Great News! Now commuters have a real choice about how to get to work. Recent changes to the Internal Revenue Code make it easier for all employers, including the Federal government, to offer public transportation benefits to their employees. U.S. employers spend $36 billion annually on employee parking.[1] It is the most common commute benefit offered to employees and the most common fringe benefit of any kind. Nearly all those eligible for free parking drive to work alone and that is the problem.

Driving to work alone contributes more air pollution, wastes energy and causes traffic congestion. These are some of the hidden costs that do not figure into the "free parking" equation. This country's tremendous investment in public transportation is not being fully used and that is a luxury that America cannot afford. To get more cars off the roads and commuters into efficient travel arrangements, the cost of commuting on public transportation is a "tax-free" employment benefit.

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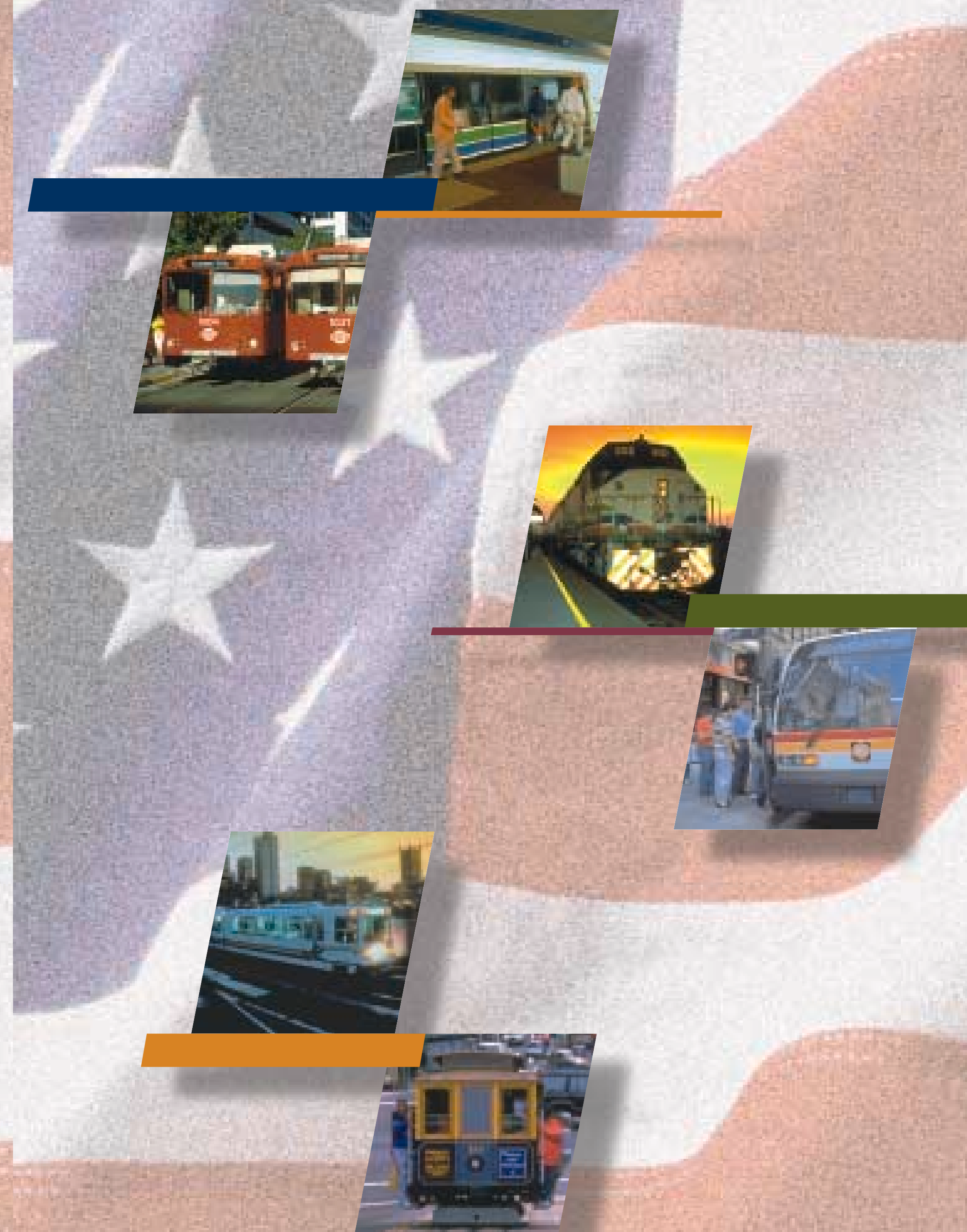
FEDERAL AGENCY OPTIONS



