

Part III - Administrative, Procedural, and Miscellaneous

Request for comments on the use of debit cards to provide qualified transportation fringes under section 132(f)

Notice 2004-46

PURPOSE

Employers and others have asked for clarification of their ability to use debit cards to provide their employees with qualified transportation fringes described under § 132(f). Qualified transportation fringes include transportation in a commuter highway vehicle (vanpooling), any transit pass, and qualified parking (collectively referred to herein as “transit benefits”) meeting the requirements of § 132(f). Qualified transportation fringes are excluded from the employee’s gross income and from wages for purposes of employment tax.

A qualified transportation fringe includes cash reimbursement for transportation in a commuter highway vehicle and qualified parking. However, under § 132(f)(3), a qualified transportation fringe does not include cash reimbursement for a transit pass if a voucher or similar item that may be exchanged only for a transit pass is readily available for direct distribution by the employer to the employer’s employees. Thus, in circumstances where vouchers are readily available, an employer must provide vouchers to its employees in order for a transit pass benefit to be excludable from gross income and wages under § 132(f). If a qualified transportation fringe can be provided through cash reimbursement, the employer must use a bona fide reimbursement arrangement. To meet the requirements for such an arrangement, first the payment must be a reimbursement, and not an advance. See § 1.132-9(b) Q/A-16(a). Second, the employee must substantiate to the employer that an expense for a transit benefit was actually incurred. See § 1.132-9(b) Q/A-16(c). There are monthly limits on the dollar value of qualified transportation fringe benefits that an employer may provide to an employee and exclude from the employee’s income and wages. The monthly limits vary depending upon the type of benefit, and are currently \$195 per month for qualified parking and \$100 per month for transit passes.

Treasury and the Service are seeking information about how debit card technology works. The operation of the technology is directly relevant to answering a number of questions that arise when applying the qualified transportation fringe benefit regulations. For example, should a debit card be considered a voucher that may be exchanged exclusively for a transit pass? If so, should employers be barred from using cash reimbursement to provide transit passes to their employees as qualified transportation fringe benefits, even if vouchers are not otherwise readily available? If a debit card can be used to purchase more than one kind of fringe benefit, does an

employer provide an advance or a reimbursement when it provides a debit card for use in purchasing various transportation benefits? Can a debit card system be established to keep amounts designated for different types of transit benefits separate to ensure that the statutory monthly limits applicable to the different types of benefits are not exceeded?

The Service and Treasury request comments on the issues described below, and any other comments on the use of a debit card to provide transit benefits, from all persons affected by this issue, including employers, employees, transit operators, voucher providers, debit card providers, and third party administrators.

BACKGROUND

Section 132(a)(5) provides that any fringe benefit that is a qualified transportation fringe is excluded from gross income.

Section 132(f)(1) provides that the term "qualified transportation fringe" means (1) transportation in a commuter highway vehicle between home and work, (2) any transit pass, and (3) qualified parking. The amount of the fringe benefit which may be excluded from gross income and wages is currently limited to \$100 per month for the aggregate of transportation in a commuter highway vehicle and transit passes, and \$195 per month for qualified parking. See § 132(f)(2); Rev. Proc. 2003-85, 2003-49 I.R.B. 1184.

Section 132(f)(5)(A) provides that a transit pass means 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 persons for compensation or hire in a commuter highway vehicle. See § 132(f)(5)(B) for the definition of a commuter highway vehicle.

Section 132(f)(3) provides that a qualified transportation fringe includes a cash reimbursement by an employer to an employee for transit benefits. However, a qualified transportation fringe includes cash reimbursement by an employer to an employee for a transit pass only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

Income Tax Regulations § 1.132-9(b) Q/A-16(b)(2) provides that a transit system voucher is an instrument that may be purchased by employers from a voucher provider that is accepted by one or more mass transit operators in an area as fare media or in exchange for fare media. Under § 1.132-9(b) Q/A-16(b)(3), a voucher provider is any person in the trade or business of selling transit system vouchers to employers, or any transit system operator that sells vouchers to employers for the purpose of direct

distribution to employees.

Section 1.132-9(b) Q/A-16(b)(4) provides that a voucher or similar item is readily available for direct distribution by an employer to employees if and only if the employer can obtain it from a voucher provider who does not impose fare media charges greater than 1 percent of the average annual value of the voucher for a transit system, or does not impose other restrictions causing the voucher not to be considered readily available. See § 1.132-9(b) Q/A-16(b)(5) and (b)(6).

Section 1.132-9(b) Q/A-16(a) provides that the term qualified transportation fringe includes cash reimbursement for transportation in a commuter highway vehicle, transit passes (if permitted), and qualified parking, provided the reimbursement is made under a bona fide reimbursement arrangement. A payment made before the date an expense has been incurred or paid is not a reimbursement, even if the employee certifies in advance that the employee will incur expenses at some future date. Under § 1.132-9(b) Q/A-16(c), a bona fide reimbursement arrangement is an arrangement under which the employee must substantiate to the employer within a reasonable period of time that an expense for transit benefits has been paid.

