XVIII-XIX. [Reserved]

XX. Qualified Transportation Plans

A. Overview

This Section discusses the tax treatment of qualified transportation fringe benefits that are made available to employees by their employers under Code § 132(f). We call these programs “qualified transportation plans,” although a written plan document is not always required.[1] Under general principles of taxation, all employer-provided benefits (including transportation fringe benefits) are taxable to the employee unless the Code provides a specific exclusion for the benefit.[2] Since 1985, when Code § 132 first became effective,[3] employers have been permitted to give the following transportation fringe benefits to employees on a tax-free basis:

- qualified parking;
- transit passes; and
- transportation in a commuter highway vehicle, if such transportation is in connection with travel between the employee’s residence and place of employment (also known as “vanpooling”).

For 2009 and later taxable years, an amendment to Code § 132 also allowed employers to reimburse certain bicycle commuting expenses on a tax-free basis.[4] Tax reform legislation enacted in December 2017 (the “Tax

[1] See subsection I.

[2] For more on the general tax principles that govern fringe benefits, see Section II.

[3] Pub. L. No. 98-369 (July 18, 1984).

[4] Pub. L. No. 110-343 (Oct. 3, 2008).

Cuts and Jobs Act"), however, suspended the exclusion for qualified bicycle commuting reimbursements for taxable years beginning after December 31, 2017, and before January 1, 2026.[4.1] The exclusion is then restored for taxable years beginning after 2025.

> **Tax Reform Changes for Years Beginning After 2017.** Tax reform legislation enacted in December 2017 (the "Tax Cuts and Jobs Act") significantly changed some of the rules affecting qualified transportation plans beginning in 2018:
>
> - *Tax Deduction Eliminated.* Effective for amounts incurred or paid after December 31, 2017, the Code has been amended to deny any deduction for "the expense of any qualified transportation fringe (as defined in Code section 132(f)) provided to an employee of the taxpayer."[*] And no deduction is available for "any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence and place of employment except as necessary for ensuring the safety of the employee."[†] The latter rule, denying a deduction for expenses "in connection with" travel between home and work (unless necessary for safety) does not apply to bicycle commuting reimbursement amounts paid or incurred after 2017 and before 2026. (Qualified bicycle commuting reimbursements are not considered qualified transportation fringes during that period and thus are taxable to employees.) For more on these amendments affecting the employers' ability to deduct transportation benefits, see subsection T.
> - *Exclusion for Bicycle Commuting Benefits Suspended.* While the Tax Cuts and Jobs Act did not alter employees' tax treatment for parking, transit, and vanpooling benefits under qualified transportation plans, it did suspend the exclusion for bicycle commuting reimbursement benefits for years beginning after 2017 and before 2026.[‡] For more on bicycle commuting reimbursement benefits, see subsection G.

* Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 13304(c)(1)(B) (2017) (adding new Code § 274(a)(4)).

† Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 13304(c)(2) (2017) (adding new Code § 274(l)). In addition to benefits under a qualified transportation fringe benefit plan, this provision appears to affect other daily transportation expenses, including those previously excluded under the de minimis fringe benefit rule (see Section VII).

‡ Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11047 (2017) (adding new Code § 132(f)(8)). The exclusion is suspended by temporarily removing qualified bicycle commuting reimbursements from the definition of qualified transportation fringe in Code § 132(f)(1). Consequently, the exclusion is unavailable during the eight-year period in which the employer's deduction is preserved, but the exclusion is restored when employers lose their deduction.

This subsection A provides an overview of qualified transportation plans, their history, and an introduction to state and local laws that may affect an employer's decision to offer a qualified transportation plan and the operation of such plans in a particular geographic area. Subsection B considers which employers may offer qualified transportation plans, and who may participate. Subsection C discusses the four types of benefits that can be qualified transportation fringes: parking, transit passes, vanpooling benefits, and bicycle commuting expense reimbursements (excludable only for years beginning before 2018 and after 2025).

The amount that can be excluded from income as a qualified parking benefit is subject to its own, inflation-adjusted statutory limit discussed in subsection D. Transit and vanpooling benefits are subject to a combined limit that, for months after 2014, is the same as the limit for qualified parking (see subsections E and F).[5] Excludable bicycle commuting benefits (for taxable years in which they are available) are also subject to a statutory limit, but that limit is not adjusted for inflation. Unlike the monthly limits for other transportation fringe benefits, the limit for bicycle commuting benefits is applied on an annual basis (see subsection G).[6] Administration of the various statutory limits is discussed in subsection H.

4.1 An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act), Pub. L. No. 115-97, § 11047 (2017) (adding new Code § 132(f)(8), which removes qualified bicycle commuting reimbursements from the definition of "qualified transportation fringe" during the suspension period).

5 Code § 132(f)(2), as amended by the Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Title I, § 105 (Dec. 18, 2015).

