UNRELATED BUSINESS INCOME FOR EMPLOYEE PARKING REDEFINED

Just-Released Internal Revenue Service Clarifying Guidance on the Tax Cuts and Jobs Act of 2017

You have likely heard that one of the provisions of the Tax Cuts and Jobs Act of 2017 redefined how qualified taxable fringe benefits for parking and other transportation related expenses must be considered by tax-exempt organizations. This will give rise to unrelated business taxable income (UBTI) for many tax-exempt organizations.

In this document, we address parking benefits specifically.

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Here are the top five FAQs about the new UBTI rules for parking benefits:

FAQ #1: The most frequently asked question is: Does this apply to my tax-exempt organization?

The answer is YES for all tax-exempt organizations! This is true even if your organization has no employees. All tax-exempt organizations must go through the exercise to evaluate and document their exposure to income taxes related to parking benefits. Parking benefits may be provided to employees (i.e. personnel who receive a W-2), contracted workers (i.e. personnel who receive a 1099-MISC), and even volunteers if restricted parking is made available to a specific list of volunteers or guests.

FAQ #2: What do you mean by "parking benefits"?

For the purposes of this new rule, parking benefits includes any provision of parking by a tax-exempt organization to its employees, contracted workers, or specifically identified guests/volunteers. This includes parking that the organization pays a third-party for out-of-pocket and parking that is simply a parking lot next to your building on property that you own or lease. If you have parking at your facility, whether it's a multi-story garage or the driveway of a home utilized in your operation (or anything in between), your organization needs to evaluate whether it is providing parking benefits.

FAQ #3: Is parking the only benefit subject to a new UBTI consideration?

No. The new rules also apply, in varying degrees, to three other benefits that may be provided: transportation via highway vehicle between an employee's residence and the place of employment (including carpooling allowances), transit passes, and bicycle commuting reimbursements. If your tax-exempt organization provides any of these benefits, including through a salary reduction agreement, you must consider the UBTI implications of those benefits. However, this document focuses only on parking.

FAQ #4: When are these new UBTI rules applicable?

These rules are applicable effective January 1, 2018. This is true regardless of what the tax-exempt organization's fiscal year is for tax reporting purposes. So an organization with a June 30, 2018 fiscal year-end should have filed a 990-T for parking benefits provided January 1, 2018 through June 30, 2018. That 990-T, and the income tax associated with it, was originally due November 15, 2018. This is true even if you were not required to file a Form 990 for the most recent fiscal year. There are some tax-planning opportunities included later in this document that could reduce the impact of late filing and payment.

FAQ #5: Where can I get help with this and/or pose questions on the details and how they apply to me?

Your Bonadio Service team is ready and willing to help you with this evaluation process, tax planning ideas, and direct help with the calculations. If your organization is not already a Bonadio client, please reach out to us—contact information is on the first page of this document.

How to Determine the Tax Exposure

There are a lot of technical elements to the new rules. To get started, think of this as two distinct questions to address:

- **Question One: Counting Spaces.** Each tax-exempt organization must determine if its employee parking is designed in a manner that subjects the organization to this tax.
- **Question Two: The Cost of Parking.** Each tax-exempt organization subject to the tax must allocate costs to its parking facilities and then apply the appropriate employee use percentage to those costs to determine UBTI.

We describe the process of answering these questions on the next few pages, with some basic examples at the end of the document.

Question One: Counting Spaces

Follow these series of questions to determine whether your organization is subject to this tax:

a. Does our organization already have a program to pay for third-party parking for employees via a monthly allowance, provision of purchased parking garage passes, or other procurement of parking spaces from a third party?

Taxation Point #1: If the answer to question (a) is "yes," the aggregate cost of procuring those spaces for employees is your organization's UBTI income, except to the extent it exceeds the individual monthly exclusion limitation ($260 for 2018) and is already included in employees' taxable income. If you provide employee parking in this manner, and only in this manner, no further analysis is necessary. Otherwise, proceed to question (b).

b. Does our organization provide parking to your employees on owned or leased property? Note that if the organization has multiple locations, and provides parking at many or all of them, each location must be evaluated separately. Parking locations that are part of a campus or complex that can reasonably be considered a single location can be evaluated collectively. However, parking facilities at your locations in different towns must be evaluated separately. Parking can be as formal as a multi-story parking garage or as informal as the driveway of a house used in the tax-exempt organization's operation.

c. Do we have specific spaces in the parking lot/facility reserved for employees, contracted personnel, or specifically identified volunteers/guest use only?