Section 1.132-9(b) Q/A-18 provides that no substantiation is required if the employer distributes a transit pass (including a voucher) in-kind to the employer's employees.

In Rev. Rul. 2003-43, 2003-21 I.R.B. 935, the Service held that under certain circumstances employer-provided expense reimbursements may be made through a debit or credit card, or certain other electronic media, and be excludable from gross income under § 105. The use of a debit card, by itself, generally was not found to be sufficient to meet the substantiation requirement under § 105(b). Instead, in addition to requiring that the Merchant Codes for the debit cards be restricted, the employee is required to substantiate the expense incurred, albeit after the initial transaction. In addition, under certain circumstances the substantiation requirement can be met without additional substantiation. First, a payment made at a doctor's office in the amount of a copayment is deemed to satisfy the substantiation requirement. Second, recurring expenses that have been previously actually substantiated are deemed to meet the substantiation requirement. Third, real-time verification at the point of sale is deemed to meet the substantiation requirement. Other than copayments, recurring expenses, and real-time substantiation, the revenue ruling requires that expenses paid through a debit card be treated as conditional pending confirmation of the charge.

ISSUES ON WHICH COMMENTS ARE SPECIFICALLY REQUESTED

1. Given existing technology, under what circumstances, if any, should a debit card be considered the equivalent of a voucher or similar item described in §

132(f)(5)(A)? We understand that a debit card may be restricted for use only at merchants with certain Merchant Codes or specific merchant card terminals. Would a rule that required use of a debit card to be limited to merchants with certain Merchant Codes or merchant card terminals be administrable? Would such a rule provide adequate controls consistent with the statutory objective of ensuring that amounts are only used to provide transit pass benefits within the meaning of § 132(f)(5)(A)? For example, under what circumstances could a debit card with Merchant Code restrictions be used to purchase something other than a transit pass within the meaning of § 132(f)(5)(A)? In addition, under what circumstances should a debit card be restricted for use only at a particular merchant card terminal in order to be considered a voucher or similar item for purposes of § 132(f)(3)?

2. If a debit card is a voucher or similar item, should the availability of the debit card in an area in which a voucher or similar item is otherwise not readily available preclude cash reimbursement for a transit pass in that area? For example, in Metropolitan Area A, a voucher or similar item is not considered readily available because fare media charges imposed by voucher providers in A exceed 1 percent of the average annual value of vouchers for a transit system. However, the charges associated with using a debit card in A that is the equivalent of a voucher or similar item are less than 1 percent of the annual value of the debit card for the transit system. Should the debit card be considered a readily available voucher in A for purposes of § 132(f)(3), and thus preclude cash reimbursement for a transit pass in A?

3. Is it appropriate to allow the use of recurring transaction substantiation such as that described in Rev. Rul. 2003-43 to meet the requirement under § 132(f)(3) that a transit pass benefit be provided through distribution of a voucher or similar item instead of cash reimbursement? For example, in circumstances in which fare media may be purchased from a merchant who is not in the trade or business of providing transportation services, and thus does not have a Merchant Category Code indicating that the merchant sells only transit passes, e.g., a convenience store, under what circumstances, if any, should recurring transaction substantiation be deemed to satisfy the requirement that a voucher or similar item be distributed?

4. Under what circumstances should an expense related to transportation in a commuter highway vehicle, a transit pass (assuming cash reimbursement is permitted), or qualified parking paid with a debit card be considered to be a bona fide reimbursement (i.e., not an advance), and considered adequately substantiated within the meaning of § 1.132-9(b) Q/A-16(c)?

5. Under what circumstances, if any, could a debit card be used to provide multiple qualified transportation fringes (e.g., qualified parking and a transit pass), and adequately ensure that the respective applicable statutory monthly limits for qualified transportation fringes are not exceeded? Given existing technology (such as multiple

purses on a debit card, and Merchant Code technology), is it possible, and, if so, how is it possible, to ensure that amounts designated for a particular benefit are used for the intended benefit, and thus that the separate applicable statutory monthly limits for transportation in a commuter highway vehicle and transit passes, and qualified parking are not exceeded? For example, if an employer provides through the use of a debit card a \$150 monthly benefit for parking and a \$100 monthly benefit for transit passes, how may use of the debit card be restricted to ensure that the respective applicable statutory monthly limits for qualified parking and other qualified transportation fringes are not exceeded?

DATES: Written and electronic comments must be submitted by October 19, 2004.

ADDRESSES: Send submissions to: CC:PA:LDP:PR (Notice 2004-46), Room 5203, Internal Revenue Service, P.O.Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW., Washington, DC 20224, Attn: CC:PA:LPD:PR (Notice 2004-46), Room 5203.

Alternatively, taxpayers may send submissions electronically directly to the Service at: Notice.comments@irs.counsel.treas.gov. All materials submitted will be available for public inspection and copying.

FOR FURTHER INFORMATION CONTACT:

- Concerning submissions, Guy Traynor at (202) 622-7180.
- Concerning this notice, John Richards of the Office of the Associate Chief Counsel (Tax Exempt & Government Entities) at (202) 622-6040 (not toll-free calls).