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# Transit Benefit\$

## GUIDE

Take advantage of  
 transit **tax breaks** and bus **discount** programs

STRENGTHEN EMPLOYEE RECRUITMENT AND RETENTION	OFFER EMPLOYEES A TAX-FREE BENEFIT	SAVE MONEY THROUGH A NEW STATE INCOME TAX CREDIT	HELP REDUCE TRAFFIC CONGESTION AND AIR POLLUTION
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*Prepared by your regional Commuter Choice Partners*

- ▶ Downtown Minneapolis Transportation Management Organization
- ▶ Saint Paul Transportation Management Organization ▶ Metro Commuter Services
- ▶ Metro Transit ▶ Midway Transportation Management Organization
- ▶ 494 Commuter Services ▶ Minnesotans for an Energy Efficient Economy

# What Are Transit Benefits?

“Transit benefits” refer to programs and policies that employers offer their employees to reduce commuting costs and to encourage the use of buses and vanpools. Employers can save over 60% of the cost of bus passes by taking advantage of federal and state tax breaks and Metro Transit discounted bus-pass programs.



## Why offer transit benefits?

- ▶ To strengthen employee recruitment and retention
- ▶ To offer employees a tax-free benefit
- ▶ To save money: No other tax-preferred benefit provides an employer a state income tax credit!
- ▶ To help reduce traffic congestion and air pollution

## Save on employee commuting costs!

Make use of regional reduced-cost bus passes and state and federal tax advantages to reap substantial savings on bus passes. The table below shows the dramatic savings possible with employer-provided bus passes.



### Employer-provided transit benefit

\$85/month value in bus passes

#### Cost to employer:

\$85.00 (tax free to employee)  
 (\$8.50) – average 10% savings through bus discount programs  
 (\$22.95) – 30% state corporate tax credit

\$53.55

Employer pays only **\$53.55**/month

### Salary increase option

\$85/month in take home pay

#### Cost to employer:

\$85.00  
 + \$40.88 (assumes 28% federal tax rate)  
 + \$8.76 (assumes 6% state tax rate)  
 + \$11.17 (employee FICA)

\$145.81

Employer pays **\$145.81**/month

## Do these programs affect personal tax returns of employees?

No. Employees are not required to retain any records or make any note of the transit benefit on their personal income tax forms. Of course, their annual compensation will be reduced in cases with a salary reduction in 2003.

## What happens at the end of the year? Is there a “use it or lose it” penalty?

No. If employees have remaining funds in a pre-tax transit account at the end of the year they may carry this amount forward to a pre-tax transit account for the next year. The risk of forfeiture may occur when an employee leaves the company: this is reduced by permitting employees to make elections on a monthly basis.

## Where can I find IRS guidance?

The IRS has recently issued rules regarding changes to the treatment of “Qualified Transportation Fringe Benefits” (see the *Federal Register*, Vol. 66, No. 81, January 11, 2001). The rules provide detailed and helpful guidance in interpreting the new law.

## Can I incorporate transit benefits as part of our existing Section 125 “Cafeteria Plan”?

No. Transit benefits may not be included in a cafeteria plan with, for example, dental care. They must be handled as a separate benefit program. The good news is that transit benefits do not have the burdensome reporting requirements of Section 125 benefits. For example, you do not have to submit a plan document to the IRS for approval or complete Form 5500 or other forms.

## How do I provide equitable benefits across different transportation modes?

The easiest way is to offer all employees the same amount as a transportation allowance. For example: \$85/month toward whatever transportation mode they choose. Any commuting costs incurred by the employee greater than \$85/month would have to be paid for using taxable income. By using one of the regional bus pass programs described in the guide, \$85/month will fully cover bus expenses.<sup>4</sup> Vanpoolers would have the majority of costs covered as the average per-employee cost for vanpools is \$80 to \$100/month. Parkers, including carpoolers, would have \$85 toward parking expenses treated as a pre-tax benefit. Finally, those employees bicycling or walking to work would receive \$85/month in taxable income.

## Can an employee receive bus passes and parking on a pre-tax basis?

Yes, so long as the bus amount does not exceed \$100/month and the parking does not exceed \$190 month, or a total of \$290/month.

## Where to find more information:

- ▶ Internal Revenue Service, Employee Benefits and Exempt Organizations Branch. Web: [www.irs.ustreas.gov](http://www.irs.ustreas.gov), Tel: 202-622-6040
- ▶ Federal Transit Administration website: [www.fta.dot.gov](http://www.fta.dot.gov). Click on *Commuter Choice*.
- ▶ Your *Commuter Choice* representative (see back cover) can provide sample documents used by other employers.

*This guide was prepared with the assistance of Mark Kinney, an employee benefits attorney with Lindquist and Vennum P.L.L.P.*

The material in this guide is not offered as legal advice.

