December 13, 2018

IRS Issues Guidance on UBTI for Parking Expenses and Other Qualified Transportation Fringes

In Notice 2018-99, issued December 10, 2018 (the "Notice"), the IRS has provided interim guidance on determining the amount of unrelated business taxable income ("UBTI") attributable to qualified parking expenses and other qualified transportation fringes ("QTFs"). The Notice may be relied on immediately pending the issuance of proposed regulations, and addresses many key questions tax-exempt organizations have been wrestling with for nearly a year, since the enactment of new Code section 512(a)(7) as part of the Tax Cuts and Jobs Act. Simultaneously, the IRS released Notice 2018-100, which provides relief for failure to pay estimated UBTI, but only for tax-exempt organizations required to file a Form 990-T for the first time due to section 512(a)(7).[1]

New UBTI Rule for Qualified Transportation Fringes

Code section 512(a)(7) provides that, for a tax-exempt employer, UBTI is increased by any amounts for which a deduction would have been disallowed under section 274 if the employer were taxable and which are paid or incurred by the tax-exempt organization for any QTF,[2] any parking facility used in connection with qualified parking, or any on-premises athletic facility.

For taxable employers, Code section 274(a)(4) provides that no deduction is allowed for the expense of any QTF provided to an employee of the taxpayer. That Code section does not refer to parking facility expenses.

The asymmetry between these two Code sections created uncertainty as to whether parking facility expenses in connection with the provision of qualified parking – specifically referenced in section 512(a)(7) but not in section 274(a)(4) – would nevertheless give rise to UBTI. Also unclear was how to calculate parking facility expenses and whether the amount excluded from an employee's income as a QTF could serve as a substitute, or even, a cap for calculating the employer's expense (and, therefore, UBTI).

Questions Answered by the Notice

Parking-related Questions

Do parking facility expenses give rise to UBTI?
Yes. The Notice gives no weight to the fact that parking facility expenses, although specifically identified in section 512(a)(7), are not referenced in section 274(a)(4), and, instead, takes the position that because qualified parking is a QTF and section 274(a)(4) refers to QTFs generally, expenses from qualified parking at facilities owned or leased by the employer are covered and can therefore give rise to UBTI. However, while parking facility expenses may give rise to UBTI, the Notice provides a safe harbor methodology, as well as an interpretation of parking facility expenses that address many of the concerns tax-exempt organizations had regarding UBTI from qualified parking (described in more detail below).

How is UBTI determined for qualified parking at a non-employer facility?
UBTI is increased by the total annual cost of employee parking paid by a tax-exempt employer to a third party. Such amount, however, is capped at the section 132(f) monthly exclusion limit for employees for QTFs (currently $260 per

[1] Efforts to repeal section 512(a)(7) have recently gained momentum through the introduction of a manager's amendment to other tax legislation by the House Ways and Means Committee Chair Brady, although repeal looks unlikely to occur during the remaining days of the 115th Congress.

[2] QTFs include (1) transportation in a commuter highway vehicle between the employee's residence and place of employment, (2) any transit pass, and (3) qualified parking. Qualified parking is 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.

month). For tax-exempt employers, amounts in excess of the section 132(f) exclusion limit are treated as additional compensation and do not give rise to UBTI.

How is UBTI determined for qualified parking at employer-owned or leased facilities?
Until further guidance is issued, the Notice provides that tax-exempt employers may use any reasonable method for determining expenses in connection with providing qualified parking at facilities they own or lease. The Notice provides a safe harbor methodology, described below, that may be used to calculate such expenses. Notably, using the value excluded by employees as QTFs under section 132 is not considered a reasonable method.

What expenses are included in total parking expenses?
Total parking expenses include, but are not limited to, repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent or lease payments.

What about depreciation?
Depreciation is not considered a parking expense and, thus, would not give rise to UBTI.

What is the safe harbor methodology?
The safe harbor, which Treasury and the IRS consider to be a reasonable method of calculating expenses in connection with providing qualified parking, involves a four-step process:

- Step 1: Reserved employee spots
    - First, identify all spots in the parking facility exclusively reserved for the organization's employees.
    - Next, determine the percentage of these reserved employee spots in relation to all spots and multiply that by the total parking expenses. This amount is included as UBTI.
    - Transition Relief: The Notice provides transition relief, allowing employers until March 31, 2019 to change their parking arrangements to decrease or eliminate reserved employee spots, with such change given retroactive recognition as of January 1, 2018.
- Step 2: Primary use of remaining spots
    - Determine whether the "primary use" of the remaining parking spots is to provide parking to the "general public." "Primary use" means greater than 50 percent of the actual or estimated usage of the spots, tested during normal hours on a typical day. Notably, non-reserved spots available to the general public, but typically empty during normal hours are nonetheless treated as provided to the general public. "General public" includes customers, clients, visitors, individuals delivering goods or services to the organization, patients of a health care facility, students of an educational institution, and congregants of a religious organization.
    - If the primary use of the remaining spots is to provide parking to the general public, the remaining total parking facility expenses are not included in UBTI.
- Step 3: Reserved non-employee spots
    - If the primary use of the spots considered in Step 2 is not to provide parking to the general public, identify any such spots specifically reserved for non-employee use. Then determine the percentage of these reserved non-employee spots in relation to all remaining spots and multiply that by the total remaining parking expenses. This amount is not included as UBTI.

