Special Edition
issue paper

Public Transit

Tax-exempt transit benefits:

The case for action—now!

For almost a decade, a broad coalition of business, labour, social, health and environmental groups has urged Canada's federal government to give tax-exempt status to employer-provided transit benefits. To date, the government has refused to act—despite all-party support from the House of Commons, despite its own studies predicting economic benefits that vastly exceed the costs, and despite almost two decades of American success with similar measures.

Canada's transit industry and its allies are not prepared to abandon this cause. The reasons to act—climate change, traffic congestion and air pollution, to name a few—are growing in number and significance. As part of its new urban strategy, the federal government has promised to support a long-term program of transit infrastructure investment—but has refused to make a simple tax amendment that could boost national transit use.

We must complement infrastructure with programs that encourage transit use through incentives and public awareness. By refusing to do so, Canada's national leaders are missing a rare and valuable opportunity to affect public policy at a local level.

An uneven playing field

Under the federal *Income Tax Act*, employer-provided parking and employer-provided transit benefits are both considered taxable. However, Revenue Canada's interpretation and the tax preferences included in the *Act* allow many employees to receive free parking as a benefit without paying income tax on it. While Revenue Canada cannot identify the extent of the problem, surveys show that about 80 percent of auto commuters receive free or subsidized parking.[a] It is no surprise that employer-provided transit benefits—which are taxed—are practically non-existent.

When deciding how to get to work, most commuters only consider out-of-pocket driving costs like gas, tolls and parking. Parking fees, where they exist, are usually the most significant of these. Tax-exempt parking benefits are thus a major incentive to commute by car, rather than transit. Tax-exempt transit benefits would level the playing field. They would provide equity for non-drivers, and balance the effect of free parking by reducing the cost of transit. And they would give employers a real incentive to offer transit benefits to their employees.

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U.S. experience shows tax exemption works

Almost 20 years ago, the United States made transit benefits tax-exempt in order to encourage transit use. In response, transit agencies and private companies have adopted a “win-win-win” strategy—joining forces to administer public transit benefits in a way that works for businesses, employees and transit companies alike.

From 1984 until 1993, the United States allowed employers to provide $15 to $21 U.S. per month in tax-exempt transit benefits. The federal government controlled costs by limiting the employers that could offer the benefit, and by requiring them to offer the benefit as new compensation rather than as a conversion of salary. Despite these restrictions, transit ridership increased 25 percent among employees who were offered the benefit.[b] Surveys in Philadelphia found that existing transit users who accepted the benefit increased their ridership by 32 percent, and that 30 percent of employees accepting the benefit were new transit users.[c]

Subsequent changes to the U.S. tax code increased the allowable benefit to $60 U.S. per month in 1993, and to $100 U.S. per month in 2002. There are no longer any restrictions on employer eligibility. Employers get a tax deduction for the expense, and save on payroll-related taxes. It’s also cheaper for employers to offer a transit benefit than to increase salaries by the same amount—after tax, a $1,200 annual transit benefit can have as much value to an employee as a raise of $2,000. Employers can convert existing wages into the benefit, rather than having to increase their corporate payroll. And as a bonus, employees can contribute toward the benefit using pre-tax salary dollars.

Increases in allowable benefits have yielded higher rates of participation by employers and employees. In the San Francisco area, employer participation rose sharply from 3 percent in 1992 to 27 percent in 2001, and the sale of transit vouchers distributed through employer benefit programs has doubled in the past year.[d] Over one-quarter of weekday riders on San Francisco’s commuter rail system enjoy employer-provided transit benefits.

University passes demonstrate the potential

What would happen if employer-provided transit benefits were made tax-exempt in Canada? Our best evidence comes from programs that sell discounted transit passes to university students:

- In the three years that BC Transit’s U-PASS has been offered to students at the University of Victoria and Camosun College on Vancouver Island, student ridership is up at least 50 percent.
- Similar programs at the University of Western Ontario and Fanshawe College in London, Ontario, have helped to increase total system ridership by 26 percent in three years.

Changing the *Income Tax Act* would create similar success stories among Canadian businesses.

For more about the American experience with tax-free transit benefits, see:

- www.commuterchoice.com
- www.commuterchoice.gov
- www.transitchek.com
- www.commutercheck.com
- www.wageworks.com

We urge [the government of Canada] to bring forward legislation, as soon as possible, to implement this easy and practical step towards revitalization of urban regions and reduction of the serious environmental impacts of urban transportation.

— The Toronto Board of Trade

The impacts of tax exemption

Figure 1 illustrates the potential impacts of tax-exempt employer-provided transit benefits in Canada. It shows two scenarios with different benefit contribution mechanisms and monthly caps, with corresponding differences in employer uptake and transit use among employees who are offered the benefit.

Figure 1 shows that Canada's federal government could limit the costs of tax exemption by capping monthly benefits and restricting the contribution mechanism. But such limitations would dissuade employers from offering the benefit, and discourage many employees from accepting it.

The increases in employee transit use shown in Figure 1 do not account for the ability of transit benefits to retain existing riders—and thus boost transit ridership over time. They also do not account for transit commuters using transit more often for non-commuting trips—an option that would be more attractive once they are using monthly passes to commute, rather than cash or tickets.

