Note: This document contains information on qualified commuter tax benefits only. The entire document, "Tax Fringe Benefit Guide" is available at http://www.irs.gov/pub/irs-tege/fringe_benefit_fslg.pdf.

Taxable Fringe Benefit Guide

FEDERAL, STATE, AND LOCAL GOVERNMENTS
THE INTERNAL REVENUE SERVICE

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Introduction

The Taxable Fringe Benefits Guide was created by the Internal Revenue Service office of Federal, State and Local Governments (FSLG) to provide governmental entities with a basic understanding of the tax issues related to employee fringe benefits and reporting under the Internal Revenue Code, regulations, and procedures.

Used as a supplement to other IRS publications, the Fringe Benefit Guide can be helpful tool for anyone responsible for determining the taxability, withholding, and reporting requirements regarding employee fringe benefits.

This publication covers:

- Which fringe benefits commonly provided by employers are taxable and which taxes must be withheld from employees' payroll,
- General procedures for computing the taxable value for those fringe benefits discussed,
- Reporting the taxable value on Forms W-2 and 1099-MISC,
- Additional federal reporting requirements that are in effect for certain fringe benefits, and
- Procedures for obtaining answers from the Internal Revenue Service to questions throughout the year regarding taxation and reporting requirements.

NOTICE

This guide is intended to provide basic information on the subjects covered. It reflects the interpretation by the IRS of tax laws, regulations, and court decisions. The explanations in the guide are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. Additional research may be required before a determination may be made on a particular issue. Citations to legal authority are included in the text. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.

What Is a Fringe Benefit?

A fringe benefit is a form of pay for the performance of services (including property, services, cash or cash equivalent) in addition to stated play. This definition applies to services of employees and independent contractors; however, unless otherwise indicated, this guide applies to fringe benefits provided by an employer to an employee. (For a discussion of whether a worker is an employee or independent contractor, see Publication 15-A.) Fringe benefits for employees are taxable wages unless specifically excluded by a section of the Internal Revenue Code (IRC). (IRC § 61 IRC § 3121, 3401) IRC § 61(a)(1)

The IRC may provide that fringe benefits are nontaxable, partially taxable, or tax-deferred.

Taxable – Includible in gross income unless excluded under an IRC section. If the recipient is an employee, this amount is includible as a wage. Bonuses are always taxable because no IRC section excludes them from taxation.

Nontaxable – Excluded from wages by a specific IRC section; for example, qualified health plan benefits excludable under section 105.

Partially taxable - Part is excluded by IRC section and part is taxable. Benefits may be excludable up to dollar limits, such as public transportation subsidy or parking under IRC §132.

Deferred taxation – Employer's contributions to an employee's pension plan may not be taxable when made, but retirement distributions may be taxed when made to the employee. *IRC §402(a)*

More than one IRC section may apply to the same benefit. For example, education expenses up to $5,250 may be excluded from tax under IRC §127. Amounts exceeding $5,250 may be excluded from tax under IRC §132.

A benefit provided on behalf of an employee is taxable to an employee even if the benefit is received to someone other than the employee, such as a spouse or a child. (Reg. § 1.61-21(a)(4))

"Taxable" means the benefit is included in the employees' wages and reported on Form W-2, subject to Federal income tax withholding, social security, (unless the employee has already reached the current year wage base limit) and Medicare. An employer's matching contribution is required for social security and Medicare.

If an employee's wages are not normally subject to social security or Medicare taxes (for example, because qualifying retirement coverage is provided by another retirement system), any taxable fringe benefits would also not be subject to social security or Medicare taxes.

QUALIFIED TRANSPORTATION FRINGE BENEFITS

Qualified Transportation Fringe Benefits (QTF)

This chapter discusses rules that apply to benefits an employer provides to his/her employees for the employee's *personal* transportation, such as commuting to and from work. *IRC § 132(f)(1); Reg. § 1.132-9(b)*

Qualified Transportation Fringe (QTF) benefits include:

- Commuter transportation in a commuter highway vehicle
- Transit passes
- Qualified parking

Employer-provided QTFs with fair market values (FMV) that do not exceed monthly excludable limits are:

- Exempt from withholding and payment of employment taxes,
- Not reported as taxable wages on the employee's W-2, and
- Not reported as gross income.

The exclusion from income applies only to employees; former employees and independent contractors are not eligible. *IRC §132(f)(5) IRS Notice 94-3; TD 8933; Regs.§1.132-9(b)*

Valuation

Generally, benefits are valued at FMV; exceptions are as noted below.

Combined Benefits

The exemption applies whether an employer provides one or a combination of these benefits to employees. The total benefits cannot exceed the statutory dollar limitations, or the excess is taxable as a wage to the employee. Workers may pay for the benefits themselves on a pre-tax basis--see the discussion under "Salary Reduction Agreements," later, for the applicable rules. *IRC §132(f)(4)*

Cash Reimbursements

Cash reimbursements can be excludable if the employer establishes a bona fide reimbursement plan. This means there must be reasonable procedures to verify reimbursements and the employees must substantiate the expense. See "Transit Passes" for additional requirements. *IRC §132(f)(3)*

Cash Advances

Cash advances are not considered reimbursements and are treated as taxable wages.

