

Transportation Fringe Benefits Update

Proposed Qualified Transportation Fringe Benefit Regulations Provide a New Roadmap

On June 23, 2020, the IRS issued [proposed regulations](#) providing guidance regarding employee taxability and employer deductibility for qualified transportation fringe (QTF) benefits. The Tax Cuts and Jobs Act of 2017 (TCJA) eliminated most employer deductions for QTF benefits provided to employees while preserving the pre-tax treatment of those benefits for employees.

Congress Puts up a Roadblock

When the Tax Cuts and Jobs Act (TCJA) passed in 2017, it generally left the pre-tax status of QTF benefits for employees alone, but employers lost the ability to take tax deductions for employer-provided commuter and parking benefits.¹ The IRS subsequently provided safe harbors and granted limited employer relief under [IRS Notice 2018-99](#) while it drafted regulations.

Relief for Tax-Exempt Entities

As originally drafted, the TCJA required tax-exempt entities to include the cost of QTF benefits in their unrelated business income (UBTI). UBTI is a tax-exempt organization's gross income earned from any unrelated trade or business that the organization regularly carries out, minus any allowable deductions. The [fiscal year 2020 spending bill](#) retroactively repealed this requirement for amounts paid or incurred after December 31, 2017. Now, the UBTI requirement only applies to QTF benefits paid by a tax-exempt entity directly related to trade or business activity that is not tax-exempt. This includes benefits provided to employees on behalf of a related entity that is not tax exempt.

Proposed QTF Regulations Safe Harbor and Effective Date

The proposed regulations both clarify and expand upon the TCJA and guidance from IRS Notice 2018-99 and are a safe harbor until the IRS publishes final regulations. The final regulations will specify an effective date beginning on or after their publication date.

¹ In a somewhat bizarre twist, the employer tax deduction for providing bicycle benefits remains (up to \$20/month), but employees must include it in taxable income. Employees cannot pay for this benefit on a pre-tax basis through payroll deductions.

Employer Tax Deduction for Excess QTF Benefits

The proposed regulations continue the limited employer relief from IRS Notice 2018-99, permitting employers to take tax deductions for QTF benefits provided in excess of the monthly QTF exclusion limit (\$270/month for 2020) and treated as taxable wages to the employees. An employee cannot avoid the taxable income by deferring the excess amounts through a salary reduction arrangement (SRA).

Example 1: Employees may sign up and pay a \$150/month fee to park in a parking garage adjacent to the employer's office. The employer does not enable employees to pay for parking on a pre-tax basis, but the employer pays \$150/month to employees who park in the garage. The amount provided does not exceed the 2020 \$270/month QTF exclusion amount, so the employer cannot deduct any of the \$150/month. The amount provided is not taxable income to the employee.

Note: *If the employer pays the \$150/month as taxable income without requiring employees to park in the garage, the employer may deduct it as a wage expense.*

Example 2: Employees may sign up and pay a \$430/month fee to park in a parking garage adjacent to the employer's office. The employer maintains a QTF benefit program enabling employees to pay \$270/month toward the parking fee on a pre-tax basis. The employer pays \$160/month in additional compensation to employees who park in the garage and contribute \$270/month through the QTF benefit program. The employer may take a tax deduction for its \$160/month contribution, because it exceeds the 2020 \$270/month QTF exclusion limit. The \$160/month is taxable income to the employees.

Employer Parking Deductions

The proposed regulations address how to determine the amount of parking expenses an employer *cannot* deduct (referred to in the proposed regulations as the "disallowance").

- **Third Party Parking Facility** – When an employer pays a third party for employee parking, the disallowance is the amount paid to the third party up to the applicable QTF exclusion limit (\$270/month in 2020) per eligible employee. Please see Examples #1 and #2 under [Employer Tax Deduction for Excess QTF Benefits](#) above.
- **My Parking Facility** – If the employer actually owns or leases all or a portion of the parking facility (which includes a parking lot), the proposed regulations give employers a choice between using the general rule or one of three simplified methodologies to calculate the disallowance amount. The employer's approach can vary from year-to-year and between different parking facilities.²
 1. **General Rule** – The General Rule allows employers to calculate the disallowance amount based on any reasonable interpretation of the law, using the actual parking expenses paid rather than the value of the parking to employees.

² Special rules for allocating mixed parking expenses and aggregating parking spaces by geographic location may also apply.