6 Code § 132(f).

There are three primary types of qualified transportation plan designs, each of which represents a different employer choice about the method of funding:

- Giveaway plan, under which an employer "gives away" to its employees benefits up to specified maximum amounts. See subsection J for details. This was the only design available until 1998, when Congress created a safe harbor from the doctrine of constructive receipt (Code § 132(f)(4)) that opened the door for parking, vanpooling, and transit pass benefits to be operated as pre-tax compensation reduction plans. As a result of that safe harbor, the pure giveaway design is no longer very common for those benefits, but it is the only design available for bicycle commuting benefits.
- Pre-tax compensation reduction plan, under which employees pay all of the costs on a pre-tax basis through the use of compensation reduction agreements. See subsection K for details. This is probably the most popular plan design—employers are not required to make any employer contributions in order to let their employees save taxes. This design is not available for bicycle commuting benefits.
- Combination plan that includes employer (giveaway) contributions, pre-tax compensation reductions, after-tax contributions, cash-outs, or a combination of those features. This hybrid allows employers to provide a subsidy while giving employees other options, too. See subsection L for details.

For a checklist of plan design choices, see subsection I. A table comparing qualified transportation plans with health FSAs and DCAPs can be found in subsection M. Subsection N illustrates how pre-tax compensation reductions may reduce employees' and employers' taxes. Compensation reductions to fund qualified transportation fringe benefits are examined more closely in subsection O. Carryovers and forfeitures of unused benefits are considered in subsection P.

Qualified Transportation Plans During the COVID-19 Emergency. The COVID-19 emergency has caused many employers to encourage or require their employees to work from home. That obviously eliminates the employees' need for commuter benefits under a qualified transportation plan, and raises questions about benefit elections and what will happen to benefits already accrued. To date, the IRS has not issued any special guidance for qualified transportation plans, but this should not be a concern for most employers because the qualified transportation plan rules are already sufficiently flexible to handle most situations resulting from the COVID-19 emergency. As explained in subsection O, most employers permit benefit election changes at least monthly. And as explained in subsection P, plans can allow current participants to carry over unused balances indefinitely. Layoffs and furloughs may raise questions about who is still an employee and a participant within the meaning of the plan (see subsection B) who can keep an unused balance for future use. But—within the statutory parameters—employers have considerable freedom to design their plans to minimize any loss of benefits (see subsection I regarding plan documents and design).

To assure that their plans' terms operate optimally through the disruption of the COVID-19 emergency, employers should consider reviewing the terms of their plans and their administrative procedures to determine whether any changes should be made. And even if no changes are needed, employers should consider reminding their employees of certain key provisions of their plans, including the ability to change compensation reductions, the rules concerning benefit carryovers, and any recent or imminent plan changes.

Other topics addressed in this Section include—

- expense substantiation and other reimbursement requirements (see subsection Q);
- reporting and disclosure obligations (see subsection R);
- other benefits affected by qualified transportation plans (see subsection S);
- deduction limits and other laws affecting qualified transportation plans (see subsection T);
- the consequences of failing to comply with the Code's requirements (see subsection U);
- correcting mistakes (see subsection V);
- other design and administration issues (see subsection W); and
- guidance lists and other tools to find the applicable law (see subsection X).

If a plan fails to comply with the Code's requirements, the employer and the employee may lose the favorable tax treatment—instead of being tax-free, the benefit will be treated as taxable wages. See Consequently, this Section addresses a wide range of questions that would interest an employer involved in establishing or administering a plan. These include questions about plan design, who can sponsor a plan, who is eligible to participate, funding, elections, benefit limits, expense substantiation, plan documentation, reporting and disclosure, and effects on other benefits.

Other Tax Breaks for Daily Transportation Between Home and Work. Daily transportation expenses incurred for travel between a taxpayer's residence and work generally are considered nondeductible commuting expenses that generally cannot be reimbursed by an employer on a tax-free basis. Benefits payable under a qualified transportation plan are probably the most significant exception to that general rule. There are other situations, however, in which an employee's transportation costs for travel between home and work may be paid or reimbursed on a tax-free basis. For example, small amounts of transit assistance (not more than $21 per month) may be excludable from an employee's income as a de minimis fringe benefit. Also, a portion of the cost of transportation paid for by an employer when other means are unsafe may qualify as a de minimis fringe. (For a discussion of both of these de minimis exclusions, see Section VII.D.) In addition, if an employee's home also qualifies as the employee's principal place of business, trips from home to another worksite may be deductible business expenses (not personal commuting expenses) that are reimbursable under an employer's accountable plan. (Business expense reimbursements, and the distinction between local business transportation and commuting, are discussed in Section II.E.)

1. *A Brief History of Transit Parity*

For many years, the combined limit for transit and vanpooling benefits was substantially less than the limit for parking benefits.[6.1] In February 2009, however, Congress amended Code § 132(f)(2) to make the aggregate monthly limit for transit passes and vanpooling the same as the inflation-adjusted monthly limit for parking beginning March 2009.[6.2] This parity rule for transit passes and vanpooling (often referred to as simply "transit parity") was to expire at the end of 2010, but it was extended for one year.[6.3] Transit parity was allowed to expire after 2011, but then, in early 2013, it was restored retroactively for 2012 and extended until the end of 2013.[6.4] Transit parity was again allowed to expire after 2013, but then, in late 2014, Congress restored it retroactively for 2014.[6.5] Transit parity expired a third time at the end of 2014, and the combined limit for transit passes and vanpooling expenses for 2015 initially fell substantially below the limit for parking.[6.6] Near the end of 2015, however, Congress restored transit parity retroactively for 2015, and finally amended Code § 132(f)(2) to provide for parity on a permanent basis.[6.7] As a result, for months after 2014, the combined limit for transit passes and vanpooling is the same as the limit for parking.

