

## IRS Updates Guidance on Transportation Fringe Benefits Provided Through Electronic Media

Incorporating technological changes, the IRS recently updated its guidance on employers' use of smartcards, debit cards, and other electronic media to provide their employees with qualified transportation benefits on a pre-tax basis. Under this guidance, the value of transit benefits provided via cards restricted to use as transit fare, or to purchase transit fare, can be excluded from gross income, as can delivery charges for passes purchased online. Beginning December 31, 2015, an employer may not use cash reimbursements for qualified transportation benefits where terminal-restricted debit cards are readily available. Employers should review their existing use of electronic media to provide qualified transportation benefits, and modify and update procedures as necessary.

### Background

Code section 132 provides that "qualified transportation benefits" are excluded from gross income. This means that employers can pay certain transportation costs — including transit passes, qualified parking, and transportation in a commuter highway vehicle between home and work — and employees can exclude the value of these benefits from their gross income. The maximum amount that an employee may exclude from gross income and wages for 2015 is \$130 per month for transportation in a commuter highway vehicle and transit passes (in the aggregate), and \$250 per month for qualified parking. The limits are adjusted each year for inflation.

**Comment.** Congress recently passed a bill that retroactively raised the monthly mass-transit subsidy from \$130 to \$250, but only for 2014. President Barack Obama signed this bill into law last week. For more information on this bill and related administrative issues, please see our [December 18, 2014 For Your Information](#).

Employers can provide qualified transportation benefits directly by purchasing transit passes and distributing them to employees, or indirectly by distributing vouchers accepted by mass transit operators (such as trains, subways, and busses) as fare



### Electronic Transit Terminology

**Fare media** – methods by which transit fares are paid, including fare cards, passes, transfers, tickets, and vouchers

**Smartcard** – card containing a memory chip that stores information uniquely identifying the card and the value stored on it, and can be used either to pay a fare or purchase fare payment, e.g. the SmarTrip card used by the Washington Metropolitan Area Transit Authority

**Terminal-restricted debit card** – card that can be used only at vendors that only sell fare media (and nothing else), e.g. the Bay Area Clipper commuter debit card

**Merchant category code (MCC)-restricted debit card** – card that can be used to make a purchase from an approved vendor that sells a variety of merchandise, e.g., the TRANServ Debit Card available to certain federal employees

media or in exchange for fare media. In providing benefits indirectly, an employer must use any “readily available” voucher (or similar item) that may be exchanged only for a transit pass given directly to the employee. The IRS considers a voucher readily available if the employer can obtain it without charges greater than 1 percent of the average annual value of the voucher, and without other restrictions.

Where a voucher is not readily available, an employer may reimburse employees for transportation benefits — but only under a “bona fide reimbursement arrangement” that (1) only provides payment for expenses that have already been incurred (and not those that are expected to be incurred in the future), and (2) requires some form of employee substantiation. Employee substantiation is not required for in-kind distribution of transit passes or vouchers.

Responding to the increased availability of electronic transit media, the IRS first addressed the use of that media for employer-provided transportation benefits in [Revenue Ruling 2006-57](#). Under that guidance, smartcards, debit cards, and other electronic media funded and distributed by an employer are generally treated as vouchers so long as they can only be used to purchase transit passes and no other items. Otherwise, cash reimbursement rules apply — including to debit cards usable only at vendors assigned a merchant category code (MCC) indicating that they sell fare media, in addition to other items. For more information on the 2006 guidance, please see our [December 14, 2006 For Your Information](#).

## Updated Guidance on Electronic Media

[Revenue Ruling 2014-32](#) reaffirms parts of, modifies, and supersedes Revenue Ruling 2006-57 and other prior guidance on the use of transit cards, debit cards, and cash reimbursement arrangements. The takeaways from this ruling are as follows:

### Cards usable only as fare media, or only to purchase fare media, are qualified transit passes excludable from employee gross income, including:

- Smartcards that can only be used as fare media
- Terminal-restricted debit cards that can only be used at vendors that only sell fare media for a transit system
- Terminal-restricted debit cards that can be used only at vendors that have been assigned an MCC but also sell merchandise other than transit fare media (for example, grocery stores that sell transit passes) — so long as the cards only work to purchase fare media

**Comment.** These types of cards are sometimes referred to as “locked” cards because, while they allow for the purchase of fare media, they cannot be used to buy other items.

**Delivery charges for transit passes employees purchase online are included as part of the transit benefit.**

Where employees obtain a qualified transit pass online, a delivery charge for the pass may be excluded from income along with the value of the pass itself.

**Cash reimbursement arrangements are no longer permitted where terminal-restricted debit cards are readily available.** Beginning December 31, 2015, employers cannot reimburse employees in cash for transit benefits if a terminal-restricted debit card is readily available in the relevant geographic area.

**Purchases made using an MCC-restricted debit card that require a cash reimbursement arrangement must meet specific requirements:**

- Advances — rather than reimbursements — are not permitted. During the first month of participation, an employee must pay for the fare media with after-tax dollars and substantiate those amounts before the employer may reimburse. For subsequent months, the employer may reimburse the employee for fare media substantiated by periodic MCC-restricted debit card statements providing sufficient information on the card's use.

**Comment.** Substantiation requirements can present a considerable administrative burden on employees and employers alike. Employees have to pay with after-tax dollars at the outset and keep their used passes, and the employer is responsible both for initial verification as well as spot checks on the use of the debit card.

The IRS provides a similar substantiation obligation for qualified expenses paid or reimbursed under a health FSA or dependent care assistance program (DCAP) provided through a cafeteria plan. Although a qualified transportation plan can be offered alongside a cafeteria plan, it must be a separate and distinct arrangement.

- Employee certifications are required. For the first month the card is used, prior to receiving reimbursement, the employee must certify that the card was only used to purchase fare media. For subsequent months, no certification is required prior to reimbursement of expenses that match the vendor and time period covered for expenses previously substantiated. However, an employee must provide a certification once annually.

**Smartcards with separate accounts for transit and non-transit use will qualify as transit passes only if the employer purchases the card and distributes transit funds to employee accounts.** An employer-provided debit card that an employee can use to fund transit or non-transit benefits available via a smartcard will not qualify as a transit pass.

## In Closing

Qualified transportation benefits may be more attractive to employers as well as employees now that more transit systems are using electronic payment methods. In response to changing technologies, the IRS has updated its rules for qualified transportation fringe benefits to expand the types of vendors from which employees may purchase transit fare and to include delivery charges for online employee purchases as part of the benefit. Nevertheless, employers in areas where transit system vouchers are not yet readily available may continue to find the administration of cash reimbursement arrangements burdensome.

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