U.S. Department of Transportation
Federal Transit Administration
400 Seventh Street, SW
Washington, DC 20590
(202) 366-1698 Fax: (202) 366-7116
www.fta.dot.gov

UNION INFORMATION

Commuter Choice
America's Way to Work

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 companies 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. It means that the majority of Americans who commute drive to work *alone* and that is the problem.

Driving to work alone contributes more air pollution, wastes energy and causes traffic congestion. It is also a luxury that many Americans cannot afford. For many workers and would-be workers, public transportation is the vital link. Vice President Gore summed it up quite accurately, "if you can't get to work, you can't go to work."

Whether it is the worker who is driving alone or the would-be worker who can't afford to drive, this country's tremendous investment in public transportation is not being fully used. Now, there are financial incentives to get more cars off the roads and more commuters into efficient travel arrangements. The cost of commuting by mass transit is a **"*tax-free*"** employment benefit.

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, an employer may give up to $65 a month or up to $780 a year, in actual eligible transportation costs *tax-free* to an employee. Participating employers lower their FICA and Federal income tax costs. In many areas, state and city income taxes are reduced as well. The maximum *tax-free* benefit may increase each year based on increases in the cost of living. The Internal Revenue Service (IRS) 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 employer 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, employers by agreement with their unions or as a matter of company policy, are offering the full transit benefit to employees. When employers pay for the benefit, it boosts employee satisfaction and that can translate into more satisfied customers. The *Commuter Choice* transit benefit is equivalent to a low cost salary or wage enhancement because for tax purposes, the benefit is not counted as income for the employee and the employer is not required to pay FICA taxes on the benefit.

The chart below shows how the *Commuter Choice* 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 state income tax rates:

Private Employer 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**

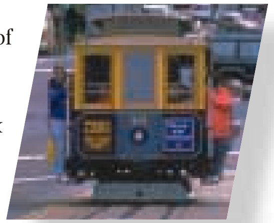
If employees were to receive an equivalent cash salary raise of $780 per year instead of the *tax-free* transit benefit, they would actually end up paying for it, reducing the value of the benefit by more than 50%. It would take almost $1,300 in taxable salary to yield $780 after taxes.

Employee-Paid Pre-tax Benefit Option

Under this option, since the employer does not pay for the *Commuter Choice* benefit, the union may ask the employer to implement the Employee-Paid Pre-tax Benefit program outside of the normal negotiation cycle. By establishing a pre-tax deduction plan, the company permits employees to exchange part of their existing gross income for an employer-provided transit or vanpool pass. Since bargaining employees fund 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.

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). The company will not have to write a plan document or obtain IRS approval. So there is less paperwork. There are no irrevocable elections or forms. A pre-tax program can be started any time of the year, or enrollment can be limited to certain times of the year.

While there is a great deal of flexibility in creating a pre-tax transit benefit program, it is advisable to consult with tax counsel to determine how your program may affect ceiling or cap limitations on employee-directed tax deferred retirement accounts, such as 401(k) plans.



Fare Share Benefit Option

The third option is for the employer and employee to share the costs. That's why this approach is called the *Fare Share* option. The employer could subsidize a part of the $65 benefit and allow your employees the option to pay the balance from pre-tax income. The employer's contribution will be in addition to salary or wages. Employers purchase the passes and vouchers, using the contributions from employer funds and employee salaries, and then distribute them to the employees.

The best way for 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 employer could provide any employee 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 a pass for $30, for a total monthly benefit of $65. The company receives an equivalent deduction from business income taxes for the $35 expense, while employees save on Federal payroll and income taxes on the $30. The company would also save 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, an employer can only reimburse employees for cash outlay for transit 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 employer 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 agency only accepts cash payments, cash reimbursement up to the $65 limit would be permitted. The reimbursement may be made from corporate 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. Employers can pay for the benefit and receive an equivalent deduction from business income taxes. Your members will receive the benefit completely free of all Federal payroll and income taxes up to the $175 limit.

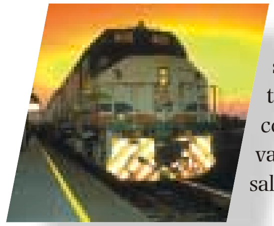
Eligible parking costs may be provided as a direct benefit, a pre-tax deduction, or as a shared expense. The same tax savings, reduced payroll costs and program flexibility apply to eligible parking expenses.

But We Provide Parking

Cash out and Convert

Many employers provide free or subsidized parking for employees, making it more economical for the employee to commute by automobile. The goal of *Commuter Choice* is to make it as economical for employees to use mass transit. If the employer only provides parking and employees want to take advantage of public transportation and other alternatives, a parking *"cash out"* program may be the appropriate choice. Here, employees may forego parking and cash out the value of the parking benefit. The value of the parking benefit will be subject to taxes. However, if up to $65 of the value is converted to *Commuter Choice* transit or eligible vanpool benefits, the amount converted will not be subject to taxes.

There is no real cost to employers, if they are leasing parking spaces for employees. They may simply transfer the cost for the parking space to a direct payment to employees. Should an employee decide to accept the cash value rather than a tax-free Commuter Choice transit or vanpool benefit, the amount is treated as additional compensation and s/he also would incur payroll and income taxes. If the cash out value is greater than $65, employees could accept a tax-free Commuter Choice transit or vanpool benefit and receive the balance in taxable salary. The employer will have to pay payroll taxes on the taxable portion of the cash out benefit provided. To offset that cost, the employer could simply lower the cash out amount by his or her share of the payroll taxes as follows:



Cost of Parking Space	**$150**
Payroll Taxes	**(12)**
Cash out Offer	**$138**

The employee could apply the additional compensation towards costs associated with commuting modes that are not considered qualified transportation fringe benefits, such as walking, bicycling, carpooling, or rollerblading to work.

Cash out provides an incentive for employees to try other commuting alternatives. The tax status of employees who continue receiving the parking benefit would not be affected.

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 companies the greatest flexibility to create programs that work for employees.

Commuter Choice . . . It works for workers. 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 the employees you represent.

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.*