

MEMORANDUM

Re: Statutory construction and various questions regarding provisions of 26 U.S.C. §132 pertaining to the Qualified Bicycle Commuting Reimbursement
Date: June 9, 2009

FACTS

Under the Emergency Economic Stabilization Act of 2008, the federal government created the Qualified Bicycle Commuting Reimbursement, which is a fringe benefit intended to be excluded from the gross income of an employee who rides a bicycle to work. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, Div. B, §211(a); 122 Stat. 2765, 3840. The benefit was codified as part of the United States tax code, becoming part of the nontaxable qualified transportation fringes allowed for in 26 U.S.C. §132(f) (2009). But following passage and enactment of the provision, some confusion has arisen among employers and other tax code observers over portions of the new provision, particularly with respect to the effect of the phrase “constructive receipt,” and how the phrase may limit the new provision’s force. There also are other undefined phrases in the section, which left some statutory vagueness, and questions over reporting the new benefits to the IRS.

- Q: Is a Qualified Bicycle Commuting Reimbursement allowed to be excluded from an employee’s gross income, thus rendering it nontaxable?**
A. Yes. A Qualified Bicycle Commuting Reimbursement is not included in an employee’s gross income, and is therefore nontaxable.

A fringe benefit is “a form of pay for the performance of services.” I.R.S. Publication 15-B (2009), Employer’s Tax Guide to Fringe Benefits, at 2 (Dec. 16, 2008). For employers and employees, fringe benefits are divided into two main categories, taxable and nontaxable fringe benefits. I.R.S. Publication 15 (2009), (Circular E), Employer’s Tax Guide, at 13 (Mar, 27, 2009). Any fringe benefit an employer provides an employee is taxable “unless the law specifically excludes it.” I.R.S. Publication 15-B at 2.

The Emergency Economic Stabilization Act of 2008 designated the Qualified Bicycle Commuting Reimbursement (QBCR) to be included in the United States Code section defining which fringe benefits are to be excluded from gross income. As a result of the Act, the tax code now provides: “Gross income shall not include any fringe benefit which qualifies as a ... qualified transportation fringe,” §132(a)(5), designating “any qualified bicycle commuting reimbursement” as a qualified transportation fringe. §132(f)(1)(D). According to the code, a QBCR is:

“[W]ith respect to any calendar year, any employer reimbursement during the 15-month period beginning with the first day of such calendar year for reasonable expenses incurred by the employee during such calendar year for the purchase of

a bicycle and bicycle improvements, repair, and storage, if such bicycle is regularly used for travel between the employee's residence and place of employment.”

§132(f)(5)(F)(i).

All qualified transportation fringes are subject to dollar-amount limitations provided in §132(f)(2). Cycling fringes are subject to “the applicable annual limitation in the case of any qualified bicycle commuting reimbursement.” §132(f)(2)(C). That amount is further defined in §132(f)(5)(F)(ii), which states that “ ‘applicable annual limitation’ means, with respect to any employee for any calendar year, the product of \$20 multiplied by the number of qualified bicycle commuting months during such year.” The code defines a qualified bicycle commuting month as one in which an employee “regularly uses the bicycle for a substantial portion of the travel between the employee’s residence and place of employment, and ... does not receive any benefit described in subparagraph (A), (B), or (C) of paragraph (1).” §132(f)(5)(F)(iii)(I)-(II).

Thus, according to the code, gross income shall not include a QBCR, rendering the benefit nontaxable. This is further supported by documentation at the time the bill was passed, which indicates the clear intention that the reimbursement should not be taxed. Rather it “allows employees to exclude reimbursements for bicycle commuting expenses from gross income.” Congressional Research Service, 110th Cong., summary accompanying the Emergency Economic Stabilization Act of 2008 (Oct. 3, 2008).

Regulatory documents published since passage of the Act further describe the tax status of the QBCR, indicating it is exempt from income tax withholding, Social Security and Medicare withholding, and federal unemployment taxes. I.R.S. Publication 15-B, at 5, Table 2-1.

Thus, §132(f) and the supporting interpretation by the IRS clearly state that a QBCR is nontaxable.