- a. Reserved Employee Parking – Employers cannot take a deduction for expenses allocated to reserved employee parking spaces.
- b. Primary Use – Employers can deduct expenses attributable to public parking (which can be limited to customers). Determine the primary use of available parking spaces by determining the number of parking spaces used by employees during peak demand relative to the total number of parking spaces available for public parking (which can be limited to customers). Do not count reserved employee spaces as available public parking. If the primary use (>50%) of available parking spaces is for public parking, all parking expenses for available public parking are generally deductible.

Example: An employer's retail store parking lot has 50 parking spaces with no reserved employee parking. During peak business hours, employees use 10 spaces with the remainder used by customers. The primary use of the parking lot is for public parking and all expenses to maintain and provide available public parking are generally deductible.

Note: *Parking spaces reserved for inventory (e.g. cars for sale at a car dealership) or otherwise unusable (e.g. parking spaces occupied by company delivery vehicles) do not count as reserved employee parking or as available for public parking.*

2. Simplified Methodologies – The proposed regulations provide three alternatives to the General Rule:

- a. Qualified Parking Limit Methodology – This is the least complicated of the three alternatives and involves simply multiplying the monthly QTF exclusion limit for qualified parking (\$270 in 2020) by either:
 - (1) The total number of spaces used by employees during peak demand for each month of the tax year; or
 - (2) The total number of employees for each month of the tax year.

Although this is the least complicated alternative, it will frequently result in the largest amount the employer cannot deduct. It may also result in taxable income to employees while the other alternatives do not.

Example: In 2020, employees used an average of 21 parking spaces during peak demand each month. The disallowance amount under the qualified parking limit methodology is $(21 \times \$270) \times 12 = \$68,040$. Any excess is deductible, but it must be included in taxable employee compensation.

Note: *Using peak demand spaces will frequently result in a lower disallowed deduction amount than using the total number of employees.*

b. Primary Use Methodology – The proposed regulations adopt the 4-part calculation method described in IRS Notice 2018–99 with minor modifications and updated definitions. We will provide three detailed examples at the end of this methodology.

- Step 1 – Reserved Employee Parking: Employers cannot take a deduction for expenses allocated to reserved employee parking spaces. The percentage of parking spaces reserved exclusively for employees multiplied by the employer’s total expenses for the parking facility is not deductible. Since there is no deduction, there is no excess amount to treat as taxable compensation.

An employer can take a deduction if the primary use of the parking facility is for public parking (see Step 2) and there are no more than 5 reserved employee spaces making up 5% or less of the total parking spaces.

- Step 2 – Primary Use: Determine the primary use of available parking spaces by determining the number of parking spaces used by employees during peak demand relative to the total number of parking spaces available for public parking (which can be limited to customers). Do not count reserved employee spaces as available parking. If the primary use (>50%) of available parking spaces is for public parking, *all* parking expenses for available parking are generally deductible and there are no tax consequences for employees. If the primary use is not for public parking, proceed to Step 3.

Example: An employer’s retail store parking lot has 50 parking spaces with no reserved employee parking. During peak business hours, employees use 10 spaces with the remainder used by customers. The primary use of the parking lot is for public parking and all expenses to maintain and provide available public parking are generally deductible.

- Step 3 – Reserved Non-Employee Parking: If the primary use of available parking is not for public parking, calculate the allowed deduction amount by determining the percentage of parking spaces reserved exclusively for non-employees and multiplying that percentage by the employer’s unallocated expenses for the parking facility.
- Step 4 – Remaining Use: If there are any unallocated parking expenses after completing Steps 1 – 3, allocate any remaining parking expenses by multiplying the percentage of parking spaces used by employees during peak hours by the remaining parking expense to determine the amount attributable to employees.

The parking expenses attributable to employees are not deductible. Since there is no deduction for the employee parking expenses, there is no excess amount to treat as taxable compensation.

Primary Use Methodology Examples:

Example 1: An employer owns and maintains a parking lot with 100 spaces in front of its place of business and spends \$20,000 to maintain the parking lot during the calendar year. The employer does not reserve any spaces for employees, and employees use 15 spaces on average during the peak demand period.

Step 1: N/A. There are no reserved employee parking spaces.

