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IRS Releases Proposed Regulations on Qualified Parking Deductions with Some Lane Changes

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Following tax reform, deductions for parking expenses may be disallowed. New proposed regulations might help employers determine how to apply the new law to real world situations.

The Tax Cuts and Jobs Act (the "TCJA") amended section 274 of the Code,[1] disallowing deductions for qualified transportation fringe benefit ("QTF") expenses, as well as expenses incurred for employee commuting. Proposed regulations related to this amendment were published in the *Federal Register* on June 23, 2020. The proposed regulations provide taxpayers with additional guidance on calculating the loss of deduction under section 274 and several simplified methods to calculate the loss as well as proposed changes to methodologies originally discussed in Notice 2018-99.

Background

Qualified Transportation Fringe Benefits and the TCJA

QTF benefits are excluded from employee income under section 132(f). Specifically, section 132(f) excludes from income the value of transportation in a commuter highway vehicle, transit passes, and

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1 Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

qualified parking. Employers can pay the value of these benefits and exclude from employee income a certain amount each month. In 2020, the monthly limit is $270, which is excludable from an employee's income for transportation in a commuter highway vehicle and the provision of mass transit passes. An additional $270 is excludable from an employee's income per month for qualified parking.

QTF employer expenses are no longer deductible. The TCJA amended section 274 to provide that: "[n]o deduction shall be allowed under this chapter for the expense of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer."[2] Further, section 274(l) was amended to provide that no expenses incurred to provide transportation between an employee's residence and their place of employment. This deduction disallowance applies to QTF expenses paid or incurred after December 31, 2017.

Notice 2018-99

Notice 2018-99 provided interim guidance and certain safe harbor calculation methods for determining what expenses are considered paid or incurred for the provision of parking expenses. When a parking facility is owned or leased by an employer, the notice does not consider depreciation expense an expense incurred for the provision of parking.[3]

Proposed Regulations

On June 23, 2020, proposed sections 1.274-13 and 1.274-14 (the "Proposed Regulations") were published in the *Federal Register*. The Proposed Regulations provided additional definitions related to qualified parking expenses, simplified methodologies for calculating parking expenses, and additional rules surrounding the disallowance related to provision of transport in a commuter highway vehicle or via transit pass to employees. Taxpayers may rely on the Proposed Regulations or Notice 2018-99 until final regulations are published.

Calculating an Employer's Expenses for Qualified Parking

Generally, if an employer pays a third party directly for qualified parking for the employer's employees, the deduction disallowed is the total amount paid to the third party for the qualified parking.[4] However, in many cases, employers do not pay one amount specifically to a third party, but rather own or lease the parking facility, either directly or as part of the lease of a building. As such, the Proposed Regulations provide a general rule (the "General Rule") and three simplified methodologies (the "Simplified Methodologies") for the determination of the deduction disallowance.

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2 Section 274(a)(4)

3 For a detailed explanation of Notice 2018-99, please see Robert Delgado and Terri Stecher, *Notice 2018-99: Tax Reform Curbs Parking Deductions and Increases UBTI*, What's News in Tax (Feb. 25, 2019).

4 Proposed section 1.274-13(d)(1).

The General Rule

The General Rule: The employer may calculate the disallowance of deduction under section 274(a)(4) for each employee who receives qualified parking using any reasonable interpretation under section 274(a)(4).[5] Certain interpretations of section 274(a)(4), however, are not considered reasonable, including:

- Using the value of the parking to determine the expense incurred for providing parking
- Improperly treating parking as available to the general public if the parking is mostly used by employees, simply because the parking may be accessed by the public at-large
- Deducting reserved employee spaces[6]

Reserved employee spaces are those spaces in the relevant parking facility set apart exclusively for the taxpayer's employees. This may be by way of signage ("Employee Parking Only") or by setting apart a separate portion of the facility and limiting access. The Proposed Regulations provide examples, but note that employee spots may be reserved in myriad ways not limited to those described in the regulations. The Proposed Regulations do state that unusable spaces or inventory spaces are not considered employee spaces.[7] Rather, inventory and unusable spaces are spaces that are filled by vehicles that may be considered inventory, are reserved for the parking of qualified non-personal use vehicles[8] or other fleet vehicles of the employer's business, or are otherwise unusable.[9]

