Do We Really Owe Tax on Our Parking Lot?

Key Aspects of the New Tax on Qualified Transportation Fringe Benefits

Ted Batson, Partner

Executive Summary

Among the many changes and provisions in the Tax Cuts and Jobs Act (TCJA) passed in December 2017, one that has resulted in confusion and extensive discussion is the taxability of certain qualified transportation fringe benefits provided to employees, including parking benefits.

- The TCJA introduced a provision under which nonprofit organizations that provide certain fringe benefits to employees must now include the value of those benefits in unrelated business income tax and report it on Form 990-T.
- If your nonprofit pays or reimburses employees for transit passes, using a commuter highway vehicle, or qualified parking expenses, you must now include the amount expended for these qualified transportation fringe benefits in unrelated business income.
- Uncertainty about the wording related to qualified parking expenses and a lack of formal guidance from the IRS has resulted in significant confusion regarding whether employer-owned parking provided to employees is subject this new tax.
- This provision is effective for expenditures occurring on or after January 1, 2018. Nonprofits need to act now to assess their employee parking and the degree of risk they are willing to accept in the absence of IRS guidance.

Below, we take a look at the most common and pressing questions we've received on this issue.

What exactly does the new tax on transportation and parking fringe benefits entail?

The TCJA introduced Internal Revenue Code (IRC) section 512(a)(7), which imputes unrelated business taxable income to exempt organizations for certain items that are no longer deductible under IRC section 274. Section 512(a)(7) reads:

> **(7) Increase in unrelated business taxable income by disallowed fringe.**
>
> Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)). The preceding sentence shall not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business which is regularly carried on by the organization. The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations or other guidance providing for the appropriate allocation of depreciation and other costs with respect to facilities used for parking or for on-premises athletic facilities.

Nonprofits need to act now to assess their employee parking and the degree of risk they are willing to accept in the absence of IRS guidance.

Ostensibly, section 512(a)(7) was added to the IRC to create parity between for-profit and nonprofit employers after the deduction for certain fringe benefits allowed to for-profit employers was eliminated, thereby increasing their tax liability. The remedy to create parity between the two sectors was to require nonprofit employers to include this amount in their unrelated business taxable income.[1]

Parsing the statute, we can observe a number of factors that are key to understanding its application:

- The statute is limited to amounts for which a deduction is not permitted under section 274.[2] Section 274 is a code section devoted to enumerating certain expenditures for which an income tax deduction is not permitted.
- New section 512(a)(7) limits its reach to three specific types of deductions, but only if they are disallowed under section 274. These are:
  1. Qualified transportation fringe benefits;
  2. Any parking facility used in connection with qualified parking; and
  3. Any on-premises athletic facility.[3]

  Section 274(a)(4) specifically denies a deduction for "any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer." A qualified transportation fringe is defined as:

  (A) Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment.

  (B) Any transit pass.

  (C) Qualified parking.

  (D) Any qualified bicycle commuting reimbursement.[4]
- Where the three expenditures enumerated under 512(a)(7) are incurred in the course of an unrelated trade or business activity, 512(a)(7) does not apply. But note that in the case of the unrelated trade or business activity, section 274 will operate to deny the organization a deduction.
- The Treasury Department is instructed to issue regulations implementing the statute.
- Section 512(a)(7) is effective for expenditures occurring on or after January 1, 2018.[5] Thus, fiscal year taxpayers with fiscal years that end in 2018 must begin to account for these expenses as part of their fiscal year ending in 2018.

What is considered a qualified transportation fringe benefit?

There are a number of terms in the definition of a qualified transportation fringe benefit that bear further explanation:

- A "transit pass" is defined as "any pass, token, farecard, voucher, or similar item" used for mass transit or transportation in a commuter highway vehicle.[6] The amount to be taken into account is the actual amount paid for the transit pass.[7] Thus if it is possible to purchase a transit pass with a face value of $70 for $65, the $65 purchase price is the amount to be taken into account.[8]

[1] As a matter of tax policy, it is interesting that Congress felt that parity is required given the explicit disparity that exists by exempting nonprofit organizations from tax in the first place.

[2] The reference to "this chapter" in section 512(a)(7) is a reference to Subtitle A, Chapter 1, which is the portion of the Internal Revenue Code dedicated to income taxes.

[3] Strangely, section 274 does not disallow a deduction for "on-premises athletic facilities." Accordingly, the reference to an "on-premises athletic facility" in section 512(a)(7) does not have any effect and will not be discussed in this article.

