



August 27, 2012

Ms. Jean Casey
CC:PA:LPD:PR
Employment Tax 2 Tax Exempt and Government Entities Division
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice 2012-38 Implementation of Rev. Rul. 2006-57-Issues for Public Comment

Dear Ms. Casey:

On behalf of the more than 1,500 member organizations of the American Public Transportation Association (APTA), I write to provide comments on the Internal Revenue Service's (IRS or the Service) Notice 2012-38 Implementation of Rev. Rul. 2006-57 – Issues for Public Comment.

About APTA

APTA is a non-profit international trade association of more than 1,500 public and private member organizations, including public transit systems; high-speed intercity passenger rail agencies; planning, design, construction and finance firms; product and service providers; academic institutions; and state associations and departments of transportation. More than ninety percent of Americans who use public transportation are served by APTA member transit systems. Our members also include public and private providers of transit benefits who work in cooperation with our transit system members.

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General Comment

APTA is a strong supporter of Qualified Transportation Fringes under Section 132(f) of the Internal Revenue Code. The tax-free benefit for transit and vanpools (transit benefit), currently allowed up to \$125 per month, has proven to be an important incentive to use transit and vanpools helping millions of employees pay for their daily commute to work which has become particularly important during these difficult economic times. We are pleased that tens of thousands of employers across the country, serving over 3 million employees have implemented transit benefit programs as an essential part of their benefit packages. Transit systems in virtually every major market see significant transit benefit usage to pay for transit fares. The transit benefit also has become a core component of efforts to reduce congestion and improve air quality by encouraging employees to switch from driving alone to work to riding transit and participating in vanpools.

History and Background

The transit benefit has been available as an employee benefit in one form or another since 1984 and was codified in statutory form in 1993. APTA and its members have worked over the years to improve upon and expand the benefit. Because of the importance of this benefit to our members and the riding public, one of our major concerns is to protect the benefit by ensuring that it is used for its intended purpose. We support efforts by the Service to ensure that there are clear and consistent rules to achieve this objective.

Over the years the administration of the transit benefit has undergone considerable evolution. Initially available only through governmental agencies that relied exclusively on the distribution of transit passes and paper vouchers, the transit benefit is now widely available from most third party benefit administrators, benefit services and transit systems using a wide range of product choices including transit smartcards, debit cards, electronic funding of transit accounts and cash reimbursement arrangements. This evolutionary process in many cases has been very positive for the transit industry, employers and employees by offering more choices and greater convenience, while allowing more efficient payment of fares.

As transit benefit use has expanded with a larger number of administrative options and product choices, we are concerned that this positive development not be compromised or endangered. This is particularly important in the area of cash reimbursement where the risks are greater for obtaining adequate substantiation. Use of products tied directly to fare payment such as transit smartcards and paper and electronic transit vouchers pose little risk and generally involve the cooperation or participation of the transit system. Therefore, we believe strongly that reimbursement programs should be required to follow clear and concise guidelines to ensure that the transit expenses have been incurred. We also believe that IRS guidelines should ensure to the extent possible that cash reimbursement should be used only in those markets that lack transit passes or transit vouchers.

Specific Questioned Posed by the Service

With these considerations in mind, we would like to offer our input on the use of electronic media to provide transit benefits. Our highest priority is to protect the transit benefit and guard against fraud or abuse associated with its use. Electronic media offers a new and important way to efficiently use benefit funds to pay for transit and vanpool expenses. Rev. Rul. 2006-57 set forth clearly the criteria under which debit cards used to provide transit benefits are compliant with IRS requirements without further substantiation (terminal-limited debit cards). We support the use of terminal-limited debit cards as a compliant means and its classification as an electronic transit voucher.

There are debit cards in use in transit benefit programs that rely on Merchant Category Code (MCC) limitations on the front end to determine whether the point of sale (POS) for that merchant falls within an appropriate transit or transportation classification. Because the MCC restriction does not limit the purchase at that POS to transit fare media, further substantiation requirements are necessary to ensure that the benefit is being used properly. In other words, MCC limited debit cards are basically cash reimbursement mechanisms that require a bona fide reimbursement arrangement.

The first question is whether any technology exists that is being used or is available that could further limit the front end process to the purchase of fare media only or to adding value to fare media like smartcards. We are not aware of any technology other than that associated with terminal-limited debit cards that could further limit purchases with MCC-limited debit cards. Therefore, the only way to make MCC-restricted debit cards fully compliant technologically on the front end is to add the restrictions that terminal-limited debit cards utilize.