Step 2: During the peak demand period, non-employees use 85% ($85 \div 100$) of available parking. The primary use of the employer's available parking is for public parking, and the employer may deduct all \$20,000 of its parking expenses.

Step 3: N/A.

Step 4: N/A.

Answer: The employer may deduct all \$20,000 of its parking expenses.

Example 2: An employer owns and maintains a parking lot with 100 spaces in front of its place of business and spends \$20,000 to maintain the parking lot during the calendar year. The employer reserves 10 spaces for employees, and employees use 15 other spaces on average during the peak demand period.

Step 1: The employer reserves 10% ($10 \div 100$) of its parking for employees and cannot deduct \$2,000 ($\$20,000 \times 10\%$) of its parking expenses.

Step 2: During the peak demand period, non-employees use 83% ($75 \div 90$) of available parking. The primary use of the employer's available parking is for public parking, and the employer may deduct the remaining \$18,000 of its parking expenses.

Step 3: N/A.

Step 4: N/A.

Answer: The employer may deduct \$18,000 ($\$20,000 - \$2,000$) of its parking expenses.

Example 3: An employer owns and maintains a parking lot with 100 spaces in front of its place of business and spends \$20,000 to maintain the parking lot during the calendar year. The employer reserves 10 spaces for employees, 5 for its own delivery vehicles, 20 spaces for visitors, and employees use 50 other spaces on average during the peak demand period.

Step 1: The employer reserves 10% ($10 \div 100$) of its parking for employees and cannot deduct \$2,000 ($\$20,000 \times 10\%$) of its parking expenses.

Step 2: During the peak demand period, non-employees use 41% ($35 \div 85$) of available parking. The primary use of the employer's available parking is not for public parking. Proceed to Step 3.

Step 3: The employer reserves 24% ($20 \div 85$) of available parking for non-employees and can deduct \$4,320 ($\$18,000 \times 24\%$) from its remaining \$18,000 in unallocated parking expenses.

Step 4: The remaining \$13,680 ($\$18,000 - \$4,320$ or $\$18,000 \times 76\%$) should be attributable to employee parking expenses, and the employer cannot deduct it.

Answer: The employer may deduct \$4,320 ($\$20,000 - \$2,000 - \$13,680$) of its parking expenses.

Note: *Parking spaces reserved for inventory (e.g. cars for sale at a car dealership) or otherwise unusable (e.g. parking spaces occupied by company delivery vehicles) do not count as reserved employee parking or as available for public parking.*

- c. Cost per Space Methodology – Employers may calculate the disallowance amount by determining the average cost per parking space and multiplying this amount by the number of parking spaces used by employees during peak demand. The average cost per space is equal to total parking expenses divided by the total number of parking spaces.

Example: An employer owns and maintains a parking lot with 100 spaces in front of its place of business and spends \$20,000 to maintain the parking lot during the calendar year. The employer reserves 10 spaces for employees, and employees use 15 other spaces on average during the peak demand period.

Answer: The average cost per parking space is \$200 ($\$20,000 \div 100$). The employer cannot deduct \$5,000 ($\200×25). The employer may deduct \$15,000 of its parking expenses ($\$20,000 - \$5,000$).

Note: *Under this method, there is no exclusion for reserved employee parking, inventory, or otherwise unavailable parking.*

Commuter Highway Vehicles and Transit Passes

The proposed regulations also apply the logic of IRS Notice 2018-99 to transit passes and commuter highway vehicle (vanpooling) benefits. Similar to the rules for parking expenses, employers may only deduct QTF benefits provided in excess of the monthly QTF exclusion limit (\$270/month for 2020) and treated as taxable wages to the employees. An employee cannot avoid the taxable income by deferring the excess amounts through a SRA. An employer must use the amount actually paid for transit passes and/or vanpooling and not its value to employees.

Which Road to Take?

Several states and localities require employers to provide transportation benefits to their employees. When stakeholders raised concerns with the IRS over the TCJA's effect on employers in these locations, the IRS responded that the TCJA's reduction of the corporate tax rate beginning in 2018 should offset the cost of losing the deduction. Employers considering eliminating the benefit should review state and local laws (see State and Local Requirements below), as well as check the tax implications and weigh them against these benefits' ability to attract and retain new employees

State and Local Requirements

Despite the TCJA's tax deduction limits, certain states and cities require employers to provide QTF benefits. Employers operating in the following cities, counties, and/or states should be aware of their local transportation and reporting requirements. Other jurisdictions may mandate QTF benefits in the future.