Furthermore, Figure 1 does not account for the wide range of substantial social benefits that would result from greater transit use by Canadian commuters. These secondary benefits have been highlighted by federal government bodies including the Prime Minister's Caucus Task Force on Urban Issues and the *Canada Transportation Act* Review Panel.[e,f] They include reductions in congestion and the resulting delays to businesses and commuters, a reduced need for road construction, cleaner air, reduced greenhouse gas emissions, improved road safety and many others. In fact, analysis for the Transportation Climate Change Table found that the benefits of tax exemption (including cost savings for road construction, parking and congestion) would be at least 3 to 7 times greater than the costs.[a]

The long road in support of tax-exempt transit benefits

1995. Campaign begun by the Canadian Urban Transit Association (CUTA) and the Federation of Canadian Municipalities (FCM)

1997. Creation of a Task Force including the Amalgamated Transit Union Canadian Council, Canadian Labour Congress, CUTA, FCM, Ontario Lung Association and Pollution Probe

1998. Unanimous recommendation as an "early action" item by the federal Transportation Climate Change Table

1999. Survey finds 75 percent of Vancouver businesses support tax exemption for transit benefits

1999. Private member's bill asking the federal government to consider tax exemption for employer-provided transit benefits passed by House of Commons, 240 votes to 25

2001. Transport Canada study on a national vision for public transit identifies 15 key policy goals, including "A level playing field [for] transit versus auto travel decisions… [including] rationalization of income tax regulations affecting allowable deductions and taxable benefits"

Support for tax exemption has been expressed by the Departments of Transport and Environment, several House Standing Committees, and hundreds of Canadian organizations representing workers, seniors, students, health care professionals, businesses, municipalities and environmentalists.

Figure 1. Potential impacts

Scenario	Contribution mechanism	Benefit cap	Employer participation	Employee transit use	Federal cost (foregone taxes)
Basic (similar to U.S. in 1991)	Employer only New benefit (no salary conversion)	$21 per month	Year 1: 1% Year 10: 5%	25% to 35% increase	Year 1: $0.67M Year 10: $3.35M
Advanced (similar to U.S. in 2002)	Employer and/or employee New benefit or salary conversion	None	Year 1: 10% Year 10: 60%	50% increase	Year 1: $19.8M Year 10: $119M

Note: Basic scenarios and estimates of employer participation and employee transit use taken from reference a

Addressing federal government concerns

The Department of Finance has put forth a number of concerns with tax-exempt employer-provided transit benefits. In response, CUTA and its allies offer the following points.

Concern: Taxes are not an appropriate tool to change people's behaviour.
Response: Canada already uses taxes for this purpose —such as the excise taxes on cigarettes and alcohol. We also enjoy tax deductions that encourage charitable donations, retirement savings and political contributions—why not transit use?

Concern: It would be an administrative burden on the federal government.
Response: Administration comes from tax collection, not tax exemptions. Other than a small change in legislation, no ongoing effort by Revenue Canada or the Department of Finance would be required. Most necessary work would be done by transit companies, municipalities and the private sector. Medical and dental benefits are already tax-exempt, and do not place a burden on the federal government.

Concern: This would set a precedent for excluding other benefits from taxation.
Response: The precedent is already set—tax exemptions have been granted to other benefits because of long-term advantages like reduced social costs. The dominance of car commuting in Canadian cities is a serious threat to our environment and our quality of life. Tax-exempt transit benefits can help us change this.

Concern: Tax exemption would be inequitable to employees of businesses that don't offer transit benefits—they would have to buy transit passes with after-tax income.
Response: Tax exemption would fix the inequity now suffered by transit commuters whose car-commuting colleagues receive free parking at work. Increased transit use by commuters would also enable transit companies to improve service for the members of society who need it the most—youth, the elderly and persons with disabilities.

Concern: Because a majority of people who would benefit from tax relief are already using transit, the cost of tax-exempt transit benefits would be high when measured against the number of new riders.
Response: We need to include more than just new riders in cost calculations. This incentive would also help to retain existing riders—an important consideration, because rider turnover is a fact of life for transit systems. The estimated cost per new rider would be drastically reduced—perhaps by half—if we included the 50 percent of existing transit users who are "choice users". As well, the government's cost estimates exclude the value of numerous economic benefits like reduced traffic congestion and pollution, and do not account for the portion of foregone taxes that would be collected later as GST or other forms of revenue.

Let's make it happen

CUTA has published this "special edition" issue paper with the hope of influencing the coming federal budget—but we need your help. Please contact your Member of Parliament, the Minister of Finance and the Prime Minister. Let them know that the time is right, more than ever, for tax-exempt employer-provided transit benefits.

References

a) IBI Group and Management of Technology Services, *Tax-Exempt Status for Employer Provided Transit Benefits*, Report to the Transportation Climate Change Table, 1999 (www.tc.gc.ca)

b) United States General Accounting Office, *Mass Transit, Federal Participation in Transit Benefits Program*, 1993

c) U.S. Department of Transportation, *TransitChek in the New York City and Philadelphia Areas*, 1995

d) www.commutercheck.com, "Commuter Check Enrollment Soars in Bay Area", media release, April 2002

e) Prime Minister's Caucus Task Force on Urban Issues, *Canada's Urban Strategy: A Vision for the 21st Century* (interim report), 2002 (www.liberal.parl.gc.ca)

f) *Canada Transportation Act* Review Panel, *Vision and Balance*, 2001 (www.reviewcta-examenltc.gc.ca)

Public Transit

The Canadian Urban Transit Association (CUTA) is the voice of Canada's public transit industry. For additional information, including research reports, industry updates, news bulletins and more, please contact us or visit our website.

Suite 1401—55 York Street
Toronto ON M5J 1R7 Canada
416-365-9800
416-365-1295 (fax)
transit@cutaactu.ca
www.cutaactu.ca

cuta actu
Canadian Urban Transit Association
Association canadienne du transport urbain

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