

IRS issues new guidance on worker parking tax on nonprofits

The IRS has issued new guidance on an unexpected and controversial provision of the Tax Cuts and Jobs Act: a new tax on non-profit employee parking.

The guidance provides a method that some non-profits may be able to use to avoid the tax, but, at the same time confirms that many non-profits will need to pay it.

By way of background, under tax reform, non-profits that make certain fringe benefits available to their employees are required pay tax on these benefits as if they were unrelated business income (UBIT). In particular, if non-profits provide parking to their employees, they are required to pay tax on the parking that they provide. (Yes, you read that right, employee parking is now taxable!)

For the first time, UBIT applies not to income, but to expenses. It appears as though Congress seems to be trying to put non-profit organizations on equal footing with taxable organizations that can no longer deduct these benefits. However, the result—a tax on employee parking—is baffling as a policy matter.

The new guidance focuses on determining the amount of parking expense that counts as a qualified transit fringe benefit. Under the guidance, certain organizations may be able to avoid the tax, if their employees and the public share parking facilities.

The easy case is where the taxpayer leases parking spots from a third party. In that case, UBIT is imposed on the amount that the taxpayer pays for the parking.

The plot thickens where the taxpayer owns or leases all or part of the parking facility. The IRS first specifies that the cost of parking can be computed using any reasonable method. It then goes on to provide some specifics on what is and isn't reasonable, and to provide a sample methodology.

Significantly, the Service states that the cost to provide parking (and not the value of the parking provided) must be utilized. This is a critical point. In Rochester, while there may be a significant cost to maintain a parking lot (think snow plowing in a harsh winter), parking spaces (in some areas at least) may still have little independent value on the market. It is the cost, not the value, that must be considered.

The IRS indicates that total parking expense includes all of the costs of maintaining the facility. These include repairs, maintenance, utility costs, insurance,



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Josh Gewolb

property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expense, security and, where applicable, rent or lease payments.

Notably excluded from this list is the cost of depreciation. The IRS specifically states that depreciation does not need to be included—a taxpayer favorable rule as the organization doesn't need to pay tax on the wear and tear on the parking lot caused by employee usage.

Next, the IRS provides a sample method for computing the portion of the parking expense attributable to employees. While this has been cited by commentators as taxpayer favorable, the actual result depends on the facts of an individual non-profit's parking situation, as described below.

The guidance divides parking spots into four categories in an attempt to differentiate whether they are properly allocable to employees:

1. Employee-Reserved Spots. If spots are reserved exclusively for employees, they are, of course, counted as employee spaces. Significantly, the IRS states that if spaces reserved for employees are released from this disfavored designation and made available to the public before March 31, 2019, they are deemed, retroactively to Jan. 1, 2018, not to be employee-reserved spots. While getting rid of these reserved spaces would reduce UBIT, it may not foster the greatest employee relations.

2. Primary Use Test. With respect to spots that are not reserved for employees, a query is made as to whether their primary use is to provide parking to the general public. This is the case if greater than 50 percent of the use of the parking spots is by the public.

Where use varies, a reasonable method can be used to determinate the relevant percentage. If more than 50 percent of the use

of a parking spot is by the public, then it is deemed not to be subject to the tax at all (not just to the extent of public use). This provision is taxpayer favorable, because under the right circumstances, there will be deemed to be no employee usage, even though employees in fact use the spaces.

For example, the regulations provide an example of a parking lot at a house of worship, where use by the flock so overwhelms the use by clergy that there is no deemed employee parking. However, there are other types of non-profit endeavours, where this fact pattern simply does not apply, based on the nature of use of the facility.

3. Non-Employee Spots. If the primary use of the taxpayer's remaining parking spots is not by the general public, the taxpayer may identify spots exclusively reserved for non-employees.

4. Remaining Spots. If there are remaining spots after the above, then the taxpayer must reasonably determine employee use during normal business hours during the normal hours of the exempt organization's activities on a typical day.

No fewer than nine examples illustrate the application of the above methodology. These provide useful insight in to the application of the rules.

The IRS states that it will be releasing regulations on this topic, and requests comments on the methodology in the notice. A separate IRS notice issued simultaneously provides relief to certain taxpayers who have not previously reported UBIT with respect to estimated tax penalties arising from the above. The IRS has also released a draft tax form and instructions reflecting the new tax. Taxpayers with under \$1,000 in UBIT are not required to file this form. (There is no broader *de minimis* exception.)

In a separate but related development, New York Governor Andrew Cuomo signed a bill late last year exempting parking-related UBIT from New York franchise tax. This knocks 6.5 percent off of the combined federal and state tax rate that would have been applicable.

In the coming months, we expect that the IRS will receive many comments on the preliminary guidance as it moves to finalize regulations. In the meantime, taxpayers are permitted to rely on the guidance in the notice. Until then, happy parking!

Josh Gewolb is a tax partner at Harter Secrest & Emery LLP.