Limitations on the Reimbursement

There are a number of limitations on the reimbursement. Primarily, it is limited to \$20 maximum per calendar month, or a maximum \$240 per calendar year, subject to several conditions. §132(f)(5)(F)(ii). First, the reimbursement must be applied to “reasonable expenses incurred by the employee ... for the purchase of a bicycle and bicycle improvement, repair, and storage.” §132(f)(5)(F)(i). Because there is no apparent confusion with respect to what constitutes “reasonable expenses,” there will be no further discussion of its interpretation in this memorandum.

Also, the QBCR is subject to the limitations of “constructive receipt.” §132(f)(4). The bicycle must be “regularly used for travel between the employee’s residence and place of employment.” §132(f)(5)(F)(i). And only an employee who “regularly uses the bicycle for a substantial portion of the travel between the employee’s residence and place of employment” may participate in the program. §132(f)(iii)(I). Interpretation of the phrases “constructive receipt,” “regularly used”/“regularly uses,” and “substantial portion” are discussed in questions below.

The code also imposes restrictions on the QBCR by preventing it from being used in conjunction with other qualified transportation fringes. §132(f)(5)(F)(iii)(II). This

restriction is not placed on the other qualified transportation fringes in §132(f). I.R.S. Publication 15-B, Table 2-1, n.6; *accord*, 33A Am. Jur. 2d. *Federal Taxation* § 7226 (2009); *IRS Offers New Fringe Benefit for Bicycle Commuters*, Payroll Guide Newsletter (RIA), Oct. 24, 2008, 2008 WL 4562930.

Example 1

Improper combination of transportation fringe benefits: *Employee A has a two-part commute in which he rides his bicycle to the train station, and completes his commute via rail. Employee A wishes to receive both the QBCR as well as a transit pass under §132(f). This is not allowed. Employee A would have to choose to take either the \$20 monthly benefit for bicycle commuting, or the allowable benefit for a transit pass in a given calendar month.*

The code also limits the time for which an employer can reimburse an employee for the QBCR. An employer can only reimburse the employee within the calendar year, or in the first three months of the following calendar year. Payroll Guide Newsletter (RIA), Oct. 24, 2008.

Further limitations imposed by the IRS in its interpretation of §132(f) include:

- The “[e]xemption [for the QBCR] does not apply to S corporation employees who are 2% shareholders.” I.R.S. Publication 15-B, at 5, Table 2-1 n.1.
- The self-employed are not eligible. I.R.S. Publication 15-B, at 19.

However, leased employees who are not directly employed by an employer *may* receive the benefit. I.R.S. Publication 15-B at 19. Also noteworthy, the QBCR is not pegged to inflation. §132(f)(6); H.R. Rep. No. 110-658, at 88-89 (2008); *accord*, Payroll Guide Newsletter (RIA), Oct. 24, 2008; 33A Am. Jur. 2d *Federal Taxation* §7221.

Q: Is an employee allowed to elect to contribute a portion of his or her salary to the QBCR, effectively reducing the employee’s taxable gross income (also known as a pre-tax contribution, or set-aside)?

A: No. An employee is not allowed to elect to contribute a portion of his salary to the QBCR. Doing so would constitute “constructive receipt” of the income, which is disallowed by §132(f)(4) with respect to the QBCR.

Example 2:

Improperly Providing the QBCR: *Employer Z hires Employee A, and offers Employee A a \$1,000 per month salary. Employer Z wishes to offer Employee A the QBCR, and says Employee A either can accept \$1,000 a month wages, or \$980 a month plus the \$20 per month QBCR. This is not allowed. Because Employee A had the choice of receiving the benefit instead of taxable income, the election would be classified as constructive receipt of wages, and thus the full \$1,000 amount would be taxable. (The treatment would be similar in the situation of Employer Z offering Employee A the option of taking a \$20 per month raise or the bicycle commuting benefit. If Employee A opted to take the benefit instead of the raise, it would*

constitute constructive receipt of wages and the additional \$20 value would thus be taxable.)

