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The Honorable Todd Kaminsky
New York State Senator
Legislative Office Building, Room 307
Albany, NY 12247

Dear Senator Kaminsky:

I am responding to your letter dated July 13, 2020 in which you wrote about employer-provided transportation benefits. Specifically, you asked whether employees may receive cash refunds for unused transportation benefits that accumulated in their transit benefit accounts as a result of compensation reduction agreements.

Employers who provide their employees with transportation benefits can exclude those benefits from their employees' gross incomes if the benefits are "qualified transportation fringes." Section 132(a)(5) of the Internal Revenue Code (the Code). A qualified transportation fringe is:

- Transportation in a commuter highway vehicle between home and work
- Any transit pass
- Qualified parking

Section 132(f)(2) of the Code provides that the amount of qualified transportation fringes an employer provides to an employee that can be excluded from gross income under Section 132(a)(5) cannot exceed a maximum monthly dollar amount, adjusted for inflation. The adjusted maximum monthly excludable amount for 2020 is \$270 per month for qualified parking. There is a separate \$270 monthly limitation for the

combined total amounts of transportation in a commuter highway vehicle and transit passes. The Code and regulations define transit passes as any pass, token, farecard, voucher or similar item entitling a person to transportation (or transportation at a reduced price) if such transportation is on mass transit facilities or is provided by any person in the business of transporting people for compensation or hire in a commuter highway vehicle.

An employer can make cash reimbursements to an employee for expenses related to qualified parking or transportation in a commuter highway vehicle only under a bona fide reimbursement arrangement. The arrangement must satisfy the substantiation requirements. See Section 1.132-9(b), Q&A-16. However, there are no employee substantiation requirements in the case of transit passes provided in kind. See Section 1.132-9(b), Q&A-18. Because there are no employee substantiation requirements in the case of transit passes, an employer may use an employee's compensation reduction amounts to provide transit passes with a value not exceeding the maximum excludable amount in any month without ensuring that the value of the transit passes provided does not exceed the employee's expenses. However, cash reimbursements for transit passes qualify only if a voucher or similar item that the employee can exchange only for a transit pass isn't readily available for employers to distribute directly to employees. Section 132(f)(3) and cash reimbursements have to be made under a bona fide reimbursement arrangement.

Section 132(f)(4) provides an exception from constructive receipt principles that permits employers to offer employees a choice between cash compensation and any qualified transportation fringe. Accordingly, employers may provide qualified transportation fringe benefits up to the applicable statutory monthly limit either in addition to employees' stated compensation, or by reducing employees stated compensation (compensation reduction). For purposes of responding to your letter, we assume that what you refer to as "pre-tax benefits" are amounts received through compensation reduction agreements. In a compensation reduction agreement, employees may designate a portion of the amount they would otherwise receive as compensation to fund qualified transportation fringe benefits they then receive from their employer. The law excludes the amount of the compensation reduction from an employee's income and wages for federal tax purposes if the employee uses compensation reduction amounts exclusively to fund qualified transportation fringes.

Employees can elect to reduce their compensation each month by an amount that does not exceed the maximum monthly excludable amount. When an employee elects to reduce their compensation for a month by an amount that exceeds the qualified transportation fringes actually provided in that month, the employer may apply this excess towards qualified transportation fringes in subsequent months. This applies as long as the employee does not receive qualified transportation fringes in excess of the maximum excludable amount in any month. Regulations Section 1.132-9, Q&A 15. Therefore, if an employee elects a monthly compensation reduction of \$200 to reimburse qualified parking expenses, but the employee incurs only \$150 in qualified

parking expenses for that month, the excess \$50 rolls over for future parking expenses. This includes a future month in a subsequent year. Regulations Section 1.132-9, Q&A 15(b).

In no case, however, may the employer provide a cash refund, even when the employee's compensation reduction amounts exceed the employee's qualified transportation fringes. Regulations Section 1.132-9, Q&A 14. In other words, an employee may receive a cash reimbursement of compensation reduction amounts only as a reimbursement of qualified transportation fringes.

We understand that due to the COVID-19 pandemic, an employee's previously elected reoccurring compensation reduction may need proper adjustment for the future. If an employee makes no election change, their compensation reductions will automatically continue, and funds will continue to accrue and roll over monthly. However, if an employee makes an election change, future compensation reductions may be reduced or stopped. An employee may revoke a compensation reduction election at any time during the year before the employee is able to receive the cash or other taxable amount at the employee's discretion and before the beginning of the period for which the qualified transportation fringe will be provided. Regulations Section 1.132-9, Q&A 14(c). Funds available prior to the revocation of a compensation reduction election will continue to be available and may be rolled over for use in a subsequent month, subject to the limitation that the employee may not receive qualified transportation fringes that exceed the maximum monthly excludable amount in any month.

The information in this letter does not constitute a ruling and is intended for informational purposes only. I hope it is helpful. If you have questions, please contact me at _____ or _____ at _____.

Sincerely,

Janine Cook
Acting Associate Chief Counsel
(Employee Benefits, Exempt Organizations and
Employment Tax)