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KPMG report: Final regulations addressing parking deduction limitations under section 274

The IRS on December 9, 2020, posted to its website a version of final regulations (T.D. 9939) addressing deduction limitations under section 274 for expenses related to qualified transportation fringe benefits, such as parking. In addition, the final regulations address the deduction elimination for certain commuting expenses paid by employers for their employees.

The **final regulations** [PDF 375 KB] (70 pages) make a variety of modifications to regulations proposed in June 2020 in response to comments received, including an exception under section 274(e)(8) for parking in rural, industrial or remote areas where the adequate and full consideration to pay for such parking is presumed to be zero as well as an option rule for federally declared disasters.

The final regulations apply to tax years beginning on or after the date the regulations are published in the Federal Register.

This report highlights some of the provisions and certain modifications made to the rules in the final regulations.

Adequate and full consideration of zero dollars ($0) in rural or remote locations

- A taxpayer can use the exception under section 274(e)(8) for parking sold to customers in a bona fide transaction for adequate and full consideration, and the deduction disallowance would not apply. In addition, "customers" under this exception include employees who purchase parking for adequate and full consideration.

- If, in a bona fide transaction, the adequate and full consideration (i.e., the fair market value) of the parking is zero, then the section 274(e)(8) exception applies even though the taxpayer does not actually sell the parking to employees. The taxpayer has the burden of proving that the fair market value of the parking is zero. However, solely for purposes of this exception, the taxpayer is treated as satisfying this burden if the qualified parking is provided in a rural, industrial, or remote area in which no commercial parking is available and an individual other than an employee ordinarily would not pay to park.

Section 274(l) commuting

- Section 274(l) provides that no deduction is allowed for any expense incurred for providing any transportation, payment or reimbursement to an employee in connection with travel between the employee's residence and place of employment. The exceptions under section 274(e) do not apply. However, a deduction is allowed for transportation or commuting expense if necessary for ensuring the safety of the employee.

- The regulations specify that residence is not limited to the employee's principal residence and the preamble specifically provides the example of commuting from a vacation home to the workplace.

- The final regulations provide a definition of employee, which includes officers of the taxpayer and employees under the common law rules.

- The final regulations clarify that temporary or occasional places of employment are not a place of employment under section 274(l). However, an employee must have at least one place of employment (i.e., a regular or principal place of business).

- The final regulations clarify that a transportation or commuting expense is necessary for ensuring the safety of the employee if unsafe conditions as described in 1.61-21(k)(5) exist for the employee. This is a modification from the proposed regulations that referenced more restricted definition of safety.

Section 274(e)(2) amounts included in employee compensation

- A deduction is generally allowed for amounts included in employee compensation, applying the exception provided under section 274(e)(2).

- For an employee that is not a "specified individual", an expense paid or incurred for a qualified transportation fringe is not subject to the deduction disallowance to the extent the taxpayer 1) properly treats the expense as compensation and wages to the employee, and 2) treats the proper amount as compensation to the employee under section 1.61-21. If the proper amount was not included in compensation, the taxpayer is limited to a deduction based on the "dollar-for-dollar" methodology generally applicable to specified individuals. Under this methodology, the deduction cannot exceed the sum of (i) the amount treated as compensation and wages, and (ii) any amount the recipient reimburses the taxpayer.

- The dollar-for-dollar methodology must always be used for specified individuals.

- The preamble provides that if the value of the qualified transportation fringe exceeds the monthly limitation, so that only a portion of the value is included in employee wages, the taxpayer may use section 274(e)(2), but must use the dollar-for-dollar methodology.

Federally declared disasters

- Certain methodologies measure employee usage in a parking facility by looking to how the parking spaces are used during the "peak demand period." This term refers to the period of time on a typical business day during the tax year when the greatest number of employees are utilizing parking spaces in the facility.

- The final regulations provide an optional rule for the peak demand period methodology that can be used for federally declared disasters.[1] A taxpayer that owns or leases a parking facility that is located in a federally declared disaster area may choose to identify a typical business day for the tax year in which the disaster occurred by reference to a typical business day in that tax year prior to the date the taxpayer was impacted by the disaster. Alternatively, the taxpayer could choose to identify a typical business day during the month(s) of the tax year in which the disaster occurred by reference to a typical business day during the same month(s) of the tax year immediately preceding the tax year in which the disaster first occurred.

Modifications to general definitions

- "General public" now includes a clarification that parking spaces that are used to park vehicles owned by members of the general public while the vehicles await repair or service by the taxpayer are also treated as provided to the general public.

- In the final regulations, the "inventory/unusable spaces" definition clarifies these spaces as not usable for parking by the general public. Taxpayers may use any reasonable methodology to determine the number of inventory/unusable spaces in the parking facility. The final regulations provide that a reasonable methodology may include using the average of monthly inventory counts.

Methodologies

- In determining "total parking expenses," there is no specific methodology for determining the amount of mixed parking expenses allocable to the parking facility. Taxpayers may use any reasonable method. The methodology must be reasonable for the expense being allocated. One methodology for multiple expenses may be used only if the methodology is reasonable for all such expenses.

- There is an optional rule for allocating certain mixed parking expenses. A taxpayer may choose to allocate 5% of certain mixed parking expenses to the parking facility. The final regulations allow this option to be used with the general rule, in addition to the primary use and the cost per space methodologies and may be used with the qualified parking methodology solely to determine total parking expenses. This optional rule can be used to determine total parking expenses under any of the parking methodologies permitted in the proposed or final regulations. This rule continues to only apply to mixed parking expenses related to payments under a lease or rental agreement, and payments for utilities, insurance, interest and property taxes. The preamble states that under the final regulations a taxpayer may choose to use the 5% optional rule for one or more mixed parking expenses but are not required to use for all mixed parking expenses.

- Aggregation of parking spaces in a single geographic location may be used in applying the general rule, primary use methodology, and cost per space methodology, but may not be used with the qualified parking limit methodology. The final regulations retain the definition of geographic location included in the proposed regulations, which requires that the tracts or parcels of land must be contiguous, meaning they share common boundaries, and are not solely touching at a common corner.

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[1] A federally declared disaster area is defined in section 165(i)(5). A "Federally declared disaster means any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act." The "disaster area" means the area so determined to warrant assistance. An election under section 165(i) is not necessary to use this optional rule in the section 274 regulations.

- The general rule continues to provide a taxpayer can use any reasonable method to calculate the disallowance of the deduction. The final regulations confirm a taxpayer cannot use the value of the qualified transportation fringe instead of the expense or fail to allocate parking expense to reserved employee spaces in determining the deduction disallowance. In addition, a taxpayer cannot improperly apply the exception in section 274(e)(7) for qualified parking made available to the public (such as treating a parking facility regularly used by employees as available to the public merely because the public has access to the parking facility). Further, a taxpayer cannot look to prior years or averaging of years to determine the disallowed deduction.

- The cost per space methodology was modified to provide that "total parking spaces" are used to calculate the disallowance instead of "available parking spaces" because reserved spaces are excluded from the definition of available parking spaces. The final regulations also clarify that this calculation can be performed monthly.

Applicability of final regulations

- The final regulations apply to tax years beginning on or after the date of publication in the Federal Register.

- Taxpayers may continue to rely on Notice 2018-99 and the proposed regulations published on June 23, 2020 in the Federal Register for expenses paid or incurred in tax years beginning after December 31, 2017 and before the date the final regulations are published in the Federal Register.

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