COMMUTER BENEFITS PROVISIONS OF THE TAXPAYER RELIEF ACT OF 1997

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SUMMARY

Commute benefits, sometimes called transportation fringe benefits, are items such as parking spaces, transit passes, vanpools, bicycle lockers or changing facilities provided by employers to defray the costs to employees of transportation to and from work. The Taxpayer Relief Act of 1997 makes offering a menu of commute benefits far more appealing to employers. Downtown employers and their employees are most likely to take advantage of the new tax law provisions.

The new law will aid efforts to attract and retain a downtown workforce. Increased availability of the full menu of tax-exempt commute benefits, combined with the choice to take salary instead of certain benefits, is expected to create noticeable net shifts in commute modes, principally from single-occupant driving to carpooling and transit. The law will improve air quality commensurate with its impacts on transportation mode-share.

The new tax law will be of interest to air quality and transportation planners long concerned that relentless growth in vehicle travel might offset the benefits of cleaner cars, fuels and factories. Air quality agencies may wish to develop more effective transportation control measures and adjust their emissions baselines to account for the new law, conduct outreach to employers and offer comprehensive commute benefits to their own employees. In addition, transportation and local planning agencies may wish to expand transit pass programs (referred to as Transit Check); use multiple transportation options, instead of just parking, to attract and retain downtown employers; and reexamine parking-related zoning practices.

WHAT ARE COMMUTE BENEFITS?

Commute benefits (defined above) are typically purchased by employers and offered in-kind to employees. The most common commute benefit offered to employees in the United States, indeed the most common fringe benefit of any kind, is employer-provided parking. A study by KPMG/Peat-Marwick finds that employers spend $36 billion annually on employee parking. A number of surveys have shown that 90% or more of the non-farm labor force is eligible for free parking at work and that nearly all who are eligible for parking drive to work alone. Even in the central business districts of cities with populations above three million, employers provide more than half of the parking used by those who drive to work alone.

Though commonplace in the early part of the century, employer-provided transit benefits all but disappeared until a tax exemption was created for them in the Energy Policy Act of 1992. Transit benefits are generally provided to employees in the form of passes bought from transit providers or transportation management associations in denominations of $10 or more, with colorful names such as TransitChek, MetroChek, T-Bill, and others (we refer to these as Transit Check in this report). The U.S. Environmental Protection Agency

(EPA) estimates that about 1% of the non-farm labor force is offered transit benefits at work, but there is no data on acceptance rates. Also, it is thought that transit benefits do not typically cover the full fare.

TAX LAW AND COMMUTE BENEFITS

Federal law offers important tax advantages to employers who provide employees with a choice of commute benefits.[♙] The law allows employers to provide commute benefits with *pre-tax* dollars. The cost of these benefits is not taxed as income. Commute benefits for which favorable tax treatment is allowed include:

- Up to $170 per month of parking at or near the work site
- Up to $65 per month of public transit for work commute transportation
- Up to $65 per month of vanpool services for work commute transportation[•]

Most employers have provided tax-exempt parking to their employees for many years, but few added vanpool or transit benefits when these were created in 1992 or allowed employees who did not drive to exchange parking benefits for salary. This was because tax-exempt commute benefits could only be provided *in addition to salary*. To offer more commute choice, employers had to give their employees a raise. Few were willing to increase their compensation and benefits budgets for this purpose in an era of downsizing in the public and private sectors.

The Taxpayer Relief Act of 1997 makes offering a menu of commute benefits far more appealing to employers. The new law effectively allows an employer to *finance commute choices with money already being spent* on compensation and benefits. Employers who presently spend money to provide tax-exempt parking can now offer employees the additional choices of taxable cash or tax-exempt (up to the dollar limits described above) transit or vanpool services. Employers who do not presently spend money to provide tax-exempt parking can now offer their employees who drive the ability to pay for parking with *pre-tax* salary, and may be able to offer the choice of tax-exempt transit or vanpool services as well.[★] Under the new law, employers can offer an expanded menu of commute benefits that increase employee welfare within existing compensation and benefits budgets, and in some cases, with net savings.

[♙] Federal tax law related to commute benefits is contained in Section 132(f) of the Internal Revenue Code, which is Title 26 of the United States Code. Federal laws (relating to Federal income and other taxes) are generally incorporated by reference into state law (relating to state taxes). The changes discussed here will generally have similar impacts with respect to state and local income taxes where these exist.

