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Notice 2018-99: Tax Reform Curbs Parking Deductions and Increases UBTI

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The tax rules for parking expenses have changed for taxable and tax-exempt entities. This article explains current guidance on the new rules and poses real world scenarios that remain unclear.

Tax reform, originally named the Tax Cuts and Jobs Act (the "TCJA"), made several sweeping changes to both section 274,¹ curtailing many common benefit deductions for taxable entities, and similar provisions for tax-exempt entities, increasing unrelated business taxable income ("UBTI") under section 512(a)(7) for qualified parking benefit expenses. In particular, the TCJA reduces or eliminates deductions related to expenses for meals, entertainment, amusement, or recreation activities, and qualified transportation fringe ("QTF") benefits (including parking) for expenses paid or incurred on or after January 1, 2018 (irrespective of the tax year).

Notice 2018-99 provides initial guidance on the potential limitations and increased UBTI related to qualified parking expenses. The notice indicates that proposed regulations consistent with the notice will be issued on the determination of nondeductible parking expenses and increase to UBTI

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¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

attributable to QTFs. Generally, until there is additional guidance, taxpayers can rely upon any reasonable method for determining the amount of nondeductible expenses under section 274(a)(4) and increase in UBTI under section 512(a)(7). However, the notice does identify certain methods deemed unreasonable as well as certain methods that are deemed reasonable.

Background

Prior to the TCJA, expenses to provide qualified transportation fringes under section 132(f) were deductible as ordinary and necessary business expenses. Qualified transportation fringe benefits include items such as transit passes, van pools, qualified parking benefits, and bicycle commuting reimbursement (post 2025)². These benefits remain excludible from employee income, except for the bicycle commuting reimbursement, which is taxable to employees through December 31, 2025.³

The TCJA amended section 274(a) to expressly disallow deductions for “the expense of any qualified transportation fringe (as defined in Section 132(f)) provided to the employee of the taxpayer.” Qualified parking is considered a QTF.

Qualified parking is defined under section 132(f)(5)(C) as parking provided to an employee (a term that does not include partners, two percent shareholders of S corporations, sole proprietors, and independent contractors) by an employer—

- On or near the employer’s business premises; or
- At a location from which the employee commutes to work (including commuting by carpool, commuter highway vehicle, mass transit facilities, or transportation provided by any person in the business of transporting persons for compensation or hire).

Parking is provided by an employer if—

- The parking is on property that the employer owns or leases;
- The employer pays for the parking; or
- The employer reimburses the employee for parking expenses.⁴

QTFs (including qualified parking) can be provided to employees without cost or pursuant to a salary reduction agreement wherein an employee elects certain QTFs subject to certain requirements and limitations within the cafeteria plan. Section 132(f) excludes the value of a QTF from an employee's gross income up to an indexed monthly limit (the 2019 limit is \$265/month).

² Section 132(f)(1).

³ Section 132(f)(5)(F)(8).

⁴ Section 1.132-9, Q/A-4(d).

Notice 2018-99

What expenses are curbed?

The notice provides that the employer's expense of providing the QTF rather than value determines the amount of the disallowance.

- **Taxpayer pays a third party for employee parking**

With respect to amounts paid to a third-party parking facility, the amount paid is the disallowed expense, except to the extent that the amount is imputed in income because it exceeds the monthly exclusion limitation (\$265 for 2019).

The notice provides several examples with a taxpayer paying a third party for employee parking. In Example 1, the taxpayer pays a third party \$100 per month per parking spot for 10 employees with total annual expenses of \$12,000. The \$100 per month per employee is excludible from employee income as a QTF. The entire \$12,000 is nondeductible.

Example 2 has the same facts as Example 1 except that the taxpayer pays \$300 per month for each parking spot. The QTF of \$260 is excludible from employee income, but \$40 per month must be reported as compensation and wages. The taxpayer has \$36,000 of total expenses of which \$31,200 ($(\$260 \times 10) \times 12$) is a nondeductible expense and \$4,800 ($(\$40 \times 10) \times 12$) is deductible as compensation and not subject to the 274 limitation.

