

# New Directions for Commuter Benefits Tax Policy

May 2019

The 2017 Tax Cut and Jobs Act (TCJA) and subsequent Internal Revenue Service (IRS) draft guidance, “Parking Expenses for Qualified Transportation Fringes Notice 2018-99 (December 2018),” made significant changes to the tax treatment of transit and parking benefits for employers.

Because these affect the balance sheets of businesses and non-profits, the number of employers offering parking and transit benefits may change, and thus the incentives for how people get to work. And while the tax changes are quite different for private businesses versus tax-exempt entities, there is a common theme: beginning in tax year 2018, outlays made to support employees getting from home to work will be more expensive for employers to provide, irrespective of how commuters travel.

Despite these recent changes, many employees still receive the tax savings of transit and parking programs courtesy of their employer. However, private businesses can no longer deduct employee transit or parking costs as a business expense, and non-profits need to pay Unrelated Business Income Tax (UBIT) on those costs. These are major changes applying to “Qualified Transportation Benefits” allowed under Section 132(f) of the tax code. TCJA also removed cycling benefits entirely until 2026.

If enforced, increasing the cost of employee parking to businesses could shift commuters away from cars and onto public transit, especially if employers respond by shifting those new costs to employees. And because around 30 percent of American workers receive parking benefits, changes to commuter benefit costs could substantially affect auto travel, transit ridership, air quality and land use. Outside the densest areas, the scope and impact of

parking vastly exceeds that of transit benefits, even in transit-rich regions like New York. In practice, however, the opposite is likely to happen without further changes in law or regulations.

Absent rules and guidance different than what’s been offered to date, more employers are likely to drop their transit benefits than alter parking practices. While the value of transit and transit benefit programs has been widely acknowledged, employee parking is more common and many of its costs could escape taxation as they are so difficult to isolate and quantify. TCJA may add to existing tax incentives already favoring auto use, and reverse many years of progress in this area.

With 260 million private automobiles on the road and studies suggesting there are about 4 parking spaces per car, there may be a billion parking spaces in America. All these spaces generate or attract traffic, and require upkeep and replacement. It is not far-fetched to suggest the aggregate cost of providing parking could be \$1 trillion annually. Whatever the actual magnitude, it is safe to say that it is enormous and unmeasured. Few towns have even inventoried their parking supply.

Given the parking sector’s enormity, even small changes to tax policies for parking and transit benefits can greatly alter price signals sent to employees, with resultant effects on the decisions millions of employees make about travel to work.



Photo: Joyfull Studio



## A Commuting History and Where We Are

To level the playing field between a tax code that long-encouraged driving relative to transit, transit advocates supported a range of transit benefit options that employers now offer. “Pass programs” first emerged in Boston in the 1970s, voucher programs such as TransitChek<sup>1</sup> and Commuter Check became popular in the 1990s, and subsequent electronic programs further popularized their use. These programs allow employees to set aside pre-tax dollars to pay for transit, allow employers to pay the costs, or a mix of the two. In time, many thousands of large and small employers in the private, public and non-profit sectors began offering the programs, benefiting millions of transit-using employees and equalizing the more commonly-provided parking incentives.

The benefit is so broadly supported that New York, San Francisco, Washington, DC, Los Angeles and Seattle have ordinances requiring employers to offer pre-tax transit programs. Similar regulations cover the entire San Francisco region, and in 2019 New Jersey adopted the first statewide ordinance.

Pre-tax transit generally reduces employee transit costs by 25 percent or more. Due to its popularity and underscored by the ordinances, most transit commuters in large cities get pre-tax transit or the more generous employer subsidy option. If use of these programs is reversed, the effects can be likened to a fare increase. For even a share of the market, 35 percent higher fares would seriously impact ridership and revenues.<sup>2</sup>

<sup>1</sup> The nation's first transit benefit program, TransitChek, was developed in the New York region on behalf of the Port Authority, MTA, NJ Transit and business community in 1987, and became a model for all subsequent transit benefit programs. Once NY demonstrated the viability of a large-scale transit benefit program, it was taken up by private benefit providers and public agencies nationwide.