[•] The dollar limits on all of the commute benefits are indexed to inflation. They will rise over time (in $5 increments) in proportion to cost of living indicators.

[★] However, the new law does not permit employers who offer only tax-exempt transit and/or vanpool benefits to provide either of these benefits in lieu of salary or other forms of compensation.

BENEFITS TO DOWNTOWN EMPLOYERS

Downtown employers and their employees are most likely to take advantage of the new tax law. Transportation alternatives offer their best services to downtown work sites. Downtown parking spaces are typically sold in discrete fashion, i.e. on a space by space basis, making it relatively easy for employers to shift spending between parking, other tax-exempt commute benefits, and salary. Moreover, downtown employers have significant incentives to depart from current practices. Downtown parking garage revenues rose by 39% between 1987 and 1992, according to the Economic Census of the United States. Today, in the downtown areas of even mid-sized cities such as St. Paul, individual parking spaces sell for as much as $220 per month. Parking costs are rising at a rate faster than inflation. A study at the University of California at Los Angeles finds that inflation-adjusted construction and maintenance costs nearly doubled between the 1960s and 1990s, due to rising land and construction costs as well as the need for tighter security and safety in parking lots.

Downtown employers consider transportation an important factor in workforce retention and attraction, and the new tax law offers significant potential benefits in this area. A study of eight Southern California employers who began offering their employees the choice to take cash in lieu of parking benefits reveals a high degree of satisfaction with the program among employees and employers. Employers described their programs as effective employee recruitment and retention incentives. Program Administrators characterized the program as “a really good experience”, “recommended”, “fairer”, “very little administrative burden” and “loved by employees.” In New York and Philadelphia, 70% of employees reported a more positive view of their employers after they began offering Transit Check. When asked to rate the importance of commute benefits to employees, 48% of New York and Philadelphia employers labeled them “very important” and another 40% labeled them “somewhat important.”

The new tax law may have longer-term implications even for suburban employers, who own or lease parking in large blocks and provide it free of charge to employers nearly 100% of the time. Such employers may wish to offer additional commute choices to limit the cost of constructing new parking, where existing supply is limited, or where driving to work must be reduced to address regional congestion or air quality concerns. Although suburban work sites are often inadequately served by transit, studies show that when offered an array of commute benefit choices, three-quarters of those who leave their cars opt for carpooling and telecommuting. The appeal of commute benefit choices is not solely dependent on the quality of public transit service to the work site.

TRANSPORTATION IMPACTS

Increased availability of the full menu of tax-exempt commute benefits, combined with the choice to take salary instead of certain benefits, should create noticeable shifts among transportation modes. The magnitude of these shifts will depend on many site-specific factors and, most importantly, on the manner and extent to which employers respond to the incentives created by the new tax law. Eight Southern California employers who began offering their employees the choice to take cash in lieu of parking benefits observed a 12% decline in the number of cars driven to work within one year. The use of carpooling nearly doubled. In the New York Metropolitan Area, between 16% and 23% of employees who previously drove to work had switched to transit as their primary means of commuting less than a year after their employers began offering Transit Check. And, while it is commonly believed that transportation alternatives appeal most strongly to persons with lower incomes, the law firm of Sidley & Austin found that 85% of its Chicago workforce regularly used transit after the firm began offering Transit Check.

For those relatively few employees who *are not* presently eligible to receive tax-exempt parking from their employers, the new law's impact on mode-share is uncertain. The law gives employers the option to allow these employees to convert taxable salary to tax-exempt free parking. This will lead some individuals to abandon other transportation modes in favor of driving alone. But such employers might also begin offering the other tax-exempt commute benefits, transit and vanpool services, which would attract some individuals to these alternatives.

AIR QUALITY IMPACTS

Environmental considerations will remain important factors in transportation policy for governments and for private firms. According to EPA, highway vehicles made up 31% of nationwide emissions of pollutants that cause urban smog in 1995. EPA has recently finalized rules tightening ambient air quality standards for soot and smog. There is also rising concern over U.S. emissions of greenhouse gases, a third of which are from motor vehicles.

The new law should improve air quality commensurate with its impacts on transportation mode-share. Using methodologies developed by the California Air Resources Board, UCLA researchers estimate that each commute vehicle removed from the road in Southern California takes with it 56 pounds per year of soot and smog-producing air pollutants, and more than two tons of greenhouse gases.