QUALIFIED TRANSPORTATION FRINGE BENEFITS

Nondiscrimination Rules

Nondiscrimination rules do *not* apply to QTFs – these benefits are exempt even if provided exclusively to highly-compensated employees. *Reg. §1.132-8*

QTFs and Cafeteria Plans

QTFs are prohibited benefits under cafeteria plan rules. You cannot include these benefits as part of a cafeteria plan. *Reg. §1.132-1(b)(2)(i)*

Commuter Vehicle Transportation

A commuter highway vehicle must:

- Be provided by, or for, an employer (hiring a third party),
- Be for travel between the employee's residence (or parking lot) and workplace,
- Have seating capacity for at least 6 adults (excluding the driver),
- Have half of its seating capacity (excluding the driver) occupied by employees,
- Have 80% of the vehicle's mileage be for transporting employees between residences, the workplace and/or parking area. *IRC §132(f)(5) Reg. §1.132-9(b)*

Commuter transportation may include vanpools, and the vehicles may be owned and operated by transit authorities or employees.

Dollar Limitations

Maximum nontaxable value: $115 per month in 2008 *IRC §132(f); Rev. Proc. 2007-66*
(Limited to the combined value of commuter transportation and transit passes per month, i.e., $115 commuter transportation + $220 parking = $335 total in 2008.) A "month" for this purpose is a calendar month or substantially equivalent period applied consistently.

Valuation

Automobile lease valuation, vehicle cents-per-mile rule, or commuting valuation rules (discussed in previous chapter) may be used in lieu of FMV. If one of these methods is used, the employer must use the same valuation rule to value the use of the commuter vehicle by each employee who shares the use. *Reg. §1.132-9(b), Q&A-21; Reg. §1.61-21(d),(e)&(f)*

Substantiation Requirements

Only *cash reimbursements* by employers for use of a commuter vehicle need to be substantiated with actual proof of the commuter vehicle use by the employee.

QUALIFIED TRANSPORTATION FRINGE BENEFITS

Transit Passes

Any pass, token, fare card, voucher, or similar item (including an item exchangeable for fare media) entitling a person to transportation**.** The pass must be used for transportation on a public or privately-owned mass transit system, or on transportation provided by a person in the business of transporting people in a vehicle, seating at least six adults, excluding the driver.

Dollar Limitations

Maximum nontaxable value is limited to the combined value of commuter transportation and transit passes per month ($115 commuter transportation + $220 parking = $335 in 2008.)

Valuation

For transit passes sold at a discount, the discounted price rather than the face amount of the transit pass can be used to figure the exclusion as long as the discount is available to the general public. *Reg. §1.132-9(b)*

Example: 10 tickets cost $17.50 if purchased separately, but a packet of 10 tickets is available to the public for $15.00, or $1.50 each. Only $15 counts toward the exclusion maximum.

Substantiation Requirements

If the employer distributes the transit passes, there are no substantiation requirements. See below for cash reimbursements. *Reg. §1.132-9(b)*

Cash Reimbursements - Special Rule

Nontaxable only if a voucher or similar item is **NOT** readily available for direct distribution to employees.

“Readily available" means it can be obtained:

1. on terms no less favorable than those available to an individual employee, and
2. without incurring a significant administrative cost *IRC§ 132(f)(3) Reg. §1.132-9(b)*

Qualified Parking

Definition

Parking provided to employees on or near the business work premises, or parking on or near a location from which employees commute to work by commuter highway vehicle, mass transit station, or vanpool. *IRC §132(f)(5)(C)*

Dollar Limitations

Maximum nontaxable value is $220 per month in 2008. *IRC §132(f)(2(B); Rev. Proc. 2007-66*

Salary Reduction Agreements

A salary reduction agreement is a way to provide QTF benefit pre-tax to employees, without additional cost to the employer. An employee can choose between receiving a fixed amount of taxable cash or QTF for a specified future period. A QTF salary reduction plan need not be in writing; but the election by the employee must be in writing or another permanent form, such as electronic. *IRC §132(f)(4); Regs. 1.1.32-9 Q&A 11-15*

The election must contain the following:

- Date of the election,
- Amount of compensation to be reduced, and the
- Period for which the election is valid.

Limitations

The salary reduction may not exceed the combined applicable statutory monthly limits for QTFs, i.e., for the calendar year 2008, the limitation is $325 ($110 + $215).

This election may not be revoked after the employee is currently able to receive the cash or after the beginning the period for which the ATF is to be provided. Any unused QTF may not be refunded. However, the unused portion may be carried over to subsequent periods and used to provide QTFs as long as the amount expended does not exceed statutory limits.