Commuter Choice

America's Way to Work

Commuter Choice=Tax Free

The Commuter Choice Benefit

It's called *Commuter Choice* because it gives employees an attractive alternative to driving to work alone – a real choice. Presently, a Federal agency may give up to $65 a month or up to $780 a year, in actual eligible transportation costs *tax-free* to an employee. The maximum *tax-free* benefit may increase each year based on increases in the cost of living. The Internal Revenue Service* will announce any annual increase in the eligible *tax-free* amount. In 2002, the maximum tax-free benefit allowed will automatically increase to cover actual costs up to $100 per month or up to $1,200 per year. *Commuter Choice* may be used on public transit buses, trains, ferries and vanpools.

Not every agency can afford to pay for the full transportation benefit so the *Commuter Choice* has built-in flexibility. Take a look at the options.

A Program for Every Budget

Employer-Paid Benefit Option

Increasingly, Federal employers, as a matter of good public policy, are offering the full transit benefit to employees. Some agencies do so to reward workers for their contributions and accomplishments. Others see it as an investment. When agencies offer the benefit, it boosts employee morale and that can translate into more satisfied customers. When agencies pick up the tab for their employees, the *Commuter Choice* transit benefit is equivalent to a low cost salary or wage enhancement. If the same amount were to be given as a pay increase, it would cost your agency more in FICA and Federal retirement system contributions. That's not all. Your employees would pay more in income taxes.

The chart below shows how the public transportation benefit stacks up against a cash salary increase. Actual savings and tax avoidance will vary based on the employee's income tax bracket and actual Federal and state income tax rates:

Federal Agency costs	Transportation Benefit	Salary Increase	Difference
Annual Benefit Amount	**$780.00**	**$780.00**	**-0-**
Employee FICA Paid @7.65%	-0-	($59.67)	($59.67)
Fed Income Taxes Paid @ 28%	-0-	($234.00)	($234.00)
State Income Tax Paid @ 6%	-0-	($46.80)	($46.80)
Value to Employee	**+$780.00**	**+$439.53**	**-$340.47**

You do the math. If your employees were to receive an equivalent cash salary raise of $780 per year instead of the tax-free transit benefit, they would actually end up paying for it, reducing the value of the benefit by more than 50%. It would take almost $1,300 in taxable salary to yield $780 after taxes. As an employer, you would avoid the costs of the matching FICA. You also gain the upper hand attracting and retaining employees in a competitive labor market. When you consider the overall value to your employees, it may cost you more not to provide *Commuter Choice.*

The Federal Employees Clean Air Incentives Act, Public Law 103-172, permits Federal agencies to encourage their employees to commute to work by means other than single occupancy vehicles. It permits the head of each agency to establish programs that provide, among other things, transit passes or vouchers to employees.

Although Congress did not specifically appropriate funds for this program, agencies may use existing appropriated funds from their employee benefits accounts to provide transit passes or vouchers to employees. Reference to this can be found in OMB Circular A-11, Object class 12, Personnel benefits, *Other allowances and payments,* which allows for "subsidies for commuting costs, that is payments to subsidize the costs of Federal civilian employees in commuting by public transportation." A comparable provision exists for military personnel in the same object class.

Employee-Paid Pre-tax Benefit Option

Okay. You are just learning about *Commuter Choice* and your budget is already set for the year. You cannot cover the cost of the benefit this year. You may be asking yourself if there is a way to broker this opportunity for your employees. You bet there is! Consider the Employee-Paid Pre-tax Benefit program.

By establishing a pre-tax deduction program, you permit your employees to use part of their existing gross income to pay their eligible transit or vanpool costs. Even though your employees pay for the benefit, they save Federal payroll and income taxes. The amount of the pre-tax deduction is no longer treated or reported as taxable salary. In many areas, this deduction may also be free of state or city income tax. The money withheld from the employee's salary is used by the agency to purchase vouchers or passes which are then distributed to the participating employees.

This special transportation pre-tax benefit program is exempt from complex use restrictions common to cafeteria plans and flexible spending accounts (FSA). These "qualified transportation fringe benefits" are excluded from cafeteria plans under Section 125 of the Internal Revenue Code (Title 26). A pre-tax program can be started any time of the year, or enrollment can be limited to certain times of the year.

The Office of Personnel Management, in a decision letter dated August 11, 1998, stated that an employee's decision to receive a transportation fringe benefit on a pre-tax basis will not affect the employee's basic rate of pay for purposes of overtime, lump sum annual leave, and calculating an employee's retirement annuity.