THE ROLE OF COMMUTER CHOICE IN AIR QUALITY PLANNING

The new tax law will be of interest to air quality planners long concerned that relentless growth in vehicle travel might offset the benefits of cleaner cars, fuels and factories. The commute benefits approach offers distinct advantages over previous efforts to address vehicle travel – such as employee trip reduction programs – which have met with widespread resistance from business. The new law encourages the established compensation and benefits community to address the issue of commute benefits where other approaches have relied on environmental agencies unfamiliar with complex human resources issues. The new law relies on positive incentives and gives employers flexibility to address commute benefits issues within the context of site specific circumstances.

HOW CAN AIR QUALITY AGENCIES ENCOURAGE COMMUTER CHOICE?

Although individual employers must ultimately take action, state and regional environmental agencies can adopt measures to enhance the new law's positive environmental implications. These include the following:

- **Use the new law as a base for more effective Transportation Control Measures.** In California, for example, a 1991 state law *requires* certain employers in polluted areas to offer the choice of cash to employees who receive free parking. The Taxpayer Relief Act of 1997 effectively permits California employers to comply with State law without incurring negative tax consequences. California has successfully included this law as a transportation control measure in its State Implementation Plan for Los Angeles.[Ψ] In other places, programs to encourage employers to offer Transit Check and other employee commute options offset the need for more expensive pollution controls.
- **Adjust emissions projections to account for the positive impacts of commuter choice.** Air quality planners may wish to re-examine their assumptions and adjust baseline forecasts of future growth in commute vehicle travel in light of the new law.
- **Conduct Outreach to private employers.** Many employers are unaware of the potential of comprehensive commute benefits for themselves or their employees. Government agencies should work with employer-organized transportation management associations in this area.
- **Offer comprehensive commute benefits options to government employees.** Government agencies typically lag behind the private sector in implementing compensation and benefits packages that increase employee welfare. Public agencies do not respond to the same tax incentives as private employers and they tend to be larger more complex organizations. However, government agencies can set an important example in the area of commute benefits while increasing employee satisfaction within tight fiscal limits.

[Ψ] Limited mandatory "Parking Cash Out" will go into effect if Los Angeles fails to attain the ambient air quality standard for Carbon Monoxide in 2000 (Rule 1504 of the South Coast Air Quality Management District). Commuter choice is also a compliance option for employers covered by employer trip reduction requirements in the State Implementation Plan (Rule 2202).

EPA appears ready to permit states to take credit for both voluntary and mandatory programs that increase the availability to employees of the full menu of tax-exempt commute benefits and the choice to take salary instead of parking benefits. Relevant guidance from EPA is forthcoming in two documents. One addresses market-based transportation control measures and the other addresses voluntary control measures.

HOW CAN TRANSPORTATION AND PLANNING AGENCIES ENCOURAGE COMMUTER CHOICE?

State and local transportation and planning agencies can take additional steps to enhance the economic, mobility and environmental benefits of the new law. These include the following.

- **Offer Transit Check.** Large-denomination transit passes are a convenient way for employers to purchase transit services for their employees. Employers are unlikely to offer transit as part of a comprehensive package of commute benefits without Transit Check, because of the inconvenience and because of the difficulty of maintaining records for tax purposes. The best Transit Check programs allow employers to purchase passes that work on all regional transit systems, e.g., bus, light rail and commuter rail. The New York Metropolitan Transit Authority earned $1 million in revenue from new ridership within one year of a $500,000 investment in Transit Check.
- **Use multiple transportation options, instead of just parking, to attract and retain downtown employers.** Many municipalities have historically used free municipal parking as an incentive for employers to locate downtown. For example, the City of St. Paul, recently announced plans to provide 400 subsidized parking spaces to keep a business downtown. Under the new tax law, cities can encourage employers to offer a menu of commute benefits as a way to manage demand.
- **Reexamine parking zoning practices**. Municipalities often require new buildings to incorporate more parking spaces than people. This practice increases development costs and virtually guarantees that employers will offer only free parking. Minimum parking requirements should be based on reasonable projections of parking demand, accounting for the impacts of the new tax law. Also, municipalities should continue the trend towards zoning requirements that encourage transit-oriented and transit-accessible development.

Commute benefits issues offer environmental, transportation and economic development agencies a rare opportunity to work together in an area of mutual interest. Both EPA and the U.S. Department of Transportation appear ready to assist state and local agencies towards this end.