified trans-

portation fringes. The proposed regulations require that employers keep records of substantiation provided by employees in order to receive cash reimbursement for qualified transportation fringes. Section 132(f)(4) provides that an employee may choose between cash compensation and any qualified transportation fringe. The proposed regulations require that employers keep records, in a verifiable form, such as written or electronic, of employee elections to reduce compensation. The value of qualified transportation fringes provided for a month exceeding the applicable statutory monthly limit must be reported on the employee's Form W-2. The burden for this requirement is reflected in the burden for Form W-2. The likely recordkeepers are employers. The likely respondents are employees.

Estimated total annual recordkeeping burden: 7,020,000 hours.

Estimated average annual recordkeeping burden per recordkeeper: The average annual recordkeeping burden will vary depending on the size of the employer. The estimated average annual recordkeeping burden per recordkeeper is 26.5 hours.

Estimated number of recordkeepers: 265,343

Estimated total annual reporting burden: 5,948,728 hours

Estimated average annual reporting burden per respondent: .8 hours.

Estimated number of respondents: 7,264,970

Estimated annual frequency of responses: Monthly.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains a proposed amendment to the Income Tax Regulations (26 CFR part 1) under section

132(f). Congress amended section 132 as part of the Energy Policy Act of 1992, Public Law No. 102-486, section 1911 (106 Stat. 3012), effective after December 31, 1992. This provision excludes from gross income the value of any qualified transportation fringe provided by an employer to an employee to the extent it does not exceed the applicable statutory monthly limit.

This 1992 amendment to section 132 resulted in three changes to the tax treatment of employer-provided transportation benefits. First, Congress added an exclusion for transportation provided by an employer to an employee in a commuter highway vehicle. Second, mass transit passes provided by an employer to an employee became excludable as a qualified transportation fringe and not as a de minimis fringe. The exclusions for transportation provided by an employer to an employee in a commuter highway vehicle and mass transit passes were made subject to an aggregate \$60 per month limit (adjusted for cost of living). Third, Congress eliminated the working condition fringe for commuter parking, imposed a \$150 per month limit (adjusted for cost of living) for the exclusion for qualified parking, and provided that employer-provided parking is excludable from gross income only as a qualified transportation fringe. The 1992 amendment provided that qualified transportation fringes could not be provided in lieu of salary.

Section 1072 of the Taxpayer Relief Act of 1997 (TRA '97), Pub. L. No. 105-34 (111 Stat. 948), amended section 132(f), effective for tax years beginning after December 31, 1997, to permit qualified parking to be provided to employees in lieu of salary. Section 9010 of the Transportation Equity Act for the 21st Century (TEA 21), Pub. L. No. 105-178 (112 Stat. 507), amended section 132(f) to increase the monthly dollar limits to \$65 for transportation in a commuter highway vehicle and mass transit passes¹ and \$175 for qualified parking and to provide that, effective after December 31, 1997, any qualified transportation fringe may be provided to employees in lieu of salary.

¹ The dollar limit for transportation in a commuter highway vehicle and transit passes was further increased to \$100 effective January 1, 2002.

Explanation of Provisions

This document contains proposed regulations under section 132. The proposed regulations provide guidance, in question and answer form, to employers that provide qualified transportation fringes to employees. Qualified transportation fringes consist of transportation in a commuter highway vehicle, any transit pass, and qualified parking provided by an employer to an employee.

Notice 94-3, 1994-1 C.B. 327, provided guidance on qualified transportation fringes in the form of questions and answers. The proposed regulations reflect statutory changes in section 132(f) since 1994, including the revised monthly dollar limits and the use of bona fide salary reduction arrangements, as permitted under TRA '97 and TEA 21, and generally conform with the guidance in Notice 94-3. In response to public comments, the proposed regulations also provided additional guidance concerning the standards for determining when the section 132(f) exclusion applies to cash reimbursement of transit pass expenses.

Section 132(f) limits the value of qualified transportation fringes that may be excluded from an employee's gross income. The proposed regulations explain that there are two categories of qualified transportation fringes for purposes of determining the amount that is excludable from gross income. The first category is transportation in a commuter highway vehicle and transit passes. The second category is qualified parking. There is a statutory monthly limit on the value of the benefits from each category that is excludable from gross income. For 1999 and 2000, the statutory monthly limit is \$65 for transportation in a commuter highway vehicle and mass transit passes and \$175 for qualified parking. An employee may receive benefits from each category provided the applicable statutory monthly limit for that category is not exceeded. The amount by which the value of qualified transportation fringes provided by an employer to an employee exceeds the applicable statutory monthly limit is included in the employee's wages for income and employment tax purposes.

The proposed regulations provide that, for purposes of valuing qualified parking, the valuation rules under section

1.61-21(b) generally apply. With respect to employer-provided van pool benefits, the regulations provide that an employer may use the special valuation rules provided under section 1.61-21(c), (d), (e), and (f) in valuing these benefits. An example in the proposed regulations illustrates that in determining the value of a transit pass sold at a discount for purposes of section 132(f), the purchase price rather than the face amount of the transit pass controls.

The proposed regulations reflect that qualified transportation fringes include cash reimbursement by an employer to an employee for expenses incurred by the employee for transportation in a commuter highway vehicle and qualified parking. Section 132(f)(3) provides that qualified transportation fringes include cash reimbursement for a transit pass only if a voucher or similar item that is exchangeable for a transit pass is not readily available for direct distribution by the employer to the employee. In defining "readily available," the regulations reflect the general standards set forth in Notice 94-3, under which an amount is readily available if an employer can obtain it on terms no less favorable than those available to an individual employee and without incurring a significant administrative cost.