ATTORNEY ADVERTISING

- Step 4: Remaining spots
    - If there are any remaining spots not addressed in Steps 1-3, reasonably determine the employee use of the remaining spots during normal hours and the allocable expenses. Such methods may include specifically identifying the number of employee spots based on actual or estimated usage, such as through number of spots, number of employees, hours of use or other measures.

The mechanics of the safe harbor are demonstrated through eight examples, two of which are specifically for tax-exempt employers.

What about employers with multiple parking facilities?
Employers may aggregate, for purposes of using the safe harbor methodology, multiple parking facilities within the same geographic location, which an example makes clear includes all parking facilities within the same city.

Will tax-exempt organizations that make all their parking available to anyone have UBTI from parking facility expenses?
If the organization has no employee-only reserved spots and can demonstrate that the primary use of the spots is for the general public, then the organization would have no UBTI. If, however, the primary use is not for the general public, then the organization would need to determine actual or estimated usage by employees and include expenses allocable to such spots in UBTI.

Other QTF Questions

Do QTFs provided through a pre-tax election give rise to UBTI?
Yes. Earlier this year the IRS updated Publication 15-B to indicate that, pursuant to section 274(a)(4), taxable employers are not permitted to deduct pre-tax employee contributions that are used to pay for QTFs. The Notice reinforces this position. In the case of tax-exempt employers, this means employee pre-tax QTF elections would give rise to UBTI.

Do on-premises athletic facilities give rise to UBTI?
Generally, no. Section 274 was not amended to address on-premises athletic facilities so the language included in section 512(a)(7) that refers to on-premises athletic facilities is viewed as a drafting error. However, pre-existing language in section 274(e) disallows a deduction for recreational expenses that discriminate in favor of highly compensated employees. The Notice interprets this language as applying to on-premises athletic facilities. Therefore, to avoid UBTI in connection with any on-premises athletic facilities, tax-exempt organizations must ensure such facilities do not favor highly compensated employees.

Can UBTI from QTFs be offset in any way?
The Notice provides a narrow pathway for reducing UBTI that results from providing QTFs. Because section 512(a)(7) treats the expenses of providing QTFs as income, unlike all other types of UBTI, there are no expenses available from the activity generating the UBTI that could be used to offset the income. However, the Notice reinforces a view articulated by Treasury and the IRS in Notice 2018-67,[3] which provided interim guidance with respect to the new UBTI silo rule of section 512(a)(6), namely that an increase to UBTI pursuant to section 512(a)(7) is not considered to result from an unrelated trade or business. Consequently, until further guidance is issued, if a tax-exempt organization has only one unrelated trade or business, it would not be subject to the silo rule of section 512(a)(6), and, in the event that unrelated trade or business has net losses for the year, such losses could be used to offset any UBTI from the provision of QTFs.

Must a tax-exempt organization whose only UBTI is from providing QTFs file a Form 990-T?
Yes, if the total UBTI resulting from the application of section 512(a)(7) is $1,000 or more.

---

[3] For additional information about the new UBTI silo rule, please see our prior Alert.

ATTORNEY ADVERTISING

Some Questions that Remain Unanswered by the Notice

What is the UBTI includible when the expenses of providing qualified parking in an employer facility exceed the section 132(f) limitation?
All of the examples in the Notice use relatively small dollars for parking facility expenses, resulting in fairly small UBTI totals. However, even with the exclusion of depreciation from the definition of parking facility expenses and the safe harbor methodology, employers with significant operating expenses for parking facilities, particularly those with significant interest expenses, where most, if not all, of the spots are not for the general public could still face the risk of UBTI exceeding the value excluded by employees from income as a QTF.

Is the section 132(f) limitation available as a cap on UBTI in all cases?
The Notice is clear that using the value excluded by employees as QTFs under section 132(f) (currently, $260 per month) is not considered a reasonable method for determining parking facility expenses, and none of the examples in the Notice involving employer-owned or leased parking facilities discuss applying the section 132(f) limitation. However, the Notice does apply the limitation as a cap on UBTI resulting from qualified parking at third-party facilities and implies that this cap may be available with respect to other QTFs. Because section 274(a)(4) and section 512(a)(7) refer to the employer's expense of providing the QTF and not the value of the QTF excluded from the employee's income, it remains unclear whether the section 132(f) limitation is available as a cap on UBTI when the employer's expense of providing a QTF does not necessarily equal the value excluded from income by the employee.

How is UBTI determined for provision of other QTFs, such as transportation in a commuter highway vehicle?
The Notice is generally focused on parking facility expenses, which have been of greatest concern to tax-exempt employers. However, the Notice is clear that looking at the value of the amount excluded by employees as QTFs is not a permissible way of determining the expense that gives rise to UBTI. In the case of non-parking QTFs, such as transportation in a commuter highway vehicle, the section 132 regulations provide several methods for calculating the exclusion amount (e.g., for van pools, the value of the fringe benefit may be determined using the automobile lease valuation rule, the vehicle cents-per-mile rule, or the commuting valuation rule). It remains to be seen whether Treasury and the IRS will also adopt these methodologies for purposes of calculating UBTI under section 512(a)(7).

Comments Requested

The Notice requests comments by February 22, 2019, on future guidance to clarify sections 512(a)(7) and 274, including on a number of the interpretive decisions made by Treasury and the IRS in the Notice.

If you have any questions about the Notice, please contact a member of the tax-exempt organizations practice.

ropesgray.com

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2018 Ropes & Gray LLP

ATTORNEY ADVERTISING