Federal Tax Alert
Provided by the National Tax Office

IRS provides guidance for all employers to determine nondeductible parking expenses

Background

Under The Tax Cuts and Jobs Act, the cost of providing qualified transportation fringe benefits, such as parking and transit passes, are no longer deductible. This not only applies to employers directly paying for these items but also to employer and employee contributions to transportation flexible spending accounts and to all costs incurred by employers who have a parking lot at an owned or leased building. This is effective for all costs incurred after December 31, 2017. While qualified transportation fringes are no longer deductible by the employer, these benefits will continue to be tax-free to the employee to the extent the value of the qualified benefits are $260 or less per month. If amounts are in excess of $260 per month in 2018 and $265 per month in 2019, the amount above $260 is taxable as wages to the employee and is fully deductible to the employer.

How are nondeductible parking costs determined?

The IRS recently issued Notice 2018-99 providing interim guidance on determining the amount of parking expenses that are not deductible. The notice also provides interim guidance for tax-exempt organizations to determine the corresponding increase in the amount of unrelated business taxable income (see this Plante Moran alert for further details on the impact to tax-exempt organizations). The notice also announced that the Department of the Treasury and the IRS intend to publish proposed regulations to address the matter further. However, it is unlikely that
Taxpayers will see any additional guidance before they file their 2018 tax returns, so taxpayers can rely upon this notice for the 2018 tax year.

**Taxpayer pays a third party for employee parking:** If parking is paid to a third party, the method to determine the nondeductible amount is relatively straightforward. The notice reaffirms that the disallowance is generally the amount paid to the third party. For example, if an employer pays $200 per month each for 20 employee parking spots in a parking garage adjacent to its office, the entire $48,000 spent for the year would not be deductible ($200 x 20 spots x 12 months). If the employer spent $300 per month on each spot, only the first $260 would not be deductible, and the remaining $40 would be deductible, because it also must be included in the taxable wages of the employee.

The notice also confirms that the disallowance also applies to amounts set aside in a transportation fringe benefits account. These accounts allow employees to set aside money on a pre-tax basis to cover their parking and qualified transportation expenses. Unfortunately, the expense disallowance applies to all amounts contributed into these pre-tax accounts, even if the employee is electing to set aside their own funds in this account (i.e., the employer’s deduction for this portion of wage expense is not deductible). Employers should consider whether the added tax cost of these plans justifies their continued usage when compared to the tax savings still provided to the employee.

While the notice does not directly address transit passes directly provided to employees or those purchased through a transportation spending account, it’s expected that future guidance will provide an identical rule for these costs. That is, the nondeductible amount will likely be the amount directly paid to a third party by the employer for a transit pass or the amount of wages set aside in a transportation spending account.

**Facilities owned or leased by employers:** An employer that owns or leases a parking facility may also have nondeductible costs, including an employer that leases an office or factory with a surface parking lot. While the notice permits a taxpayer to use any “reasonable method” to compute its disallowed expenses, it provides a safe harbor methodology that consists of a four-step formula.

Any reasonable method for determining disallowed parking expenses must begin with determining the pool of costs attributable to a parking facility. The notice notes that such costs include, but are not limited to, repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscaping, parking lot attendants, security, and rent or lease payments. The notice provides, however, that any depreciation is not included in this pool or costs and is always fully deductible. Similarly, expenses for items not located directly in the parking facility, such as adjacent landscaping and lighting, are not included in the pool of costs.

*Taxpayers rarely track these types of parking facility expenses in any single location in their general ledgers, so accumulating these costs will likely be a manual, time-consuming process. One significant, unanswered question is how to allocate lease costs to a parking facility when the lease covers both the building and parking with no breakdown of the lease payment between the two. In many situations, there will be no easy way to determine that breakdown, but reasonable attempts will have to be made.*
Once a taxpayer determines the appropriate pool of parking expenses, the safe harbor methodology is applied as follows:

- **Step 1 – Reserved Employee Parking**: Costs attributable to employee reserved parking spots must be determined and treated as nondeductible parking expenses. A parking spot or section of parking may be considered employee reserved by use of signage or segregation by a barrier. The notice, however, provides that a taxpayer may take actions up until March 31, 2019, to decrease or eliminate employee reserved parking and the changes will be considered to have been made retroactively to January 1, 2018. For example, employers may change signage or remove barriers to decrease or eliminate reserved employee parking. Note that this will generally only be beneficial for taxpayers that meet the ‘more than 50 percent test’ in Step 2, or those whose reserved employee parking spots aren’t typically fully utilized.

- **Step 2 – Primary Use of Remaining Parking**: The taxpayer must next determine the primary use of the remaining non-reserved parking spots. If more than 50 percent of the remaining parking spots are for general public use, then all remaining parking expenses are considered fully deductible. Use by the general public includes use by customers, clients, visitors, students, patients, individuals delivering goods or services, and also includes parking spots that are empty during normal business hours. The general public does not include employees, partners, or independent contractors.