<sup>2</sup> Ecola, Liisa, and Michael Grant. Impacts of Transit Benefits Programs on Transit Agency Ridership, Revenues, and Costs. *Journal of Public Transportation*, 2008. Baker, Stuart, Richard Oram, and David Judd. Tax-Free Transit Benefits at 30: Evolution of a Free Parking Offset. *Journal of Public Transportation*, 2010.

## How TCJA Changed Tax Treatment of Commuter Benefits

TCJA and Notice 2018-99 made seismic changes to the commuter benefit tax framework. Seemingly technical and obscure, the changes alter practices dating to before commuting was even considered an employee benefit, and decades of reforms. Parking and transit benefits are now wholly integrated in employment practice, land use and the economy. The new law and regulations may spawn considerable changes, especially in areas where transit and car travel compete.

The potential impacts cause significant policy concern. It is well-documented that auto users receive very favorable treatment relative to transit, foot and bicycle travelers in the form of a tax-free benefit, free parking.<sup>3</sup> But TCJA and Notice 2018-99 may significantly undermine transit programs that were increasingly successful in offsetting structural inequalities in workplace travel. The programs deliver important public benefits.

TCJA introduces concepts very new to many employers, and many remain unaware of the changes. Notice 2018-99 created new issues, and leaves key questions unresolved regarding how costs should be calculated for tax purposes. Just how the law will affect transit use, land use and air quality remains to be seen. Whether and how employers will end up passing increased parking and transit benefit costs along to employees is not yet clear. Nor is there clarity on how employees will respond to whatever changes in costs they may experience. Much is unknown but given what is known and can be anticipated, there is considerable reason for serious concern.

### Key questions include:

1. Will the new tax provisions cause employers to reduce their transit and/or parking benefit programs, and to what extent for each?
2. Will employers pass on added costs they face for transit and/or parking programs to employees, and to what extent for each?
3. What will net effects on transit ridership be?

While there is early anecdotal evidence of employer responses, without systematic data on employers' reactions and employees' altered travel behavior in response, this issue overview report is intended to provide summary information about the recent tax law changes, a framework for understanding how they work and their potential significance, and a menu of policy options.

<sup>3</sup> Wilson, Richard W., and Donald C. Shoup. Parking subsidies and travel choices: assessing the evidence. *Transportation*, 1990.

Whatever motivated the tax law changes, their effect is clear: for both the pre-tax and subsidy options all transportation benefits will cost more for employers to provide. Putting aside critical loopholes in Notice 2018-99, the changes impact virtually all employers in the private and non-profit sectors.

The new law does not change employee savings from payroll taxes such as Medicare and Social Security (typically 7.65 percent) or income tax (usually 25-35 percent). Employers will also still save their share of payroll taxes (also 7.65 percent).

What the new law does, in the case of for-profit businesses, is disallow deductions from business income for commuter benefit costs. If an employer pays income tax at 21 percent as TCJA established, the transportation benefit would cost that much more. For tax-exempt organizations, the new law makes the costs of providing commuter benefits subject to UBIT, also now 21 percent. For both private and non-profit employers, supplemental expenses related to providing the benefits, such as administrative costs, are also not deductible or are subject to UBIT.

**For for-profit businesses**, the new statute stipulates that, with exceptions for expenses “necessary for ensuring the safety of the employee” or “includable in employee wages,” there shall be:

*No business deductions for “the expense of any qualified transportation fringe (as defined in Section 132(f)) provided to the employee of the taxpayer.”*

and

*No business deduction for any expense incurred for providing transportation, payment, or reimbursement to an employee relating to travel between the employee’s home and workplace.*

For example, a business with income of \$1,000 that provides commuter benefits worth \$100 to employees previously would have paid tax on \$900 (income minus previously deductible commute benefit expense), but now must pay tax on its entire business income of \$1,000. For a non-profit that provides the same \$100 in commute benefits, previously the organization incurred no tax liability but now must pay 21 percent tax on the \$100 commuter benefit.

**For businesses**, many costs that were deductible as business expenses no longer are, including:

- ▶ Direct subsidy or amounts directed to pre-tax deductions
- ▶ Facility and equipment costs such as for parking lots and structures, maintenance and security
- ▶ Expenses for company-provided shuttles that link businesses to regional transit networks or remote parking
- ▶ Benefit-related expenses (with the caveat that IRS has not specified the extent of these expenses), which may include administrative costs such as staff or fees, direct costs such as marketing, and others.

