Tax Accounting in Parking Transactions

Revenue Procedure 2000-37 (the "Safe Harbor") provides great latitude to taxpayers and an Exchange Accommodation Titleholder (EAT) participating in parking transactions under its guidance. Taxpayers can have physical control of the parked property. They can loan the funds to the EAT to purchase the parked property. Taxpayers can even be given a "call" to acquire the parked property whenever they are ready to take title. That flexibility ends, however, when it comes to determining who is treated as the owner of the parked property for federal income tax purposes.

The Safe Harbor states:

> *...the taxpayer and the exchange accommodation titleholder agree to report the acquisition, holding, and disposition of the property as provided in this revenue procedure. The [Qualified Exchange Accommodation] agreement must specify that the exchange accommodation titleholder will be treated as the beneficial owner of the property for all federal income tax purposes. Both parties must report the federal income tax attributes of the [parked] property on their federal income tax returns in a manner consistent with this [Qualified Exchange Accommodation] agreement.* (Rev. Proc. 2000-37 Section 4.02(3))

If the requirements of the Safe Harbor are met, the EAT will be treated as the owner of the parked property for federal income tax purposes. The goal for both the EAT and the taxpayer is to establish the structure of the parking transaction in a manner that provides the greatest ability to recognize the economic attributes of the property. Since it is ultimately the taxpayer who is paying for expenses and receiving income from the parked property, we want to make sure the parking arrangement is documented and reported in a manner that allows the taxpayer to be in essentially the same position they would be in if they held title directly (with the exception of depreciation which is discussed below).

By using the triple net lease, the accounting of the EAT's holding of the parked asset is simplified. All income and expenses associated with operating the parked property will be reported under the taxpayer (or to an affiliate of the taxpayer if the lease is set up with an affiliate as the tenant). Items such as rent received from a tenant, utility expenses, and minor (non-capital) repairs are all reported by the taxpayer without the involvement of the EAT.

Sometimes expenses are incurred that can only be deducted by the owner of the property. Real estate taxes may be the best example. Since the taxpayer is not the owner of the parked property, they are not allowed to take a deduction for any real estate taxes paid or accrued during the EAT's ownership. Since the taxpayer is the one paying these items, the lease agreement classifies such payments as rent paid to the EAT, allowing the taxpayer to deduct the payment (labeling it as "rental expense"). The EAT will then report the "rental income" and take the off-setting deduction. This allows all parties to be in approximately the same place they would be in if the EAT was not on title.

The same is true for lender payments under notes to where the EAT or SPE are the borrower, and not the taxpayer. Since the taxpayer is not the borrower, they would generally not be in a position to deduct the interest payments. Principal payments are treated as additional advances on the loan from the taxpayer to the EAT. By classifying such payments as "rent" the deduction goes on the taxpayer's return and creates a net-zero taxable result for the EAT.

Since all payments run directly from taxpayer to the appropriate payees, the EAT is not in a position to know what payments have been made. It is the taxpayer's responsibility to provide the EAT with an accounting of the items to be considered "rent", (i.e. the "Tax Accounting").

A form for providing the Tax Accounting information will be provided to the taxpayer with the documents circulated at the conclusion of the exchange. It is strongly encouraged that the taxpayer consult his/her accountant or tax advisor when completing this form. The EAT does not have an obligation to follow-up with the taxpayer for incomplete or missing Tax Accounting, so the taxpayer will want to make sure that the form is completed and returned to the EAT in a timely manner.

It is important that the taxpayer be consistent in reporting the parking transaction. If expenses are listed on the Tax Accounting, the taxpayer will need to be sure that they are reported as “rental expenses” on his/her return. Conversely, if an expense is not listed on the Tax Accounting the EAT will not be reporting it as rental income, so the taxpayer should not be reporting it as a rental expense.

One final note, since the taxpayer does not own the parked property, the taxpayer cannot claim depreciation (for tax purposes) during the period legal title is held by the EAT. (Neither can the EAT, as the property is inventory to the EAT.) Because the taxpayer claiming depreciation on a tax return is not consistent with the EAT being the owner for federal income tax purposes, to do so would take the transaction outside the Safe Harbor. The loss of the ability to claim depreciation during the EAT’s ownership is an opportunity cost that should be factored into the taxpayer’s evaluation of the overall costs of the exchange.