Example 3

Properly Providing the QBCR: *Employer Z hires Employee A, and offers Employee A a \$1,000 per month salary. Employer Z wishes to offer Employee A the Qualified Bicycle Commuting Benefit. Employer Z notifies Employee A he may receive \$20 a month should he wish to use the benefit, and Employer Z would provide a \$20 voucher which could be used at area bicycle stores. Employee A continues to receive \$1,000 a month, as well as the voucher. This is an acceptable method to provide the benefit because Employee A did not have a choice to opt for a lower taxable income by taking the benefit, not constituting constructive receipt of income.*

Example 4

Properly Providing a qualified transportation fringe benefit other than the QBCR: *Employer Z wishes to provide Employee A with a transit pass. Employer Z does not wish to pay for the benefit, but tells Employee A she can transfer \$120 each month from her wages into an account used specifically for the transit pass, and the money would then be nontaxable. Employee A opts to reduce her taxable income to take advantage of the benefit. This is an acceptable method to provide the benefit because the law lifts the limitations of the constructive receipt doctrine for qualified transportation fringe benefits other than the QBCR.*

Broadly, the doctrine of constructive receipt “provides that cash and receipts in kind are reportable as income either when they are actually received or when they are constructively received. Income is constructively received when, although a taxpayer has the power to receive income, she chooses not to do so – generally, to obtain favorable tax treatment.” *In re United Air Lines, Inc.*, 438 F.3d 720, 733 (7th Cir. 2006).

Thus, an employee might not actually receive money for some reason in a tax year, but because the funds were under his or her control the money might be constructively applied to the employee’s gross income under the doctrine, and thus would be taxable.

Congress has lifted the doctrine for certain situations. Possibly the most well-known instances are with regard to certain retirement benefits (retirement investment plans under 26 U.S.C. §401(k) do not allow constructive receipt for a certain percentage of an employee’s income invested in the plan, effectively reducing the employee’s taxable gross income), and the qualified transportation benefits found in §132(f)(A)-(C) (van pools, transit passes and qualified parking).

Congress first barred constructive receipt of mass transit benefits under §132(f) in 1998 when it replaced paragraph (4) of §132(f). Prior to the 1998 changes, free parking was the only transportation fringe for which the constructive receipt doctrine was lifted (i.e., the only transportation fringe for which pre-tax contributions were allowed). “Transit passes and vanpool benefits [were] only excludable if provided in addition to, and not in lieu of, any compensation otherwise payable to an employee.” H.R. Conf. Rep. 105-550 at 542-3. That status for transit and vanpool benefits meant they were offered to an employee only on a “take-it-or-leave-it basis,” creating a “strong inducement for

employees to drive to work, even in those instances where an employee would prefer alternative methods of commuting.” 144 Cong. Rec. S1723-01, at S1742 (statement of Sen. Chafee).

After the 1998 amendment, the paragraph read:

“NO CONSTRUCTIVE RECEIPT. – No amount shall be included in the gross income of an employee solely because the employee may choose between any qualified transportation fringe and compensation which would otherwise be includible in gross income of such employee.”

Pub. L. No. 105-178 §9010(a). Legislative documentation at the time indicates the paragraph was created to “give all employees the flexibility to determine the type of employer-subsidized transportation benefit that they want to use or whether they want to receive cash instead of using these employer-provided benefits,” 144 Cong. Rec. S1723-01, at S1742 (statement of Sen. Roth), and to bring transit benefits into parity with parking benefits, 144 Cong. Rec. S1723-01, at S1742 (statement of Sen. Chafee); *see also*, Statement by President William J. Clinton upon signing H.R. 2400 (Pub. L. No. 105-178) (June 9, 1998), 1998 U.S.C.C.A.N. 223 at 224.; U.S. House of Representatives Committee on Ways and Means, *The Committee Announces Conference Action on Provisions of H.R. 2400, the “Transportation Equity Act for the 21st Century”*, <http://waysandmeans.house.gov/legacy.asp?file=legacy/fullcomm/105cong/fc-26act.htm> (May 22, 1998) (last viewed on June 5, 2009).

