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In 2008, San Francisco enacted a commuter benefits ordinance requiring all nongovernmental employers with 20 or more employees, no matter where located, to provide their San Francisco employees with one of three options in subsidized commuting benefits effective January 19, 2009. San Francisco has since adopted an annual certification process requiring employers to notify the city of conformance or exemption from the ordinance through a questionable administrative process. In addition, as part of federal stimulus legislation passed in February 2009 tax-free benefits have been raised as of March, 2009, coincidentally San Francisco's minimum commuter subsidy option also increased from \$45 to \$55 per month as of July 1, 2009.

San Francisco Commuter Ordinance — Update on Enforcement and Enhanced Federal Commuter Benefits

By GJ Stillson MacDonnell

In 2008, San Francisco enacted an ordinance (Ordinance) requiring private employers with 20 or more employees, as defined more completely below, to offer employees “subsidized” commuting benefits.¹ The Ordinance became “effective” for implementation on January 19, 2009. It requires employers to provide employees at least one of the following three options: (1) allow employees to elect to deduct commuting costs from pre-tax wages to purchase transit passes or vanpool rides (but not parking); (2) the employer may pay no less than \$45 per month (raised to \$55 on July 1, 2009) for transit passes or reimburse employees for a portion of carpool or vanpool expenses; and/or (3) the employer may operate a vanpool, bus, or similar multi-passenger shuttle-type service at no cost to employees. The Ordinance's stated purpose is to reduce air pollution and carbon dioxide emissions in San Francisco to 20 percent below the city's 1990 levels by the year 2012 by encouraging the use of public transportation or vanpooling. Whether or not the environmental goals can be met, the Ordinance complicates doing business in San Francisco. The Ordinance adds yet another (and sometimes conflicting) layer to subsidized employee commuting benefits that are already provided for under federal tax law as Qualified Transportation Fringe Benefits (QTFB).² This article discusses the new San Francisco Ordinance as well as its interplay with QTFBs and California laws allowing employees to cash out employers' subsidized parking for additional wages under the California Air Resources Board's “Parking Cash-Out Program.”³

As of April, the San Francisco Department of Environment began sending notices to San Francisco employers requiring them to annually notify the city of conformance or exemption. Administratively, the city is also requiring covered employers to notify employees of compliance with the Ordinance by posting a certificate of compliance at worksite(s) visible to all employees. The administrative process also seems to make it easy and encourages employees to file complaints requiring compliance with this Ordinance.

How the San Francisco Ordinance Works

Covered Employers

The Ordinance covers San Francisco employers (“Covered Employers”) other than governmental entities (*i.e.*, excludes state and federal employers in San Francisco) that have 20 or more employees in a given week, counting not only employees working in the city but also employees who work outside of San Francisco. For the purposes of determining Ordinance coverage only, the Ordinance counts full-time, part-time and temporary employees as well as workers provided by temporary services, staffing companies or similar entities to a San Francisco company. Consequently, a San Francisco employer may be covered by the Ordinance even if it has a workforce almost totally populated by temporary workers or paid by agencies, or has only one employee located in San Francisco.⁴

The Ordinance defines the term *employer* to include corporate officers and executives who directly or indirectly control wages, hours, or working conditions of employees.⁵ This provision potentially creates personal liability for such individuals for the penalties imposed under the Ordinance (as discussed further below).⁶ It is unclear from the Ordinance’s legislative history why such individuals were included in the definition.

At least as written, the Ordinance does not appear to cover related companies (*i.e.*, parent companies or other subsidiaries) either for purposes of determining whether an entity is a Covered Employer or as to liability for enforcement purposes. However, for the “Employer Compliance Procedures” that accompanied the “Employer Compliance Form (see further discussions below), first issued in April, the instructions provide that only one Annual Compliance Form should be filed for all related entities considered to be part of a controlled group of corporations for income tax filing purposes. Thus, the instructions consider such members to be counted as one employer even though the Ordinance makes no mention of such related entities.