[4] IRC § 132(f)(1).

[5] Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 13703(b) (2017).

[6] IRC § 132(f)(5)(A).

[7] Treas. Reg. § 1.132-9(b), Q&A 9, Ex 6.

[8] Ibid.

- A “commuter highway vehicle” is a vehicle that is designed to be used on a highway and can seat six or more persons, not including the driver.[9] At least 80% of miles driven must reasonably be expected to be for the purpose of transporting employees to work from their residences and back.[10] In addition, on such commuting trips at least half of the seats for adults must be occupied by employees, not including the driver.[11]
- “Qualified parking” is defined as “parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work [using a transit pass], in a commuter highway vehicle, or by carpool.”[12] Qualified parking does not include parking provided near the employee’s residence.[13] Employer-provided parking includes parking on property an employer owns or leases, parking for which the employer pays, or parking for which an employer reimburses an employee.[14]
- Qualified transportation fringes may be part of an employee salary reduction plan.[15] However, the IRS has announced that qualified transportation fringes offered under such a plan are not deductible as a result of the disallowance of a deduction provided in new section 274(a)(4).[16]

What does this mean for our organization?

Some parts of this rule appear to be straightforward, while other parts are very murky. If your nonprofit does one of the following, you must now include the amount expended for these qualified transportation fringe benefits in unrelated business income:[17]

1. Provide employees with transit passes or reimburse for such passes;
2. Pay for employees to use a commuter highway vehicle or reimburse employees for such use; or
3. Pay for or reimburse employees for qualified parking expenses

If the annual amount of such expenditures exceeds $1,000, this “income” is now subject to reporting on IRS Form 990-T.[18] Other than the $1,000 specific deduction provided by IRC section 512(b)(12), it is unclear what other deductions, if any, may be available to offset this income in arriving at unrelated business taxable income. This amount may also be taxable by the state in which the employees work. For large organizations operating in multiple states, this may require filing a return in multiple states. Note that qualified transportation fringe benefits of up to $260 per month are not includible in an employee’s taxable wages.[19] Amounts in excess of $260 per month are includible in taxable wages.

Many organizations that provide this benefit will now find that they must file a return and pay a tax when they have never had this issue in the past. Moreover, if they owe this tax, they are subject to making estimated tax payments if the expected tax liability is $500 or more.[20] For calendar year taxpayers, estimated tax payments are due on April 15, June 15, September 15, and December 15. For fiscal year taxpayers, estimated tax payments are due on the fifteenth day of the fourth, sixth, ninth, and twelfth months of the fiscal year.

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[9] IRC § 132(f)(5)(B).

[10] Ibid.

[11] Ibid.

[12] IRC § 132(f)(5)(C).

[13] Ibid.

[14] Treas. Reg. § 1.132-9(b), Q&A 4.

[15] Treas. Reg. § 1.132-9(b), Q&A 11.

[16] IRS Publication 15-B, Employer’s Tax Guide to Fringe Benefits, Internal Revenue Service, 21, (Feb. 22, 2018) (“Section 13304 of P.L. 115-97 provides that no deduction is allowed for qualified transportation benefits (whether provided directly by you, through a bona fide reimbursement arrangement, or through a compensation reduction agreement) incurred or paid after December 31, 2017”).

[17] Certain jurisdictions require that employers provide transportation benefits to their employees. Among these jurisdictions are New York City, Washington, D.C., San Francisco, Berkley, CA, Richmond, CA, and a number of counties in the San Francisco Bay Area. This benefit is typically required when the organization has 20 or more employees.

[18] Note that IRS Form 990-T is a paper-filed form for which electronic filing is not currently available.

[19] The $260 figure is the 2018 amount. The excludible amount is indexed for inflation annually. IRC § 132(f)(6). The IRS publishes notice of the amount each year.

[20] IRS Form 990-W is used to compute estimated tax payments.

Nonprofit organizations that are nonprofit corporations or unincorporated associations compute their tax using a flat rate of 21%. For nonprofit organizations organized as charitable trusts, the tax is computed using a graduated rate table as follows:

2018 Trust Tax Rate Schedule

If taxable income is:	The tax is:
Not over $2,550	10% of taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

Example: Alpha Inc. is a nonprofit organization with headquarters in Washington, D.C. Alpha has 30 employees and it provides a transit pass to each employee at a cost of $240 per month per employee. Alpha's annual cost for this benefit is $86,400. Alpha must include this amount in its gross unrelated business income reported on IRS Form 990-T. After taking into account the $1,000 specific deduction provided by section 512(b)(12), Alpha's taxable income is $85,400. At a tax rate of 21%, Alpha's tax on this amount is $17,934.