There are no known federal court cases interpreting §132(f)(4) since the 1998 amendments¹. There is only one known I.R.S. Revenue Ruling regarding the section. Rev. Rul. 2004-98, 2004-2 C.B. 664 (employer “X” cannot reduce employee’s gross income for tax purposes while providing employee both parking and a reimbursement that puts employee in same financial position he would have been had he not entered the reduced compensation agreement). The ruling further explains how the 1998 changes make a difference in calculating taxable income:

“An employee may exclude from gross income employer reimbursements for qualified parking expenses, but only if those expenses were actually incurred by the employee. If an employee is given a choice between cash compensation or an employer-provided benefit under a statutory exception to the constructive receipt rules, such as §132(f)(4), or if an employer unilaterally reduces an employee's cash compensation for the purpose of providing a non-taxable benefit, the benefit is treated as provided directly by the employer rather than purchased by the employee with the amount of the compensation reduction. Otherwise, the value of the benefit would not be excluded from the employee's gross income.”

¹ This determination is based on electronic searches of the Westlaw databases, which include reported and unreported cases in all federal courts, including tax courts, the U.S. Code as well as Internal Revenue Service and Treasury Department regulations. Further references in this memorandum to lack of known references, or specific number of references are based on similar research, either of the Westlaw databases or other broad electronic databases, including the Library of Congress’s <http://thomas.loc.gov>, or the World Wide Web, using the Google search engine when it was possible to craft a narrow Web search.

Rev. Rul. 2004-98. Paragraph §132(f)(4) remained unchanged until the 2008 amendments resulting from the Emergency Economic Stabilization Act. The current language of §132(f)(4) as amended reads:

“No constructive receipt. – No amount shall be included in the gross income of an employee solely because the employee may choose between any qualified transportation fringe (*other than a qualified bicycle commuting reimbursement*) and compensation which would otherwise be includible in gross income of such employee” (emphasis added to reflect language added by the 2008 amendments).

The language added in 2008 reflects the legislative intent prior to its passage. “A bicycle commuting reimbursement fringe benefit cannot be funded by an elective salary contribution on the part of an employee.” H.R. Rep. 110-658 at 88-89.

The IRS issued guidance with respect to the §132(f)(4)’s effect on the QBCR earlier in 2009.

“Generally, you can exclude qualified transportation fringe benefits from an employee’s wages even if you provide them in place of pay. *However, bicycle commuting reimbursements do not qualify for this exclusion.* For information about providing qualified transportation fringe benefits under a compensation reduction agreement, see [Treasury] Regulations section 1.132-9(b)(Q-11).”

I.R.S. Publication 15-B, at 19 (emphasis added); *accord*, Payroll Guide Newsletter (RIA), Oct. 24, 2008. The Treasury Regulations referred to further describe the method in which gross income is reduced for tax purposes via compensation reduction agreements. Generally, an employee can elect to reduce his or her compensation by a limited amount and earmark it to be used specifically for a qualified transportation fringe benefit. That dollar amount then is subtracted from the employee’s gross income. Treas. Reg. §1.132-9(b) (2006); 26 C.F.R §1.132-9(b) (2006).

Therefore, the clause “other than a qualified bicycle commuting reimbursement” in §132(f)(4) retains constructive receipt premise only for the QBCR, with the result being that employees cannot elect to reduce their salary any amount to apply it to the value of the QBCR. Thus, it is only an employer-provided benefit.

Q: How might a court or administrator interpret the terms “regularly used” and “regularly uses” as used in §132(f)(i) and §132(f)(iii)(I)?

A: “Regularly used” and “regularly uses” could be defined as narrowly as 75% of workdays – or 15 days every four full-time work weeks – or as broadly as what a court’s subjective determination of “regular” might be (but industry interpretation might be persuasive – see following question).

There are no known instances in which §132 itself, the IRS regulations or IRS publications state a specific definition of “regularly used” or “regularly uses” in terms of their interpretation in §132. The only direction from legislative materials regarding the QBCR’s creation is found in H.R. Rep. No. 110-658, at 88-89, which states that when

“usage of a bicycle is infrequent,” the employee cannot qualify for a reimbursement under the provision.

In §132, “regularly used” and “regularly uses” modify, respectively, how often the bicycle is used, and how often the employee uses a bicycle to travel to and from work. Although the word “regular” or its derivations appear in more than 130 sections of the code, there is no definition of the term itself. However, more common phrases using variants of “regular” are defined in specific sections, such as “regular tax liability” and “regular income.”

