UTILIZATION AND IMPACTS OF COMMUTER BENEFIT TAX DEDUCTIONS FOR BUSINESSES

Virginia Department of Rail and Public Transportation

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Introduction

During its 2020 session, the General Assembly considered Senate Bill (SB) 277 establishing an individual and corporate income tax deduction for commuter benefits provided by an employer to its employees for the taxable years 2021 through 2025. If the legislation is enacted, private Virginia businesses will be allowed to take a Virginia corporate tax deduction for the costs associated with providing a Commuter Tax Benefit program to their employees. The deduction will be available only to the employer and limited to $265 per employee each month.

The bill included two enactment clauses. First, it required subsequent legislative action for the provisions of the bill to become effective. Second, it required the Virginia Department of Rail and Public Transportation (DRPT) to study the impacts of the legislative language and issue a report to the General Assembly by December 2020.

The General Assembly included language in its Biennial Budget allowing the Governor to delay legislative reports by one year due to the on-going COVID-19 pandemic; and DRPT subsequently elected to delay submission of this report.

Background

The Commuter Tax Benefit is an employer-provided benefit that allows employees to pay for certain transportation expenses tax-free. The Internal Revenue Service permits employees to use their wages on a tax-free basis to pay for transit expenses, to commute in a commuter highway vehicle (most commonly vanpools), and to pay for qualified parking, typically at or near the employee's workplace. The benefit can be provided as a subsidy or as a pre-tax deduction that allows employees to set aside part of their compensation on a tax-free basis to pay for the eligible expense. The IRS adjusts the monthly limit allowed for the benefit annually based on a cost-of-living index. In 2019, the monthly limit was $265. It increased to $270 for 2021.

The Federal Tax Cuts and Jobs Act of 2017 (TCJA) eliminated the business tax deduction for any expense of the Commuter Tax Benefit provided by the employer for its employees. Prior to the TCJA, private employers were able to include the cost of the Commuter Tax Benefit in their cost of doing business. With this change, employers' expense to provide this benefit became higher than previously experienced, possibly discouraging higher employer participation in the benefit program, thereby reducing the use of public transportation such as transit and vanpooling.

In 2019, Virginia subsequently conformed to the federal change and removed the employer tax benefit from the Code of Virginia. The changes to the Commuter Tax Benefit did not affect the employee's use of the benefit or its tax savings.

Methodology

DRPT's analysis on this issue had several components. First, DRPT examined comparable states and local jurisdictions, including:

- California (including San Francisco Bay Area),
- District of Columbia,
- Massachusetts,
- Minnesota
- New Jersey,
- New York (including New York City),
- North Carolina,
- Maryland,
- Washington (including Seattle).

It was determined that many states, like Virginia, did not change their state business tax laws to offset the federal disallowance of the business tax deduction for purposes of state business taxes.

However, a number of local jurisdictions enacted incentives or mandates that either encouraged or mandated employers to offer the Commuter Tax Benefit to their employees, respectively. For example, the District of Columbia requires employers with 20 or more employees to provide a transit benefit, either pre-tax or a direct benefit. Virginia does not provide any incentives or mandates that follow this practice.

Second, DRPT examined the commuter benefits that Virginia businesses currently provide. While Virginia businesses do not report the amount of commuter benefits provided to their employees on the business' tax forms, this report analyzed surveys conducted in other jurisdictions, Bureau of Labor Statistics surveys, and the annual benefit survey of Society for Human Resource Management to make an assumption on the percent of employers providing a public transportation benefit.

Third, the study relied on transit fare elasticity formulas to determine the impact of the benefit on employees' behavior equating employees' tax savings to receiving a discount on their transit or vanpools fares. This reduction in the cost of using transit or vanpools was based on various assumptions required to arrive at a composite transit and vanpool average monthly cost.

Fourth, DRPT analyzed the impact that COVID-19 has had on public transportation operations and revenues. The COVID-19 pandemic continues to disrupt commuting patterns. Many employers continue to have employees work from home for at least part of the work week. While public transportation ridership is growing each month since its nadir in April 2020, it has not yet fully returned to pre-pandemic levels. Also, there continues to be some concern among former transit riders to return as COVID-19 and its variants continue to affect Virginians.

Additionally, in an effort to limit contact between bus operators and riders, many of Virginia's transit agencies implemented zero-fare and rear-door boarding policies at the start of the pandemic. Several of these transit agencies plan to continue a zero-fare policy over the upcoming years. Using funding from the Commonwealth's new Transit Ridership Incentive Program, these agencies are:

- City of Alexandria DASH,
- Charlottesville Area Transit,
- Fredericksburg Regional Transit,
- Mountain Empire Transit (MEOC),
- Greater Richmond Transit Company.

Zero-fare policies will eliminate an employer's cost of providing a transit benefit and therefore lower the potential impact to the General Fund.

Lastly, using these above analysis, this study developed a range of impacts for tax years 2022, 2023, and 2024. DRPT created a minimum range, which was based on a low adoption of the Commuter Tax benefit and a low return to transit and vanpooling, to a maximum range, which was based on a high adoption of the benefit with a moderate return to transit and vanpooling.

Conclusions

After completing its analysis, DRPT made the following conclusions:

1. **Transit Ridership Impact: When an employer provides a benefit to cover an employee's cost of using public transportation, DRPT estimates that five to ten percent more employees will use these services than without the benefit.**

Research by the Transit Cooperative Research Program found that transit use increases by approximately 11 percent when employees receive a transit benefit. When the Virginia Department of Transportation first provided a transit benefit to their employees, approximately 30 percent of its employees started using transit instead of driving alone. Hampton Roads Transit saw a five percent increase in transit usage through its employer-based transit pass program, GoPass.

2. **Business Impact: While employees were largely unaffected by the federal and state tax changes and continued to use their benefits to pay for their commuting expenses on a tax-free basis each month up to the federal limits, employers' tax liability increased due to the disallowance of the tax deduction on the Commuter Tax Benefit amounts used by their employees. Private employers who previously participated in the benefit program saw a net increase in their taxes commensurate with the application of the six percent Virginia business tax on the amount of the benefit used by their employees.**

Providing transit benefits has its advantages for employers. With a public transportation benefit as part of a benefits and compensation package, employers can effectively compete for hiring and retention of employees. In addition, some employers are able to offer transit benefits as a means to reduce the costs of providing parking for employees. For these reasons, some of Virginia's largest employers, including Capital One, Inova Health System, and Freddie Mac, provide transit benefits to their employees.

3. **Revenue Impact: The portion of this bill providing a tax preference for public transportation benefits would have an estimated negative General Fund revenue impact of up to $10 million per year, dependent on level of adoption, commuting patterns, and fare policy.**

In conclusion, if enacted, SB 277 would lead to an increase in the use of public transportation by five to ten percent and would lead to a decrease in annual general fund revenues by up to $10 million. Additionally, it would lead to more employers offering the benefit; and it would provide employers with another tool to recruit and retain employees.