[6.1] The original statutory limits were $100 for transit and vanpooling combined, and $175 for qualified parking. Code § 132(f)(2).

[6.2] The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 (Feb. 17, 2009) (ARRA). Before the parity rule became effective, the combined limit for transit pass and vanpooling expenses for 2009 was $120, and the parking limit was $230. Rev. Proc. 2008-66, 2008-45 I.R.B. 1107 (setting inflation-adjusted limits for parking, vanpooling, and transit passes for 2009).

[6.3] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312 (Dec. 17, 2010). Guidance issued during this period of parity kept both limits at $230 per month. Rev. Proc. 2009-21, 2009-16 I.R.B. 860 (revising the aggregate vanpooling and transit pass limit for months beginning after February 17, 2009 and before January 1, 2010); Rev. Proc. 2009-50, 2009-45 I.R.B. 617 (setting limits for 2010); Rev. Proc. 2011-12, 2011-2 I.R.B. 297 (setting limits for 2011).

[6.4] American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 203 (Jan. 2, 2013) (ATRA) (extending parity rule in Code § 132(f)(2) until the end of 2013, effective for months after December 31, 2011). Prior to ATRA, the 2012 combined limit for transit pass and vanpooling expenses was $125 per month, and the 2012 limit for parking was $240 per month. Rev. Proc. 2011-52, 2011-45 I.R.B. 701 (setting limits for 2012).

[6.5] Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, § 103 (Dec. 19, 2014) (TIPA) (extending parity rule in Code § 132(f)(2) until the end of 2014, effective for months after December 31, 2013). Prior to TIPA, the 2014 combined limit for transit pass and vanpooling expenses was $130 per month, and the 2014 limit for parking was $250 per month. Rev. Proc. 2013-35, 2013-47 I.R.B. 537 (setting limits for 2014).

[6.6] Rev. Proc. 2014-61, 2014-47 I.R.B. 860 (setting parking limit for 2015 at $250 per month and the combined limit at $130 per month). For the limits in other years, see the Table of Plan Limits behind Appendix Tab 4.

[6.7] Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Title I, § 105 (Dec. 18, 2015).

2. *State and Local Laws May Require Offer of Transportation Benefits*

Generally, employers who are eligible to sponsor qualified transportation plans can choose whether to implement such a plan. (See subsection B for a discussion of who can sponsor a qualified transportation plan.) However, local concerns about air quality and traffic congestion have led some cities and states to adopt laws requiring employers to provide transportation benefits. For example, in 2009 San Francisco adopted an ordinance requiring employees to be provided with at least one of the following benefits:

- the opportunity to pay transit or vanpooling expenses on a pre-tax basis under a qualified transportation plan consistent with Code § 132(f);
- employer-supplied transit passes or reimbursement for equivalent vanpool charges, up to the value of an adult San Francisco MUNI Fast Pass that includes BART travel ($98 beginning July, 2019); or
- free employer-provided transportation in a multi-passenger vehicle, such as a vanpool or bus.

Only employers with an average of at least 20 employees per week (including temps) are subject to the ordinance, but employees are counted whether they work in or outside San Francisco. Employees who must be offered the benefit are limited to persons who performed an average of at least 10 hours of service per week within San Francisco for the same employer in the previous month and who are subject to California's minimum wage law. Violation of the ordinance is an infraction that may trigger fines starting at $100 for the first infraction in a year, rising to $200 for the second infraction in the same year, and increasing to $500 per infraction for the third and all subsequent infractions in a year. All employers must submit an Annual Employer Compliance Form.[6.8]

Later, effective September 30, 2014, requirements similar to the San Francisco ordinance (and ordinances adopted by Berkeley, Richmond and San Francisco International Airport) became applicable to all public, private and non-profit employers with at least 50 full-time employees in the San Francisco Bay area, under a pilot program authorized by state law and jointly administered by the Bay Area Air Quality Management District and the Metropolitan Transportation Commission (Air District/MTC).[6.9] Employers subject to the pilot program were required to register with the Air District/MTC and comply with the other program requirements even if they were also subject to a local ordinance. Employers not covered by the pilot program remained subject to any applicable local governmental rules.[6.10] To prevent duplicative reporting requirements, employers subject to the pilot program were advised to register and report to the Air District/MTC for the pilot program, and information regarding their worksites in the local jurisdictions with overlapping local ordinances would be shared with those jurisdictions.[6.11]

The pilot program had an expiration date of January 1, 2017, but before that could occur, the California legislature amended the statute to remove the expiration date, making the program permanent with only minor changes.[6.12]

[6.8] S.F., Cal., Ordinance 199-08 (Aug. 22, 2008), available at http://www.sfbos.org/ftp/uploadedfiles/bdsupvrs/ordinances08/o0199-08.pdf (as visited Sept. 4, 2019). *See* SF Environment, How to Implement a Commuter Benefits Program: Guide for San Francisco Employers (May 2018), available at https://sfenvironment.org/sites/default/files/fliers/files/sfe_tr_cbo_employer_guide.pdf (as visited Sept. 4, 2019). "SF Environment" is shorthand for the San Francisco Department of the Environment, a department of the city and county of San Francisco.