We would like to make clear at this point that the use of the term “terminal-limited debit card” needs clarification. The restriction that certain debit cards can only be used for fare media purchases can be accomplished in a number of ways. Generally, the debit card is not in and of itself limited to transactions at certain POS locations; rather, the transactions are processed on the back end in such a way that purchases are only approved if they meet certain conditions. In many cases, the processor has the merchant identification (MID) numbers of POS devices that are associated with these MIDs at which only fare products are sold. In many cases, the transit operator provides these numbers to the transit benefit provider. Other debit card processors could use the terminal identification numbers of each individual POS device at which fare media is sold. In either case, the restriction to fare media sales is accomplished through the processing of the transaction and not on the card. We believe that any of these processes fall within the term “terminal-limited debit card” since the effect is the same.

The second question seeks information about whether terminal-limited debit cards should be “readily available” in the same fashion as paper vouchers. We see no reason why electronic vouchers should not be “readily available” in the same fashion as paper transit vouchers. If the use of terminal-limited debit cards in a region meets the test of being “readily available” then cash reimbursement, including the use of MCC-limited debit cards, should not be available to provide the benefit. As we indicated previously, we are concerned with the risk of using cash reimbursement arrangements as compared to products like transit passes, transit smartcards and electronic vouchers. We strongly encourage the use of these latter products as protecting the interests of all parties involved in the delivery and use of transit benefits.

The second question also seeks to gather information on the use of terminal-limited debit cards. We know that terminal-limited debit cards are used in many of the transit markets where credit and debit cards are accepted for the purchase of fare media. Our members include some of the major third party administrators (TPAs) of transit benefit programs around the country who offer terminal-limited debit cards in all of the markets they serve. Our transit system members know that transit benefit debit cards are being widely used. Employers can easily obtain these debit cards through most major TPAs.

Terminal-limited debit cards are being used to purchase fare media at ticket vending machines located in stations, at transit pass sales offices and through transit system online pass outlets. Some transit systems allow commuters to register their benefit cards with their pass accounts so that each month the transit system can automatically charge the cost of the monthly ticket to that cardholder's account.

You also seek information about issues arising from the transition from paper vouchers to electronic vouchers. Terminal-limited debit cards are important to the transition from paper vouchers. In fact, in New York and in the San Francisco Bay Area, for example, where paper vouchers are no longer accepted for certain services or types of transit passes, transit benefit users can use terminal-limited debit cards instead. We are not aware of any significant problems associated with this transition.

Finally, you ask whether electronic media not already designated as meeting the criteria of an electronic transit voucher or smartcard could meet the requirements of a bona fide cash reimbursement arrangement if an after the fact method of reviewing monthly purchases is followed with or without a sweep-away mechanism to reclaim unused funds at end of the month. First, we do not think that electronic media that do not meet the requirements of an electronic transit voucher such as a terminal-limited debit card or smartcard should be considered compliant with the addition of a monthly after the fact review process. Again, we believe that this system could introduce a significantly higher level of fraud and abuse in its implementation and enforcement posing serious problems for the future of the benefit.

We believe the standards for a bona fide reimbursement arrangement given the choices today of fully compliant products should require a stricter standard for cash reimbursement. As stated in Section 1.132-9, Q/A-16, a bona fide reimbursement system should include receipts, which are available in virtually all systems that allow the use of electronic media such as credit and debit cards. The third situation described in Rev. Rul. 2006-57 (in which the employees are required to pay for fare media with after-tax amounts during their first month of participation in the program and get a reimbursement by adding this reimbursement amount to their debit card accounts in the second month after substantiation with receipts of their first month's transit expenses) should be the standard when cash reimbursement is permitted.

We also do not see the relevance of the sweep away mechanism to the substantiation of use. Because some employers who subsidize their employees' use of transit might want to reclaim funds each month unused for the benefit has more to do with protecting the employer's monies than with the use of the benefit for its intended purpose. In the pre-tax use of the benefit, which is the primary means through which the benefit is offered outside of the federal government, there is no need to reclaim funds since it is the employee's funds. As long as the funds associated with the electronic media are being used for eligible transit expenses and within the monthly benefit limitations, funds may remain in the benefit accounts as

long as the benefit recipient remains an employee of the company through which the program is offered. There is no “lose it or use it” rule in this respect. An employee’s funds are not lost at the end of a benefit month or quarter. They are simply carried forward to fund the next time period.

Additional Comments

We would also like to make a the following comments and observations concerning the operation and guidelines for the use of transit benefits that are of importance to the continued use of the program:

1. As noted previously, the transit benefit program has evolved significantly over the past two decades in response to the ever-evolving demands of the marketplace and the sophistication of new fare collection systems developed by transit systems. For the first decade, transit benefit programs were offered primarily through public entities as a way to encourage transit and vanpool use. The primary products were either transit passes or paper vouchers and their use was limited to the region in which the products were applicable. Although cash reimbursement was not initially permitted when the benefit was allowed as a de minimis benefit, section 132(f) of the Code was written to allow cash reimbursement, but only where vouchers and transit passes were not “readily available”. The rationale for this bias against cash reimbursement was that transit passes and vouchers were the best way to ensure the compliant use of the benefit, and cash reimbursement could introduce greater risk. However, the limited availability of the benefit made it necessary to relax this concern to allow employers to undertake programs where the available products were too administratively burdensome. And, because there was virtually no competition in the marketplace of transit benefit providers, there was a danger that the sole provider could charge unreasonable fees.