There are no other instances of the phrase “regularly uses” in Title 26 of the code beyond the use in §132. There are four other instances of the phrase “regularly used” in Title 26. It appears in 26 U.S.C §446(b) (2009) (“If no method of accounting has been *regularly used* by the taxpayer”); 26 U.S.C. §807 (e)(5)(B)(iv) (2009) (“the net surrender value under the contract is not *regularly used*”); 26 U.S.C. §1221(a)(8) (2009) (“supplies of a type *regularly used* or consumed by the taxpayer”), 26 U.S.C. §1301(b)(1)(B) (2009) (“gain from the sale or other disposition of property ... *regularly used* by the taxpayer”) (emphasis added in all instances). There is no piece of the code that directly matches the language in §132, applying “regularly used” to a method of travel or transportation.

However, a phrase in 26 U.S.C. §7701 (2009) contemplates a similar situation as is contemplated in §132, albeit for a different purpose. “If an individual *regularly commutes* to employment (or self-employment) in the United States from a place of residence in Canada or Mexico, such individual shall not be treated as present in the United States on any day during which he so commutes.” §7701(b)(7)(B) (emphasis added).

No known judicial opinion has interpreted that section of code with respect to what constitutes “regularly commutes.” The IRS, however, has interpreted that portion of §7701 as saying that one commutes regularly “if you commute to work in the United States on more than 75% of the workdays during your working period.” Tax Topic 851 – Resident and Non-Resident Aliens, <http://www.irs.gov/taxtopics/tc851.html> (last visited June 2, 2009); I.R.S. Publication 519 (2008), U.S. Tax Guide for Aliens, at 5 (April 14, 2009).

If the same approach were applied to the QBCR, a rider would have to ride to work 15 days a month in a 20-day work month. However, the two sections are distinguishable by policy purposes, and thus the IRS’s limitations for §7701(b)(7)(B)’s commuting provision likewise can be differentiated.

The plain language of §7701(b)(7)(B) grants an exception to an alien who “regularly commutes” into the United States. The paragraph was one of many instituted as part of the Deficit Reduction Act of 1984’s section to create more definition between a resident alien and a nonresident alien. H.R. Rep. 98-432 at 1523 (1984); 1984 U.S.C.C.A.N. 697, 1162. Section 7701(b)(7)(B) was apparently drafted as a way to prevent certain individuals who had a “closer connection with a foreign country than with the United States and a tax home in that foreign country” from being classified as resident aliens, a classification that would make the taxpayer more susceptible to income tax. H.R. Rep. 98-432 at 1524; 1984 U.S.C.C.A.N. at 1163. The later IRS interpretation of the paragraph subjects only those who have commuted 75% or more of the time to the provision.

In §132, the regular use of a bicycle promotes other ends, including fewer vehicles on the road resulting in less wear and tear on public infrastructure, lower carbon emissions, and healthier lifestyles. Therefore, in determining what constitutes whether an employee “regularly uses” a bicycle, a court or administrator might consider a lower threshold in order to provide an incentive to promote use of the QBCR, as seen in H.R. Rep. No. 110-658, at 88-89.

“As part of a package of alternatives to reduce the nation’s reliance on fossil fuels and to encourage conservation of energy resources, the Committee believes that the exclusion from gross income for qualified transportation fringe benefits should be extended to cover expenses incurred by an employee in commuting to work by bicycle. Bicycle commuting achieves both goals of reducing fossil fuel reliance and encouraging conservation. Such commuting involves recurring expenses and the Committee believes that incentives should be provided to encourage this nonmotorized form of commuting.”