[6.9] Regulation 14: Mobile Source Emission Control Measures, Rule 1: Bay Area Commuter Benefits Program (Mar. 19, 2014), available at http://www.baaqmd.gov/~/media/dotgov/files/rules/regulation-14-rule-1-bay-area-commuter-benefits-program/documents/rg1401.pdf?la=en (as visited Sept. 4, 2019). *See* Bay Area Commuter Benefits Program Employer Guide (Jan. 4, 2016), available at https://commuterbenefits.511.org/docs/employer_guide.pdf (as visited Sept. 4, 2019). There are several differences between the requirements of the pilot program and the San Francisco ordinance. For example, the pilot program requires a higher number of full-time employees before it applies, uses a slightly different method for figuring the required subsidy for an employer-paid transit benefit, and allows employers to request approval of alternative benefit options.

[6.10] Bay Area Commuter Benefits Program: Frequently Asked Questions (Jan. 4, 2016), available at https://commuterbenefits.511.org/docs/faq.pdf (as visited Sept. 4, 2019).

[6.11] Bay Area Commuter Benefits Program: Frequently Asked Questions (Jan. 4, 2016), available at https://commuterbenefits.511.org/docs/faq.pdf (as visited Sept. 4, 2019).

[6.12] Cal. Gov't Code § 65081, as amended by Senate Bill 1128, available at http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB1128 (as visited Sept. 4, 2019). In addition to removing the program's expiration date, the legislation removed a reference to bicycle commuting as a possible pre-tax benefit (an apparent error in the original legislation, since bicycle benefits cannot be offered on a pre-tax benefits as explained in subsection G), and added employer financial support for bicycle commuting as an optional feature of an employer-paid benefit. While employer subsidies for public transit or vanpooling under the employer-paid benefit option must at least equal the monthly cost of commuting via public transit or vanpool, or $75 (subject to a cost-of-living adjustment), whichever is lower, the bicycle subsidy must at least equal the monthly cost of commuting by bicycle or $20 (not adjusted), whichever is lower.

In 2016, Washington, D.C. and New York City joined the growing list of cities implementing their own laws requiring businesses to offer transit benefits.[6.13] And in 2019, New Jersey adopted the first statewide requirement that employers offer pre-tax transportation fringe benefits.[6.14] Under the New Jersey statute, every employer in the state that employs at least 20 persons must offer its employees an opportunity to utilize a pre-tax transportation fringe benefit. Limited exceptions apply for employees covered by a collective bargaining agreement and persons employed by the federal government. The statute defines a "pre-tax transportation fringe benefit" as a benefit that provides commuter highway vehicle and transit benefits, consistent with Code § 132(f)(1), at the maximum benefit levels allowable under federal law "to be deducted for those programs from an employee's gross income" (i.e., funded by pre-tax compensation reductions). Violations may result in civil penalties of up to $250 per employee for the first violation, and after 90 days each additional 30-day period in which the benefit is not offered constitutes an additional violation subject to a penalty of $250. The law is "inoperative" until rules and regulations under the statute have been adopted or one year elapses, whichever happens first.

Given the spread of these types of state and local requirements, employers will need to consult the laws of the various state and local jurisdictions in which they operate to assure that they are meeting all applicable requirements relating to employer-sponsored commuting benefits.

B. Who Can Sponsor and Who Can Participate in a Qualified Transportation Plan?

1. Any Type of Employer Can Sponsor

Any employer can sponsor a qualified transportation plan for its employees, no matter what the employer's size. Eligible employers include corporations (Subchapter S or Subchapter C), partnerships, non-profit organizations, government entities, limited liability companies (LLCs), limited liability partnerships (LLPs), and sole proprietorships. (Caution: Certain owners are ineligible for the Code § 132(f) tax exclusion, as discussed in subsection B.) Government employers can sponsor qualified transportation plans, as can companies in the private sector. For example, federal employees are allowed to exclude their mass transit and vanpooling commuting costs from taxable wages and to pay for those benefits through compensation reduction.[7] Businesses that are under common control or are part of an affiliated service group (called controlled groups) may sponsor a single plan for all of their employees.[8]

See subsection H for a discussion of how the statutory limits apply when individual employees work for multiple related or unrelated employers.

[6.13] Employer Commuter Benefits Toolkit (Aug. 2019), available at https://godcgo.com/wp-content/uploads/2019/08/Employer-Commuter-Benefits-Toolkit-2019_082319.pdf (as visited Sept. 4, 2019); NYC Commuter Affairs: Commuter Benefits Law, available at https://www1.nyc.gov/site/dca/about/commuter-benefits-law.page (as visited Sept. 4, 2019). Both laws apply only to businesses with 20 or more employees.

