Client Alert: New IRS Guidance Addresses the Tax Cost of Providing Parking to Employees, Even for Tax-Exempt Employers

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Federal Tax Reform Changed the Rules for Employer-Provided Parking

As a result of the Tax Cuts and Jobs Act (12/22/2017), *an employer that provides parking to its employees may have a higher tax bill, even if the employer is a tax-exempt organization*. Starting in 2018, an employer is no longer able to deduct the expense associated with "any parking" provided to employees on or near the workplace. Additionally, tax-exempt organizations are required to increase their unrelated business taxable income (UBTI) by any amount paid or incurred for employee parking. The IRS issued Notice 2018-99 (the Notice) on December 10, 2018, to assist employers in determining which parking expenses are no longer deductible (or are includable in UBTI). Businesses and tax-exempt organizations may rely on the Notice immediately, pending the publication of further guidance.

New IRS Guidance Describes How to Determine the Tax Cost

The Notice clarifies that all employers who own or lease parking spaces, lots or garages (i.e., employer parking facilities) that their employees use, as well as employers who reimburse employee expenses for parking in a third-party parking facility, will be subject to the rule. Accordingly, the method for determining the amount of the employer's parking expense that is nondeductible (or the amount that increases UBTI) depends on whether the employer owns or leases its own parking facility.

Employer-Owned or Leased Parking Facilities

If the employer owns or leases a parking facility, the Notice states that the employer may calculate the nondeductible expense amount (or corresponding UBTI amount) using any reasonable method based on the "total parking expenses" of the organization. The Notice also provides a safe-harbor (the Safe Harbor) that the IRS has deemed to be

"a reasonable method."

Total Parking Expenses. Under the Notice, an employer first calculates its "total parking expenses," which include, but are not limited to, repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, cleaning, landscape costs, parking lot attendant expenses, security, and applicable rent or lease payments. Fortunately, however, capital expenses are **not** included in total parking expenses, so organizations still will be able to obtain the full tax benefit from depreciation on parking facilities.

Employee-Reserved Spots. All employers must take into account their employee-reserved parking spots in determining the nondeductible amount of parking expenses (or increase in UBTI). The Notice clarifies that parking spots may be exclusively reserved for employees by a variety of methods, including specific signage (e.g., Employee Parking Only) or a separate facility or portion of a facility segregated by a barrier to entry or limited by terms of access. Under the Safe Harbor, the portion of total parking expenses allocable to such employee-reserved spots is nondeductible (or will be includable in UBTI).

- ***Special Retroactive Relief.*** The Notice provides a special opportunity for organizations to retroactively reduce or eliminate the tax cost of employee-reserved spots for 2018. Employers have until March 31, 2019 to change their parking arrangements to decrease or eliminate the number of employee-reserved parking spots, which will be given retroactive recognition as of January 1, 2018.

Use of Parking Facilities by Visitors, Guests and other Members of the General Public. Under the Safe Harbor, the employer must determine the primary use of parking spots that are not reserved exclusively for employees. If an employer can prove that *more than 50%* of such parking spots are made available to visitors, vendors, customers, clients, patients, students or other members of the "general public" during normal hours on a typical day (even if many of the spots are empty), then 100% of the expenses for the non-reserved spots are deductible (and are not included in UBTI). If 50% or fewer of the spots are made available to the general public, then the employer must use a "reasonable method" to determine the actual employee use of the spots. The employer's disallowed deduction (or additional UBTI) will be based on the estimated percentage of employee use.

- The "general public" does not include owners or independent contractors of the organization.

Spots Reserved for Visitors, Guests and Owners. Under the Safe Harbor, the portion of total parking expenses allocable to spots reserved exclusively for visitors, guests and owners of the organization always are deductible (and will not be included in UBTI).

Aggregating Parking Facilities. Under the Safe Harbor, employers may aggregate (but apparently are not required to aggregate) multiple parking facilities within the same geographic location. This aggregation rule may help certain employers meet the "over 50%" threshold for visitor and guest availability described above.