In contrast to the Ordinance, the QTFBs under Internal Revenue Code (IRC) section 132(f) are wholly voluntary programs that may provide either pre-tax or employer-subsidized commuting expenses. Employers may also provide parking benefits, up to certain limits. Likewise, a QTFB has no minimum employer size for participation, and the employer can selectively make such QTFBs available.

Employers that currently maintain QTFB programs should review such programs to determine whether existing programs extend to San Francisco-based employees and, if not, consider amending programs to provide one or more of the benefits provided for under the Ordinance.

Employees Covered By Ordinance

For Ordinance purposes, a *covered employee*⁷ is someone who performs on average at least ten hours of work per week in the previous month for compensation in San Francisco, is entitled to payment of at least minimum wages under California Labor Code or a Wage Order, or participates in a Welfare-to-Work Program. It is unclear from the Ordinance if a Covered Employee must have worked at least ten hours in every week of the previous month to participate. However, the Complaint Form made available by the Department asks: “Have you worked an average of 10 hours/week in the previous calendar month?” By using an averaging, an employee with fluctuating hours that go below 10 in some weeks would seemingly be covered under this Ordinance.

Measuring participation by hours worked in the previous month potentially allows Covered Employers to drop employees in any month following insufficient qualifying hours. As a practical matter, a Covered Employer will probably not want to monitor hours for this purpose and take advantage of this provision, at least with respect to employee only-paid benefits, such as an employee’s pre-tax election to pay for commuting expenses.

It appears that if an employee is not directly paid by an otherwise Covered Employer, then that employee would still be covered, for purposes of the Ordinance, only as an employee of the employer actually paying the wages. For instance, if the Jones Company has one employee paid directly and 20 temps who are paid by the Smith Temporary Agency, then the Ordinance’s benefits for such temps, if any, would be provided by the Smith Temporary Agency, not the Jones Company, even though their work is counted towards determining

whether or not the Jones Company is a Covered Employer. The Jones company would have to provide the Ordinance's benefits for the one employee it pays directly.

Benefits Provided By the Ordinance

The Ordinance requires that a Covered Employer provide at least one of the following three options to a covered employee:

- 1. Pre-tax Election:** Employer creates a program under IRC section 132(f) (*i.e.*, a QTFB) that allows employees to make a "pretax purchase" of transit passes or vanpool charges up to the federal level (in 2009, \$120 per month through February 2009: \$230 as of March 1);
- 2. Employer-Paid Benefit:** Employer supplies or reimburses for transit passes or cost of vanpool charges up to the monthly cost of an adult San Francisco Muni Fast Pass (\$45 a month through June 2009, \$55 as of July 1, 2009); or
- 3. Employer-Provided Transit:** Employer provides transportation for free to employees in a vanpool, bus or similar multi-passenger vehicle operated by or for employer.⁸

An employer with an existing QTFB program that enables employees to pay commuting expenses through a Compensation Reduction Arrangement (pre-tax basis) for transit passes should be able to comply with the Ordinance's first option without further action or adjustments to its existing program, as long as all covered employees can participate in that QTFB. While employer-provided parking is not an option under the Ordinance, nothing in the Ordinance precludes a Covered Employer from continuing to subsidize employee parking.

The second option provides for a Covered Employer to subsidize a transit pass on a tax-free basis up to \$55 a month as of July 1, 2009, subject to the provisions of IRC section 132(f)(5)(A) for transit passes. The initial level was \$45 per month and was subject to future cost of living adjustments (COLA), which adjusted to \$55.00 as of July 1, 2009. Under federal law, an employer could provide a subsidy of up to \$120 per month towards such transit passes through February 2009, and thereafter the stimulus legislation adjusted the limit to \$230.00 per month. The subsidy option creates a direct expense for an employer, in addition to possible administrative costs. The second option is more costly to Covered Employer than the first option.