[6.14] N.J. Rev. Stat. § 27:26A-3 (as amended by S. 1567, "An Act concerning pre-tax transportation fringe benefits, and amending and supplementing P.L. 1992, c. 32").

[7] Executive Order 13150 (Apr. 21, 2000) (ordering federal agencies to implement programs under Code § 132(f) for mass transportation and vanpools). The order directed each federal agency in Washington, D.C. and certain surrounding areas (National Capital Region) to implement a qualified transportation fringe benefit program under which federal employees working in that region would receive transit passes on a tax-free basis "in addition to current compensation." A three-year, nationwide transit pass pilot program was also adopted for three federal agencies. The transit pass program in the National Capital Region was subsequently codified and expanded to include employees of the legislative and judicial branches and employees of independent agencies. Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, § 3049 (2005). For more information about transit benefits for federal employees, visit the U.S. Department of Transportation's TRANServe website, available at http://transerve.dot.gov/index.html (as visited Sept. 4, 2019).

[8] All employees that are treated as employed by a single employer under Code § 414(b), (c), (m) or (o) (relating to controlled groups of corporations, trades or businesses under common control, or affiliated service groups) are treated as employed by a single employer for this purpose. Treas. Reg. § 1.132-9, Q/A-10. This regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits. For details about how to identify the members of a controlled group in the context of a cafeteria plan, see *Cafeteria Plans* (Thomson Reuters/Tax & Accounting, 1991-present, updated quarterly).

2. Only Current Employees Can Participate

Only individuals who are "currently employees at the time the qualified transportation fringe is provided" are eligible to participate.[9] As used in the regulations, the term "employee" includes only common-law employees, other statutory employees (such as officers of corporations), and leased employees.[9.1] Whether an individual is considered a common-law employee is influenced by many factors, but the most significant of these is whether the recipient of the individual's services has the right to control the manner and means by which those services are performed.[9.2]

For sample language describing which employees are—and are not—eligible to participate in a qualified transportation plan, see the sample transportation plan document behind Appendix Tab 5.

a. Former Employees Cannot Participate

Former employees cannot participate in a qualified transportation fringe benefit plan. Consequently, an employer cannot reimburse otherwise qualified transportation expenses that are neither incurred nor paid by former employees *before* their employment termination date. However, this "no former-employee participants" rule does not prevent an employer from reimbursing a claim for an expense submitted by a former employee within the plan's applicable run-out period (i.e., the period after the close of a coverage period during which reimbursement claims may still be submitted) if the claim is for qualified transportation expenses that were incurred or paid *before* the employee's termination date, including expenses that were incurred *before* but paid *after* the termination date.

b. Self-Employed Individuals Cannot Participate

Self-employed individuals (partners, sole proprietors, more-than-2% shareholders in a Subchapter S corporation, and independent contractors) are ineligible for the income exclusion.[10] (Note: The ineligibility of more-than-2% shareholders of a Subchapter S corporation should also make their spouses, children, parents, and grandchildren ineligible.)[10.1]

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9 Code § 132(f)(1); Treas. Reg. §§ 1.132-1(b)(2)(i) and 1.132-9, Q/A-5. This regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits.

9.1 Treas. Reg. § 1.132-9, Q/A-5; Code § 414(n)(3)(C) (leased employees treated as employees of the recipient of the services for purposes of Code § 132); Treas. Reg. § 1.132-9, Q/A-10 (acknowledging application of Code § 414(n)(3)(C) to qualified transportation benefits). Strangely, Q/A-5 cross-references a portion of the definition of employee used for working condition fringe benefits, Treas. Reg. § 1.132-1(b)(2)(i), which makes no mention, and offers no definition, of the term "statutory employee." Generally, for employment tax purposes the term "statutory employee" includes certain delivery drivers, life insurance agents, home workers, and traveling salespersons, if the prescribed conditions are met. *See* Statutory Employees, available at https://www.irs.gov/businesses/small-businesses-self-employed/statutory-employees (as visited Sept. 4, 2019).

9.2 IRS Publication 15-A (Employer's Supplemental Tax Guide) (2016) ("anyone who performs services for you is generally your employee if you have the right to control what will be done and how it will be done"). The Supreme Court identified the following factors to be considered when assessing whether a worker is a common-law employee: the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 14 EBC 2625 (1992). For further discussion of how to identify common-law employees, see Section XIV.C of *Self-Insured Health Plans* (Thomson Reuters/Tax & Accounting, 2012-present, updated quarterly).

10 Code § 132(f)(5)(E); *see also* IRS Notice 94-3, 1994-3 I.R.B. 14 and Treas. Reg. § 1.132-9, Q/As-5 and -24. *See also* IRS Information Letter 2001-0050 (Jan. 28, 2001); and IRS Publication 15-B (Employer's Tax Guide to Fringe Benefits) (noting that more-than-2% shareholders should be treated in the same way as partners in a partnership for fringe benefit purposes, but that the benefit should not be treated as a reduction in distributions to the more-than-2% shareholder).