A more general approach applied by courts in interpreting “regular” in the code is to define what is not regular. When a situation does not amount to something that is regular, it sometimes is defined as occasional. In *Adam v. Comm’r*, 60 T.C. 996 (1973), the court determined if the petitioner was engaged in a trade or business in the course of selling property. The controlling version of §1221 excluded from capital assets “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.” 26 U.S.C. §1221(1) (1954). The court inferred that regularity could determine the ordinariness, and held the petitioner’s conduct “lacked the sustained and *regular* character that generally accompanies a business,” but rather was “intermittent and *occasional*.” *Adam*, 60 T.C. at 1001 (emphasis added). In *Jackson v. Comm’r*, 76 T.C. 696 (1981) (overturned by *Crawford v. Comm’r*, 65 T.C.M. (CCH) 2540 (1993), on a separate point of law), the court was determining whether the petitioner, a licensed real estate salesperson, was entitled to a deduction for the cost of maintaining a home office. The code – §280A(c)(1) at the time – did not allow a deduction for the use of a dwelling unit, unless “to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a *regular basis* – (A) as the taxpayer’s principal place of business,” (emphasis added). The court held that rather than exclusive and regular use of the home office as a principal place of business, petitioner’s use was only occasional. *Jackson*, 76 T.C. at 700. In finding for the government, the court further noted the congressional committee reports for §280A indicated that “Expenses attributable to *incidental* or *occasional* trade or business use of an exclusive portion of a dwelling unit would not be deductible.” *Id.* (emphasis added in court’s opinion).

Applying this approach to §132, an employee would qualify as one who regularly uses a bicycle to commute to work if he or she were more than an occasional rider. In comparison, Merriam-Webster defines “occasional” as “encountered, occurring, appearing, or taken at irregular or infrequent intervals.” <http://www.merriam-webster.com/dictionary/occasional>, 3d definition (last viewed June 2, 2009). “Regular” is defined as “orderly, methodical ... recurring, attending or functioning at fixed, uniform, or normal intervals.” [http://www.merriam-webster.com/dictionary/regular\[1\]](http://www.merriam-webster.com/dictionary/regular[1]), 3d definition (last viewed June 2, 2009); and “constituted, conducted, scheduled, or done in

conformity with established or prescribed usages, rules, or discipline. ... Normal, standard.” [http://www.merriam-webster.com/dictionary/regular\[1\]](http://www.merriam-webster.com/dictionary/regular[1]), 4th definition (last viewed June 2, 2009). Applied to §132, a commuter who rode a bicycle to work once a week on average could possibly qualify as a regular rider by virtue of not riding at “irregular or infrequent intervals.”

One IRS document that combines interpretation of both “regularly used” and “substantial portion” simply calls for a subjective determination based “on all the facts and circumstances.” T.D. 9417, 2008-37 I.R.B. 693. In its discussion of farmer and fisherman income averaging with respect to §1301(b)(1)(B), *supra*, the IRS states:

“Gain or loss from the sale or other disposition of property that was *regularly used* in the individual’s farming or fishing business for a *substantial period* of time is treated as attributable to a farming or fishing business. ... Property that has always been used solely in the farming or fishing business by the individual is deemed to meet both the *regularly used* and *substantial period* tests. Whether property not used solely in the farming or fishing business was *regularly used* in the farming or fishing business for a *substantial period* of time depends on all the facts and circumstances.”

T.D. 9417, 2008-37 I.R.B. 693 (emphasis added.) Thus, if for the purposes of §1301, the property does not meet the threshold test of having “always been used,” then whether the property was regularly used for a substantial period is up to interpretation on a case-by-case basis.

As applied to §132, this approach would leave definition to a court or administrator, and would have unpredictable results, but could also – by applying policy purposes stated above – lead to less restrictive interpretation than that found with respect to §7701’s use of “regularly commutes,” which is defined narrowly as meaning 75% of the days commuted.

Q: How might a court or IRS administrator interpret the term “substantial portion” as used in §132?

A: Should a pattern develop with respect to organizations’ determination of “substantial portion,” it would be persuasive in setting a definition. Current definitions of “substantial” with respect to tax provisions are not on point with §132’s use and vary widely.

Neither the legislative history of the changes to §132, the IRS regulations nor IRS publications state a specific definition of “substantial portion” in terms of its interpretation in §132. The legislative guidance only goes so far as to say an “insubstantial portion” shall not qualify for a reimbursement under the provision. H.R. Rep. No. 110-658, at 88-89.

There are 11 sections of Title 26 in which the phrase “substantial portion” appears, in addition to §132. None of the uses of the phrase, aside from that in §132, refers to the portion, division, ratio or amount of travel, or use of a thing with which to travel or commute. While “substantial” and its variants appears in approximately 270

sections of the code, there are no known instances of its use in conjunction with commuting, travel or distance.

