

IRS Offers Guidance on Applying Test for Deductibility of Parking Expenses

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The Tax Cuts and Jobs Act of 2017 (TCJA) generally eliminated employer deductions for expenses incurred to provide employee parking benefits but left intact deductions for expenses associated with parking provided for customers and the general public. Because nondeductible employee parking expenses are often closely intertwined with deductible general public or customer parking expenses, employers may have difficulty distinguishing between the two under the TCJA.

To address this issue, the Internal Revenue Service (IRS) intends to propose regulations distinguishing nondeductible employee parking expenses from those associated with customers and the general public. Until those regulations are effective, taxpayers can rely on the guidance that the IRS issued in [Notice 2018-99](#) to allocate parking expenses between nondeductible employee parking expenses and deductible parking expenses for the general public and customers.

Impact of the TCJA

Prior to the TCJA, employers were permitted to deduct expenses incurred to provide qualified transportation fringe benefits (QTFBs) to employees. Deductible expenses included qualified parking, transit passes, vanpool benefits, and bicycle commuting reimbursements. “Qualified parking” is parking provided to employees near the employer’s business premises or near a location from which employees commute to work (excluding employees’ residences).

With one exception addressed below, the TCJA generally disallows any employer deduction for providing qualified parking to employees. As updated by the act, Section 274(a)(4) of the Internal Revenue Code now disallows employer deductions for amounts incurred to provide QTFBs, such as qualified parking, to employees. Similarly, for tax-exempt employers, Code Section 512(a)(7) increases unrelated business taxable income (UBTI) for any disallowed deduction for expenses incurred to provide employees with QTFBs.

Purpose of Notice 2018-99

Although the TCJA disallows deductions for qualified employee parking expenses, employers are still permitted deductions for ordinary and necessary businesses expenses, including expenses incurred to provide and maintain parking for the general public and for customers. However, the act does not specify how to apportion deductible and nondeductible expenses when an employer provides a common lot for use by employees, customers, and/or the general public.

Therefore, the IRS issued Notice 2018-99 to provide interim guidance on this and similar issues until regulations can be promulgated.

Employer Pays a Third Party for Employee Parking

Generally, amounts paid by an employer to a third party for employee parking are nondeductible under Code Section 274(a)(4). This is most applicable to employers that operate in urban areas and provide employee parking via third parties’ parking facilities due to limited street parking and the high cost of real estate. The nondeductible portion is equal to the taxpayer’s total annual cost of employee parking paid to the third party.

However, when expenses paid for an individual employee’s parking exceeds the monthly exclusion amount in Code Section 132(f)(2) (\$265 per month for 2019), any amount in excess of the monthly exclusion is imputed as income to the employee, subject to wage withholding and reporting. The employee must pay income tax on these amounts, and the employer is permitted a matching deduction for the portion included in employee income.

Employer Owns or Leases Parking

Until regulations are released, employers that own or lease parking facilities may use any reasonable method to allocate their parking expenses between nondeductible employee parking and deductible customer/general public parking. However, these calculations must be based on the employer’s *expense* to provide the parking spaces, according to the notice; an allocation based on the parking

benefit's *value* to employees will not be considered reasonable.

These considerations may be more applicable to employers with businesses in suburban or rural locations, where free parking is provided to employees and customers.

The notice focuses on allocating parking expenses between deductible and nondeductible amounts based on the use of the parking spaces. Under this approach, each parking space is deemed deductible or nondeductible. The employer may then deduct the proportion of total parking expenses based on the ratio of deductible parking spaces to total parking spaces. Beginning in 2019, to be considered reasonable, the expense allocation method used must allocate expenses to reserved employee parking spaces.

The notice provides a four-step methodology that the IRS deems reasonable, whereby the first three steps each classify a category of parking spaces as deductible or nondeductible. Each step is applied in sequential order. To the extent the first three steps do not categorize all of the parking spots as either deductible or nondeductible, any uncategorized parking spaces are evaluated in a "reasonable" manner in step 4.

1. *Reserved employee spaces.* Any parking spaces reserved for employees are nondeductible. Such parking spots may be reserved under a number of methods, including signs (e.g., "Employee Parking Only"), assigned spaces, and/or designated areas.
2. *Spaces available to the general public and employees.* Step 2 evaluates the primary use of all remaining parking spaces as a whole during normal hours on a typical business day. (Parking spots that generally remain empty are considered to be for public use.) If more than 50 percent of these remaining spaces are for use by the general public (including customers), then *all* of these remaining spaces are deemed deductible. If not, then the employer proceeds to steps 3 and 4.
3. *Reserved nonemployee spots.* If the spaces evaluated in step 2 were *not* deemed primarily for public use, any parking spaces reserved for nonemployees are deemed deductible. Such spots may be reserved by a variety of methods, including signs and/or designated areas.
4. *Other spots.* Any remaining uncategorized parking spaces are categorized using a reasonable method based on their normal use. The portion of these parking spaces normally used by employees is deemed nondeductible, and the remaining portion is deemed deductible.

Example

Employer Big Box spends \$1,000 annually to provide and maintain a parking lot with 100 spaces, 10 of which are reserved for Big Box managers and 35 of which are designated for customer parking only. Other Big Box employees typically occupy 50 of the non-reserved spaces, while the remaining spaces are normally occupied by customers or the general public, or go unused.

Step 1: Ten percent (10 out of 100) of the spaces are reserved for employees; therefore, 10 percent of Big Box's parking expenses are nondeductible.

Step 2: The remaining spots are deemed not to be primarily for public use because the majority (50 out of 90) of the remaining spaces are generally used by employees.

Step 3: Thirty-five percent (35 out of 100) of the spaces are reserved for customer parking only. The expenses associated with these parking spaces are deductible.

Step 4: Because 5 percent (5 out of 100) of the unmarked spaces are normally occupied by customers or the general public, or go unused, expenses incurred are deductible.

The notice provides numerous other examples highlighting each of the four steps.

Application to Tax-Exempt Organizations

Like taxable organizations, tax-exempt organizations are impacted by the TCJA's changes to the treatment of QTFBs. The notice requires tax-exempt organizations to categorize parking expenses in the same manner as taxable organizations. However, these organizations are ultimately treated differently due to their tax-exempt nature, where deductions to reduce taxable income do not apply. Instead, tax-exempt organizations are subject to UBTI.

Tax-exempt organizations must increase their UBTI by any employee parking expense deemed nondeductible. Note that even though these nondeductible expenses increase the organization's UBTI, providing employee parking is not itself considered an unrelated trade or business (tax-exempt organizations with more than one unrelated trade or business receive different treatment).

Conclusion

Though the notice provides helpful guidance regarding the allocation of parking expenses in various situations, some questions remain.

For example, one of the challenges employers may face is determining the expense incurred for parking if access to parking facilities is part of a lease agreement. It is unclear how and whether an employer is required to allocate parking expenses in a lease agreement that does not separately identify the amount attributable to parking. Trying to apply the four-step methodology to such a situation may become more complex in the event the parking facility is shared among tenants.

In preparation for future regulations, the IRS has requested comments concerning treatment of expenses paid for nondeductible employee parking. However, it is unclear when these regulations may be issued.

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