10.1 See Code § 1372(b), which applies Code § 318 attribution rules to the definition of 2% shareholder (which effectively means a more-than-2% shareholder).

Partnership-Owned Entities. Some partnerships have reportedly had their partners become employees of a non-corporate entity that is wholly owned by the partnership. Generally, the Code disregards such entities—it does not treat them as separate from their owner—but one of the regulations refining that general rule states that such entities will be treated as corporations for employment tax purposes.* That separate status does not apply for self-employment taxes.†

Some taxpayers initially argued that the self-employment tax regulation denying separate status to wholly owned non-corporate entities applied only to sole proprietorships and not to partners, so partners could be treated as employees of the separate entity. To clarify the regulations and assure that the same rules apply to sole proprietors and partners, the IRS amended the self-employment tax regulations in May 2016 to explicitly provide that a non-corporate entity that is wholly owned by a partnership will not be treated as a corporation for self-employment tax purposes. Instead, the entity will be disregarded, and partners of the partnership owning the entity will be subject to the same self-employment tax rules as partners in entities that do not own disregarded entities.‡

* Treas. Reg. § 301.7701-2(c)(2)(iv)(B).

† Treas. Reg. § 301.7701-2(c)(2)(iv)(C)(2).

‡ The argument for narrowing application of the self-employment tax rule rested on that regulations' explicit reference to sole proprietors and the lack (prior to the 2016 amendment) of an example addressing partners. The regulations as amended apply on the later of August 1, 2016, or the first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan sponsored by a disregarded entity. An entity's affected plans include any qualified plan, health plan, or Code § 125 cafeteria plan that benefits participants affected by these regulations (e.g., one that includes partners of a partnership that is the entity's sole owner). Treas. Reg. § 301.7701-2(e)(8). The amended regulations were issued in May 2016 in temporary form, and in July 2019 in final form. T.D. 9766, 2016-21 I.R.B. 855 (May 4, 2016); Self-Employment Tax Treatment of Partners in a Partnership That Owns a Disregarded Entity, 84 Fed. Reg. 31478 (July 2, 2019).

Can self-employed individuals obtain any favorable tax treatment for transportation expenses, even though they are ineligible for a qualified transportation plan? Yes. Individuals who are partners, more-than-2% shareholders, and independent contractors may still obtain income exclusions under the working condition and de minimis fringe provisions in Code §§ 132(a)(3) and (a)(4), even though they don't qualify under Code § 132(f).[10.2]

Example: Other Fringe Benefit Exclusions May Be Available to Self-Employed Individuals. Patty is a partner in Prime Partnership. She commutes to and from her office every day and parks free of charge in Prime's parking lot. Patty can't exclude the value of her parking under Code § 132(f) because she is self-employed, but she can exclude it if it qualifies as a de minimis fringe under Code § 132(a)(4).* Also, any tokens or farecards provided to her by Prime that enable her to commute on a public transit system are excludable if the value of the tokens and farecards in any month doesn't exceed the limits in the regulation regarding de minimis transit passes.† The de minimis fringe benefit exclusions are more limited than the qualified transportation fringe benefits limits, however. For example, a partner receiving a farecard from the partnership can only exclude its value up to $21 per month (the limit for a de minimis fringe under Treas. Reg. § 1.132-6(d)(1)), which is much less than the Code § 132(f) combined limit for transit pass and vanpooling expenses.‡ Moreover, if amounts in excess of $21 are provided, then under Treas. Reg. § 1.132-6(d)(1), the entire amount is taxable.

* *See also* Treas. Reg. § 1.132-9, Q/A-24(d). The example in the regulation offers no indication as to how likely it is that parking in this sort of situation would qualify as a de minimis fringe benefit.

† Treas. Reg. § 1.132-9, Q/A-24(b).

‡ IRS Information Letter 2001-0050 (Jan. 28, 2001).

[10.2] Treas. Reg. § 1.132-9, Q/A-24(a). The working condition fringe benefit exclusion may be available for transit, but it would not be available for parking. See Treas. Reg. § 1.132-9, Q/A-24(c), citing Treas. Reg. § 1.132-5(a)(1). While de minimis fringe benefit treatment for parking is possible, the usual strict requirements for the de minimis fringe exclusion will apply, and it seems unlikely that they will often be met by regular commuting expenses. Note that this regulation was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits.

c. Leased Employees and PEOs

Some companies hire other organizations to supply workers and handle payroll functions. We refer to those other organizations here as professional employer organizations (PEOs), but they go by many names, including temporary employment agencies, staffing firms, and employee leasing companies. A PEO may characterize itself as the employer or "co-employer" of the workers it provides, but whether those workers are employees of the PEO or employees of the employer receiving the services (the "client") for purposes of Code § 132(f) will be determined by applying the common-law definition of employee.[11] That determination depends on the facts and circumstances of each worker.[11.1] As a result, individuals working for the same client may not all have the same common-law employer. In most cases, however, workers supplied by a PEO will be employees of the client under the common-law rules.[11.2]