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## Endnotes

1. Eligible employers include Corporations (See M-4 MN Franchise Tax Return), Sole Proprietors (M-1 Tax Return), Partnerships (M-3 Tax Return) and S corporations (M-3 Tax Return). State Corporate Income Tax Forms have a new line item for claiming this tax credit.
2. The caps for transit and parking benefits are adjusted annually based on inflation. For 2004 and beyond, see [www.fta.dot.gov/library/policy/cc/2003lqtd.html](http://www.fta.dot.gov/library/policy/cc/2003lqtd.html).
3. Vanpools are referred to as “Commuter Highway Vehicles” in IRS documents.
4. 31-day passes purchased through Transitworks! cost \$76.50 for the \$2.25 fare card, \$59.40 for the \$1.75 fare card, and \$37.80 for the \$1.25 fare card. Bus fares may increase in the future, check with Metro Transit for latest fare information.
5. Section 132 (f)(3) allows cash reimbursement for transportation fringes “only if a voucher or similar item that is exchangeable for a transit pass is not readily available.”

## step 9.

### Claim the 30% state transit tax credit on your tax returns.

State Corporate Franchise Tax Forms (M-4) include a line item for claiming the transit tax credit (see [www.taxes.state.mn.us/corps/forms/2002/pdf/etp.pdf](http://www.taxes.state.mn.us/corps/forms/2002/pdf/etp.pdf)). Employee-paid transit benefits (using pre-tax income) are not eligible for the MN Corporate income tax credit.

If you have questions about this new tax credit, please contact the MN Dept. of Revenue at the following numbers:  
Corporations (651-297-7000),  
Partnerships and  
S Corporations (651-296-3475),  
Sole Proprietors  
(651-296-3781).

## step 10.

### Claim net expenditure on transit as a federal and state tax deduction (i.e., business expense).

Expenditures on transit are treated as a deductible business expense for both federal and state corporate taxes, up to the \$100/month cap.<sup>2</sup>



## Common Questions

### ► What if we have employment sites around the country?

It should be relatively easy to implement the federal pre-tax transits benefit in any city in the U.S. Several states (Connecticut, Georgia, Maryland, New Jersey, and Washington) also offer state tax benefits for transit. Transit operators in many cities (Denver, Seattle, Phoenix, Washington, D.C., to name a few) offer some type of discount program targeted to employers. As is the case in Minnesota, if such a program exists, employers are required to participate in order to be eligible for federal pre-tax treatment of transit benefits. For help in researching programs in other locales, contact the Downtown Minneapolis TMO (612-370-3987) or the transit provider in the city in which you are interested.

### ► Is it possible to take advantage of both the federal and state pre-tax transit option and the Minnesota corporate tax credit for transit?

Yes. However, if an employer writes off the full expenditure on transit benefits as a cost of doing business on their federal and state tax returns, and claims the 30% state tax credit in the same year, then in the following year they would have to report the value of the 30% state tax credit as income. Employee-paid (pre-tax income) transit benefits are not eligible for the MN Corporate income tax credit.

## Employer transit incentives

### 1. Minnesota corporate income tax credit (30%) for bus pass and vanpool expenses

Beginning with tax year 2000, employers who subsidize the cost of bus passes for employees and who currently pay state corporate income taxes can claim a credit on their tax return.<sup>1</sup> The tax credit is simple: employers may reduce the amount of their state taxes by 30% of the expenditure they make on bus passes or vanpool expenses for employees.

### 2. Federal and state tax-free treatment of transit benefits, up to specified limits

Employers can provide transit as a tax-free employee benefit, or allow employees to pay for bus passes using pre-tax income up to \$100 per month.<sup>2</sup>

Three options are available:

- Employer-paid tax-free benefit to employees
- Employee-paid using pre-tax income
- Any combination of employer or employee financial contribution.

This step alone, with no financial contribution, will save 30–40%. Transit benefits are very easy to administer, and unlike flexible spending accounts, are not subject to complex disclosure and reporting requirements.

### 3. Regional discounted bus-pass programs

Three regional programs offer savings on bus passes, from 5% to 25%.

- **Metropass** is an annual unlimited-ride pass that employers purchase to sell or give to employees.
- **Transitworks!** allows employers to sell on-site, or give, 31-day and Stored Value bus passes to employees on a monthly basis.<sup>4</sup>
- **Commuter Checks** are transit (bus and vanpool) vouchers that employers can give or sell to employees. The vouchers can be redeemed at all bus pass sales outlets or given directly to vanpool drivers for payment of monthly fees.