- **Parking owned or leased by taxpayer**

The notice provides that for a parking facility owned or leased by the taxpayer, the lost deduction is related to the expenses related to the facility. These expenses include, but are not limited to, repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent or lease payments or a portion of a rent or lease payment. However, depreciation is not an expense for this purpose. Additionally, expenses paid for items not located on or in the parking facility, including items related to property next to the parking facility, such as landscaping or lighting, are not included.

However, the notice does not provide a specific method for determining the amount of the employer's expenses associated with the parking facility. As such, when the lease and overhead expenses are not bifurcated between the office space and parking facility (e.g., if the lease agreement does not specifically state the cost of leasing the parking facility), any reasonable method may be used to allocate the associated costs. For example, employers may allocate expenses based on relative square feet, estimated usage, or the fair market value of similar parking facilities in the local area. This information may be determined by working with the employer's real estate department or KPMG's economic valuation services group.

Safe-Harbor Allocation Methods—Two Lanes

The notice generally provides that the allocation of expenses is based on any reasonable method; but, the notice does contain a couple lanes of safe harbor approaches within four steps set forth in the notice.

- **Step One: Calculate the disallowance for reserved employee spots**

The taxpayer identifies the number of parking spots in the parking facility and the amount exclusively reserved for the taxpayer's employees. Spots can be reserved in a variety of ways including a "For employees only" sign or a separate facility or portion of a facility segregated by a barrier or limited entry.

The taxpayer must determine the percentage of reserved employee spots in relation to total parking spots. The percentage is multiplied by the taxpayer's total parking expenses. The product is the amount of parking expenses that is nondeductible under section 274(a)(4) or additional UBIT for a tax-exempt entity. The notice expressly deems a failure to allocate expenses to reserved employee spots to be an unreasonable allocation method for tax years beginning on or after January 1, 2019. However, a taxpayer can reduce or eliminate their reserved employee parking spots through March 31, 2019 and treat this change as retroactive to January 1, 2018.

- **Step Two (Lane One): Determine the primary use of remaining parking spots "primary use test"**

The taxpayer must determine whether the primary use of the remaining parking spots is for the general public or employees. The "general public" includes customers, clients, visitors, individuals delivering goods or services to the taxpayer, patients of a health care facility, students of an educational institution and congregants of a religious organization. The general public does not include employees, partners, or independent contractors of the taxpayer.

If the primary use (greater than 50 percent) of the remaining spots is for the general public, then the remaining expenses are deductible. Primary use of the parking spots for taxable entities is tested during normal business hours on a typical business day or, in the case of an exempt organization, during the normal hours of the exempt organization's activities on a typical day. Non-reserved spots that are available to the general public but empty during such periods are treated as available to the general public. If the actual or estimated usage varies significantly between days or times of the year, the taxpayer may use any reasonable method to determine actual or estimated use.

- **Step Three (Lane Two): Calculate the allowance for reserved nonemployee spots**

If the primary purpose is not to provide parking to the general public, then the taxpayer may identify the number of spots in the facility that are exclusively reserved for nonemployees. Nonemployees include visitors and customers, as well as partners, sole proprietors, and two percent shareholders of S corporations. Spots can be reserved in a variety of ways including a "For customer only" sign or a separate facility or portion of a facility segregated by a barrier or limited entry. There is no transition rule for changing reserved nonemployee spots. The taxpayer can determine the percentage of reserved

nonemployee spots in relation to the remaining total parking spots and multiply that percentage by the remaining parking expenses. The product of that calculation is the amount that is not subject to the section 274(a)(4) disallowance.

- **Step Four: Determine remaining use and allocable expenses**

If there are any remaining expenses after calculating steps 1-3, the taxpayer must reasonably determine the employee use of the remaining parking spots during normal business hours on a typical day during normal hours and the related expenses allocable to those spots. Methods may include specifically identifying the number of employee spots based on actual or estimated use.

Safe Harbor Notice Examples

In Example 3 of the notice, a big box retailer has a surface lot next to its business with 500 parking spots for customers and employees with total annual expenses of \$10,000. There are no reserved parking spots for employees and approximately 50 employees park in the lot on a typical day. 300 spots usually remain empty. Under step 1, no amount is specifically nondeductible because there are no reserved employee spots. Under step 2, the primary purposes (450/500 = 90%) of the lot is used for the general public. None of the \$10,000 expenses are subject to disallowance under section 274(a).