Taxation Point #2: If the answers to questions (b) and (c) are "yes," you must allocate costs, at a minimum, to the reserved employee spaces and those costs must be reported as UBTI. Proceed to question (d) regardless of whether you answered (b) and (c) yes or no.

Question One: Counting Spaces (Continued)

d. Are some or all of the parking spaces available to the general public? The general public includes visitors, patients, customers, delivery persons, and generally anyone who is not an employee, not a contractor engaged for regular service at your location, and not on an exclusive list of volunteers/ guests.

e. Can you show that the parking spaces, other than those reserved for employees, are generally used more than 50% by the general public during your normal business hours? This is called "the primary use test." It is important to note that spaces that are empty but available (i.e. empty and not reserved for employees) are considered available for the general public for the purpose of this test.

Taxation Point #3: If the answer to questions (d) and (e) are "yes," the remaining parking spaces (i.e. those not identified in question (c)) are NOT subject to the new UBTI requirements. This conclusion must be supported by documentation with actual data about the organization's parking facilities and the typical usage of these facilities. See the basic examples at the end of this document. If the answer to either question (d) or (e) is "no," you must proceed to question (f).

f. Are there spaces reserved for the general public? The cost associated with these spaces would be carved out of the UBTI considerations. This would include spaces reserved for visitors to the extent employees are prohibited from parking in those spaces.

g. The remaining parking spaces are allocated based on "typical" usage. So if question (e) is answered "no," then the number of spaces not accounted for in questions (c) and (f) would be allocated to "employee use" or "non-employee use" based on the typical pattern of usage during the tax-exempt's normal business hours. There is no specific mandated method for this allocation. However, it must be reasonable. Generally, if you operate in an area where people drive their cars to work, the number of spaces allocated to employee use would be expected to be fairly close to the number of employees.

Question Two: The Cost Of Parking

The guidance makes it clear that the UBTI is calculated based on the *tax-exempt employer's cost* of the parking, not the *fair value* of the parking. So using some sort of daily market rate from nearby parking garages is not an option to quantify the cost of parking facilities owned or leased by the tax-exempt organization. This also prohibits an organization from claiming that there is plenty of free on-street parking around so the parking lot's fair value is zero.

As noted in question 1.a. above, if a tax-exempt employer is buying space in a third-party-owned garage or parking facility for its employees, the cost for UBTI purposes is the aggregate cost paid to the third party for that parking, unless it exceeds the individual monthly limit per employee ($260 per month in 2018) that can be excluded from each employee's taxable income.

For employer owned or leased parking facilities, the employer must use a reasonable method to allocate costs to the parking facility. These expenses include, but are not limited to:

- Repairs & maintenance
- Trash removal
- Utility costs
- Cleaning
- Insurance
- Landscaping
- Property taxes
- Parking lot attendant expenses
- Interest
- Security
- Snow, ice and/or leaf removal
- Rent or lease payments

Depreciation is not to be included in the costs of the parking facility. All of the costs on the list, if not specifically identifiable to the parking facility, must be allocated to the parking facility. For example, if the tax-exempt employer pays one utility bill that includes the lighting and other electricity for the parking facility and all the electricity for the employer's adjacent building, a portion of the utility bill must be allocated to the utility cost of the parking facility.

There is no prescribed methodology for allocating these costs at this time. Each tax-exempt organization must establish its own methodology and document that methodology in a manner that provides contemporaneous support for the resulting UBTI determination.

Remember that costs must be accumulated for each of the tax-exempt organization's parking facilities separately. Aggregating costs of parking lots is only allowed when the lots are related to a single location.

The accumulation of the costs related to the tax-exempt organization's parking facilities will result in a total cost of each parking facility. The UBTI percentage, as determined for each parking facility (or aggregated parking facilities for a single location), based on the analysis of parking spaces in question one above, will be applied to the total costs of each parking facility to determine the UBTI amount for each parking facility. The parking facilities' UBTI amounts will be summed for all of the tax-exempt organization's parking facilities to arrive at the organization's total UBTI to be reported as income on Form 990-T.