In addition, the proposed regulations clarify the meaning of "significant administrative costs." The proposed regulations provide that the determination of whether obtaining a voucher would result in a significant administrative cost is made with respect to each transit system voucher. A transit system voucher is a voucher that is accepted by one or more mass transit operators (e.g., train, subway, and bus) in an area as fare media (or in exchange for fare media). The proposed regulations provide a safe harbor under which administrative costs are treated as significant if the average monthly administrative costs incurred by the employer for a voucher (disregarding delivery charges imposed by the fare media provider to the extent not in excess of \$15 per order) are more than 1 percent of the average monthly value of the vouchers for a system. These standards are intended to provide clear guidance so that employers can determine when qualified transportation fringes include cash reimbursement for transit passes.

The proposed regulations provide that

reimbursements may be made only pursuant to a bona fide reimbursement arrangement. Thus, an employee must provide substantiation that an expense has been incurred for qualified transportation fringes in order to receive a reimbursement. The regulations recognize that the substantiation requirements vary depending upon the payment method used to purchase transportation in a commuter highway vehicle, mass transit passes, and qualified parking. The regulations provide examples of what constitutes reasonable reimbursement procedures in certain circumstances. For example, if an employee uses metered parking, the substantiation requirement may be satisfied if the employee certifies that the expense was incurred and the employer has no reason to believe the employee did not actually incur the expense.

The proposed regulations provide that there are no substantiation requirements

with respect to mass transit passes provided directly by an employer to its employees. Of course, an employer may impose its own substantiation requirements in addition to those required under the regulations.

The proposed regulations follow the approach taken in Notice 94-3 with respect to taxing the value of employer-provided parking benefits provided to members of car and van pools. The regulations provide that the "prime member" bears the tax consequences with respect to the parking space.² The prime member is the employee to whom the parking space is assigned.

The proposed regulations reflect that qualified transportation fringes may be provided under a compensation reduction arrangement which permits an employee to make a compensation reduction election. A compensation reduction election is an election in which the employee chooses between a fixed amount of compensation to be received at a specified future date and a fixed amount of qualified transportation fringes to be provided with respect to a specified future period (such as a calendar month). The proposed regulations provide

² Other pool members may choose to reimburse the costs of the prime member, in which event, under Rev. Rul. 55-555, 1955-2 C.B. 20, the reimbursements will not be includible in the prime member's gross income. See also Rev. Rul. 80-99, 1980-1 C.B. 10.

that the compensation reduction election for any month in a year may not exceed the aggregate statutory monthly maximum for that year (e.g., \$240 for 1999 and 2000 (\$65 plus \$175)). The election must be made before the employee is able currently to receive the taxable compensation. Under the proposed regulations, the determination of whether the employee is able currently to receive the taxable compensation does not depend on whether the compensation has been constructively received for purposes of section 451.

The proposed regulations require that an election be irrevocable after the beginning of the period for which the qualified transportation fringes will be provided. However, unused amounts can be carried over to any subsequent months, including months in subsequent years, but cannot be used for any purpose other than qualified transportation fringes under section 132(f).

The proposed regulations provide that the exclusion for qualified transportation fringes applies only to employees. Partners, 2-percent S-corporation shareholders, and independent contractors are not considered to be employees for purposes of qualified transportation fringes. However, amounts may be excludable pursuant to the working condition fringe rules and the de minimis fringe rules that apply to partners, 2-percent S-corporation shareholders, and independent contractors under section 132(d) and (e).

The proposed regulations provide that qualified transportation fringes not exceeding the applicable statutory monthly limit are not subject to employment taxes. However, qualified transportation fringes exceeding the applicable statutory monthly limit are includible in the employee's wages for income and employment tax purposes. If the value of non-cash qualified transportation fringes provided to an employee exceeds the applicable statutory monthly limit, the employer may follow the reporting and withholding guidelines provided in Announcement 85-113, 1985-31 I.R.B. 31. Announcement 85-113 provides that employers may elect, for purposes of the FICA, the FUTA, and federal income tax withholding, to treat noncash fringe benefits as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually. An-

ouncement 85-113 also provides a special accounting rule for noncash fringes provided during the last two months of a calendar year.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

An Initial Regulatory Flexibility Analysis has been prepared as required for the collection of information in this notice of proposed rulemaking under 5 U.S.C. § 603. The analysis follows:

Initial Regulatory Flexibility Analysis

This proposed rule may have an impact on small organizations that provide qualified transportation fringes in the form of cash reimbursement or that offer qualified transportation fringes in lieu of salary. Section 132(f)(3) provides that qualified transportation fringes may be provided in the form of cash reimbursement. The legislative history indicates that cash reimbursements must be made pursuant to a bona fide reimbursement arrangement. Thus, this proposed rule provides that employers must receive substantiation from employees as a condition to providing cash reimbursement for qualified transportation fringes. Section 132(f)(4) provides that an employee may choose between cash compensation and qualified transportation fringes. This proposed rule provides that employers must keep records with respect to employee compensation reduction elections. Thus, the requirements under this proposed rule create a collection of information requirement for employers.

The objectives of this proposed rule with respect to employee substantiation of qualified transportation fringes is to carry out the legislative intent that cash reimbursement be provided by an employer only under a bona fide reimbursement arrangement. The objective of the record-keeping requirement with respect to employee compensation reduction elections is to ensure against recharacterization of taxable compensation after it has been paid to an employee. The legal basis for this proposed rule is section 132(f)(3) and (4).