- **Step 3 – Reserved Nonemployee Parking**: If the taxpayer concludes in Step 2 that the primary use of remaining non-reserved parking spots is not for the general public, the taxpayer then calculates costs associated with reserved nonemployee spots and treats this amount as fully deductible. Similar to Step 1, reserved nonemployee spots may be reserved by use of signage, a separate facility/portion of the facility, or segregation by a barrier.

- **Step 4 – Use of Remaining Parking**: If there are any remaining parking spots after completion of Steps 1-3, the taxpayer must use a reasonable method to determine employee use of remaining spots and treat costs allocated to those spots as nondeductible.

When determining the use of parking spots, a taxpayer may use any reasonable method. As taxpayers rarely track the precise usage of open parking, it is likely that reasonable estimates based on employee headcount at a location during normal business hours will often be utilized. If a taxpayer owns or leases more than one parking facility in a single geographic location, the taxpayer may aggregate the number of spots in those facilities. However, it may not aggregate facilities across different geographic locations.

The safe harbor methodology is illustrated by the following examples.

**Example 1**: A retailer owns a surface parking lot adjacent to its store with 500 spots that are used by its customers and employees. It usually has approximately 50 employees parking in the lot in non-reserved spots and approximately 300 non-reserved parking spots that are empty during normal business hours on a typical business day.

- **Step 1 – Reserved Employee Parking**: Because none of the parking spots are exclusively reserved for employees, there is no amount to be specifically allocated in this step.
• **Step 2 – Primary Use of Remaining Parking:** The primary use of the parking lot is to provide parking to the general public because 90% (450/500) of the lot is used by the public. The 300 empty non-reserved parking spots are treated as provided to the general public.

• **Result:** Because the primary use of the parking lot is to provide parking to the general public and there are no reserved employee parking spots in Step 1, all of the expenses associated with the lot are fully deductible.

**Example 2:** A manufacturer owns a surface parking lot adjacent to its plant. It incurs $10,000 of total parking expenses, excluding depreciation on the lot. The parking lot has 500 spots. Approximately 400 employees park in the lot in non-reserved spots during normal business hours on a typical business day. The lot also has 25 spots reserved for nonemployee visitors at the entrance to the office portion of the building.

• **Step 1 – Reserved Employee Parking:** Because none of the parking spots are exclusively reserved for employees, there is no amount to be specifically allocated in this step.

• **Step 2 – Primary Use of Remaining Parking:** The primary use of the parking lot is not to provide parking to the general public because 80% (400/500 = 80%) of the lot is used by employees.

• **Step 3 – Reserved Non-Employee Parking:** Because 5% (25/500) of the parking spots are reserved nonemployee spots, the $500 ($10,000 x 5%) allocable to those spots is fully deductible.

• **Step 4 – Use of Remaining Parking:** The taxpayer must reasonably determine the deductibility of the remaining $9,500 of costs. Because 400 of the remaining 475 parking spots are used by employees during normal business hours on a typical business day, $8,000 of the remaining parking expenses are nondeductible (400/475 x $9,500).

• **Result:** Since no expense disallowance was computed in Step 1, the total nondeductible amount is the $8,000 from Step 4.

**Example 3:** A manufacturer owns multiple parking lots and garages adjacent to its manufacturing plant, warehouse, and office building at its complex in Detroit. The taxpayer chooses to aggregate the parking spots in the lots and garages at its complex in Detroit. However, it may not aggregate the spots in parking lots and garages at other facilities in the Detroit area that are not part of the complex or facilities in other cities. It incurs $50,000 of total parking expenses related to the parking lots and garages at its complex in Detroit. The taxpayer has 10,000 total spots in Detroit that are used by its visitors and employees; 500 spots are reserved for management and 8,000 are ordinarily used by other employees on a typical business day.

• **Step 1** – Because 500 spots are reserved for management, $2,500 ((500/10,000) x $50,000) is the amount of total parking expenses that is nondeductible for reserved employee spots.

• **Step 2** – The primary use of the remainder of the parking facility is not to provide parking to the general public because 84% (8,000/9,500) of the remaining parking spots in the facility are used by employees.

• **Step 3** – Because none of the parking spots are exclusively reserved for nonemployees, there is no amount specifically allocated to reserved nonemployee spots.
• **Step 4** – The taxpayer must reasonably determine the deductibility of the remaining $47,500 of costs. Because 84% (8,000/9,500) of the remaining parking spots in the lot are used by its employees during normal business hours on a typical business day, the taxpayer reasonably determines that $40,000 (($50,000-$2,500) x 84%) of its total parking expenses is not deductible.

• **Result:** Both the $2,500 allocable to reserved employee parking and $40,000 allocable to general employee parking are treated as not deductible leaving only $7,500 of deductible parking expenses at this facility.

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