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IRS releases guidance on qualified transportation benefit deductions

TAX ALERT | December 11, 2018

Background

The Tax Cuts and Jobs Act (TCJA) amended section 274(a) to eliminate or limit the tax deductions for expenses related to certain employer-provided qualified transportation fringe (QTF) benefits. The qualified transit pass expenses, qualified van or transit bus expenses and qualified parking expenses are generally still excluded from employee income under section 132(f), but to the extent the employer provides these benefits as defined in section 132(f), the section 274(a)(4) rules apply to limit the employer's tax deductions.

Because tax exempt organizations do not generally take tax deductions, Congress also amended section 512(a) to require tax exempt organizations to pay unrelated business income tax (UBIT) to the extent a deduction is not allowable by reason of section 274 and the expense is paid or incurred by the organization for any qualified transportation fringe benefits, any parking facility used in connection with qualified parking under section 132(f), or any on-premises athletic facility.

In early guidance, the IRS noted (in Publication 15-B) that where employer-provided qualified transportation fringe benefits are paid for by employees using salary reduction elections, the pre-tax amounts under the salary reduction elections are still excluded from employee income, but the employer cannot circumvent section 274(a)(4) and deduct that amount as a compensation expense.

Guidance focuses on parking expenses

One open issue under section 274(a)(4) has been how to determine the amount of the loss of deduction for, and likewise the UBIT arising from, employer-provided qualified parking fringe benefits. In Notice 2018-99 (the Notice), the IRS provides guidance to assist employers with this determination.

The IRS provides that the employer can use any reasonable method of determining the loss of deduction, but that using the fair market value (FMV) of the parking provided to the employee is ***not*** a reasonable method, because, "Although the value of a QTF is relevant in determining the exclusion under section 132(f) and whether the section 274(e)(2) exception..applies, the deduction disallowed by section 274(a)(4) relates to the expense of providing a QTF, not its value."

The Notice breaks the treatment of parking expenses into two separate categories:

1. ***Employer pays a third party for employee parking spots.*** Under the Notice, the amount the employer pays to allow its employees to park at the third party lot or garage is generally the total annual cost of the employee

parking paid to the third party. However, if the cost of the parking for employees is above the annual section 132(f) limit ($260 for 2018, $265 for 2019), the amount of the cost above the section 132(f) limit must be treated as taxable compensation to the employees. The amount that is above the section 132(f) limit and is reported as W-2 wages is excluded from section 274(a)(4) and thus is deductible by the employer (and is not treated as UBIT by a tax exempt entity), fitting within the section 274(e)(2) exception for items included in compensation.

2. ***Employer owns or leases all or a portion of a parking facility.*** The Notice defines parking expenses as regular costs of taking care of the garage, parking lot or other parking facility — repairs, maintenance, utilities, insurance, property taxes, interest, removal of snow, leaves, trash, cleaning, parking attendant costs and the actual lease or rental payments for the lot or portion of the lot. Notably, depreciation is ***not*** considered a cost of parking.

The notice then provides for allocating the expenses between:

1. Spaces reserved (by using a barrier, signs, etc.) for employees
2. Spaces reserved (by using a barrier, signs, etc.) for the general public (nonemployees)
3. Spaces that can be used by either employees or the general public

The employer reasonably allocates the percentage of the total costs to the reserved employee spaces and this percentage of the total costs is nondeductible. The employer reasonably determines the percentage of the total costs for spaces reserved for non-employees and this percentage of the total costs is deductible.

Where the remaining nonreserved parking spots can be used by both employees and by customers or other non-service providers (students at a school, congregants at a religious entity, visitors at a hospital, etc.), the employer must determine the "primary use" of the spaces. If more than 50 percent of the use on a typical business day, during normal business hours, is by employees, then the employer costs of the remaining spots are subject to section 274(a)(4) loss of deduction. If the spots generally sit empty or available for general public use during normal business hours on a typical business day, the taxpayer can exclude the costs as being provided to the general public and then the costs for these nonreserved spaces are still deductible.

The Notice provides several examples of how to allocate the costs to the various categories of parking spots. In addition, the Notice provides that if the employer currently has reserved spots for employees but decreases or eliminates the reserved employee spots before March 31, 2019, the employer can treat the re-designated spots as not reserved employee spots retroactive to Jan. 1, 2018. Of course, if such spots are nonreserved, but are still primarily used by the employees, the employer will still likely lose the deduction for those spaces.

One concern that the Notice raises is that even if the value of parking is zero, such as in a rural area, the Notice suggests that if the employer "provides" the parking, section 274(a)(4) will still eliminate the deduction for the expenses of providing the parking. Per reg. section 1.132-9 Q&A 4,

(d) Parking is provided by an employer if –

(1) The parking is on property that the employer owns or leases;

(2) The employer pays for the parking; or

(3) The employer reimburses the employee for parking expenses (see Q/A-16 of this section for rules relating to cash reimbursements).

Conclusion

Overall, the Notice answers many of the outstanding questions that are critical for determining the section 274(a)(4) loss of deduction for qualified parking spaces, and determining the UBIT that applies based on section 512(a)(7). Employers should review the Notice and consider their reasonable method to calculate these expenses for what is a quickly approaching tax compliance season for many.

Tax exempt organizations will also need to consider the new guidance and determine their allocated costs of providing employee parking.

Related Notice 2018-100, issued at the same time, provides tax exempt entities a waiver of additions to tax for underpayment of estimated income tax to the extent that employers underpaid their estimated income tax based on the section 274(a)(4) changes to the tax treatment of qualified transportation fringe benefits.

The Notice provides that the IRS will issue proposed regulations with additional guidance, but that until the regulations are finalized, the Notice can be relied upon.

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