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Employer-Provided Parking/Transit Passes May Be UBTI

The recent tax reform act limits an employer's income tax deduction for providing its employees qualified transportation fringe benefits (QTFs). The law change applies to expenditures paid or incurred after December 31, 2017. Tax-exempt organizations are affected because the disallowed expenditures are characterized as unrelated business taxable income (UBTI). Below is an overview of the new tax rules and an illustration of their application. If you would like to discuss further the impact of these changes, please contact us.

Prior to the law change, employers could deduct expenses paid or incurred for providing its employees fringe benefits such as any transit pass, qualified parking, commuter highway vehicle transport, and qualified bicycle commuting reimbursement. In 2018, the employee would not, <u>and still does not after the law changes</u>, have to report as wages the fringe benefit (except for bicycle commuting reimbursement) as long as the value was $260 or less per month (increases in 2019 to $265). For purposes of these rules, an employee is any individual currently employed, including corporate officers. Partners, greater than 2% S Corporation shareholders, sole proprietors, and independent contractors are not considered employees.

We will discuss and illustrate below that these UBTI rules do not apply to any QTF that must be included in the employee's taxable wages, or to any QTF that is deemed made available to the general public.

Now, let's discuss the law changes for employer-provided parking. A parking facility includes indoor and outdoor parking garages/structures, parking lots, and other areas where employees may park near a place of business or commuting location. A taxpayer may aggregate spaces in parking facilities in a single geographic location for purposes of allocating expenses to employee parking, but may not do so in facilities in different locations.

Third party owned parking facility. UBTI is the total annual cost of the employee parking. If the employer's monthly payment for any one employee exceeds $260, the excess must be treated as employee compensation; but such excess is not considered UBTI.

Example 1: Employer A pays B, a third party who owns a parking garage across the street from A's office, $100 per month for each of A's 10 employees, or $12,000 annually. The $100 per month is not treated as employee compensation; thus the $12,000 is treated as UBTI as a disallowed QTF.

Example 2: Assume the same facts as Example 1, except that A pays B $300 per month for each employee, or $36,000 per year. Of the $300 per month, the $40 in excess of $260 is treated as employee compensation. Therefore, of the $36,000 annual expenditures, $4,800 ($40 excess x 10 employees x 12 months) is not treated as UBTI, but the remaining $31,200 is.

Employer-owned or leased parking facility. Until the IRS issues further guidance, an employer may use any reasonable method to calculate the potential UBTI. Expenditures to consider include (but are not limited to) repairs, maintenance, utility costs, insurance, property taxes, interest, snow/ice/leaf/trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent/lease payments, or a portion of the building rent/lease payments. Depreciation on a parking structure is not considered.

The IRS did issue temporary guidelines in mid-December 2018 that illustrates a reasonable method (albeit not the only method). The IRS clearly stated though that using the value of the parking is not a reasonable method. The IRS provided a four-step analysis.

Step 1. Identify the expenditures related to parking spaces reserved exclusively for the employees. The suggested formula is to multiply the ratio of reserved employee parking spaces to the employer's total parking spaces, times the total parking expenditures.

Step 2. Determine whether the "primary use" of the remaining spaces is to provide parking to the “general public.” If so, the remaining parking expenditures are not UBTI. Primary use means greater than 50% of the actual or estimated use of the parking spots. The general public includes, but is not limited to, customers, clients, visitors, delivery persons, patients, students, congregants. The general public does not include employees, partners or the employer’s independent contractors.

Step 3. If the primary use of the remaining spaces is not to provide parking to the general public, identify the expenditures related to reserved nonemployee spaces. Nonemployees include visitors, customers, partners, sole proprietors and 2% or more S Corporation shareholders. The suggested formula is to multiply the ratio of the reserved nonemployee spots to the remaining total parking spots, times the employer’s remaining total parking expenditures. The calculated product represents the additional UBTI.

Step 4. If there are remaining parking expenditures not specifically categorized in Steps 1 through 3 as non UBTI or UBIT, determine the estimated employee use of and expenses allocable to the remaining parking spaces.

A tax-exempt organizations with UBTI may have to report it on the IRS Form 990-T. A Form 990-T must be filed if the organization has gross income from an unrelated trade/business (including the QTF amount) of $1,000 or more. The first $1,000 of UBTI is exempt from taxation and any excessis subject to a flat 21% tax rate.

Illustration of Four-Step Process

E, the employer owns a surface parking lot adjacent to its office building. E incurs $10,000 of total parking expenses. E's parking lot has 500 spots that are used by its visitors and employees. E has 50 spots reserved for management and has approximately 400 employees parking in the lot in non-reserved spots during normal business hours on a typical business day. Additionally, E has 10 reserved nonemployee spots for visitors.

Step 1. Because E has 50 reserved spots for management, $1,000 ((50/500) x $10,000 = $1,000) is the amount of total parking expenses that is UBTI.

Step 2. The primary use of the remainder of E's parking lot is not to provide parking to the general public because 89% (400/500 = 89%) of the remaining parking spots in the lot are used by its employees. Thus, under the primary use test, expenses allocable to these spots are not categorically classified as not subject to UBTI.

Step 3. Because 2% (10/450 = 2.22%) of E's remaining parking lot spots are reserved nonemployee spots, the $200 allocable to those spots ($10,000 x 2%)) is not treated as UBTI.

Step 4. E must reasonably determine the employee use of the remaining parking spots during normal business hours on a typical business day and the expenses allocable to employee parking spots.

For more information, please contact Susan Jones, Nonprofit Principal and Practice Leader or Steve Glover, Tax Principal and Nonprofit Tax Specialist. They can also be reached at 847-205-5000.

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