New Parking Expense Rules for Taxable Employers and Tax-Exempt Organizations

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The Internal Revenue Service issued guidance last December to help employers that own or lease employer parking facilities or reimburse employees for parking expenses to navigate the recent change to the parking expense deductions and unrelated business income rules in the Internal Revenue Code (the "**Code**").

In December of 2017, the Tax Cuts and Jobs Act, (the "**Act**") disallowed a corporate income tax deduction for expenses incurred with respect to qualified transportation fringe ("**QTF**") expenses provided by employers to their employees.[1] Such expenses include the cost of parking lots, parking spaces, and garages. In addition, the Act also required tax-exempt employers to increase their unrelated business taxable income ("**UBTI**") by the amount of QTF expense that would otherwise be disallowed as a deduction.[2]

The law changes became effective for the 2018 taxable year, and the IRS issued Notice 2018-99 late last year to assist both taxable and tax-exempt employers in determining how the change will affect their parking expense deductions and UBTI, respectively. The new rules apply to (i) all employers that own or lease employee parking facilities, *e.g.,* parking lots, parking spaces, and garages, that their employees use; and (ii) employers that reimburse employees for parking expenses paid to a third-party owned parking facility.

The Department of Treasury is expected to issue proposed regulations, which will include guidance on how to determine the amount of the QTF parking expense. In the interim, taxable and tax-exempt employers may rely upon Notice 2018-99. The Notice provides that employers may use any *reasonable method,* or the safe harbor provided in the notice, to determine the amount of the QTF parking expense.

QTF Benefit Exclusion from Income

A fringe benefit is a form of compensation for the performance of services. Any fringe benefit provided by an employer to an employee is taxable income to the employee unless the Code provides an income tax exclusion. The value of a QTF benefit is generally excluded from an employee's taxable income under Code section 132(f). QTF benefits include employer payment or reimbursement for the use of commuter vehicles, transit passes, and qualified parking on or near the employer's business premises. Previously, employers could deduct all expenses that stemmed from QTF benefits made available to employees. Under the new Code provisions, the employer can still deduct expenses related to the portion of QTF benefits in excess of the exclusion amount, *i.e.,* $265 per month for each employee receiving QTF benefits, which are taxable to employees. The expenses related to employer-provided parking that are excluded from an employee's taxable income as a QTF benefit are no longer tax deductible by the employer.

Tax-Exempt Employers

For tax-exempt employers the expenses related to employer-provided parking that are excluded from an employee's taxable income as a QTF benefit must be added to the organization's unrelated business income.

Form 990-T Requirements

A tax-exempt employer is required to file IRS Form 990-T, *Exempt Organization Business Income Tax Return,* to report its aggregate UBTI generated if the amount is greater than $1,000. In general, if the UBTI amount is less than $1,000, a tax-exempt organization will not be required to file a Form 990-T.

Netting of Unrelated Business Income from Employer-Provided Parking

As a result of the Act, Congress eliminated the ability of tax-exempt organizations to offset income from one unrelated business activity with losses from another unrelated business activity if the activities both stemmed from separate trades or businesses. The UBTI originating from employer-provided parking is not considered to be a separate trade or business. Notice 2018-99 provides that a tax-exempt organization may offset UBTI incurred from employer-provided parking with a loss from another unrelated business income activity. The notice, however, provides no guidance if there is more than one source of UBTI.

Reasonable Methods to Determine QTF Expenses

To determine the amount of the QTF parking expense, Notice 2018-99 divides employer-provided parking into two categories: (i) third-party owned parking facility that the employer pays on behalf of its employees either directly or indirectly through a compensation reduction agreement; and (ii) Employer-owned or leased parking facilities available for employees.

1. **Third-Party Owned Parking Facility**

Notice 2018-99 provides that the total amount paid to the third party minus any parking-related amounts included in employee income, will be the amount that is nondeductible for taxable entities (added to UBTI for tax-exempt entities).

If the amount paid for employee parking exceeds the Code section 132(f)(2) monthly limitation per employee, then it becomes taxable to the employee. For 2019, the permissible exclusion amount is $265 per month. Thus, if the employer pays to a third-party less than or equal to $265 per month per employee, such amount will be nondeductible or included in UBTI. Any amounts paid over $265 per month per employee must be included in the employee's income, and the employer will be allowed to take a corresponding deduction.

2. **Employer-Owned or Leased Parking Area**

"Any reasonable method" based upon the "total parking expenses" of the employer may be used to calculate the parking costs provided to employees when the employer owns or leases the parking area. Notice 2018-99 provides a four-step safe-harbor method that is deemed to be reasonable.