The third option involves employer-provided transportation between home and work on a "no cost" basis in a vanpool, bus, or similar multi-passenger vehicles operated by or for the employer. To the extent "at no cost" is reasonably interpreted as "free" or "tax-free," providing this option may be problematic under the Internal Revenue Code. Under the Internal Revenue Code, an employer can subsidize, in 2009, up to \$230 a month beginning March 1 (before March limited to \$120 a month) for a vanpool that qualifies as a "Commuter Highway Vehicle" under the QTFB rules. It remains unclear whether San Francisco intends that such vanpools be free even if the cost of providing the services exceeds the tax-free limits imposed for QTFBs. It is also remains unclear whether the Ordinance would require an employer to gross up an employee's wages so that the net "effect" would be no cost over the employee's "normal" wages if the monthly cost exceeds the tax-free cap. The vanpool option presents additional difficulties. For example, how does an employer calculate fair market value (FMV) for vanpool purposes? The most common method used under federal law to calculate FMV is using the Commuting Valuation Rule.⁹ Under that rule, vanpool transportation is valued either one way at \$1.50 or \$3.00 for round trip per commute. So, if an employee commutes no more than 20 days per month, the fair market value under the round trip method would be a mere \$60.00 (20 x \$3.00) and well within the \$230 cap set for period beginning March 2009. However, under IRS regulations, this method for valuing cannot be used to value the cost to an employee who is considered to be a "control employee."¹⁰ Absent a gross-up of a control employee's wages, such employer-provided transportation does not appear to be doable at "no cost" to such employees. It is unclear whether such technical considerations were contemplated by the San Francisco Board of Supervisors.

Finally, while the cost to an employee for vanpool transportation may be nil, the actual cost of providing this type of benefit is often well beyond the imputed FMV. The cost can be significant to the employer—whether provided by company vehicles or through outsourcing. The relative costs should be carefully considered before offering this option.

San Francisco Enforcement and Certification Process

Under the Ordinance, the Department of Environment (“Department”) “in consultation with the San Francisco Office of Labor Standards Enforcement is to promulgate rules and regulations.” Prior to the implementation date of the Ordinance, the Department notified various San Francisco business organizations and purportedly sent notices to businesses registered with the city. The Department began to distribute certification forms for completion by employers and related documents in April but it did not present these materials and compliance rules to the Commission on the Environment for its approval until May 26, 2009, at which time the notification materials were approved but no rules or regulations were issued.

Federal Bicycle Commuting Expense Reimbursement Program

Since the enactment of the San Francisco Ordinance, and as part of the federal Emergency Economic Stabilization Act of 2008, IRC section 132(f) had been amended to allow employers, as of January 2009, to reimburse employees up to \$20 per month towards bicycle commuting “reasonable” expenses for employees who “regularly use” a bike to commute, provided these employees do not receive any other type of transportation reimbursement. *Reasonable expenses* include the cost of purchasing a bike, bike improvements, repair and storage. These are considered to be reasonable as long as the bike is regularly used for travel between a residence and place of business. While the San Francisco Ordinance makes reference to encouraging biking and walking, the Ordinance does not presently compel making such bike subsidies available. Given the federal change, it is likely that San Francisco will ultimately amend its ordinance to add bike subsidies. While the bike benefit is tax-free at the federal level, at present, such bike benefits are not tax-free under California law. Given the state’s budget crisis, it may be some time before California considers conforming legislation, and as of July 2009, no conforming legislation was pending.

How Does this Ordinance Work with Parking Subsidies?

IRC section 132(f) allows an employer to provide subsidized parking for employees. In 2009, such “qualified” parking benefits are available for up to \$230 per month on a tax-free basis. Under QTFB programs, an employee can receive a combination of vanpool and transit passes of \$230 a month (as of March 2009), as well as receive “qualified parking,” for a total tax-free monthly “commuting benefit” of \$460 (as of March 2009) paid either on a pre-tax basis and/or by a subsidy from the employer. While the San Francisco Ordinance’s objective is to reduce driving, it does not force a Covered Employer to either eliminate a parking fringe benefit or prohibit an employee from driving.

While employer-provided parking is typically associated with parking in close proximity to the workplace, for QTFB purposes, it can also be used to subsidize parking at or near a location from which the employee commutes to work, such as a vanpool or carpool pick-up location or a mass transit facility.¹¹

How Does this Ordinance Work with California’s Parking Cash-Out Program?