In a context unrelated to travel, a substantial portion need not be greater than 50 percent of the item to which the term applies. *Nelson v. Comm’r*, 130 T.C. 70 (2008). The court was interpreting 26 U.S.C. §451(d), which itself does not contain the term “substantial portion,” but for which an IRS ruling later interpreted using the phrase. The particular question at bar was whether a farming business could defer federal crop insurance proceeds from one year to the next. The question hinged on an earlier ruling, Rev. Rul. 74-145, 1974-1 C.B. 113, which stated that for a farmer to be allowed to defer the insurance proceeds to the following year, it would have to expect to sell a “substantial portion” of its crops in the year following the year the crops were grown. Rev. Rul. 74-145 further indicated that a substantial portion was more than 50% of crops sold in the year following the year the crops were grown.

The court noted in its opinion, that “substantial portion” has varying meanings. *Nelson*, 130 T.C. at 77 (“We acknowledge that the word ‘substantial’ appears in other contexts throughout the Internal Revenue Code as well as throughout the regulations and often is used to refer to ‘less than 50 percent.’ ”); *Nelson*, 130 T.C. at 77, n.4 (noting that “substantial” in 26 U.S.C. §45D(d)(2)(A)(ii) and (iii) refers to 40% of tangible business assets, and in 26 U.S.C. §6662(d)(1)(A) “substantial” may refer to an understatement of tax of just 10 % of the tax required to be shown on a return).

The meaning of substantial also might be determined in part by industry-wide accounting methods. Such methods are considered persuasive in determining if a taxpayer is conforming to tax rules. *See e.g.*, *Nelson*, 130 T.C. 70 (petitioner’s “method and percentages ... for allocating and reporting income ... are consistent with the [petitioner’s] partnerships’ above cash method of accounting and with the accounting and tax reporting practices within the sugar beet industry”). Notably, however, the court added that the accounting methods were “recognized and accepted generally by respondent” – the tax commissioner – suggesting that industry-wide acceptance does not necessarily translate into acceptance by the IRS. Applied to the “substantial portion” phrasing in §132, it would follow that industry-wide methods of determining what is a “substantial portion of travel” from home to workplace would be highly persuasive to the IRS on condition they are accepted by the IRS.

Other organizations have concluded that the burden of defining “substantial portion” and regularly uses”/“regularly used” rests on employers until further interpretation emerges from the I.R.S. Oregon University System Fiscal Policy Manual §§ 66.100, 66.170, <http://www.ous.edu/cont-div/fpm/frin.66.100.php> (last visited March 26, 2009) (“Employers may apply their own reasonable interpretation of ‘regularly uses’ and ‘substantial portion’ or travel”); Bicycle Commuter Benefits Added as Qualified Transportation Fringe Benefit, Groom Law Group, http://www.groom.com/media/publication/290_bicyclearticle_1_.pdf (last visited June 2, 2009) (“The statute does not define either ‘regularly uses’ or ‘substantial portion’ so unless the Internal Revenue Service provides guidance on the meaning of those terms, employers will be left to apply their own reasonable interpretations of those terms”).

Coupled with the reasoning in *Nelson* – which is not inconsistent with determining meaning for “regularly used”/“regularly uses” – another approach evolves: As workplaces determine the meanings of the terms, an industry standard may develop

with increased application of the QBCR. That standard would be subject to acceptance by the IRS and the courts, although it would have a strong possibility of acceptance. Until that occurs, however, it is uncertain what test the IRS or a court might apply.

Benefits to Employers

Q: What monetary benefits are there for an employer to participate in the QBCR program as it stands (an employer-provided benefit)?

A: Primarily, the employer can provide the QBCR without having to pay FICA taxes on the value of the QBCR.

