

Unrelated Business Income Tax

Old and New Traps for the Unwary

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Part Two

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Agenda

Part I

- Identifying Unrelated Business Income (UBI)
- Exceptions to UBI
- Reporting and paying UBIT
- New silo-ing rules on calculating UBIT

Part II

- New UBIT rules on parking and commuter benefits

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**New UBIT rules on parking and
commuter benefits**

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2017 Tax Reform

- **2 significant UBIT changes affecting nonprofits**
 1. New UBIT reporting rule – reporting by individual trades and business activities
 2. New tax on parking and commuter benefits

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Parking and Commuter Benefits

- Tax Cuts and Jobs Act added IRC §512(b)(7), which requires 501(c)(3) organizations to treat the **expenses of qualified transportation fringe (QTF) benefits** as **unrelated business income**
- Applies to expenses incurred after December 31, 2017
 - Sunsets on December 31, 2025

Parking and Commuter Benefits

- What is a “qualified transportation fringe” benefit (QTF)?
 - IRC § 132(f)(1)
 - For purposes of this section, the term “qualified transportation fringe” means any of the following provided by an employer to an employee:
 - (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

Parking and Commuter Benefits

- What is a “qualified transportation fringe” benefit (QTF)?

Parking for CAA Employees

- CAA owns or leases property for employees to park
- CAA pays a third party parking operator for employees to park

Commuter Benefits

- Transit passes
- Reimbursements for van pools or parking expenses

Why are QTF Expenses Taxed as Income?

- Tax reform act sought to “level the playing field” between for-profit and non-profit employers
 - **For-profit employers** no longer allowed to take a **deduction** on QTF expenses under IRC § 274(a)(4)
 - **Non-profit employers** don’t take deductions because they generally don’t pay federal income tax
 - Instead, tax reform act treats a nonprofit employer’s QTF expenses as **unrelated business income**
 - Nonprofits required to **pay UBIT** on expenses > \$1,000 per year

IRS Notice 2018-99 – Parking Lot Guidance

- <https://www.irs.gov/pub/irs-drop/n-18-99.pdf>
- **Purpose of notice**
 - How nonprofit organizations compute the increase to UBI under IRC § 512(a)(7) attributable to parking expenses
- **Nonprofit CAAs** that provide free parking to employees must go through the analysis in Notice 2018-99 to determine tax liability
 - Even if the public (e.g., clients, volunteers, vendors) are also allowed to park for free in the lot

IRS Notice 2018-99 – Parking Lot Guidance

- **General rule**
 - Tax-exempt organizations that own or lease parking facilities where their employees park may use any reasonable method to determine the amount of expenses to add to UBI
- IRS Notice 2018-99 outlines a “safe harbor” method
 - Using the **value** of parking to employee is **not** a reasonable method
 - Fair market value is relevant in determining the amount that is excludible from an employee’s wages under IRC § 132(f)
 - But nonprofit cannot use value to determine UBIT liability

IRS Notice 2018-99 – Parking Lot Guidance

- Notice 2018-99 identifies 2 parking scenarios:
 1. A taxpayer pays a third party for employee parking spots
 2. A taxpayer owns or leases all or a portion of a parking facility

- The notice does not specifically address:
 - An office lease that includes parking but does not apportion the lease cost to the parking
 - Multi-tenant facilities where all tenants share equal access to parking

CAA Pays Third Party for Employee Parking

- Nonprofit must treat the annual amount paid to the third party for employee parking as UBI

- Reduce this amount by any portion included in employee compensation (e.g., if the amount paid exceeds the monthly exclusion amount)
 - IRC § 132(f) provides a monthly exclusion of \$260 (2018) or \$265 (2019) for transportation passes or qualified parking

CAA Owns or Leases Parking Lot

- Parking facility =
 - Indoor and outdoor garages and other structures
 - Parking lots where employees may park on or near:
 - the business premises of the employer
 - a location from which employees commute to work

CAA Owns or Leases Parking Lot

- **Parking expenses that count as unrelated business income:**
 - Repairs
 - Maintenance
 - Utility costs
 - Insurance
 - Property taxes
 - Interest
 - Snow and ice removal
 - Leaf removal
 - Trash removal
 - Cleaning
 - Landscaping costs
 - Parking lot attendant expenses
 - Security
 - Rent or lease payments

CAA Owns or Leases Parking Lot

- The IRS specifies a 4-step process for computing the expenses to treat as UBI
 - **Step 1** – Compute expenses for reserved employee parking spots and treat as UBI
 - **Step 2** – Determine the primary use of the remaining parking spots (spots not reserved for employees)
 - **Step 3** – Identify parking spots reserved for non-employees
 - **Step 4** – Determine the parking expenses allocable to employee parking and treat as UBI

CAA Owns or Leases Parking Lot

- Step #1:
 - **Reserved employee parking spots**
 - Reserved parking spots include:
 - “Reserved for Executive Director” or “Employee Parking Only”
 - Does not include handicapped parking spaces (unless specifically reserved for handicapped employees)

CAA Owns or Leases Parking Lot

- Step #1 (continued):
 - **Reserved employee parking spots**
 - Expenses allocable to reserved employee spots count as UBI
 - **Example #1**: CAA reserves one spot for its Executive Director.
 - How to calculate UBI?
 - Determine % of reserved employee parking spaces in relation to total parking spaces
 - Multiply this fraction by the total parking expenses for the parking lot
 - If reserved employee parking removed by March 31, 2019, then no parking will be deemed reserved from January 1, 2018 and onward.