Generally, the "total cost of parking" includes, but is not limited to: rent or lease payments, repairs and maintenance costs, insurance costs, utility costs, property taxes, interest, snow and leaf removal, cleaning, landscape costs, security, and parking lot attendant expenses. Depreciation and additional expenses paid for items not located in the parking area are not considered to be included in the cost of parking. Capital expenses and improvements are not included in the "total cost of parking" for the employer.

Four-Step Safe Harbor Method To Calculate QTF

Employers should first calculate the "total parking expenses" (not the fair market value of parking) and the total number of parking spots it provides.

The following steps allow the employer to classify each parking spot, and its allocated parking expense, as tax deductible or non-deductible (or included in UBTI).

1. **Step One: Calculate Reserved Spots for Employees**

Employers must determine the total reserved spots for employees in comparison to the total parking spots and calculate the percentage of employee spots that are reserved. There are numerous ways in which parking spots are reserved for employees. Examples include limited access parking areas or signage depicting that parking is only for employees.

To calculate the cost of the reserved employee spots, the percentage of employee spots must be multiplied by the total cost of parking.

If a parking spot is reserved for an employee, then the cost allocated to such spot is not a tax deductible expense (or it will be includable in UBTI). Employers have until March 31, 2019, to decrease or eliminate reserved employee spots, and the change will be retroactive to January 1, 2018.

Example: Tax-Exempt Organization K is a hospital and owns a surface parking lot adjacent to its building. K incurs $10,000 of total parking expenses. K's parking lot has 500 spots that are used by its patients, visitors, and employees. K has 50 spots reserved for management and has approximately 100 employees parking in the lot in non-reserved spots during the normal operating hours of the hospital. Because K has 50 reserved spots for employees, $1,000 ((50/500) x $10,000 = $1,000) is the amount of total parking expenses that is nondeductible for reserved employee spots. K must increase its UBTI by $1,000, the amount of the deduction disallowed.[3]

2.

Step Two: Determine Primary Use of Remaining Spots aka "The Primary Use Test"

Employers must determine the primary use of the parking spots that are not reserved spots for employees, owners, or independent contractors of the organization. Usage of the spots is determined during normal business hours on a normal business day.

If greater than 50% of the remaining spots are provided to or reserved for the general public, such as visitors, customers, clients, patients, or students, then 100% of expenses allocated to these parking spots is a deductible expense (and not included in UBTI).

If less than 50% of the remaining spots are provided to or reserved for the general public, then the employer is required to calculate the actual employee use of the spots using a "reasonable method" in comparison to the total remaining parking spots and to calculate the percentage of parking spots used by employees.

If a parking spot is used by an employee, then the cost allocated to such spot is not a tax deductible expense (or will be includable in UBTI).

Example: Tax-Exempt Organization J, a religious organization that operates a church and a school, owns a surface parking lot adjacent to its buildings. J incurs $10,000 of total parking expenses. J's parking lot has 500 spots that are used by its congregants, students, visitors, and employees, and 10 spots that are reserved for certain employees. During the normal hours of J's activities on weekdays, J usually has approximately 440 non-reserved parking spots that are empty. During the normal hours of J's activities on weekends, J usually has approximately 400 congregants parking in the lot in non-reserved spots and 20 employees parking in the lot in non-reserved spots.

Because usage of the parking spots varies significantly between days of the week, J uses a reasonable method to determine that the primary use of the remainder of J's parking lot is to provide parking to the general public because 90% (440/490 = 90%) of the spots are used by the public during weekdays and 95% (470/490) of the spots are used by the public on weekends. The empty, non-reserved parking spots are treated as provided to the general public. Thus, expenses allocable to these spots are excepted from the disallowance under the primary use test, and only $200 of the expenses for the provision of the QTF will result in an increase to UBTI.[4]

3.

Step Three: Calculate Allowance for Reserved Nonemployee Spots

Reserved nonemployee spots are fully deductible. Employers must determine the total reserved nonemployee spots in comparison to the total parking spots and calculate the percentage of spots that are reserved for nonemployees. To calculate the cost of the reserved nonemployee spots, the percentage shall be multiplied times the total cost of parking.

4. **Step Four: Determine Use for Remaining Spots and Allocate Expenses**

If any parking expenses remain that are not otherwise categorized as deductible or nondeductible, then the employer must reasonably determine employee use of parking spots during normal business hours. An employer may specifically identify spots actually used by employees or make a reasonable estimation of employee usage. Employee usage may be based on the number of employees, number of parking spots, hours of use, or other reasonable considerations.

[1] Code section 274(a)(4).
[2] Code section 512(a)(7).
[3] Notice 2018-99, Example 10
[4] Notice 2018-99, Example 9

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