Under the general rules discussed earlier in this subsection, workers who are common-law employees of the client can participate in the client's qualified transportation plan if the client's plan authorizes their participation. But those workers cannot participate in a plan for employees of the PEO.[12] Similarly, workers who are common-law employees of the PEO can participate in a qualified transportation plan operated by the PEO, but they cannot participate in a plan for employees of the client unless they are "leased employees" of the client and the client's plan authorizes their participation. For this purpose, a leased employee is an individual who is not an employee of the client and has provided services to the client on a substantially full-time basis for at least a year, if the services are performed under the client's primary direction or control.[13] Under Code § 414(n), a leased employee can be treated as an employee of the client for purposes of participating in the client's qualified transportation plan.[14]

3. Discrimination Testing Not Required for Income Exclusion

Nondiscrimination testing is not required for qualified transportation fringe benefits.[15] (See the sample ABC, Inc. Transportation Fringe Benefits Plan document behind Appendix Tab 5 for a design in which an employer subsidizes parking for senior management employees but pays nothing for rank-and-file employees.) In most cases, however, employers will want to extend such benefits to as wide a cross-section of employees as possible to maximize employee tax savings and employer federal employment tax savings. And just because there are no nondiscrimination testing requirements under the Code doesn't mean that employers can act arbitrarily. Once a plan has been established, employers should administer it on a uniform and consistent basis.

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11 To date, there is no guidance affirming that a worker can simultaneously be a common-law employee of both the PEO and the client for fringe benefit purposes, including transportation benefits under Code § 132. The *Vizcaino* case may have complicated this analysis, but it did not state that a worker could be the common-law employee of a PEO and a common-law employee of the client at the same time. *Vizcaino v. Microsoft Corp.*, 173 F.3d 713, 23 EBC 1209 (9th Cir 1999). For more on the *Vizcaino* case and co-employment, see Section IX of *Cafeteria Plans* (Thomson Reuters/Tax & Accounting, 1991-present, updated quarterly).

11.1 *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 14 EBC 2625 (1992) identified the following factors to be considered when assessing whether a worker is a common-law employee: the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party. For further discussion of how to identify common-law employees, see Section XIV of *Self-Insured Health Plans* (Thomson Reuters/Tax & Accounting, 2012-present, updated quarterly).

11.2 Certified Professional Employer Organizations; Notice of Proposed Rulemaking and Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations, 81 Fed. Reg. 27360, 27363 (May 6, 2016).

12 Recent changes to the Code authorizing the certification of qualifying PEOs allow those PEOs to assume exclusive liability for the federal employment taxes of workers who are common-law employees of the PEO's clients, but the certification rules do not appear to affect which entity (PEO or client) is the employer for benefit plan purposes. Code §§ 3511 and 7705. *See* Treas. Reg. § 31.3511-1 (setting forth the federal employment tax liabilities of certified PEOs). For a discussion in the cafeteria plan context of structures that a PEO might consider to help provide fringe benefits to workers who are common-law employees of the PEO's clients, including prototype and multiple employer plan approaches, see Section IX of *Cafeteria Plans* (Thomson Reuters/Tax & Accounting, 1991-present, updated quarterly).

13 For details about how to identify leased employees in the context of a cafeteria plan, and for other issues raised by leased employees, PEOs, and employee outsourcing, see Section IX of *Cafeteria Plans* (Thomson Reuters/Tax & Accounting, 1991-present, updated quarterly).

14 Code § 414(n)(3)(C); Treas. Reg. § 1.132-9, Q/A-10. We note that the regulation acknowledging application of the rule to qualified transportation benefits was adopted before the bicycle commuting benefit was added to Code § 132(f), but nothing in the bicycle commuting provisions of Code § 132(f) suggests that this regulation will not also apply to bicycle commuting benefits. The leased employee rule applies to many fringe benefits, including Code §§ 79 (group-term life insurance), 106 (employer-provided coverage under accident or health plans), 117(d) (qualified tuition reductions), 125 (cafeteria plans), 127 (educational assistance programs), 129 (dependent care assistance programs), 132 (no-additional-cost services, qualified employee discounts, working condition fringe benefits, de minimis fringe benefits, qualified transportation fringe benefits, qualified moving expense reimbursements, and other benefits), 137 (adoption assistance), and 274(j) (employee achievement awards).

15 Code § 132(j)(1) (imposing nondiscrimination rules on some Code § 132 fringe benefits, but not on qualified transportation fringe benefits).

4. Participation Limits

Because Code § 132 does not impose any nondiscrimination or other restrictions on the ability of employers to determine who can participate in a qualified transportation plan, employers have considerable discretion to determine which employees will be allowed to participate. For example, participation could be limited to employees working in a certain location, to full-time employees, to a group of employees that is disproportionately highly compensated, or even to employees selected on a discretionary, case-by-case basis.

a. Limiting When Participation Begins

Implicit in employers' discretion to determine which employees can participate in a qualified transportation plan is substantial freedom to determine when an employee who is eligible to participate actually becomes a participant. In a pre-tax compensation reduction plan (described in subsection K), actual participation (i.e., the right to obtain benefits or incur expenses that can be reimbursed by the plan) will be contingent upon an employee's election to have amounts taken from his or her compensation that are then available either to pay for qualified benefits or to reimburse the employee for qualified expenses.[16] But in a giveaway plan (described in subsection J), where the employer pays the entire benefit, the plan might not require any employee election to commence participation.