Jurisdiction	Covered Employers	Transportation Requirements	More Information
Berkeley, CA	Berkeley employers with at least 10 employees working an average of 10 hours per week	Employers must offer one or more of these options: <ul style="list-style-type: none"> • Pretax plan allowing employees to exclude transit, vanpool, or bicycle commuting expenses from taxable wages (bike expenses subject to TCJA limits); • A transit subsidy equal to the value of a local monthly AC transit pass; or • An employer-provided shuttle service. 	Berkeley Municipal Code 9.88
Los Angeles, CA Including Orange County and portions of San Bernardino & Riverside Counties	Employers with 250 or more employees	Employers must register with the South Coast Air Quality Management District and choose one of the options to reduce emissions.	Rule 2202 South Coast Air Quality Management District

Jurisdiction	Covered Employers	Transportation Requirements	More Information
Richmond, CA	Richmond employers with at least 10 employees working an average of 10 hours per week	Employers must offer one of the following options: <ul style="list-style-type: none"> • Pretax plan allowing employees to exclude transit, vanpool, or bicycle commuting expenses from taxable wages (bike expenses subject to TCJA limits); • Employer purchased transit pass or reimbursement for vanpool charges equal to the cost of an adult monthly transit pass; • Employer provided vanpool or bus; or, • Other benefit preapproved by city. 	Commuter Benefits Ordinance 22-09
San Francisco, CA	Employers with a location in San Francisco that have 20 or more employees nationwide	Employers must offer one of the following options to employees who work an average of at least 10 hours/week within San Francisco County: <ul style="list-style-type: none"> • Pre-tax plan allowing employees to exclude transit, vanpool from taxable wages; • Employer paid monthly benefit equal to the cost of the San Francisco Muni "A" Pass (including BART); • Employer provided company funded bus or van service transporting employees to and from the workplace; or, • Any combination of the above options. 	San Francisco's Commuter Benefits Ordinance
San Francisco Bay Area, CA	Employers with at least 50 full-time employees within the Bay Area Air Quality Management District	Employers must register with the Bay Area Commuter Benefits Program and offer one of the following options: <ul style="list-style-type: none"> • Pretax plan allowing employees to exclude transit, vanpool from taxable wages; • Subsidy to reduce monthly transit or vanpool expenses; • Employer provided transit service; or, • Another commuter benefit that is as effective as one of the above options. 	San Francisco Bay Area Commuter Benefits Program

Jurisdiction	Covered Employers	Transportation Requirements	More Information
New York City, NY	Non-governmental New York City employers with at least 20 full-time, non-union employees	<p>Covered employers must offer commuter benefits to eligible employee (meaning employees can use pre-tax dollars to purchase transportation benefits). Transit that is covered includes:</p> <ul style="list-style-type: none"> • NYC regional mass transit services, including Metropolitan Transportation Authority subway and bus; Long Island Rail Road; Amtrak; New Jersey Transit; and Metro-North; • Eligible ferry and water taxi services; • Eligible vanpool services; • Eligible commuter bus services; and • Access-A-Ride and other area paratransit providers. <p>Employers can also purchase a transit pass or pay for other transportation on public or privately owned mass transit or commuter highway vehicle.</p>	New York City Commuter Benefits Law
New Jersey	Employers with 20 or more employees Effective April 1, 2020	Employers must offer a pre-tax transportation benefit allowing employees to exclude funds used to pay for commuter highway vehicle and transit benefits from their gross income.	SB 1567 N.J. Press Release
Seattle, WA	Employers with 20 or more employees Effective January 1, 2020; enforcement begins January 1, 2021	Employers must offer pre-tax deduction for transit or vanpool expenses, or subsidize purchase price of transit pass.	Commuter Benefits Ordinance
Washington, D.C.	Employers with at least 20 employees	<p>Employers must offer one of the following options:</p> <ul style="list-style-type: none"> • Pretax plan allowing employees to exclude mass transit or vanpool from taxable wages; • Employer paid tax-free subsidy of a transit pass for public transit system, or reimbursement of vanpool costs of an equivalent amount to a trip on public transit; or, • Employer provided bus or vanpool service for employees. 	D.C. Commuter Benefits Law D.C. Commuter Benefits Regulations

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