Generally, benefits keep employees loyal and motivated, *Employer's Guide to Fringe Benefit Rules* ¶100 (David Fuller & Jerry Holmes eds., Thompson Publishing Group 2009). Quantitatively, the amount reimbursed to each employee who meets the requirements of the QBCR – up to \$240 a year – is not reported as income. Like other qualified transportation benefits, that value is “excludable from wages for purposes of all employment taxes and [is] not reported on the Form W-2.” *Id.* at ¶104. Not reporting the income as wages translates into a savings to the employer on its portion of FICA (Medicare and Social Security) taxes, *id.* at ¶643, and unemployment taxes, I.R.S. Publication 15-B at 6. Also, there may be local tax incentives available for employer provided benefits, depending on the jurisdiction. *Id.* at ¶633.

As an employer-provided benefit, the benefit will likely be a net cost to the employer. However, because the qualified transportation fringe programs under §132 are relatively easy to manage, *id.* at ¶633, with few reporting requirements to the IRS, *id.*, ¶606, ¶643, and the benefit is not subject to employment taxes, there is no dilution of the buying power of the benefit: The employer does not have to pay its share of FICA taxes on the benefit, and the employee does not pay any taxes. (In certain cases, the employer might see a cost-savings on unemployment taxes also.) Therefore there is a dollar-for-dollar ratio for the benefit, costing the employer less in comparison than it would to provide the same amount in taxable wages, and allowing the employee to have greater buying power with the income than if the money were taxable.

Example 5

Employer Z provides the QBCR to her company of 25 employees. Each employee maximizes the use of the program, participating year-round. The total cost of the reimbursements is \$6,000. Assuming each employee already earned \$7,000, there would be no effect on federal unemployment taxes. If the employer instead had paid the value of the benefit in wages, the employer in most instances would have had to pay approximately \$459 in FICA taxes (the employer's 50% share of 15.3% FICA taxes on employee wages). Thus, Employer A's cost of providing the benefit is \$6,000 plus any administrative costs, whereas providing the same amount in wages to the employee would have cost \$6,459 in this example.

Q: What monetary benefits would there be to an employer for the QBCR to be an employee-provided benefit?

A: The QBCR would function like the other qualified transportation fringes under §132, generally costing only the administrative cost of the program, and providing a savings of FICA taxes on nontaxable wages directed toward the benefit.

If the QBCR were to become an employee-provided benefit (e.g., the QBCR were put on equal footing as the other qualified transportation benefits in §132 with respect to constructive receipt), the cost to the employer would fall further, and there could possibly be a cost savings.

In addition to the benefits of the employer-provided program – mainly, avoiding employment taxes on the benefit – the employer’s actual cost to provide the benefit would only be the embedded, or up-front cost of plan administration. *Id.* at ¶633. Generally, these can be provided in-house, but there may be programs available locally to administer the program for the employer. *Id.*

Example 6

Employer Z decides to offer a transit pass program to his company of 25 employees. They each accept the compensation-reduction agreement maximum of \$120 per month. Had the employer not offered the program, she would have paid unemployment and FICA taxes on the employees’ full salary. However, because the transit benefit is nontaxable, Employer Z reduces her taxable wages by \$36,000, likely resulting in a savings of \$2,754 in FICA taxes. Assuming the compensation reduction does not reduce any salaries below \$7,000, there would be no savings on unemployment taxes. In this simple case, participating in the program is more favorable to the employer so long as the program itself costs less than the combined value of employment taxes the employer would pay if it did not participate in the program, or \$2,754 in this case.

Q: What must an employer do to account for the benefit?

A: There are few reporting requirements regarding the QBCR, but an organization should consult its tax adviser before providing the benefit.

There are few reporting requirements for employers to provide a qualified transportation fringe benefit program. But note: Not all states treat transportation benefits the same as the federal government. *Id.* ¶606. For instance, what might be excludable for federal tax purposes may not be excludable for state tax purposes. There are differences in methods by which employers can substantiate their transportation expenses. *Id.* ¶606. There is no requirement for a formal plan document, but employees should receive a formal salary reduction/participation form that conforms to IRS minimum requirements. *Id.* ¶633.

Therefore, before instituting a plan, employers should consult their tax advisers.

For more information from the IRS on how to structure the program, and how to account for the QBCR, see I.R.S. Publication 15-B (2009), Employer’s Tax Guide to Fringe Benefits, and I.R.S. Publication 15 (2009), (Circular E), Employer’s Tax Guide.