> **Example: Commencement of Participation in a Pre-Tax Compensation Reduction Plan.** Abby is hired in mid-March as a full-time employee of Great River Ltd. Under the Great River Transportation Plan, all transportation benefits are funded by pre-tax compensation reductions. The Plan states that an eligible employee does not become a Plan participant until the first day of the first calendar month for which the eligible employee has a compensation reduction election in effect. It also states that compensation reductions cannot begin until after the employee has completed six consecutive full months of service. As a full-time employee, Abby is an eligible employee. Abby can submit a completed compensation reduction election by the deadline in September and become a participant as early as October 1st. If she does not submit her first compensation reduction election until the December deadline, she can begin participating on the following January 1st.

b. Limiting When Participation Ends

Do employers have similar freedom to determine when participation ends? We know that former employees cannot participate, but the regulations do not specify when participation ends for an individual who is still an employee but becomes ineligible to participate (e.g., because the plan is limited to full-time employees and the employee's hours are reduced). Plans typically provide a run-out period during which employees or even former employees can obtain reimbursement for expenses that were incurred during participation. But can an employee who is no longer eligible to participate continue to receive benefits or incur reimbursable expenses based on amounts that were taken from his or her compensation during participation, or that were credited to his or her account during participation?

An employer that is providing transportation benefits under a giveaway plan will want to clarify in the plan documents exactly when an employee's participation ends. Nothing in the qualified transportation plan regulations prevents unused employer-paid benefits from being forfeited immediately when an employee loses eligibility to participate in the plan.

In the case of a compensation reduction plan, however, the ability to forfeit unused balances is less certain. While the regulations do not specifically provide for participation after compensation reductions are stopped (or some other event has occurred that would ordinarily make an employee ineligible), neither do the regulations specifically permit a forfeiture to the employer of compensation reduction amounts set aside by an individual who is still an employee.[17] As a result, pre-tax compensation reduction plans may want to allow

[16] Coverage in a pre-tax compensation reduction plan may begin immediately after the initial election is made, or—more commonly—it may wait until the beginning of the next regular (usually monthly) coverage period. Treas. Reg. § 1.132-9, Q/A-14(e) (Example 3 describes an employee who makes an election on February 27 and incurs reimbursable expenses on February 28).

[17] Even if such forfeitures are permissible, they may be hard to explain, discourage participation, and invite disputes.

a "spend-down" of accounts—both for employees who have discontinued compensation reductions and for employees who are no longer eligible to make compensation reductions and otherwise participate in the plan—so long as the spend-down does not occur after termination of employment.[17.1]

Example: Termination of Participation in a Pre-Tax Compensation Reduction Plan. Assume the same facts as in the preceding example, except that after participating in the Great River Transportation Plan for four years, Abby ceases to be an eligible employee because she changes to part-time status. Because she overestimated her expenses, Abby has an unused balance of $450 to her credit under the Plan after reimbursement of all of the qualifying transportation expenses she incurred before becoming a part-time employee.

Abby cannot make any additional pre-tax compensation reduction contributions because she is no longer an eligible employee. Abby does not immediately cease to be a participant, however, because under the terms of the Plan, any employee of Great River with an outstanding Transportation Plan balance can incur qualifying expenses and be reimbursed for those expenses until the balance to the employee's credit under the Plan is exhausted or the employee terminates employment. Abby will therefore remain a participant, and will be able to spend down her account balance, unless she terminates employment before incurring sufficient reimbursable expenses. According to the Plan, after her termination of employment, Abby will have a limited time to request reimbursement for qualifying expenses incurred as a participant before her employment termination. Any balance remaining in Abby's account after that run-out period ends will be forfeited.

The following table summarizes when participation will end in some common circumstances.

Event	When Participation Ends*
Participant in a giveaway plan remains an employee, but ceases to be the kind of employee who is ordinarily eligible for employer-provided benefits	Determined by plan design; typically immediate
Participant in a pre-tax compensation reduction plan remains an employee but ceases to be the kind of employee who is eligible to elect compensation reductions	Uncertain; cautious employers may prefer to delay until exhaustion of participant's unused compensation reduction amounts (or earlier termination of employment), but some plans end participation immediately
Participant ceases to be an employee	Determined by law; immediate upon termination of employment†

* Note, in any of these situations, the plan may offer a run-out period during which qualified expenses incurred or paid during participation may still be submitted for reimbursement.

† IRS Information Letter 2019-0002 (Mar. 11, 2019).

[17.1] In response to an inquiry on behalf of an individual who was fired after accumulating nearly $400 of unused compensation reductions under her employer's qualified transportation plan, the IRS wrote that amounts accumulated by former employees cannot be used or refunded, regardless of whether they were additions to regular compensation or funded by compensation reductions, because qualified transportation plans can only provide benefits to current employees. IRS Information Letter 2019-0002 (Mar. 11, 2019).