CAA Owns or Leases Parking Lot

- Step #2:
 - **Identify the “primary use” of the remaining spots (spots not reserved for employees): employee parking or public parking?**
 - “Primary use” means > 50% of the actual or estimated usage of the parking spots during normal hours of activity.
 - Determine primary use by testing during normal business hours on a typical day
 - “General public” includes clients, visitors, volunteers, vendors, interns, etc. (but not employees)
 - Empty (but available and not reserved) spots are treated as public parking spots

CAA Owns or Leases Parking Lot

- Step #2 (continued):
 - Identify the “primary use” of the remaining spots: employee parking or public parking?
 - **Example #2:** A CAA has 100 spots in its parking lot (none are reserved for employees) and 75 employees. There is no public transportation in the area and as a result, most employees drive their own cars to work.
 - The CAA concludes that the “primary use” of the 100 spots is for **employee** parking because most, if not all, 75 employees likely park in the lot.

CAA Owns or Leases Parking Lot

- Step #2 (continued):
 - Identify the “primary use” of the remaining spots: employee parking or public parking?
 - **Example #3:** A CAA has 100 spots in its parking lot (none are reserved for employees) and 20 employees who park in the lot. Most of the remaining spots in the lot are empty, though clients and vendors who come to the CAA’s offices also park in the lot.
 - The CAA concludes that the “primary use” of the 100 spots is for **public** parking because more than 50% of the spots are either empty or used by non-employees.

CAA Owns or Leases Parking Lot

- Step #2 (continued):
 - Identify the “primary use” of the remaining spots: **employee parking or public parking?**
 - If the CAA determines that the primary use is for **public parking**, then **none** of the CAA’s expenses for these spaces count as UBI, and the CAA does not need to move on to steps 3 and 4.
 - If the CAA determines that the primary use is for **employee parking**, then it most move on to steps 3 and 4 to determine its total UBIT liability.

CAA Owns or Leases Parking Lot

- Step #3:
 - **Parking spaces reserved for non-employees (e.g., visitors, clients, volunteers, independent contractors)**
 - If the CAA reserves any parking for non-employees, the expenses allocable to these spots do not count as UBI.

CAA Owns or Leases Parking Lot

- **Step #4:**
 - **What are the parking expenses allocable to employee parking?**
 - These expenses are considered UBI
 - CAA can use any reasonable method to determine the employee use of its parking spots (during normal hours of activity on a typical day).

CAA Owns or Leases Parking Lot

- **Example #4:** A nonprofit CAA owns a parking lot with 200 spaces and reserves 20 spaces for its executive staff and reserves an additional 18 spaces for its clients. The CAA estimates that 135 non-reserved spaces are typically used for employee parking during its normal hours of operation on a typical day. The CAA incurs \$10,000 in total annual expenses of operating the parking lot.
 - **Under Step 1**, the CAA must allocate 10% of its total parking costs, or \$1,000, to reserved employee parking ($20/200 = 10\%$). The CAA would treat this \$1,000 as UBI.
 - **Under Step 2**, the CAA determines that the “primary use” of the remainder of its parking lot is to provide **employee parking** because 75% ($135/180 = 75\%$) of the 180 spots not reserved for employees are typically used by its employees. Thus, the CAA must move on to Steps 3 and 4 to determine its UBIT liability for these 180 spots.

CAA Owns or Leases Parking Lot

- **Example #4 (ctd.):** A nonprofit CAA owns a parking lot with 200 spaces and reserves 20 spaces for its executive staff and reserves an additional 18 spaces for its clients. The CAA estimates that 135 non-reserved spaces are typically used for employee parking during its normal hours of operation on a typical day. The CAA incurs \$10,000 in total annual expenses of operating the parking lot.
 - **Under Step 3**, because 10% ($18/180 = 10\%$) of the CAA's remaining parking spots are reserved for clients, the \$900 in parking expenses allocable to these spots ($\$9,000 \times 10\%$) is *not* considered UBI.
 - **Under Step 4**, the CAA must reasonably determine the use of the 180 parking spots and the related expenses allocable to employee parking. The CAA estimates that 135 spots (75%, or $135/180$) of these spots are used by the CAA's employees during normal hours of operation on a typical day, so must count **\$6,750** (75% of the \$9,000 in remaining parking costs) as taxable UBI.