For many years, California has had a “Parking and Cash-Out Program,” which allows employees to waive otherwise employer-paid parking in favor of receiving an equivalent adjustment to wages.¹² Under a QTFB program, such an employee may also be able to elect subsidized transit passes, pretax transit passes, and/or participate in a “vanpool.” Nothing in the San Francisco Ordinance directly affects this “cash-out,” but forcing a Covered Employer to offer one of the options under the Ordinance potentially increases an employer’s expense for employees who cash out their parking benefits, *i.e.*, increased wages plus Ordinance benefits. This state program perhaps provides the financial basis for a Covered Employer to limit employees to the first option under the Ordinance.

Administering These Options

With the introduction of QTFB programs, numerous companies have become purveyors of administrative and support services for

commuter benefit programs. These range from payroll service companies to organizations that specialize in administering pre-tax, ERISA, or non-ERISA benefits. If an employer has an existing program, its vendor is likely prepared to assist with the implementation and administration of the Ordinance options. If a company does not have such a program, it will need to create one, and this will take both time and impose costs on the employer.

What Penalties Are Provided By the Ordinance?

The Ordinance designates the Department of the Environment as the department responsible for enforcement purposes. The director can issue administrative citations and civil penalties to any Covered Employer that fails to provide at least one of the required transportation benefits to covered employees. The current penalty scheme provides for a fine not to exceed \$100 for the first violation of any infraction under the Ordinance, a fine not to exceed \$200 for a second violation and a fine not to exceed \$500 for each additional violation within the same year. In addition to the penalties, the city can recover the cost of enforcement from a Covered Employer. While the definition of Covered Employer extends to certain executives or officers, whether the Ordinance will be used against such individuals appears to be left to the regulators.

The Department of Environment, in consultation with the Office of Labor Standards Enforcement for the City and County of San Francisco, is to promulgate rules and regulations to assist in the implementation and enforcement of the Ordinance. As of the May's Commission meeting no formal rules and regulations were adopted.

What Are the Implementation Issues?

Neither the Ordinance nor the IRC rules allowing for a QTFB program require that such benefits be provided under a written plan. QTFBs also are not subject to regulation under ERISA. In notices that accompanied a packet from Department of Environment beginning in April 2009, in a Question/Answer format the Department (subsequently approved by the Commission) took the position that annually all San Francisco business must submit a compliance form. *San Francisco businesses* were defined as an individual or entity that is subject to a business registration certificate. If such business is part of a "controlled group of corporations," as defined for income tax filing purposes (unclear as to under whose filing—state or federal), only one form is to be filed listing all related corporations, with such corporations to be considered one employer under the Ordinance. This Q/A is contrary to the stated Ordinance definition of "employer" in several ways. Under the Ordinance, an *employer* is not limited to corporations but would include all forms other than government entities. While a *Covered Employer* counts employees both within and without the city for purposes of determining "coverage," the Ordinance does not expressly make related employers accountable collectively under the Ordinance.

These instructions further require an annual filing by June 30 and the posting of Certificate of Compliance issued by the Department to be posted at the worksite(s) in an area visible to "all" employees, apparently imposing on such employers an obligation to post in multiple locations unless employees have a common worksite collection point.

Since the Ordinance does not require uniformity of benefits for related employers, the one-form-fits-all approach is particularly problematic, as the "Employer Compliance Form" to be completed by all, even business that claim to be exempt, have no place for differentiating benefits between related employers (again, the Department seemingly mistakenly equates employers to corporations). Additionally, the Department has created an "Employee Compliant Form" that seeks information about employment history, existence of "transportation benefits" and no specific place to complain about such benefits but rather provides: "Do you have anything else to add?"

Also included are forms entitled "Notice of Warning" and "Request for Audit or Appeal of Notice of Citation." Apparently, the procedure contemplates all employers having the burden of proving compliance or exemption from the Ordinance with a potential lock step from Notice of Warning to Citations with less than a veiled threat of penalties and enforcement costs. None of this "guidance" or forms have been promulgated as rules or regulations as required by the San Francisco City Charter.¹³

While nothing in the Ordinance compels that employees participate, some waiver or acknowledgement should be obtained from non-participating employees as confirmation of their choices.