Example 4 provides that a manufacturer taxpayer has a surface parking lot and incurs \$10,000 in parking expenses. The lot has 500 parking spaces. There are 25 spots reserved for visitors. Typically 400 employees park in the nonreserved spots. In step one, there are no reserved spots for employees so no amount is allocated to lost deduction. In step 2, the primary purposes is for employee parking (400/500 = 80%) and expenses must be allocated to those spots. In step 3, deductible amounts are allocated to reserved visitor parking (25/500 = 5%) for \$500 (\$10,000 x 5%) and the remaining \$9,500 could be subject to disallowance. Under step 4, the taxpayer must reasonably determine the employee use of the remaining parking spots during normal business hours and the expense allocable to employee parking spots.

Future Regulations

Notice 2018-99 states that the IRS and Treasury intend to publish proposed regulations under sections 274 and 512, and that those proposed regulations will include guidance on the determination of nondeductible parking expenses and other expenses for QTFs and the calculation of increased UBTI attributable to QTFs.

Until the regulatory guidance is issued, taxpayers and tax-exempt organizations that own or lease parking facilities where their employees park may use “any reasonable method” as provided by notice 2018-99 to determine the amount of nondeductible expenses under section 274(a)(4) or the amount of the increase in UBTI under section 512(a)(7).

Also, until those proposed regulations are issued, taxpayers may rely on the guidance in Notice 2018-99 to determine the amount of nondeductible parking expenses for QTFs under section 274(a)(4) as well as the increase in UBTI under section 512(a)(7).

Notice 2018-100

As a practical matter, the broad general public definition in Notice 2018-99 will generally help mitigate the impact for many tax-exempts, particularly houses of worship and universities. In addition, Notice 2018-100 provides for certain exempt organizations relief from the estimated tax penalty in 2018 for

parking QTF benefits for those entities that were not previously required to file a Form 990-T or that will not exceed the \$1,000 threshold below which an organization is not required to file a Form 990-T or pay the unrelated business income tax.

Frequently Asked Questions that Require Clarity

Notice 2018-99 is an initial pass at formulating rules to address qualified parking. However, there are real world scenarios, including the following, which exceed the limits of the notice and require clarity:

- When employees make after-tax payments for parking, the impact under section 274(a)(4) is unclear. There was a request for comments in the notice on the exception under section 274(e)(8) for goods and services sold for fair and adequate consideration, so additional information is likely in future guidance.
- The notice is unclear on how to treat zero value employer-provided parking. Additional guidance or proposed regulations are expected to provide that zero value employer-provided parking is a qualified transportation fringe under section 132(f) and expenses may be nondeductible.
- It is unclear how employers should allocate the total parking expenses in lease and/or ownership scenarios such as when:
 - Expenses are commingled (security for a building and parking, lighting, etc.)
 - The lease fails to allocate to a parking facility
 - The lease allocates zero to the parking facility
- The notice does not address mixed use parking scenarios where there may be parking spaces available to several unrelated business when employees of the businesses in total may exceed the 50 percent threshold, but the available public spaces exceed each separate businesses' employees. For example, a business may be one of six that occupy a plaza with 100 parking spots. Each business has 10 employees parking in the lot in unreserved spots for a total of 60 parking spaces occupied by employees, leaving 40 spaces available to the public. Although the total parking spaces cumulatively are not primarily for the general public, the public spaces available (40) substantially exceeds each separate businesses' employees utilizing the lot. Additional guidance is needed to pragmatically address this common scenario when it also is extremely difficult to obtain facts beyond one's own business.
- The notice does not address how to treat business use parking (employer-provided vehicles, non-personal use vehicles), in the safe harbor four-step calculation.

- Certain individuals (such as staff physicians and others) may not satisfy the definition of general public, nor the definition of employee, independent contractor, etc. Clarity is required to distinguish between general public and nonpublic parkers or even provide a path for those situations that are in between.
- Whether the rules extend to foreign branches or controlled foreign corporations for purposes of calculating taxes is an open question.
- How the rules affect pass-through entities and tax-exempt partners needs clarification.

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