Note that as described above, if Alpha simply allows for a salary deduction arrangement which permits employees to set aside a portion of their compensation to provide for this benefit, it is still subject to the tax.

Example: Washington Community Outreach pays $750 per month to rent five employee parking spaces in the garage adjacent to the building in which its offices are located. This is an annual expenditure of $9,000. As payments made to a third-party to provide a parking facility for its employees, the full $9,000 is includible in unrelated business income under section 512(a)(7).

Example: Silver Lake Bible College rents 25 parking spaces from a nearby church for the exclusive use of its faculty and staff. The college pays $6,000 per year for these spaces. As payments made to a third-party to provide a parking facility for its faculty and staff, the full $6,000 is includible in unrelated business income under section 512(a)(7).

But what about the "parking lot tax" we've been hearing about? Do we owe tax when our employees park in our own parking lot?

First, we should note that there is a lot we do not know regarding the actual meaning of section 512(a)(7). The IRS has yet to issue any formal guidance and does not appear prepared to do so any time soon. However, if you look back at the language of section 512(a)(7) quoted above, there is a phrase that is giving most exempt organization professionals pause — specifically the portion emphasized below:

> … for any qualified transportation fringe (as defined in section 132(f)), *any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)),* or any on-premises athletic facility (as defined in section 132(j)(4)(B)).

The reason for the confusion is that conceptually, "qualified parking" is already included in the definition of a "qualified transportation fringe" discussed above. By adding in this particular phrase calling out parking facilities, it appears that Congress has identified parking facilities as a separate category subject to tax. If this is the case, it is very possible that parking provided to employees in a lot that is owned by an employer or leased by an employer incidental to an office lease could give rise to some amount which would be includible in income under section 512(a)(7).

The IRS has yet to issue any formal guidance and does not appear prepared to do so any time soon.

How would the taxable amount be computed? The short answer is we won't know until the IRS issues guidance. But consider the following possible approach the IRS could take:

> ***Example:*** First Community Church (FCC) owns its building and the adjacent parking lot containing 500 parking spaces. These parking spaces are used by employees and members alike as they attend services and work at the church. None of the spaces are dedicated for employee use. FCC has 30 full- and part-time employees who use the parking lot throughout the week. FCC does not charge others for the use of its parking lot (in fact others in the community have no need to use the parking lot) and it is not customary in FCC's community to charge for parking.
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> FCC's parking lot is parking provided to employees on property an employer owns (see the definition of qualified parking above). Arguably some portion of the cost of making this parking available to its employees may fall within the meaning of section 512(a)(7) as a "parking facility used in connection with qualified parking" and therefore be subject to tax under section 512(a)(7). However, until the IRS provides definitive guidance, how this fact pattern will be treated is unknown.
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> If FCC is required to pay tax on the parking it provides to its employees, how might the taxable income be computed? Assume that FCC paid $150,000 to construct and pave the parking lot and is depreciating the lot over 15 years (i.e., the annual depreciation expense is $10,000). FCC pays $3,000 per year in snow removal costs and an additional $6,000 per year in miscellaneous maintenance expenses. FCC's employees use 6% of the parking spaces in the lot (30 employees divided by 500 spaces).
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> On these facts, FCC's annual cost to provide parking to its employees is as follows:

Depreciation expense	$10,000
Snow removal	$3,000
Maintenance expense	$6,000
Total expenses	$19,000
Times	6%
Total employee cost of parking	$1,140

> Because this cost is greater than the $1,000 gross unrelated business income threshold for filing a return, FCC will be required to file a Form 990-T, and will likely owe a small amount of tax.

Is there an alternative interpretation that would yield a different result? Perhaps. Some commentators query whether the reference to parking facilities as defined in section 132(f)(5)(C) is merely amplifying the preceding reference to qualified transportation fringe benefits rather than creating a separate category of cost subject to tax.[21] There is also a question as to whether the disallowance of a deduction for qualified transportation fringe benefits under section 274(a)(4) extends to disallow a deduction for the underlying parking facility used to provide qualified parking.[22] Since 512(a)(7) only takes effect if a deduction is disallowed by section 274, if section 274(a)(4)'s denial of a deduction for qualified transportation fringe benefits does not include the underlying parking facility, then the reference to parking facilities in section 512(a)(7) is just surplus language having no effect.