**For tax-exempt organizations** (which, through universities, hospitals, churches, foundations, charities, etc., comprise 10 percent of national employment) the law in effect imposes a new tax liability, both in concept and scope. The concept that a given category of expense will be treated as income for tax purposes is novel. And while UBIT formerly applied to the relatively few non-profit organizations with income-generating activity, it now applies to every entity with UBIT above a \$1,000 threshold. Allowing just one employee to direct \$85 per month to transit would exceed the \$1,000 threshold. Virtually all non-profit organizations will face new accounting requirements, need to file a tax return, and pay significant new taxes.

To illustrate the potential impact on tax-exempt organizations, imagine an organization with 30 employees who each direct \$50 of pre-tax salary to transit per month. With the 21 percent UBIT, and putting aside indirect costs, the entity will now owe \$3,780 in taxes. Many charities already face difficulties sustaining contributions given TCJA’s increase in the standard deduction. TCJA was not good for non-profits.

UBIT greatly exceeds the 7.65 percent payroll tax savings of pre-tax programs, and the payroll tax savings is already reflected in budgets while the 21 percent is new cost. Nonprofits that discontinue their transit programs would generally save 13.35 percent of the pre-tax amounts, plus UBIT on administrative and other costs, plus the administrative and other costs themselves. The employees’ fares would rise by about 30 percent.

Like any new tax law, TCJA’s changes spawned IRS regulations. [Notice 2018-99](#) provides guidance including methods to distinguish employee parking from that needed for customers and visitors; categories of “parking provision” expenses to be included; and ways to identify and allocate parking costs. A major feature of this guidance is the assertion that “any reasonable method” would be acceptable for estimating the use of parking benefits. This is a serious flaw because identifying parking costs or estimating actual use of parking isn’t straightforward. Another problem concerns how employers whose parking costs are bundled into leases should determine the costs. Further, the notice states that employee parking expenses can be deductible if 50 percent or more of the parking is for customers or visitors – as is the case for shopping centers or big box stores – but transit benefits for even one employee would remain non-deductible.

Last, and this is a problem in TCJA language as opposed to Notice 2018-99, how can it be determined, for example, when an employee parking lot (as opposed to on-street parking, perhaps) is “necessary for insuring the safety of the employee”? Are old neighborhoods or crossing an arterial road to get to a bus stop unsafe? Is the absence of sidewalks unsafe? Would “any reasonable method” also be acceptable to determine safe versus unsafe conditions?

Notice 2018-99 is identified as a draft, and comments were due February 22, 2019. While IRS indicated Notice 2018-99 could be relied upon for an undetermined period, hopefully final regulations will address these and other remaining concerns.



# Impact on Commuter Benefits

Substantial research shows that providing employee parking affects commuter behavior, just as fares affect transit use. The research shows that increases in the cost of at-work parking markedly reduces driving, as measured by share of single-occupant vehicles (SOV) at work, use of ridesharing and transit, average cars per person at the workplace, and elasticity of demand for driving.

Subsequent research added further nuance, showing:

- ▶ that imposing parking fees affects mode choice<sup>4</sup>
- ▶ how employers can reduce parking demand by reducing charges for carpoolers<sup>5</sup>
- ▶ that imposing fees for SOV users and reducing available spaces can reduce the share of employees driving alone and total parking spaces needed<sup>5</sup>
- ▶ how availability of free parking can swamp the effects of transit benefits<sup>6</sup>

Clearly, economic incentives have large impacts on employee commute behavior. As a result, TCJA's changes can be expected to alter commuter behavior. But with uncertainty surrounding precisely how the tax law will be interpreted, implemented and enforced, it is not clear how it will affect transit ridership. While the probable effects are anticipated to be a serious concern for transit, actual impacts of the new law will depend on a number of factors:

## 1 With parking so integrated in our land use and building practices, what actual tax increases will businesses and tax-exempt organizations pay, and what program changes might result?