Tax Planning Considerations—Does this Apply?

It is theoretically possible to conclude that zero parking spaces are subject to UBTI. This would require that no spaces are reserved for employees, contracted personnel, or specifically named volunteers, not even for the employee-of-the-month, the CEO, or the Board Chair. In that case, all spaces would be non-reserved. If it can be reasonably shown that there are no reserved spaces and more than 50% of spaces are typically used by or available to the public, all spaces could be shown to be not subject to UBTI.

There is a transition rule allowing an employer to change reserved parking space designations (i.e. reduce the number of spaces reserved for employees) by March 31, 2019 and have that change effective for tax purposes retroactive to January 1, 2018. Understanding the income tax impact of reducing reserved employee parking vs. the effect such reduction might have on employee morale is critical when considering such a change.

The requirement to consider parking at each location separately is likely to be very onerous for organizations with operations that are geographically spread out. Remember that multiple lots at the same location can be aggregated. So if you have a location with a visitor lot in front and an employee lot behind, for example, those lots could be aggregated for the analysis of usage.

It is reasonable that tax-exempt organizations do not have a complete inventory of every parking lot, how many spaces are in each, how many of those are reserved, and what is the typical usage of each lot. So starting this conversation sooner rather than later is important. Remember, this guidance was issued December 10, 2018, so it's new for everyone.

If Your Organization Has Taxable Income—Five Considerations

1. The guidance states that if the UBTI gross taxable income amount is less than $1,000, the tax-exempt organization is not liable for taxes and does not have to file a 990-T.

2. Keep in mind that these new rules were effective January 1, 2018 regardless of the tax-exempt organization's fiscal year-end for tax filing purposes. So an organization with a fiscal year-end of June 30, 2018, for example, should have calculated the UBTI related to parking facility benefits provided from January 1, 2018 through June 30, 2018 and filed a 990-T for its fiscal year ended June 30, 2018. This 990-T would have been due November 15, 2018 (unless extended). The guidance includes no provision for relief from this filing requirement. To the extent this organization already filed its Form 990 for the fiscal year ended June 30, 2018 with certain boxes checked indicating that no 990-T or UBTI was filed or generated for the fiscal year, the Form 990 itself may need to be amended.

If Your Organization Has Taxable Income—Five Considerations (Continued)

3. The guidance does relieve tax-exempt organizations of responsibility for remitting quarterly estimated tax payments related to this new parking facility UBTI change for 2018 for organizations that were not previously required to file Form 990-T, so penalties for failure to pay such estimates will not be assessed for 2018. Note that quarterly estimates should be made for 2019. Amounts due for 2018 parking activity must be paid by the initial date of the return (May 15, 2019 for tax-exempt organizations with December 31, 2018 year-ends). This tax expense should be accrued for financial reporting under generally accepted accounting principles, and could result in additional footnote disclosures to the extent it is deemed material.

4. Estimated taxes should be paid timely for the four quarters of 2019 if the tax-exempt organization is subject to UBTI under these new rules. Again, tax-exempt organization with fiscal year-ends for tax reporting purposes may already be late for estimated tax payments.

5. Generally, taxable income calculated for parking benefits (as well as for the other three types of benefits (see FAQ #3)) will be subject to federal income tax at a rate of 21%. For New York State, this parking activity has been specifically exempted from State income tax.

Conclusion

There are a lot of details in this guidance, and additional clarification is likely on this topic. The process to determine taxable income described in this document is a high level summary. It is critical that every organization document its allocation methodologies and overall process to assess and conclude on the taxability of its employee parking provision.

If you have any questions related to these complicated new IRS requirements, please contact your Bonadio service representative. If you are not currently a Bonadio client please contact one of our Partners as listed on the first page.