However, as noted at the outset, we do not yet know what guidance the IRS will provide with respect to a scenario such as that confronted by FCC. We are truly flying blind until the IRS acts. We also do not know what changes in the facts could make a difference. For example, would the answer change if FCC reserved 15 parking spaces for employee parking, or if employees parked in a separate lot reserved for employees?

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[21] As an example, see "Separating Fact From Fiction Regarding the 'Parking Lot Tax,'" Elaine Sommerville and Frank Sommerville, Church Law and Tax Report, accessed August 17, 2018, https://www.churchlawandtax.com/web/2018/august/separating-fact-from-fiction-regarding-parking-lot-tax.html.

[22] See Ibid.

Also note that if the cost of providing a parking facility is subject to the new tax under section 512(a)(7), it does not appear that this will result in an amount includible in the taxable income of employees.

We don't own our building; we lease space. Are we subject to this tax?

The definition of qualified parking (see above) includes parking on property leased by an employer. Accordingly, it is arguable that this scenario is a "parking facility used in connection with qualified parking" and that the cost of leasing the property (or a portion of the property) for parking is includible in unrelated business income under section 512(a)(7). Consider the following examples:

Example: Beta Mission leases and is the sole tenant in its building and the adjacent parking lot containing 60 parking spaces. These parking spaces are used by employees and visitors alike as they come to work and meet with Beta Mission staff. None of the spaces are dedicated for employee use. Beta Mission has 10 full- and part-time employees who use the parking lot through the week. Beta Mission does not charge visitors or others for the use of its parking.

Beta Mission's parking lot is parking provided to employees on property leased by an employer (see the definition of qualified parking above). As with the parking lot owned by an employer, arguably some portion of the cost of making this parking available to its employees falls within the meaning of section 512(a)(7) as a "parking facility used in connection with qualified parking" and is subject to tax. As noted above, until the IRS provides definitive guidance, how this fact pattern will be treated is unknown.

If Beta Mission must pay tax on its employer-provided parking, how should it compute the taxable amount? As in the First Community Church example above, we won't know the answer until the IRS issues guidance. But consider the following possible computation.

To determine the taxable amount in this example, it is necessary to determine the cost of providing the parking. The cost in this example would likely consist of a reasonable allocation of a portion of the rent paid each month to occupy the building and parking lot. Accordingly, assume that the total rent paid each year is $60,000. After consulting with a local real estate professional, Beta Mission determines that a reasonable allocation of the rent between the building and the parking lot is $8,000 to the parking lot and $52,000 to the building. Beta Mission's employees use 16.67% of the available parking (10 employees/60 spaces). Thus, a reasonable allocation of the parking lot expense to the cost of providing a parking facility for employee use is $1,333.33 (16.67% of $8,000). This would be the amount includible in unrelated business taxable income.

Example: Saltwater Christian College (SCC) rents space in a multi-tenant office building to operate a satellite campus 40 miles from its main campus. The rental agreement includes the designation of 30 spaces in the building's parking lot for the use of faculty, staff, and students attending classes at the satellite campus.

SCC is providing a parking facility on property the college leases. Arguably, this falls within the definition of qualified parking as described above. Accordingly, it seems at least possible, if not probable, that the spaces provided in the lease are a "parking facility used in connection with qualified parking" and are subject to tax under section 512(a)(7).

The question that remains is how the college can determine the taxable amount in this scenario. Assume the college determines that the building management leases parking spaces in the parking lot to other tenants at a rate of $150 per month. Six faculty and staff members make use of the parking lot at the satellite campus. Accordingly, the college's taxable amount for providing an employee parking facility at the satellite campus is $10,800.

Example: Assume the same facts as the previous example, except that the building management does not lease individual parking spaces to other tenants. How might SCC determine the taxable amount in this case?

Further assume the annual rent for the building space and parking spaces is $45,000. After surveying the local area and consulting with building management, the college determines that it is appropriate to allocate $7,500 of the annual rent to the parking spaces and the balance to the building space. Six faculty and staff members make use of the parking lot at the satellite campus. Their use represents 20% of the total usage. Accordingly, the college's includible amount for providing an employee parking facility at the satellite campus is 20% of $7,500, or $1,500.

As described in the preceding section, in the absence of guidance from the IRS it is not yet known whether the circumstances faced by Beta Mission and Saltwater Christian College will result in a tax. As alluded to after the earlier First Community Church example, it is possible that if there are spaces reserved for employees, the answer could change.

This is a mess! Will the IRS actually require us to pay tax on the parking we own?