Despite the guidance in Notice 2018-99, how parking costs should be calculated remains complex and unclear. The difficulties reflect the variety of ways parking is provided. For example:

- ▶ Some employers lease or otherwise make payments to third parties for parking (or reimburse employees). In this case the direct outlay can serve as the amount of non-deductible expense or amount subject to UBIT, plus administrative and other costs, though the definition of "other costs" remains unclear.
- ▶ Many employers own parking facilities, in which case employers would need to calculate capital, operating, maintenance and administrative costs. Separating costs for

<sup>4</sup> Peng, Zhongren, Kenneth Dueker and James Strathman. Residential location, employment location, and commuter responses to parking charges. *Transportation Research Record*, 1996.

<sup>5</sup> Su, Qing, and Liren Zhou. Parking management, financial subsidies to alternatives to drive alone and commute mode choices in Seattle. *Regional Science and Urban Economics*, 2012.

<sup>6</sup> Hamre, Andrea, and Ralph Buehler. Commuter mode choice and free car parking, public transportation benefits, showers/lockers, and bike parking at work: evidence from the Washington, DC Region. *Journal of Public Transportation*, 2014..

employee, customer and visitor spaces is a further complication, as is the appropriate treatment of financing costs and depreciation.

- ▶ Many employers have parking included in their overall facility lease. In this case, calculations by landlords may be needed to identify parking costs. This is a particularly difficult issue not addressed by Notice 2018-99.
- ▶ Many employers in large retail and mixed-use settings have their employees park in lots or garages that are also used by customers and visitors. Some of the employers may generate more traffic and require more parking than others, yet spaces used by one employer's staff are not specifically allocated from the total. One part of this problem was addressed and arguably exacerbated by Notice 2018-99's "50 percent rule" — parking expenses remain deductible where customer and visitor parking is "reasonably expected" to comprise 50% or more of non-dedicated parking spaces. Dedicated or reserved parking spaces for employees would still be non-deductible, though the tax would be avoided simply by "unreserving" spaces. In some cases the provisions would encourage more parking to be provided, or some simply "signed" differently.

## 2 How will employers respond to IRS guidance?

Notice 2018-99 provides temporary rules for employers to follow until more complete regulations are adopted. It includes numerous illustrations but fundamentally it allows employers to use "any reasonable method" to determine nondeductible costs or UBIT. It does state that the value or cost of a parking benefit to employees cannot serve as a proxy for the cost to the employer of providing that benefit, but overall the generality of the guidance leaves crucial questions unanswered. This makes it hard to predict how employers will respond, though it is sensible to suggest that employers will generally minimize tax obligations when it is possible and legal to do so.

What complicates matters is that what is legal will inevitably be hard to logically state, and this is a problem for transit and transit-using employees. For transit benefits, the value of a pass or pre-tax deduction, plus administrative costs, is fairly easy to establish, but parking costs are by no means straightforward. For parking leased by an employer or reimbursed to the employee, per Notice 2018-99, those costs can be deemed to be the nondeductible amount, plus administrative and other costs. So in these situations, the costs are also relatively easy to identify, but leased and reimbursed parking are the least common ways in which parking is provided.

Most employers provide parking to employees in lots or structures, with spaces allocated for visitors and customers as well as employees and often shared with other employers, so the issues become very complex. How to disentangle parking costs from general property-acquisition and maintenance costs is not addressed by Notice 2018-99, nor is the situation where employee parking is "bundled" into an overall building lease. This situation applies in many suburban and urban settings where transit is a viable commute alternative. Identifying and

allocating costs folded into overall building construction and financing, separating costs of administration, maintenance, etc., will be difficult to calculate and subject to potentially wildly differing assumptions and conclusions. For bundled parking, if tenants rely on information provided by the landlord, who is responsible for its accuracy? It can be assumed that landlords would have the incentive to “low ball” stated parking costs to keep their site competitive. This suggests a serious compliance problem given that bundled parking is so common.

It is reasonable to expect that employers will comply only weakly with the intent of TCJA’s parking provisions, given the changes and complexities. With the lack of attention this topic has had to date, at least some employers will ignore the new provisions, intentionally or not, probably for a considerable period. Compliance can’t be expected if IRS doesn’t issue clear, thorough and consistent guidance. It may not even be possible to provide such guidance. Can the “bundled landlord low-ball problem” even be addressed? And who could say that providing parking isn’t necessary for insuring employee safety? Ultimately, it is probable that transit programs will be taxed or discontinued, but most parking won’t.