Any preexisting commuting subsidy QTFB program should be reviewed and updated to be sure to include all Covered Employees under at least one of the Ordinance's options. To simplify compliance, an employer that has an existing QTFB program with fewer options than the Ordinance provides should limit the program only to options now available. Likewise, for an employer presently subsidizing transit passes, it is recommended that the subsidy level for covered employees be the same for San Francisco Ordinance purposes. For example, if the employer already provides in 2009 the COLA limit of \$230 for pretax transit pass subsidies, the employer should not reduce the subsidy to \$55 (as of July 1, 2009).

Covered Employers that did not as of January 19, 2009, have a QTFB program should target implementation as soon as possible for Ordinance purposes. The Ordinance singles out employees working in San Francisco not only to receive a commuting subsidiary not required under the IRC, but also to receive benefits that an employer may not be providing outside of San Francisco. Any Covered Employer who has not implemented the Ordinance may wish to consider providing San Francisco-like options to workers outside of San Francisco, as a parity consideration.

Next Steps for Implementation — A Checklist

The following checklist is offered to assist employers in complying with the San Francisco Ordinance if they have not done so by the January 19, 2009 implementation date:

1. Determine if the employer is covered by the San Francisco Ordinance;
2. Determine which employees are covered employees under the San Francisco Ordinance;
3. Review existing QTFB programs, if any, with respect to their scope and coverage;
4. Review San Francisco Ordinance options;
5. Determine which San Francisco option(s) will be initially provided, including their financial and administrative costs;
6. Arrange for administration of benefits and training for at least one employee who will assist in administration of the program;
7. Advise covered employees, in writing, as soon as possible as to the option(s) being offered under the Ordinance;
8. Adjust any existing written program to reflect option(s) to be provided;
9. If there is no existing QTFB program in place for San Francisco employees, adopt a written program to detail the Covered Employer's implementation of the Ordinance;
10. Determine Ordinance implementation date if beyond January 19, 2009;
11. For the pre-tax option, obtain elections from employees prior to the processing date for payroll on or after the implementation date;
12. Review and monitor for compliance with San Francisco rules and regulations;
13. Upon implementation, monitor the program for effectiveness, efficiency, costs, as needed;
14. Consider whether to offer bike subsidy under new federal law; if so, determine implementation date.
15. At least monthly, monitor for eligibility changes for new or departing covered employees.
16. Develop process for notifying new or departing employees of eligibility or ineligibility information.

17. Develop and collect acknowledgements/waivers from otherwise Covered Employees not electing to participate under the Ordinance.

18. Be prepared to annually certify compliance with Ordinance.

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¹ San Francisco Ord. 199-08.

² Int. Rev. Code § 132(F).

³ A.B. 2109.

⁴ San Francisco Ord. 199-08 § 421(a)(4).

⁵ San Francisco Ord. 199-08 § 421(a)(5).

⁶ San Francisco Ord. 199-08 § 421(c)(3)-(4).

⁷ San Francisco Ord. 199-08 § 421(a)(3).

⁸ Transportation in a "Commuter Highway Vehicle," which is a vehicle that seats at least six adults (excluding driver) for which 80% of mileage use is reasonably expected to be used for the purpose of transporting employees between home and work at least half capacity for such trips. IRC § 132(f)(5)(B) Treas. Reg. 1.132-9, Q&A-2. Ordinance § 421(a)(8).

⁹ Treas. Reg. 1.61-21(f).

¹⁰ A *control employee* is an officer earning at least \$95,000 a year in 2009, a director earning \$185,000 or more per year, or a 1% owner.

¹¹ I.R.C. § 132(f)(5)(C) and Treas. Reg. 1.132-9, Q/A4.

¹² A.B. 2109, Cal. Health & Safety Code § 43845, Cal Rev. Tax Code §§ 17202, 17090, 24343.5.

¹³ San Francisco Charter Sect. 4.104.