Fare Share Benefit Option

The third option is for the agency and the employee to share the costs. That's why this approach is called the *Fare Share Commuter Choice* Benefit. The agency could subsidize a part of the $65 benefit and allow your employees the option to fund the balance from pre-tax income. The agency's contribution will be in addition to salary or wages. Agencies purchase the passes or vouchers, using the contributions from agency funds and employee salaries, and distribute them to the employees. Whatever the amount of the contribution, agencies will still save on payroll taxes.

The best way for your employees to stretch the value of the amount they are paying, is to arrange for the funds to be taken out of their paychecks before taxes are applied, as a pre-tax benefit. For example, an agency could provide any member who elects to participate in the program a transit pass worth $35 in addition to his/her regular salary. The employees could use pre-tax income that is exchanged for an agency provided pass for $30, for a total monthly benefit of $65. Employees save on Federal payroll and income taxes on the $30 and the agency saves on payroll taxes on the $30.

Cash Reimbursement Restrictions

Cash Reimbursement for transit expenses is permitted in very limited circumstances. These tax incentives are intended to boost transit ridership, so cash reimbursement for commuting expense is discouraged. In fact, the only time an agency can reimburse employees for cash outlay for transit is in areas where vouchers or bus/rail passes, tokens, farecards, tickets, etc. are not "readily available" to be exchanged for transit or vanpool services. See IRS rules governing section 132(f) benefits for a definition of "readily available." In most cases, the agency must provide vouchers or bus/rail passes, tokens, farecards, tickets, etc., instead of cash reimbursement.

For purposes of illustration, if the employee commutes on Transit Agency A and the transit agency only accepts cash payments, cash reimbursement up to the $65 limit would be permitted. The reimbursement may be made from appropriated funds or pre-tax employee salaries, or a combination of both.

What s Covered?

Buses, Trains, Ferries and . . .

Vanpools. Also referred to as "Commuter Highway Vehicles" under IRS rules, vanpools are defined as any highway vehicle that has seating capacity of at least six adults excluding the driver and meets two requirements for mileage use. At least 80 percent of the vehicle mileage use must be reasonably expected to be (1) for transporting employees in connection with travel between their residences and their place of employment, and (2) on trips during which the number of employees transported for commuting is, on average, at least one-half of the adult seating capacity excluding the driver.

The designated employee "prime member" (often the driver or the person assigned the parking space) who travels in a vanpool and uses commercial parking is eligible for the parking benefit (up to $175 per month). At the same time, the prime member is eligible to receive the vanpool benefit (up to $65 per month). All other employees commuting in a vanpool who are not the "prime member" are only eligible for the vanpool benefit and not the parking benefit. Only one person can receive the parking benefit.

The Parking Connection

Those who have to drive to make a connection to public transportation may be eligible for the parking connection benefit. In recent years, residential growth and expansion has occurred away from the downtown urban areas, making it difficult to rely solely on mass transit. Commuter Choice makes it possible for commuters to enjoy tax-free incentives for driving when the automobile is a part of the commute trip and mass transit is used for the remainder of the trip.

For instance, the eligible parking benefit may be up to $175 per month to pay for parking at a location from which employees commute by public transportation, such as a park-and-ride lot, transit station or facility, or vanpool staging area. Agencies can pay for the benefit using appropriated funds. Your employees will receive the benefit completely free of all Federal payroll and income taxes up to the $175 limit.

Eligible parking costs may be provided as a direct benefit, a pre-tax deduction, or as a shared expense. The same tax savings, reduced payroll costs and program flexibility apply to eligible parking expenses.

2 + 2 = More

The Bottom Line

Commuter Choice makes sense. It is a great way to provide employees with a cost-effective, value-added benefit. The changes in the Internal Revenue Code allow your agency the greatest flexibility to create a program that works for you and your employees. Remember, satisfied employees means satisfied customers.

Commuter Choice . . . It works for business. It works for the government. It works for the economy. It works for the environment. It works for the country.

So what are you waiting for? Contact your local transit provider today to find out how you can take full advantage of the *tax-free Commuter Choice* transportation benefit. These options can provide real savings to your agency and your employees.

Commuter Choice
America's Way to Work

[1]KPMG Peat Marwick Study

**The information presented here does not constitute official tax guidance or a ruling by the United States Government. Taxpayers are urged to consult with the Internal Revenue Service of the U.S. Department of the Treasury or a tax professional for specific guidance on any matters related to Federal tax law.*