CAA Owns or Leases Parking Lot

- **Example #4 (ctd.):** A nonprofit CAA owns a parking lot with 200 spaces and reserves 20 spaces for its executive staff and reserves an additional 18 spaces for its clients. The CAA estimates that 135 non-reserved spaces are typically used for employee parking during its normal hours of operation on a typical day. The CAA incurs \$10,000 in total annual expenses of operating the parking lot.
 - **Total UBI liability:**

UBI	Spaces Generating UBI
\$1,000	20 reserved employee spaces
\$6,750	135 spaces primarily used as employee parking
Total UBI = \$7,750	CAA required to file Form 990-T

CAA Owns or Leases Parking Lot

- **Example #5:** A nonprofit CAA leases its central administrative office, and the lease includes a parking lot adjacent to the office building. The CAA incurs \$10,000 in total parking expenses. The CAA's leased parking lot has 100 spaces and doesn't include any spots reserved for employees or other individuals. During the normal hours of the CAA's activities on weekdays, approximately 40 employees park in the lot, and approximately 60 parking spots are empty.
 - **Under Step 1**, the CAA does not have any reserved employee spots, so doesn't allocate any parking costs to reserved employee parking.
 - **Under Step 2**, the CAA must determine whether the "primary use" of the 100 non-reserved spaces is for employee parking or for general public parking. The 60 empty spots are treated as parking provided to the general public. Based on this assessment, the CAA concludes that the primary use of the 100 spots is for **general public parking** ($60/100 = 60\%$). **Thus, the CAA does not need to move on to Steps 3 and 4.**

CAA Owns or Leases Parking Lot

- **Example #5 (ctd.):** A nonprofit CAA leases its central administrative office, and the lease includes a parking lot adjacent to the office building. The CAA incurs \$10,000 in total parking expenses. The CAA's leased parking lot has 100 spaces and doesn't include any spots reserved for employees or other individuals. During the normal hours of the CAA's activities on weekdays, approximately 40 employees park in the lot, and approximately 60 parking spots are empty.
 - None of the CAA's parking expenses are considered taxable UBI.
 - The CAA is **not** required to file a Form 990-T
 - So long as it doesn't have other UBI of \$1,000 or more.

CAA Owns or Leases Parking Lot

- **Multiple parking locations**
 - Aggregate spots in one geographic location (e.g., all lots in one city)
- **Possible to have no UBI liability from parking?**
 - Yes, if no reserved employee parking **and** > 50% of spaces in the parking lot are used by the public or empty during the CAA's normal business hours.
- **How do CAAs pay for UBIT?**
 - Cannot be charged to federal grants (2 C.F.R. § 200.470(b)(iii))

Commuter and Transportation Benefits

- **Compensation reduction agreements**
 - How it works
 - Employee pays for mass transit passes or parking fees from pre-tax income
 - Employer deducts the cost of the pass from the employee's income
 - Effectively reduces total compensation to employee
 - Employer may or may not subsidize commuter fees
 - IRS sets annual pre-tax limits (\$265/month for 2019)
 - IRS Publication 15-B:
 - **Employee pre-tax salary deferral (i.e., the amount CAAs deduct from employee's wages to pay for transit pass or parking costs) count as UBI, even if the CAA does not subsidize any part of the cost of the pass.**

Filing Quarterly Estimated UBIT

- New UBIT tax on parking and commuter benefits effective January 1, 2018
 - Regardless of when CAA's fiscal year begins
- CAAs that expect to owe more than \$500 in UBIT must make quarterly estimated tax payments
 - Due April 15, June 15, September 15, and December 15
 - Use Form 990-W to calculate quarterly estimated tax payments
 - **IRS Notice 2018-100**: Penalties for failure to make quarterly estimated tax payments in 2018 waived for tax-exempt organizations that were not previously required to file Form 990-T

Key Takeaways

1. Transit passes and payments to third parties for employee parking spots will always add to UBI.
 - To the extent provided on a pre-tax basis
2. Parking spaces reserved for employees will always add to UBI.
 - “Reserved for Executive Director”
 - “Employee Parking Only”
 - Removal of reserved parking by March 31, 2019 retroactively effective to January 1, 2018

Key Takeaways

3. Parking spaces not reserved for employees:

- If more than 50% of these spaces are used by people other than employees, no additional UBI.
- If more than 50% of these spaces are used by employees, nonprofit must attribute the expenses of the parking lot(s) based on employee use as an addition to UBI.
- Must make good faith estimate of employee usage of parking
 - Count employee use on a “typical” business day

Key Takeaways

4. Parking expenses include a range of items such as:

- Repairs, maintenance, security, landscaping, snow removal, leaf removal, sweeping, etc.
- Parking expenses do not include depreciation

5. Leased parking counts

- If lease includes parking spaces, must allocate a portion of rent to parking
- If lease doesn't include parking spaces, technically must allocate a portion to parking (or revise lease)
- Same calculation rules regarding reserved/nonreserved and parking for general public apply

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