All classes of employers will likely

offer qualified transportation fringes and therefore will be affected by this proposed rule. Approximately 265,000 small entities may be affected by this proposed rule. There are no professional skills necessary for the recordkeeping required under this proposed rule.

The IRS is not aware of any other relevant federal rules which may duplicate, overlap, or conflict with this proposed rule.

A less burdensome alternative for small organizations would be to exempt those entities from the recordkeeping requirements under this proposed rule. However, it would be inconsistent with the statutory provisions and the legislative history to exempt those entities from the recordkeeping requirements imposed under this rule. This proposed rule provides several options which avoid more burdensome recordkeeping requirements for small entities. This proposed rule provides that (1) there are no substantiation requirements if the employer distributes transit passes in kind; (2) a compensation reduction election can be made electronically; (3) an election to reduce compensation can be automatically renewed; and (4) an employer can provide for deemed compensation reduction elections under its qualified transportation fringe benefit plan.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand, and on the administrability of the rules in the proposed regulations. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 1, 2000, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security pro-

cedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601 (a) (3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by May 10, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is John Richards, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.132-0 is amended by adding entries for §1.132-9 to read as follows:

§1.132-0 Outline of regulations under section 132.

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§1.132-9(a) Table of Contents.

§1.132-9(b) Questions and Answers.

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Par. 3 Section 1.132-9 is added to

read as follows:

§1.132-9 Qualified Transportation Fringes.

(a) *Table of Contents.* This section contains a list of the questions and answers in §1.132-9.

Q-1. What is a qualified transportation fringe?

Q-2. What is transportation in a commuter highway vehicle?

Q-3. What are transit passes?

Q-4. What is qualified parking?

Q-5. To which workers may qualified transportation fringes be provided?

Q-6. Must a qualified transportation fringe benefit plan be in writing?

Q-7. Is there a limit on the value of qualified transportation fringes that may be excluded from an employee's gross income?

Q-8. What amount is includible in an employee's wages for income and employment tax purposes if the value of the qualified transportation fringe exceeds the applicable statutory monthly limit?

Q-9. Are excludable qualified transportation fringes calculated on a monthly basis?

Q-10. May an employee receive qualified transportation fringes from more than one employer?

Q-11. May qualified transportation fringes be provided to employees pursuant to a compensation reduction agreement?

Q-12. What is a compensation reduction election for purposes of section 132(f)?

Q-13. Is there a limit to the amount of the compensation reduction?

Q-14. When must the employee have made a compensation reduction election and under what circumstances can the amount be paid in cash to the employee?

Q-15. May an employee whose qualified transportation fringe costs are less than the employee's compensation reduction carry over this excess amount to subsequent periods?

Q-16. How does section 132(f) apply to expense reimbursements?

Q-17. May an employer provide nontaxable cash reimbursement under section 132(f) for periods longer than one month?

Q-18. What are the substantiation requirements if an employer distributes transit passes?

Q-19. May an employer choose to impose substantiation requirements in addition to those described in this regulation?

Q-20. How is the value of parking determined?

Q-21. How do the qualified transportation fringe rules apply to van pools?

Q-22. What are the reporting and employment tax requirements for qualified transportation fringes?

Q-23. How does section 132(f) interact with other fringe benefit rules?

Q-24. May qualified transportation fringes be provided to individuals who are partners, 2-percent shareholders of S-corporations, or independent contractors?

(b) Questions and Answers.

Q-1. What is a qualified transportation fringe?

A-1. (a) The following benefits are “qualified transportation fringe” benefits:

(1) Transportation in a commuter highway vehicle.

(2) Transit passes.

(3) Qualified parking.

(b) An employer may simultaneously provide an employee with any one or more of these three benefits.

Q-2. What is transportation in a commuter highway vehicle?

A-2. Transportation in a commuter highway vehicle is transportation provided by an employer to an employee in connection with travel between the employee’s residence and place of employment. A “commuter highway vehicle” is a highway vehicle with a seating capacity of at least 6 adults (excluding the driver) and with respect to which at least 80 percent of the vehicle’s mileage is reasonably expected to be—

(a) For transporting employees in connection with travel between their residences and their place of employment; and

(b) On trips during which the number of employees transported for commuting is at least one-half of the adult seating capacity of the vehicle (excluding the driver).

Q-3. What are transit passes?

A-3. 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—

(a) On mass transit facilities (whether or not publicly owned); or

(b) Provided by any person in the business of transporting persons for compensation or hire in a highway vehicle with a

seating capacity of at least six adults (excluding the driver).

Q-4. What is qualified parking?

A-4. (a) “Qualified parking” is parking provided to an employee by an employer—

(1) On or near the employer’s business premises; or

(2) At a location from which the employee commutes to work by carpool, commuter highway vehicle, mass transit facilities, transportation provided by any person in the business of transporting persons for compensation or hire or by any other means.

(b) However, parking on or near property used by the employee for residential purposes is not qualified parking.

(c) Parking is provided by an employer if—

(1) The employer pays for the parking;

(2) The employer reimburses the employee for parking expenses; or

(3) The parking is on property that the employer owns or leases. See Q/A-16 of this section for rules relating to cash reimbursements.

Q-5. To which workers may qualified transportation fringes be provided?