For both the General Rule and two Simplified Methodologies (public use and cost per space methodologies), the Proposed Regulations allow the number of spaces in multiple parking facilities in the same geographic location to be aggregated.[10] The definition of a parking facility is fairly straightforward and includes indoor or outdoor structures and garages, as well as parking lots where the taxpayer provides qualified parking—this may include multiple parking facilities, but specifically excluded from the definition are spots on or near a property on which an employee parks for residential purposes.[11] Geographic location is defined as "contiguous tracts or parcels of land owned or leased by the taxpayer. Two or more tracts of land are contiguous if they share common boundaries or would share common boundaries but for the interposition of a road, street, railroad, stream, or similar property." The definition goes on to specifically exclude lots that touch only on a corner from the definition of geographic location.[12] Thus, an employer with multiple lots in a small range of space may

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5 Proposed section 1.274—13(d)(2)(i).

6 Proposed section 1.274-13(d)(2)(i)(A)-(C).

7 Proposed section 1.274-13(b)(7).

8 Defined in reference to section 1.274-5(k), but generally, vehicles for specialized purpose that employees would not regularly drive for personal purposes.

9 Proposed section 1.274-13(b)(9).

10 Proposed section 1.274-13(c)(2).

11 Proposed section 1.274-13(b)(4).

12 Proposed section 1.274-13(b)(5).

not aggregate the lots as within the same geographic location unless those lots share a common border, which limits the usefulness of this provision.

The position in the Proposed Regulations is narrower than the guidance provided in Notice 2018-99. In example 8 of the notice, the taxpayer owns multiple parking lots and garages adjacent to its manufacturing plan, warehouse, and office building at its complex in City X. The notice allows the taxpayer to aggregate all these facilities, but it cannot aggregate facilities in another city. Under the Proposed Regulations, the taxpayer could only aggregate if these facilities were located on contiguous tracts of land.

The Simplified Methodologies

The Proposed Regulations provide three Simplified Methodologies—one of which is similar to a four-step safe harbor from Notice 2018-99. Comments indicated the four-step safe harbor was unduly complex, prompting the addition of two new Simplified Methodologies.

If using the Simplified Methodologies (other than the qualified parking limit methodology) to determine expenses, taxpayers may use any reasonable methods for allocating portions of mixed parking expenses to a parking facility. A mixed parking expense is an expense incurred partially for parking and partially for non-parking purposes, such as a building lease when rent includes both the use of the building and the parking facility.[13] A taxpayer may choose to allocate five percent of the following expenses to parking: lease or rental agreement expenses, property taxes, interest expense, and utility and insurance expenses.[14]

Qualified Parking Limit Methodology

In response to comments suggesting that a standard cost per parking space method, similar to mileage rates or per diem rates, be used to calculate the disallowance related to qualified parking, the Proposed Regulations adopt the qualified parking limit methodology. The qualified parking limit methodology allows taxpayers to calculate the deduction disallowance by multiplying the total number of employee parking spaces used during the peak demand period by the monthly income exclusion limit provided by section 132(f)(2).[15] Peak demand period is the period of time on a typical business day when the greatest number of an employer's employees are using parking spaces at the parking facility. When considering shifts, the peak demand period would be when the largest number of employees are parking, though shift overlaps (when both shifts may be parking while one shift arrives and the other leaves) may be disregarded. Any reasonable method may be used to determine the peak demand period and can include surveys or periodic inspections.[16] The peak demand period definition is used in other parking methodologies. The Proposed Regulations include a request for comment on significant changes in parking use during a tax year, as has been highlighted by Covid-19.

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[13] Proposed section 1.274-13(b)(13).