The end result of the provisions and guidance will likely be to reinforce existing incentives for driving relative to transit for commuting, and roll back the equity and sustainability gains the transit benefit programs delivered over the past forty years.

*Traffic may worsen with negative economic, environmental and health results. Particularly for lower income employees, it will cost more to get to work.*

### **3 Will current economic strength delay the rate at which private employers make program changes? Will it accelerate in a downturn?**

With TCJA’s overall reduction in business taxes and the current economic strength, businesses and some non-profits may feel they have the resources to absorb the new tax costs of parking and transit benefits. When the next economic downturn occurs employers may decide that the programs, especially transit, should be discontinued. Transit benefits are variable costs that can be cut while parking costs are mostly semi-variable or fixed. Some employers might put costs onto employees. This would magnify declines in transit ridership that normally occur during a slow down.

### **4 How robust will IRS enforcement be, and how will it affect adaptation to new rules?**

How much compliance there will be, how soon it might happen, and how much of an IRS enforcement priority this will be is all unknown. Through the years, the IRS has not made compliance with Section 132(f) a priority, and compliance is far more complicated now.

It remains unclear how effective the TCJA provisions will be relative to the intent that all commuting benefits be taxed. With the complexities, uncertainties and practical considerations noted above, it is hard to expect a good result relative to environmental, equity or other goals transit use supports.





# Opportunities for Action

TCJA's commuter provisions introduced uncertainty and raised concerns. Decades of work to correct inequitable tax treatment of transit may be erased. But TCJA also introduced the profoundly valuable idea that employer-provided parking should be handled differently. Properly addressing employee parking could correct deep and serious distortions reflected in building codes, construction finance, lending standards, planning practice, the entire real estate market, and of course commuter behavior. Fixing the distortions would be worthwhile, but may also be disruptive in numerous ways.

Establishing a framework to tally parking costs in a logical and thorough way across all its manifestations in urban, suburban and even rural settings will be hard. Creating price signals to allocate costs with individuals, employers, and public agencies motivated to seek economically efficient outcomes is a challenge that's eluded solution for decades. There is no promise the problems can be overcome, but the TCJA provisions offer hope that careful work might be rewarded. An important door may have opened to reduce use of workplace parking. It's a good start at a good goal.

IRS and Congress should consider the following:

1. IRS should address the issues raised here as it finalizes Notice 2018-99. Most importantly, it needs to conduct a careful, balanced, and thorough analysis supporting the valuation of parking costs, especially regarding the bundled parking context and locations where employee and customer parking is mixed. The safety determination is also problematic. There should be no loopholes.
2. Congress should mandate or the IRS could allow a “stay” of TCJA's transit provisions:
  - a. until the valuation of all commonly-used parking situations is clarified
  - b. because the total value of employer-provided parking dwarfs that of employer-provided transit benefits
  - c. acknowledging that valuing parking costs will inevitably remain very difficult to consistently discern, which is also true for the safety provision.Such a stay would also be warranted on equity, fairness or environmental grounds. This would mitigate the risk that transit benefit programs are abandoned during the potentially lengthy period when parking valuation rules are being established.
3. IRS or Congress should issue a stay on the non-profit/UBIT elements of TCJA, which could be justified by:
  - a. the likely modest revenue yield from the non-profit sector
  - b. the potential hardship to the charitable sector
  - c. the especially burdensome administrative requirements (having to file a UBIT return is new to most non-profits). Legislation was recently introduced to address this issue – termed the “church tax”. Perhaps some relief should be given to certain segments of the non-profit sector, e.g., 501(c)(3) charities, but not universities.