A-5. Qualified transportation fringes may be provided only by employers to employees. The term “employee” for purposes of qualified transportation fringes is defined in §1.132-1(b)(2)(i). This term includes only common law employees and other statutory employees, such as officers of corporations. See Q/A-24 of this section for rules regarding partners, 2-percent shareholders, and independent contractors.

Q-6. Must a qualified transportation fringe benefit plan be in writing?

A-6. No. Section 132(f) does not require that a qualified transportation fringe benefit plan be in writing.

Q-7. Is there a limit on the value of qualified transportation fringes that may be excluded from an employee’s gross income?

A-7. (a) *Transportation in a commuter highway vehicle and transit passes.* Before January 1, 2002, up to \$65 is excludable from the gross income of an employee for transportation in a commuter highway vehicle and transit passes provided by an employer for a month. On January 1, 2002, this amount is increased to \$100 per month.

(b) *Parking.* Up to \$175 is excludable from the gross income of an employee for qualified parking in a month.

(c) *Combination.* An employer may provide qualified parking benefits in addition to transportation in a commuter highway vehicle and transit passes.

(d) *Cost-of-living adjustments.* The amounts in paragraphs (a) and (b) of this Q/A-7 are adjusted annually, beginning with 2000, to reflect cost-of-living. The adjusted figures are announced by the Service before the beginning of the year.

Q-8. What amount is includible in an employee’s wages for income and employment tax purposes if the value of the qualified transportation fringe exceeds the applicable statutory monthly limit?

A-8. Generally, an employee must include in gross income the amount by which the fair market value of the benefit exceeds the sum of the amount, if any, paid by the employee and any amount excluded from gross income under section 132(a)(5). Thus, assuming no other statutory exclusion applies, if an employer provides an employee with a qualified transportation fringe that exceeds the applicable statutory monthly limit and the employee does not make any payment, the value of the benefits provided in excess of the applicable statutory monthly limit is included in the employee’s wages for income and employment tax purposes. See § 1.61-21(b)(1). The following examples illustrate the principles of this Q/A-8:

Example 1. (i) For each month in 2000, Employer M provides a transit pass valued at \$75 to Employee D, who does not pay any amount to Employer M for the transit pass.

(ii) In this example, because the value of the monthly transit pass exceeds the statutory monthly limit by \$10, \$120 (\$75 - \$65, times 12 months) must be included in D’s wages for income and employment tax purposes for 2000 with respect to the transit passes.

Example 2. (i) For each month in 2000, Employer M provides qualified parking valued at \$195 to Employee E, who does not pay any amount to M for the parking.

(ii) In this example, because the fair market value of the qualified parking exceeds the statutory monthly limit by \$20, \$240 (\$195 - \$175, times 12 months) must be included in Employee E’s wages for income and employment tax purposes for 2000 with respect to the qualified parking.

Example 3. (i) For each month in 2000, Employer P provides qualified parking with a fair market value of \$220 per month to its employees, but charges each employee \$45 per month.

(ii) In this example, because the sum of the amount paid by an employee (\$45) plus the amount

excludable for qualified parking (\$175) is not less than the fair market value of the monthly benefit, no amount is includible in the employee's wages for income and employment tax purposes with respect to the qualified parking.

Q-9. Are excludable qualified transportation fringes calculated on a monthly basis?

A-9. Yes. The value of transportation in a commuter highway vehicle, transit passes, and qualified parking is calculated on a monthly basis to determine whether the value of the benefit has exceeded the applicable statutory monthly limit on qualified transportation fringes. Except in the case of a transit pass, the applicable statutory monthly limit applies to qualified transportation fringes used by the employee in a month. In the case of a transit pass, the applicable statutory monthly limit applies to the transit passes provided by the employer to the employee in a month for that month or for any previous month in the calendar year. Monthly exclusion amounts are not combined to provide a qualified transportation fringe in any month exceeding the statutory limit. A "month" is a calendar month or a substantially equivalent period applied consistently. The following examples illustrate the principles of this Q/A-9:

Example 1. (i) Employee E incurs \$150 for qualified parking used during the month of June, 2000, for which E is reimbursed \$150 by Employer R. E incurs \$180 in expenses for qualified parking used during the month of July, 2000, for which E is reimbursed \$180 by R.

(ii) In this example, because monthly exclusion amounts may not be combined to provide a benefit in any month greater than the applicable statutory limit, the amount by which the amount reimbursed for July exceeds the applicable statutory monthly limit (\$180 minus \$175 equals \$5) is includible in E's wages for income and employment tax purposes.

Example 2. (i). Employee F receives transit passes from Employer G with a value of \$195 in the month of March (when the applicable statutory monthly limit is \$65). F was hired during January and has not received any transit passes from G.

(ii). In this example, the value of the transit passes (three months times \$65 equals \$195) is excludable from F's wages for income and employment tax purposes. However, if F was not hired until March, only \$65 would be excludable from F's wages for income and employment tax purposes.

Example 3. (i). Each month during 2000, Employer R distributes transit passes with a face amount of \$70 to each of its employees. Transit passes with a face amount of \$70 can be purchased from the transit system by any individual for \$65.

(ii). In this example, because the value of the transit passes distributed by R does not exceed the applicable statutory monthly limit (\$65), no portion of the transit passes is included as wages for income and employment tax purposes.

Q-10. May an employee receive qualified transportation fringes from more than one employer?