[14] Proposed section 1.274-13(c)(1).

[15] Proposed section 1.274-13(d)(ii)(A).

[16] Proposed section 1.274-13(b)(14).

This method is only available to employers that include amounts incurred in excess of the monthly section 132(f)(2) limitation in employees' compensation. General exceptions provided by section 274(e)(2) and the Proposed Regulations, which allow for deduction of amounts included in employee income, cannot be applied to reduce the deduction disallowance under this method.[17]

Primary Use Methodology

The primary use methodology is similar to the Notice 2018-99 safe harbor method for determining the deduction disallowance expense, but is altered in response to comments received on that notice. Under this method, employers may aggregate parking spots in one geographic location and may allocate mixed used expenses as described above.

First, the taxpayer must determine the total number of spaces in the parking facility and total parking expenses incurred. Total parking spaces are the total number of spots (or the employer's portion of those spaces) in the parking facility.[18] The total parking expenses are all those expenses "related to the total parking spaces in a parking facility," which can include maintenance, repairs, insurance, utilities, snow and ice removal, trash removal, etc., but specifically does not include allowances for depreciation deductions or expenses paid for property adjacent to the parking such as landscaping.[19]

The taxpayer must then determine the number of reserved employee spaces in the parking facility. The number of reserved employee spaces is divided by the total number of parking spaces and multiplied by the total parking expenses to determine what portion of the total expenses are disallowed in step 1 of this methodology.[20]

Step 2 of the primary use methodology requires the employer to determine the primary use of the remaining spaces.[21] The primary use of parking spaces is the greater than 50 percent (actual or estimated) use of the available parking spaces in the parking facility.[22] Available parking spaces are the total parking spaces contained in a parking facility minus reserved employee spaces, reserved nonemployee spaces, and inventory/unusable spaces where employees and the general public may park.[23] Reserved non-employee spaces are, essentially, the reverse of the reserved employee spaces. These are spaces reserved by the taxpayer or for use by the taxpayer, but not for the taxpayer's employees—for example, parking for customers, vendors, clients, partners, two-percent shareholders of an S corporation, sole proprietors, independent contractors, etc. These spots may be reserved similarly to the manner in which employee spots may be reserved, via signage or setting limits on entry, though inventory and unusable spots are also not considered non-employee spaces.[24]

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17 Proposed section 1.274-13(d)(ii)(A).

18 Proposed section 1.274-13(b)(6).

19 Proposed section 1.274-13(b)(12).

20 Proposed section 1.274-13(d)(2)(ii)(B)(1).

21 Proposed section 1.274-13(d)(2)(ii)(B)(2).

22 Proposed section 1.274-13(b)(11).

23 Proposed section 1.274-13(b)(10).

24 Proposed section 1.274-13(b)(8).

If the primary use of the available spaces is to provide parking to the general public, then the remaining parking expenses may be deducted. Parking spaces that are not reserved and are available to the general public are considered available to the general public even if normally empty during the employer's business hours.[25]

The "general public" is defined to include, but is not limited to, clients, customers, vendors, visitors, individuals delivering goods to the taxpayers, students of an educational institution, and patients of a healthcare facility. It also includes, for multi-tenant building lots, employees, partners, two percent shareholders of an S corporation, sole proprietors, and independent contractors of unrelated tenants of the multi-tenant building—however, employees, partners, two percent shareholders of an S corporation, sole proprietors, and independent contractors of the employer are not considered the general public.[26]

If the primary use is not to provide parking to the general public, then an allowance for the non-employee reserved spaces must be calculated in a similar manner as to how the disallowance for reserved employee spaces is calculated. This can be expressed as a fraction in which the non-employee reserved spaces are the numerator and the total remaining parking spaces (after accounting for the reserved employee spaces) are the denominator; this fraction is multiplied by the total remaining parking expenses (after accounting for the portion of the expenses that is attributable to the employee reserved spaces).[27]