At this point no one knows. The IRS has not been forthcoming as to what their guidance will be or when it will be made available. We do not know where the IRS will draw the line. It seems clear that scenarios in which there are specific amounts paid directly for parking will fall within the scope of section 512(a)(7). It is less clear what the result will be when an organization owns or leases the parking it provides, particularly when there is no designated employee parking.

In the absence of guidance, what should our organization do?

The first thing every nonprofit should do is understand the type or types of parking it provides to its employees. You should then assess where each type of parking falls on a continuum that ranges from actual payment for parking at one end of the continuum to the mere provision of undifferentiated parking to employees and visitors on the other end.

In considering what parking is most likely to be subject to tax, consider the following chart.

Type of Parking	Likelihood of Taxation
Direct payments specifically for parking	Very High
Lease agreements that specify a specific number of spaces for parking and only employees use the specified parking	High
Lease agreements that specify a specific number of spaces for parking and permit undifferentiated use between employees and others (e.g., visitors, church members, etc.)	Moderate
Lease agreements that permit unlimited, undifferentiated use of parking for employees and others (e.g., visitors, church members, etc.)	Low
Use by employees of employer-owned, employee-designated parking	Moderate
Use by employees of employer-owned, undifferentiated parking (i.e., there is no designated employee parking)	Low

Very High = Clearly within the reach of the statute as written
High = Likely within the reach of the statute as written
Moderate = Probably within the reach of the statute as written
Low = Possibly within the reach of the statute as written

After making this assessment, your organization should determine the degree of risk you are willing to accept in the absence of IRS guidance and determine if your organization should plan to pay tax on any of your employer-provided parking.

The first thing every nonprofit should do is understand the type or types of parking it provides to its employees.

If, after assessing the likelihood that your employer-provided parking is subject to taxation, you determine that you do need to pay the tax, what are your next steps?

1. Estimate your expected tax liability so that you can begin to make estimated tax payments. The examples above may be useful in assisting you with the tax computation.
    a. If your fiscal year is the calendar year or a 2018 fiscal year-end that has not already passed, you should consider making a "catch up" estimated tax payment as soon as possible to account for the missed quarterly estimated tax payments.
    b. If your 2018 fiscal year-end has already passed, you should not only compute estimated tax payments for your 2019 tax year, but also estimate the tax due for your 2018 tax year and make that payment as soon as possible.
2. Reach out to your tax preparer to inform them that a Form 990-T will be required for 2018 to ensure the timely preparation of the form. This may include filing for an extension of time to file the return if your year-end has already passed.

If you decide to exclude certain employee parking from inclusion in the tax computation, you will avoid payments now but run the risk that later guidance issued may be contrary to your decision. At that point, you will need to evaluate whether to file a return and report the employee parking cost as income, pay the tax, and be prepared to petition the IRS to avoid any penalties and interest assessed.

What is the future of this tax?

Five bills have been introduced into Congress that would repeal section 512(a)(7): S. 3317, introduced by Sen. Ted Cruz (R-TX), S. 3332, introduced by Sen. James Lankford (R-OK), H.R. 6037, introduced by Rep. Mike Conaway (R-TX), H.R. 6460, introduced by Rep. Mark Walker (R-NC), and H.R. 6504, introduced by Rep. James Clyburn (D-SC). Encouraging your elected officials to vote for this legislation is an opportunity to eliminate this new tax.

In addition, many organizations have petitioned the IRS to delay implementation of the statute until guidance is released. There have also been calls for the IRS to announce it will not assess penalties and interest until there is clarity on what types of parking will fall within the statute.

Late-breaking news

In Notice 2018-67, the IRS announced that amounts that are taxable under section 512(a)(7) are not subject to the "siloing" rule of section 512(a)(6).

We will provide updates as they occur. In the meantime, please contact us with any questions.

About the Author

Ted R. Batson, Jr., Partner and Tax Counsel
Professional Practice Leader – Tax
tbatson@capincrouse.com
317.885.2620, ext. 1150

As a certified public accountant and tax counsel, Ted advises exempt organizations of all sizes on a wide range of issues. This includes consulting on tax and employee benefit related matters, representation before state and federal tax authorities, and assistance with firm audit or advisory engagements to formulate advice and counsel on important operating and tax issues. Ted also leads the firm's tax preparation practice, including IRS Forms 990 and 990-T and related state forms.

Note: Although licensed to practice law in Indiana, Ted's services through CapinCrouse do not involve the practice of law and consequently do not result in the creation of an attorney-client relationship.

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