A-10. Yes. The statutory monthly limits described in Q/A-7 of this section apply to benefits provided by an employer to its employees. For this purpose, all employees treated as employed by a single employer under section 414(b), (c), (m), or (o) are treated as employed by a single employer. See § 1.132-1(c). Thus, qualified transportation fringes paid by entities under common control under section 414(b), (c), (m), or (o) are combined for purposes of applying the applicable statutory limit. In addition, an individual who is treated as an employee of the employer under section 414(n) is treated as an employee of the employer for purposes of section 132. See § 414(t). The following examples illustrate the principles of this Q/A-10:

Example 1. (i) During 2000, Employee E works for Employers M and N, who are unrelated and not treated as a single employer under section 414(b), (c), (m), or (o). Each month, M and N each provide qualified parking benefits to E with a value of \$100.

(ii) In this example, because M and N are unrelated employers, and the value of the monthly parking benefit provided by each is not more than the applicable statutory monthly limit, the parking benefits provided by each employer are excludable as qualified transportation fringes assuming that the other requirements of this section are satisfied.

Example 2. (i) Same facts as in Example 1, except that M and N are treated as a single employer under section 414(b).

(ii) In this example, because M and N are treated as a single employer, the value of the monthly parking benefit provided by M and N must be combined for purposes of determining whether the applicable statutory monthly limit has been exceeded. Thus, the amount by which the value of the parking benefit exceeds the monthly limit (\$200 minus \$175 equals \$25) for each month in 2000 is includible in E's wages for income and employment tax purposes.

Q-11. May qualified transportation fringes be provided to employees pursuant to a compensation reduction agreement?

A-11. Yes. An employer may offer employees a choice between cash compensation and any qualified transportation fringe. An employee who is offered this choice and who elects qualified transportation fringes is not required to include the cash compensation in income if—

(a) The election is pursuant to an arrangement described in Q/A-12 of this section; (b) The amount of the reduction in cash compensation does not exceed the limitation in Q/A-13 of this section;

(c) The arrangement satisfies the timing and reimbursement rules in Q/A-14 and 16 of this section; and

(d) The related fringe benefit arrangement otherwise satisfies the requirements set forth elsewhere in this section.

Q-12. What is a compensation reduction election for purposes of section 132(f)?

A-12. (a) *Election requirements generally.* A compensation reduction arrangement is an arrangement under which the employer provides the employee with the right to elect whether the employee will receive either a fixed amount of cash compensation at a specified future date or a fixed amount of qualified transportation fringes to be provided for a specified future period (such as qualified parking to be used during a future calendar month). The employee's election must be in writing or another form, such as electronic, that includes, in a permanent and verifiable form, the information required to be in the election. The election must contain the date of the election, the amount of the compensation to be reduced, and the period for which the benefit will be provided. The election must relate to a fixed dollar amount or fixed percentage of compensation reduction. An election to reduce compensation for a period by a set amount for such period may be automatically renewed for subsequent periods.

(b) *Negative election permitted.* An employer may provide under its qualified transportation fringe benefit plan that a compensation reduction election will be deemed to have been made if the employee does not elect to receive cash compensation in lieu of the qualified transportation fringe provided that the employee receives adequate notice that a compensation reduction will be made and is given adequate opportunity to choose to receive the cash compensation instead of the qualified transportation fringe.

Q-13. Is there a limit to the amount of the compensation reduction?

A-13. Yes. Each month, the amount of the compensation reduction may not exceed the combined applicable statutory monthly limits for transportation in a commuter highway vehicle, transit passes, and qualified parking. For example, for 2000, an employee could elect to reduce compensation for any month by no

more than \$240 (\$65 for transportation in a commuter highway vehicle and transit passes, plus \$175 for qualified parking) with respect to qualified transportation fringes. If an employee were to elect to reduce compensation by \$250 for a month, the excess \$10 (\$250 minus \$240) would be includible in the employee's wages for income and employment tax purposes.

Q-14. When must the employee have made a compensation reduction election and under what circumstances can the amount be paid in cash to the employee?

A-14. The compensation reduction election must satisfy the following requirements.

(a) *Timing of election.* The compensation reduction election must be made before the employee is able currently to receive the cash or other taxable amount at the employee's discretion. The determination of whether the employee is able currently to receive the cash does not depend on whether it has been constructively received for purposes of section 451. The election must specify that the period (such as a calendar month) for which the qualified transportation fringe will be provided must not begin before the election is made. For this purpose, the date a qualified transportation fringe is provided is—

(1) The date the employee receives a voucher or similar item; or

(2) In any other case, the date the employee uses the qualified transportation fringe.

(b) Thus, a compensation reduction election must relate to qualified transportation fringes to be provided after the election.

(c) *Revocability of elections.* The employee may not revoke a compensation reduction election after the employee is able currently to receive the cash or other taxable amount at the employee's discretion. In addition, the election may not be revoked after the beginning of the period for which the qualified transportation fringe will be provided.

(d) *Compensation reduction amounts not refundable.* Unless an election is revoked in a manner consistent with paragraph (c) of this Q/A-14, an employee may not subsequently receive the compensation (in cash or any form other

than by payment of a qualified transportation fringe under the employer's plan). Thus, an employer's qualified transportation fringe benefit plan may not provide that an employee who ceases to participate in the employer's qualified transportation fringe benefit plan is entitled to receive a refund of the amounts by which the employee's compensation reduction exceeds the actual qualified transportation fringes provided to the employee by the employer.