If any parking spaces are not accounted for after this step, the employer may allocate the remaining expenses by determining how many of the available parking spaces are used by employees during the peak demand period and disallowing the expenses allocable to those parking spaces.[28]

Cost per Space Methodology

Under the cost per space methodology, an employer must determine the total parking expenses and total parking spaces—both the geographic aggregate rule and mixed expenses rule may be used for this determination. The cost per space is then determined by dividing the total parking spaces by the total parking expenses. That cost per space is then multiplied by the total number of spots occupied by employees during the peak demand period.[29]

Exceptions

Several exceptions apply to deduction disallowances under section 274(e). The Proposed Regulations identify which are relevant, and also limit certain exceptions that may otherwise be available.

Generally, under section 274(e)(2), expenses that would otherwise be nondeductible under section 274(a) are deductible if treated as compensation to employees. The Proposed Regulations allow for the

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[25] Proposed section 1.274-13(d)(2)(ii)(B)(2).

[26] Proposed section 1.274-13(b)(3).

[27] Proposed section 1.274-13(d)(2)(ii)(B)(3).

[28] Proposed section 1.274-13(d)(2)(ii)(B)(4).

[29] Proposed section 1.274-13(d)((2)(ii)(C).

availability of this deduction in relation to QTFs, but limit it only to those amounts included in compensation above the monthly exclusion limit set by section 132(f)(2).[30] Further, unless the full amount required to be treated as compensation is included in income, this exception is likewise unavailable to offset the deduction disallowance.[31] The preamble to the Proposed Regulations, as well as the Proposed Regulations themselves, make it explicit that the provision of qualified parking with a zero value is not an exception to the disallowance rules.[32]

Availability to the general public is likewise an exception to the deduction disallowance for QTFs. Thus, to the extent that the primary use of a parking facility is not for the provision of parking to the general public, allocations may still be made to except certain expenses allocable to spots provided for the general public.[33]

And finally, any QTF, including qualified parking that is sold by the employer for adequate and full consideration in a bona fide transaction is excepted from the deduction disallowance. This exception applies even if the QTF is sold to an employee, so long as the employee pays adequate and full consideration and the transaction is bona fide.[34]

Commuting Provisions

The Proposed Regulations also add certain definitions for the interpretation of section 274(l). Generally, section 274(l) disallows deductions for any expenses paid, incurred, or reimbursed to an employee for the provision of transport between the employee's residence and place of business.

The Proposed Regulations define the employee's residence in reference to section 1.121-1(b)(1), a broad definition that encompasses an abode of the taxpayer, regardless of whether or not it is the principal abode of the taxpayer. Further, the Proposed Regulations disallow deductions for expenses for travel originating at a transit hub near the employee's residence and ending at a transit hub near the employee's place of business.[35] Thus, if an employee commutes to his or her place of business via airplane, the aircraft expenses or ticket charges are disallowed as a deduction.

If commuting is provided for the safety of an employee, section 274(l) provides an exception and a deduction for the expenses may be allowed. The Proposed Regulations caution that a bona fide business-oriented security concern must exist with respect to the employee under section 1.132-5(m).[36] Under section 1.132-5(m)(2), a mere generalized concern for safety is not enough to establish a bona

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30 Proposed section 1.274-13(e)(2)(i)(A)-(B).

31 Proposed section 1.274-13(e)(2)(i)(C).

32 Taxpayers taking a zero value approach (on the basis that section 132(f) does not apply if there is zero value or the full value is included in income at zero value) may want to consider that approach in light of the Proposed Regulations.

33 Proposed section 1.274-13(e)(2)(ii).

34 Proposed section 1.274-13(e)(2)(iii).

35 Proposed section 1.274-14(a).

36 Proposed section 1.274-14(b).

fide business-oriented security concern; rather, there must be a specific basis under which a concern for a particular employee is established, which generally forecloses this exception for concerns such as weather or other general considerations.

Conclusion

Employers may want to reconsider approaches to the deduction disallowance analysis in light of the Proposed Regulations given the new definitions and now available Simplified Methodologies.

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