Negative Election

A negative election is permitted, if the employee receives adequate notice that a salary reduction will be made and is given adequate opportunity to choose to receive cash compensation instead of the QTF. A negative election means that no response is a "Yes," that is, the employee wants the QTF and does NOT choose the cash.

Effect on Deferred Compensation Plans

When employees participate in a deferred compensation plan, they are limited to a percentage of their compensation annually that they may contribute. In **computing** what is considered compensation for purposes of the limitation, an employer may exclude certain fringe benefits, including QTFs. *IRC §314(e) IRC §403(b)(3); IRC §414(s)(2)&(3); IRC §415(c)(3); IRC §125*

QUALIFIED TRANSPORTATION FRINGE BENEFITS

Other Local Transportation Benefits

Three other local transportation fringe benefits allow employers to provide transportation for commuting to employees that is excludable from wages or taxed at $1.50 each way:

- Occasional Cab Fare
- Unusual Circumstances
- Unsafe Conditions

Occasional Cab Fare (Local Transportation)

Local transportation fare provided to **any** employee, regardless of income, is a nontaxable de minimis fringe benefit if it is **reasonable, occasional** and is provided to permit the employee to work overtime. *Reg. §132-6(d)(2)*

For this purpose, "occasional" means infrequent; occurrence that is not regular or routine. *Reg. §132-6(d)(2)(A)*

"Overtime" involves an extension of the employee's normal work schedule. *Reg. §132-6(d)(2)(B)*

Unusual Circumstances and Unsafe Conditions

Local transportation for commuting provided to an employee by an employer because of unusual **and** unsafe conditions is taxable to the employee as a wage at a maximum rate of $1.50 each way. This benefit is not available to individuals considered control employees. *Reg. §132-6(d)(2) (C)(iii)(A)*

Example: "Unusual circumstances" includes an employee temporarily working outside his normal work hours or an employee temporarily making a shift change. *IRC §132-6(d)(2)(C)(iii)(B)*

Unsafe Conditions

"Unsafe conditions" is determined by a history of crime in the geographic area surrounding the employee's workplace or residence and the time of day during which the employee must commute. *IRC §132-6(d)(2) (C)(iii) (C)*

Unsafe Conditions Only

Local transportation for commuting provided to an employee by an employer **solely** because of unsafe conditions is taxable to the employee as a wage at a rate of $1.50 each way. This benefit is available to qualified employees and the employer is required to have a written plan. *Reg. § 1.61-21(k)*

The exclusion applies for employees covered by the Fair Labor Standards Act (FLSA) of 1938 **and** with compensation not exceeding specified dollar imitations in IRC § 414(q)(1)(C). Employees covered under the FLSA are not exempt from minimum wage and IRS provisions. See Reg. §1.61-21(k)(6) for details.

For this purpose, unsafe conditions exist if a reasonable person would, under the facts and circumstances, consider it unsafe for the employee to walk to or from home, or to walk or use public transportation at the time of day the employee must commute. *Reg. §61-21(j)(5)*

Example: Each month during 2008, the state health department distributes transit passes with a face amount of $125 to all employees. These same passes can be purchased from the transit system by any individual for $115. Because the value does not exceed the applicable statutory monthly limit of $115 for 2008, no portion of the transit pass is includible as compensation.

Example: Agency Y maintains a QTF benefit arrangement. Employees of Y are aid twice per month, with the payroll dates being the 10th and 25th day of the month. Employee Q elects, before the first day of the month, to reduce his compensation in return for QTFs totaling $215 through the year 2007 (for qualified parking). Does this create taxable income for Q? No, because the election was made before he could receive the cash and the election is for a specific period, the arrangement satisfies the requirements for a valid salary reduction.

Example: In the above example, if employee Q revoked his election on the 10th of the month, it would be effective for the second pay period, since the revocation cannot be effective during a current pay period. It must be for a future period.

Example: Maddy buys a $115 transit pass each month in 2008. At the end of each month, she presents her used transit pass to her employer and certifies that she purchased and used it during the month. The employer reimburses her $115. Lulu also purchases a monthly transit pass for $115, but presents it to her employer at the beginning of the month and certifies that she purchased it and will use it during the month. Her employer reimburses her at the time she presents the transit pass. In both situations, the employer has established a bona fide reimbursement arrangement for purposes of excluding the $115 reimbursements from the employee's gross income in 2008.

Example: Allison is a qualified employee under the requirements for the commuting valuation rule and works as a data-entry clerk for the state revenue department. Her normal hours of work are 11 p.m. to 7 a.m. Public transportation, the only means of transportation available to her is considered unsafe by a reasonable person at the time she is required to commute from home to her workplace. DOR hires a car service to pick her up at her home each evening to transport her to work and to return her to home each morning when she finishes her shift. The amount includible in Allison's income is $1.50 for the one-way commute from home to work each evening, because public transportation is considered unsafe at that time of day. However, the value of the commute from work to home each morning is includible in Allison's income at FMV since unsafe conditions ***do not*** exist for that trip home.