(e) *Examples.* The following examples illustrate the principles of this Q/A-14:

Example 1. (i) Employer P maintains a qualified transportation fringe benefit arrangement. Employees of P are paid twice per month, with the payroll dates being the first and the fifteenth day of the month. Under P's arrangement, an employee is permitted to elect at any time before the first day of a month to reduce his or her compensation payable during that month in an amount up to the applicable statutory monthly limit (i.e., for 2000, \$65 if the employee elects coverage for transportation in a commuter highway vehicle or a mass transit pass, or \$175 if the employee chooses qualified parking) in return for the right to receive qualified transportation fringes up to the amount of the election. If such an election is made, P will provide a mass transit pass for that month with a value not exceeding the compensation reduction amount elected by the employee or will reimburse the cost of other qualified transportation fringes used by the employee on or after the first day of that month up to the compensation reduction amount elected by the employee. Any compensation reduction amount elected by the employee for the month that is not used for qualified transportation fringes is not refunded to the employee at any future date.

(ii) In this example, the arrangement satisfies the requirements of this Q/A-14 because the election is made before the employee is able currently to receive the cash and the election specifies the future period for which the qualified transportation fringes will be provided. The arrangement would also satisfy the requirements of this Q/A-14 and Q/A-13 of this section if employees were allowed to elect to reduce compensation up to \$240 (for 2000) per month.

(iii) The arrangement would also satisfy the requirements of this Q/A-14 (and Q/A-13 of this section) if employees were allowed to make an election at any time before the first or the fifteenth day of the month to reduce their compensation payable on that payroll date by an amount not in excess of one-half of the applicable statutory monthly limit (depending on the type of qualified transportation fringe elected by the employee) and P provides a mass transit pass on or after the applicable payroll date for the compensation reduction amount elected by the employee for the payroll date or reimburses the cost of other qualified transportation fringes used by the employee on or after the payroll date up to the compensation reduction amount elected by the employee for that payroll date.

Example 2. (i) Employee Q elects to reduce his compensation payable on March 1 of a year (when the statutory monthly limit for transportation in a

commuter highway vehicle and transit passes is \$65) by \$195 in exchange for a mass transit voucher to be provided in March. The election is made on the preceding February 27. Employee Q was hired in January of the year. On March 10 of the year, the employer of Employee Q delivers to Employee Q a mass transit voucher worth \$195.

(ii) In this example, \$130 is included in Employee Q's wages for income and employment tax purposes because the compensation reduction election fails to satisfy the requirement in this Q/A-14 and Q/A-12 of this section that the election relate to qualified transportation fringes to be provided for a future period to the extent the election relates to \$65 worth of transit passes for each of January and February of the year. No amount would be included in Employee Q's wages as a result of the election if \$195 worth of mass transit passes were instead delivered to Employee Q in May of the year (because the compensation reduction would relate solely to fringes to be provided for a future period and the amount provided does not exceed the aggregate limit for the period, i.e., the sum of \$65 for each of March, April, and May)

Q-15. May an employee whose qualified transportation fringe costs are less than the employee's compensation reduction carry over this excess amount to subsequent periods?

A-15. Yes. An employee may carry over unused compensation reduction amounts to subsequent periods under the plan of the employee's employer. The following example illustrates the principles of this Q/A-15:

Example. (i) By an election made before November 1, 1999, Employee E elects to reduce compensation in the amount of \$65 for the month of November, 1999. E incurs \$50 in employee-operated commuter highway vehicle expenses during November for which E is reimbursed \$50 by Employer R. By an election made before December 1, 1999, E elects to reduce compensation by \$65 for the month of December. E incurs \$65 in employee-operated commuter highway vehicle expenses during December for which E is reimbursed \$65 by R. Before January 1, 2000, E elects to reduce compensation by \$50 for the month of January. E incurs \$65 in employee-operated commuter highway vehicle expenses during January for which E is reimbursed \$65 by R because R allows E to carry over to January, 2000, the \$15 amount by which the compensation reductions for November and December exceeded the employee-operated commuter highway vehicle expenses incurred during those months.

(ii) In this example, because E is reimbursed in an amount not exceeding the applicable statutory monthly limit, and the reimbursement does not exceed the amount of employee-operated commuter highway vehicle expenses incurred during the month of January, the amount reimbursed (\$65) is excludable from E's wages for income and employment tax purposes.

Q-16. How does section 132(f) apply to expense reimbursements?

A-16. (a) *In general.* The term "qualified transportation fringe" includes

cash reimbursement by an employer to an employee for expenses incurred or paid by an employee for transportation in a commuter highway vehicle or qualified parking. The reimbursement must be made under a bona fide reimbursement arrangement which meets the rules of paragraph (d) of this Q/A-16. The term “cash reimbursement” does not include cash advances.

(b) *Special rule for transit passes.* The term “qualified transportation fringe” includes cash reimbursement for transit passes made under a bona fide reimbursement arrangement, but, in accordance with section 132(f)(3), only if no voucher or similar item that may be exchanged only for a transit pass is readily available for direct distribution by the employer to employees. For this purpose, a voucher or similar item is “readily available” if an employer can obtain it—

(1) On terms no less favorable than those available to an individual employee; and

(2) Without incurring a significant administrative cost.