Factoring in Value to Employees. In the Notice, the IRS made clear that an employer's disallowed deduction (or additional UBTI) is based on the expense of parking facilities to the organization, and not the value of such parking to the employees. The value of employer-provided parking still is excludable from an employee's income (subject to a cap, which is $260/month in 2018 and $265/month in 2019).

Third-Party Reimbursement Arrangements

If an employer pays a third party for employee parking spots (including through a compensation reduction arrangement), the total annual cost of employee parking paid to the third party, less any parking-related amounts included as wage income to the organization's employees, is nondeductible (or UBTI). The value of employer-provided parking that is excludable from an employee's income is subject to a cap, which is $260/month in 2018 and $265/month in 2019. Thus, any amount that an organization pays to a third party for an employee parking spot is nondeductible (or included in UBTI), up to $260/month in 2018 and $265/month in 2019.

Special Rules for Tax-Exempt Employers

For tax-exempt organizations, Congress's new parking expense disallowance rule is particularly problematic because it treats disallowed expenses of the organization as taxable income. Although there are some questions that remain unanswered, the Notice should help tax-exempt organizations navigate this otherwise difficult change in the law. In addition to the rules computing UBTI described above, the Notice provides the following guidance specifically for tax-exempt organizations:

The $1,000 Deduction. The overall $1,000 deduction that applies to all UBTI also applies to UBTI generated from employer-provided parking.

Filing a Form 990-T. An organization that has $1,000 or less in UBTI generated from employer-provided parking (and no other UBTI) generally will not need to file a Form 990-T. An organization with more than $1,000 in UBTI from employer-provided parking will need to file a Form 990-T, even if it has no UBTI from other sources.

Netting UBTI from Employer-Provided Parking. As part of tax reform, Congress eliminated the ability of tax-exempt organizations to net the losses of one trade or business against the income of another trade or business. The UBTI generated from parking-related expenses is **not** a "separate trade or business" for purposes of this new rule. Consequently, if a tax-exempt organization has only one other potential source of UBTI, the organization could use any net losses from that business to offset UBTI from employer-provided parking. It is not clear how these rules work if the tax-exempt organization has more than one other potential source of UBTI.

Example:

The following example, which has been adapted from the Notice, illustrates the application of the rules described above:

Employer-Owned Parking Facilities: An organization owns a surface lot adjacent to its buildings and incurs $10,000 of total parking expenses in 2018. The lot has 500 spots, 10 of which are reserved for certain employees, through signage. During the normal hours of the organization, approximately 90 employees are parking in the lot in non-reserved spots. Under the safe-harbor methodology:

(1) $200 is nondeductible (or includable in UBTI) as a result of the 10 spots reserved exclusively for employees (10/500 x $10,000); and

(2) The remaining $9,800 is deductible (or not includable in UBTI) because the primary use of the remaining 490 spots is to provide parking to the general public. The primary use of the non-reserved spots is determined by dividing the typical number of employees parking in the non-reserved spots (90) by the total number of non-reserved spots (490). Because the result does not equal or exceed 50%, the primary use of the non-reserved spots is to provide parking to the general public.

If the organization removes its "employee-reserved" signs by March 31, 2019, all of its parking-related expenses will be deductible for 2018 (or such expenses will not generate UBTI).

If, instead of 90, approximately 300 employees were parking in the 490 non-reserved spots during the normal hours of the organization on a typical day, then the "public availability" exception would not apply. The primary use of such non-reserved spots would not be to provide parking to the general public, because 50% or more of the spots (300/490 = 61%) would be treated as used by employees. The organization would need to determine the actual employee use of the 490 non-reserved spots, using any reasonable method (e.g., 61% of $9,800). The percentage of total expenses allocable to employee use would be nondeductible (or includible in UBTI).

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As noted above, businesses and tax-exempt organizations may rely on the Notice immediately, pending the publication of further guidance. If you have any questions about the deductibility of parking-related expenses, or the inclusion of such expenses in UBTI, please contact your Vorys attorney.