Today, the situation has changed and TPAs and transit systems offer very convenient products and services. There are many benefit providers who offer transit benefit services and competition for business is strong helping to keep down administrative fees. Cash reimbursement is no longer the necessary safety valve it was thought to be in those early days. We believe the IRS should reconsider its regulations regarding cash reimbursement and revise its criteria for “readily available” to reflect this new reality.

In particular, we would like to make it easier for transit passes and paper and electronic vouchers to qualify as “readily available”. Since the vast majority of transit benefit programs are pre-tax programs in which the employer saves on payroll taxes on the amounts set aside for the benefit, we believe that the 1 percent rule no longer accurately reflects whether the product is so expensive as to make the product “unavailable” to employers. We also see competition as a way to keep fees to a level that no longer poses a problem for employers.

We urge a standard that either pegs the fee threshold closer to the 7.65 percent of the payroll tax savings realized by the employer or removes the threshold entirely. Employers now have so many choices for benefit administrators in the marketplace that unreasonable costs are no longer an issue – an employer facing unreasonable fees can now simply change administrators.

2. We would also like to make the IRS aware of new developments in fare collection that will have a profound impact on how riders pay for fares. Today, most fare collection systems are proprietary

and require the use of a transit system's own fare media, whether a smartcard, magnetic or paper ticket. Electronic media such as debit and credit cards are used to purchase fare media or to add value to accounts managed by transit operators associated with its fare media.

Transit benefit programs are tailored to allow benefits to be used on these types of systems. However, the transit industry is looking to change this model by becoming more like a merchant, in which anyone having a bankcard can purchase a fare at the point of entry in the same way a person makes a purchase at any retail establishment. Called an "open fare payment system", transit systems would install POS devices at their faregates and onboard their buses and trains to allow riders to tap or swipe their credit or debit cards at the POS and pay their fare as a normal retail transaction. Similarly, federal employees will be able to use their Personal Identity Verification (PIV) or Common Access Card (CAC) identification credentials to pay fares from a centralized transit benefits account resident at the transit agency. Accounts could be set up at the transit agencies for certain riders who want to prepay fares to obtain a discounted fare for a period of time, for high value purchases or for certain discounts available to certain types of riders like students and senior citizens. Several large systems have awarded contracts to begin converting their systems to this new model, including the Chicago Transit Agency (CTA) and the Southeastern Pennsylvania Transportation Authority (SEPTA) in Philadelphia. Others agencies like the MTA in New York and WMATA in Washington, DC have planning efforts underway.

The transit benefit industry will work to adapt the program to this new situation. But it is important to point out that the standards for compliant use of transit benefits have to ensure that the benefit is being used for its intended purpose while allowing sufficient flexibility to complement these new systems. One way to do this would be for the Service to adopt a rule that if the transit operator endorses the use of the benefit process for its new system then it qualifies as a compliant process. We would be pleased to assist the Service in defining such a rule.

3. The scope of eligible uses of the transit benefit has not been clearly communicated to employers, leading most to conclude that the transit benefit is limited to the commuting expenses of the employee who is receiving the benefit. However, unlike commercial highway vehicles like vanpools, commuter parking and bicycling where the eligible use is restricted to commuting purposes and for expenses incurred by the employee for their own commuting, transit benefits can be used for any type of transit expense, whether for commuting or other travel, and can be used by any person to whom the employee who receives the benefit offers it whether it's a spouse, child, relative, etc. The differing statutory bases and alternative use of the word "employee" for vanpool, commuter parking, and bicycling programs and "person" for commuter benefits clearly supports this broad scope.

This is an important clarification as the federal government, states and local jurisdictions are trying to reduce congestion and improve air quality by encouraging greater use of transit. Financial incentives like the transit benefit are strong inducements to changing travel behavior. In fact, one study done by TransitCenter, Inc. in 2009 demonstrated that 17 percent of employees who received the transit benefit switched from driving. We, therefore, urge the IRS to issue a statement as to the eligibility for the use of transit benefits so that we can take advantage of this program in addressing important federal goals.

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We appreciate the opportunity to assist the Service in solving these important issues and would be happy to provide any additional information necessary to complete this process. For additional information, please contact James LaRusch, APTA's chief counsel and vice president corporate affairs, at (202) 496-4808 or jlarsch@apta.com.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Michael P. Melaniphy". The signature is fluid and cursive, with a long, sweeping underline that extends to the right.

Michael P. Melaniphy
President & CEO