(c) *Significant administrative cost.* Administrative costs relate only to fees paid to fare media providers. The determination of whether obtaining a voucher would result in a significant administrative cost is made with respect to each transit system voucher. A transit system voucher is a voucher that is accepted by one or more mass transit operators (e.g., train, subway, and bus) in an area as fare media (or in exchange for fare media). Administrative costs are treated as significant if the average monthly administrative costs incurred by the employer for a voucher (disregarding delivery charges imposed by the fare media provider to the extent not in excess of \$15 per order) are more than 1 percent of the average monthly value of the vouchers for a system. Thus, whether a voucher is readily available without incurring a significant administrative cost is determined with respect to the transit system in each area for which the voucher may be used. The following example illustrates the principles of this Q/A-16:

Example. (i) Company C in City X sells mass transit vouchers to employers in the metropolitan area of X worth \$65 each. Several different bus, rail, van pool, and ferry operators service X, and a number of the operators accept the vouchers either as fare media or in exchange for fare media. Em-

ployers can readily obtain vouchers for distribution to their employees. To cover its operating expenses, C imposes on each voucher a 50 cents charge, plus a \$15 charge for delivery. Employer M disburses vouchers purchased from C to its employees who use operators that accept the vouchers.

(ii) In this example, because the cost of a voucher disbursed to M’s employees is not more than 1 percent of the value of the voucher (50 cents divided by \$65 equals 0.77 percent) and the delivery charges are disregarded because they are not more than \$15, vouchers for X are readily available. Thus, the vouchers disbursed to M’s employees are qualified transportation fringes and any reimbursement of mass transportation costs in X would not be a qualified transportation fringe.

(d) *Substantiation requirements.* Employers that make cash reimbursements must establish a bona fide reimbursement arrangement to establish that their employees have, in fact, incurred expenses for transportation in a commuter highway vehicle, transit passes, or qualified parking. For purposes of section 132(f), what constitutes a bona fide reimbursement arrangement may vary depending on the facts and circumstances, including the method or methods of payment utilized within the mass transit system. The employer must implement reasonable procedures to ensure that an amount equal to the reimbursement was incurred for transportation in a commuter highway vehicle, transit passes, or qualified parking. The following are examples of reasonable reimbursement procedures for purposes of this Q/A-16:

(1) An employee presents to the employer a parking expense receipt for parking on or near the employer’s business premises and certifies that the parking was used by the employee and the employer has no reason to doubt the employee’s certification.

(2) An employee submits a used transit pass to the employer at the end of the month and certifies both that he or she purchased it, and that he or she used it during the month, or presents a transit pass to the employer at the beginning of the month and certifies that it will be used during the month. In both cases, the employer has no reason to doubt the employee’s certification.

(3) If a receipt is not provided in the ordinary course of business (e.g., if the employee uses metered parking or if used transit passes cannot be returned to the user), the employee certifies to the employer the type and the amount of expenses incurred and the employer has no reason to

doubt the employee’s certification.

Q-17. May an employer provide nontaxable cash reimbursement under section 132(f) for periods longer than one month?

A-17. Yes. Qualified transportation fringes include reimbursement to employees for costs incurred for transportation in more than one month, provided the reimbursement for each month is calculated separately and does not exceed the applicable statutory monthly limit for any month. See Q/A-8 and 9 of this section if the limit for a month is exceeded. The following example illustrates the principles of this Q/A-17:

Example. (i) Employee R pays \$100 per month for qualified parking used during the period from April 1, 2000 through June 30, 2000. After receiving adequate substantiation from R, R’s employer reimburses R \$300 in cash on June 30, 2000.

(ii) In this example, because the value of the reimbursed expenses for each month did not exceed the applicable statutory monthly limit, the \$300 reimbursement is excludable from R’s wages for income and employment tax purposes as a qualified transportation fringe.

Q-18. What are the substantiation requirements if an employer distributes transit passes?

A-18. There are no substantiation requirements if the employer distributes transit passes. Thus, an employer may distribute a transit pass for each month with a value not more than the statutory monthly limit without requiring any certification from the employee regarding the use of the transit pass.

Q-19. May an employer choose to impose substantiation requirements in addition to those described in this regulation?

A-19. Yes.

Q-20. How is the value of parking determined?

A-20. Section 1.61–21(b)(2) applies for purposes of determining the value of parking.

Q-21. How do the qualified transportation fringe rules apply to van pools?

A-21. (a) *Van pools generally.* Employer- and employee-operated van pools, as well as private or public transit-operated van pools, may qualify as qualified transportation fringes. The value of van pool benefits which are qualified transportation fringes may be excluded up to the applicable statutory monthly limit for transportation in a commuter highway vehicle and transit passes, less the value of

any transit passes provided by the employer for the month.

(b) *Employer-operated van pools.* The value of van pool transportation provided by or for an employer to its employees is excludable as a qualified transportation fringe, provided the van qualifies as a “commuter highway vehicle” as defined in section 132(f)(5)(B) and Q/A-2 of this section. A van pool is operated by or for the employer if the employer purchases or leases vans to enable employees to commute together or the employer contracts with and pays a third party to provide the vans and some or all of the costs of operating the vans, including maintenance, liability insurance and other operating expenses.

(c) *Employee-operated van pools.* Cash reimbursement by an employer to employees for expenses incurred for transportation in a van pool operated by employees independent of their employer are excludable as qualified transportation fringes provided that the van qualifies as a “commuter highway vehicle” as defined in section 132(f)(5)(B) and Q/A-2 of this section. See Q/A-16 of this section for the rules governing cash reimbursements.

(d) *Private or public transit-operated van pool transit passes.* The qualified transportation fringe exclusion for transit passes is available for travel in van pools owned and operated either by public transit authorities or by any person in the business of transporting persons for compensation or hire. In accordance with paragraph (b) of Q/A-3 of this section, the van must seat at least six adults (excluding the driver). See Q/A-16(b) and (c) of this section for a special rule for cash reimbursement for transit passes.