4. Congress should issue a stay or exemption for small employers. All employers file quarterly and annual employment reports and it would be relatively easy, for example, to make employers with fewer than 20 employees exempt from the commuter benefit provisions. Administrative burden is the primary reason employers with fewer than 20 employees are exempted from all of the transit benefit ordinances.
5. IRS should implement guidance that specifies “notional amounts” that employers can use to avoid complex tallying of parking costs. For example, in lieu of detailed accounting, all employers in a given geography could use a standard parking cost value (e.g., \$5 per day or \$100 per month per employee) as a non-deductible employee parking cost. This could apply only to employers that could not affirm that they do not incur employee parking costs. “Default” parking costs could vary by geography, similar to food and lodging per diems. This would save administrative effort and make compliance and enforcement more straightforward. It would also reflect IRS’s Commuting Rule within the Fringe Benefits Valuation Rules, which requires employers to include in employee wages \$1.50 per trip per person for commuting in an employer-owned vehicle. This would be a practical solution to the otherwise elusive shared parking and bundled parking problems, and would be consistent with other tax practices, such as per-mile costs of driving (which vary for business vs. charity), child care credit, the standard deduction for dependents, and other complex cost-calculation rubrics.
6. Permit business deduction of employee parking costs, and UBIT exemptions, for employers who offer transit benefits, provided that a threshold level of transit benefit is not just offered but in fact used by at least an appreciable share of employees, e.g., 20 percent. Employers with this level of transit use could then deduct parking expenses. This idea would need to be supported by careful analysis to ensure that the desired outcome – employer-provided transit benefits – could and would actually result.
7. Reverse the TCJA provision that removed biking as a Sec. 132(f) option. The bike benefit should mirror other commuter benefits, and be raised to a fixed percentage of the parking benefit amount with a cost of living index. Bike share participation should be a tax-free benefit option.
8. Explore provisions to update Sec. 132(f) to reflect changes in urban transport enabled by the “e-hailing platform-based” ridesharing services. Such changes ought to assure verifiable mode shift and reduced vehicle miles traveled (VMT), support last-mile access to and from transit stations or other transit-enabling travel, and not support “taxi-like” commuting.
9. IRS should solicit input from urban transport experts, assemble an advisory group of parking and transit and commuter benefit experts, or otherwise be certain the best information is used as the very thorny parking topic is addressed, especially to explore the parking cost process that is vital for rule-making in this area. TCJA has created a very challenging but most valuable opportunity to address parking as a persistent urban transport problem.
10. As an alternative to the more “policy entrepreneurial” options identified above, a more straightforward “do no harm” approach would reverse the TCJA provisions related to commuter benefits and re-establish the pre-2018 status. This could be a reasonable political response, but would sidestep the opportunity to develop a more balanced and beneficial policy. It could be an interim measure.



Photo: Philip Yb Studio

Photo: Les Palenik



## Final Thoughts

In much the same way that we rarely think of the atmosphere as having weight, the parking we assume to be as freely available as oxygen actually costs a lot to provide, and is a consequential input cost in our overall national economy.

For the amount of capital consumed in providing parking and the economic externalities fore parking fosters, it is important that we have tax laws whose economic efficiency we can positively affirm. The pre-TCJA transit benefit provisions were important corrections to biases in the tax code that favor auto use. TCJA's commuter benefit provisions and supportive regulations need to be modified, more or less, to ensure that progress made is not lost. If we can't properly address parking we should at minimum not hamper transit. Total auto use, measured by VMT, has fallen in recent years. Why reverse that?

Yet, TCJA's commuter benefit provisions, while worrying in many ways, may open the door to appropriate action on parking costs. With added sensitivity to impacts on transit and transit-using commuters, this may be just what the doctor ordered. If handled with proper care, efficient and equitable outcomes could be delivered across our economy.

**In preparing this report**, RPA benefited from the expertise, insight, and review provided by a panel of industry experts including Jon Bosworth, Larry Filler, David Judd, Richard Oram, Jason Pavluchuk, and David Straus.

The report was written by Nat Bottigheimer and Christopher Jones, and designed by Dave Zackin.

RPA extends its gratitude to the Fund for the Environment and Urban Life for its support.

**Regional Plan Association** is an independent, not-for-profit civic organization that develops and promotes ideas to improve the economic health, environmental resiliency and quality of life of the New York metropolitan area. We conduct research on transportation, land use, housing, good governance and the environment. We advise cities, communities and public agencies. And we advocate for change that will contribute to the prosperity of all residents of the region. For more information, please visit [rpa.org](http://rpa.org).

\*This report was released in April, 2019 and updated in May, 2019.