*“Transit is crucial to our ability to operate business downtown.*

*Metropass is a fabulous program.”*

BARBARA SHAW, TCF BANK



**Vanpools<sup>3</sup>** can also take advantage of the same federal and state tax benefits as those available for bus passes. A vanpool is a vehicle with a 7-person seating capacity carrying at least 4 passengers. These vanpools can be operated by groups of employees, employers, or by private providers. Vanpools can also take advantage of free or discounted parking rates in downtown Minneapolis and downtown St. Paul.

To find out about existing vanpool routes, creating a vanpool, and new regional incentives, contact **Metro Commuter Services** at 651-602-1602 or **VPSI**, a private vanpool provider, at 612-331-4299.



# 10 Easy Steps to Implement Transit Benefits

## step 1. Determine which regional bus pass program is best for you.

You must participate in one of the three regional transit incentive programs described in this guide to take advantage of federal and state tax benefits for bus passes<sup>5</sup>.

Some things to consider: The Metropass program requires an up-front purchase of passes, and a two-year contract. It also offers the largest savings. Transitworks! and Commuter Checks are available to employers of any size and can be bought in bulk and inventoried. Transitworks! provides more convenience for employees but slightly more administrative commitment as bus passes are sold on-site; Commuter Checks have the advantage of being used for both bus passes and vanpool expenses.

## step 2. Meet with representatives from your human resource department, payroll department, and employee union to determine the impact of new transit benefits on existing benefits and procedures.

- ▶ It is critical to assess the impact of any salary reduction on other benefits. A salary reduction (i.e., pre-tax bus pass purchase) may affect other benefits, such as 401 (k) plans, long-term disability insurance, and Social Security.
- ▶ Unions may raise equity issues if only a subset of employees receive transit benefits. Since parking can also be set up as a pre-tax benefit (up to \$190/month), you may want to offer all employees a standard transportation allowance. However, only employer expenditures on transit or vanpool expenses are eligible for the 30% state corporate income tax credit.

- ▶ Who is eligible? Any employee except partners, more than 2% S-corporation shareholders, or independent contractors are eligible for the federal and state pre-tax benefits. Any employer that pays state corporate income tax is eligible for the 30% tax credit for transit expenses.

*NOTE: Transit Benefits (Section 132 (f) of the Internal Revenue Code) may not be offered through cafeteria plans (Section 125 of the IRC).*

## step 3. Decide what level of benefit to provide.

A program to meet every budget is available. Transit benefits can be arranged as:

- ▶ an employer-paid tax-free fringe benefit
- ▶ a pre-tax income (salary reduction) for employees
- ▶ any combination of employer-employee financial contribution

As a result, employers can directly subsidize transit programs as much or as little as they choose and still take advantage of substantial tax benefits.

In the employee-paid (pre-tax income) scenario, we recommend allowing only one or two salary reduction options to employees. This will help simplify program administration. With Metropass



all employees can join the program for the same salary reduction each month. If you are using Transitworks! or Commuter Checks, you may want to offer two monthly salary reduction options: for example, \$85/month or \$70/month to allow for variation in bus fares paid or days commuting each month.

## step 4. Create a simple benefit plan document.

Although not required by the IRS, you should create a simple plan document that details how employees enroll in and leave the program, the relationship to other employee benefits, and how accounting records will be maintained. This will help avoid disputes with employees and serve as a guide to administer the plan.



## step 5. Create an election form (only required with the employee-paid, pre-tax income option).

If employee bus passes are paid for entirely by the employer, no election form is necessary. In the case of employees using pre-tax income, the IRS requires that before receiving the transit benefit, employees sign a form stating that they elect to have their salary reduced (called an election form). You can use the same form to fulfill the Minnesota requirement that employers obtain written authorization from employees for any salary reduction. The form must include the date of the election, the amount of compensation to be reduced, and the period for which the election will apply.

## step 6. Create an enrollment schedule and exiting procedure.

As with other benefits, you need to create a procedure for when and how employees enroll in and exit a transit benefit program. You decide who is eligible for the benefit and the details of when employees can enroll in and exit the program. Most often, employers allow month-to-month entry and exit with a mid-month notification deadline.

## step 7. Keep accurate records of modified payroll system and pre-tax salary reductions.

- ▶ Modify payroll system for reductions.
- ▶ Withhold salary from employees.
- ▶ Modify W-2s for reduced wages. Pre-tax transit deductions can be noted in Box 14 (miscellaneous deductions) on Form 1099.
- ▶ Keep accurate records of the purchase of bus passes from Metro Transit or the Commuter Check Corporation. Under the employee-paid, pre-tax income scenario, you must reconcile the employer expenditure on bus passes with the pre-tax salary deductions by employees.

## step 8. Introduce the new transit benefit to employees.

Employees stand to save a significant amount of money by taking advantage of employer-sponsored transit benefits. Use regular communication channels to inform employees of this new benefit. Also, your Commuter Choice Partners (see back of Guide) can help inform employees of their bus options and simplify riding the bus for the first time.

*continued on next page*