Examples

Example 1: Tax-exempt employer with three distinct, separate locations in different towns. Parking lot data for the three locations is as follows:

	Total Spaces	Reserved For		Not Reserved	Typical Usage of *Non-Reserved* Spaces		
		Employees	Visitors		Employees	Non-employees	Empty
Location A	100	60	5	35	10	15	10
Location B	14	0	0	14	9	5	0
Location C	48	1	12	35	21	6	8

Applying the questions above, the spaces are subject to UBTI as follows:

- Question (a) regarding procuring parking spaces from a third party is answered "no"—all parking is provided on owned or leased lots.
- Question (b) regarding providing parking on the organization's owned or leased property is answered "yes"—the organization provides parking to employees at its locations.
- Question (c) regarding spaces reserved for employees is answered "yes" for locations A and C, and answered "no" for location B—the spaces reserved for employees in locations A and C are subject to UBTI.
- Question (d) regarding parking facilities being available for the general public is answered "yes" for all three locations—the organization's parking lots are used by the general public.
- For Question (e) regarding the percentage of unreserved parking available for the general public, the organization needs to do some math:

	Total Spaces NOT Reserved for Employees	Of Those, Spaces Typically Used by or Available to the General Public	Percentage of Unreserved Spaces Typically Used by or Available to the General Public
Location A	40	30	75%
Location B	14	5	36%
Location C	47	26	55%

Locations A and C have percentages used by or available to the general public of greater than 50%, and therefore all spaces not reserved for employees are NOT subject to UBTI, and the remaining questions do not need to be addressed for locations A and C. Location B has a percentage used by or available to the general public of less than 50%, so it does not meet the "primary use test" in question (e). Therefore, the organization must proceed to question (f) for Location B only.

Example 1 (Continued):

- Question (f) regarding parking reserved for non-employees is only addressed for location B, and the answer is "no" because there are zero spaces reserved for visitors at location B.
- For Question (g) regarding the percentage of unreserved spaces typically used by employees, nine of the 14 unreserved spaces (64%) at location B are typically used by employees, and therefore 64% of the costs associated with parking at location B are UBTI income.
- In total, here are the percentages of parking costs associated with each location that are subject to UBTI:

	Total Spaces	Spaces Subject to UBTI			
		Reserved for Employees Question (c)	Allocated in Question (g)	Total	Percentage of Spaces Subject to UBTI
Location A	100	60	0	60	60%
Location B	14	0	9	9	64%
Location C	48	1	0	1	2%

- For each location, total parking costs must be separately accumulated and the appropriate percentage will be reportable UBTI.

Example 2: Not-for-profit employer with one location that has three parking lots. Parking lot data for the three lots is as follows. The key difference in Example 2 is that all three parking lots relate to the same location and can therefore be aggregated for the purposes of this analysis.

	Total Spaces	Reserved For		Not Reserved	Typical Usage of *Non-Reserved* Spaces		
		Employees	Visitors		Employees	Non-employees	Empty
Location A	100	60	5	35	27	3	5
Location B	14	0	0	14	9	5	0
Location C	48	1	12	35	21	6	8
Total	**162**	**61**	**17**	**84**	**57**	**14**	**13**

Applying the questions above, the spaces are subject to UBTI as follows:

- Question (a) regarding procuring parking spaces from a third party is answered "no"—all parking is provided on owned or leased lots and not procured from a third-party.
- Question (b) regarding providing parking on the organization's owned or leased property is answered "yes"—the organization provides parking to employees on its campus.
- Question (c) regarding spaces reserved for employees is answered "yes"—the 61 spaces reserved for employees are subject to UBTI.
- Question (d) regarding parking facilities being available for the general public is answered "yes"—the organization's parking lots are used by the general public.
- For Question (e) regarding the percentage of unreserved parking available for the general public, the organization needs to do some math. For the remaining 101 spaces not reserved for employees, 44 (17 reserved for visitors, 14 typically used by non-employees, and 13 empty) are typically used by or available for the general public, representing 44% of these spaces (i.e. less than 50%). Therefore, this organization has answered question (e) "no" and must proceed to questions (f) and (g).
- For question (f) regarding parking reserved for non-employees, the 17 spaces reserved for visitors are NOT subject to UBTI.
- For question (g) regarding the percentage of unreserved spaces typically used by employees, of the 84 spaces that are not reserved, 57 of them are typically used by employees and therefore subject to UBTI.
- So on an overall basis, 118 (61 reserved for employees and 57 typically used by employees) out of the total 162 spaces, or 73%, are subject to UBTI. Therefore, 73% of the total cost of the parking lots is UBTI.