(e) *Value of van pool transportation benefits.* Section 1.61-21(b)(2) provides that the fair market value of a fringe benefit is based on all the facts and circumstances. Alternatively, transportation in an employer-provided commuter highway vehicle may be valued under the automobile lease valuation rule in § 1.61-21(d), the vehicle cents-per-mile rule in § 1.61-21(e), or the commuting valuation rule in § 1.61-21(f). If one of these special valuation rules is used, the employer must use the same valuation rule to value the use of the commuter highway vehicle by each employee who share the use. See § 1.61-21(c).

(f) *Qualified parking prime member.*

If an employee obtains a qualified parking space as a result of membership in a car or van pool, the applicable statutory monthly limit for qualified parking applies to the individual to whom the parking space is assigned. This individual is the “prime member.” In determining the tax consequences to the prime member, the statutory monthly limit amounts of each car pool member may not be combined. If the employer provides access to the space and the space is not assigned to a particular individual, then the employer must designate one of its employees as the prime member who will bear the tax consequences. The employer may not designate more than one prime member for a car or van pool during a month. The employer of the prime member is responsible for including the value of the qualified parking in excess of the statutory monthly limit in the prime member’s wages for income and employment tax purposes.

Q-22. What are the reporting and employment tax requirements for qualified transportation fringes?

A-22. (a) *Employment tax treatment generally.* Qualified transportation fringes not exceeding the applicable statutory monthly limit described in Q/A-7 of this section are not wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding. Any amount by which an employee elects to reduce compensation as provided in Q/A-11 of this section is not subject to the FICA, the FUTA, and federal income tax withholding. Qualified transportation fringes exceeding the applicable statutory monthly limit described in Q/A-7 of this section are wages for purposes of the FICA, the FUTA, and federal income tax withholding and are reported on the employee’s Form W-2, Wage and Tax Statement.

(b) *Employment tax treatment of cash reimbursement exceeding monthly limits.* Cash reimbursement to employees (for example, cash reimbursement for qualified parking) in excess of the applicable statutory monthly limit under section 132(f) are treated as paid for employment tax purposes when actually or constructively paid. See §§ 31.3121(a)-2(a), 31.3301-4, 31.3402(a)-1(b) of this chapter. Employers must report and deposit the amounts withheld in addition to re-

porting and depositing other employment taxes. See Q/A-16 of this section for rules governing cash reimbursements.

(c) *Noncash fringe benefits exceeding monthly limits.* If the value of non-cash qualified transportation fringes exceeds the applicable statutory monthly limit, the employer may elect, for purposes of the FICA, the FUTA, and federal income tax withholding, to treat the non-cash taxable fringe benefits as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually.

Q-23. How does section 132(f) interact with other fringe benefit rules?

A-23. For purposes of section 132, the terms “working condition fringe” and “de minimis fringe” do not include any qualified transportation fringe under section 132(f). If, however, an employer provides local transportation other than transit passes, the value of the benefit may be excludable, either totally or partially, under fringe benefit rules other than the qualified transportation fringe rules under section 132(f). See §§ 1.132-6(d)(2)(i) (occasional local transportation fare), 1.132-6(d)(2)(iii) (transportation provided under unusual circumstances), and 1.61-21(k) (valuation of local transportation provided to qualified employees).

Q-24. May qualified transportation fringes be provided to individuals who are partners, 2-percent shareholders of S corporations, or independent contractors?

A-24. (a) *General rule.* Section 132(f)(5)(E) states that self-employed individuals who are employees within the meaning of section 401(c)(1) are not employees for purposes of section 132(f). Therefore, individuals who are partners, sole proprietors, or other independent contractors are not employees for purposes of section 132(f). In addition, under section 1372(a), 2-percent shareholders of S corporations are treated as partners for fringe benefit purposes. Thus, an individual who is both a 2-percent shareholder of an S corporation and a common law employee of that S corporation is not considered an employee for purposes of section 132(f). However, while section 132(f) does not apply to individuals who are partners, 2-percent shareholders of S corporations, or independent contractors, other exclusions for

working condition and de minimis fringes may be available as described in paragraphs (b) and (c) of this Q/A-24. See §§ 1.132-1(b)(2) and 1.132-1(b)(4).

(b) *Transit passes.* The working condition and de minimis fringe exclusions under section 132(a)(3) and (4) are available for transit passes provided to individuals who are partners, 2-percent shareholders, and independent contractors. For example, tokens or farecards provided by a partnership to an individual who is a partner that enable the partner to commute on a public transit system (not including privately-operated van pools) are excludable from the partner's gross income if the value of the tokens and farecards in any month does not exceed the dollar amount specified in § 1.132-6(d)(1). However, if the value of a pass provided in a month exceeds the dollar amount specified in § 1.132-6(d)(1), the full value of the benefit provided (not merely the amount in excess of the dollar amount specified in § 1.132-6(d)(1)) is includible in gross income.

(c) *Parking.* The working condition fringe rules under section 132(d) do not apply to commuter parking. See § 1.132-5(a)(1). However, the de minimis fringe rules under section 132(e) are available for parking provided to individuals who are partners, 2-percent shareholders, or independent contractors that qualifies under the de minimis rules. See § 1.132-6(a) and (b). The following example illustrates the principles of this Q/A-24:

Example. (i) Individual G is a partner in partnership P. Individual G commutes to and from G's office every day and parks free of charge in P's lot.

(ii) In this example, the value of the parking is not excluded under section 132(f), but may be excluded under section 132(e) if the parking is a de minimis fringe under § 1.132-6.

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