

Special Tax Rules Applicable to State Legislators

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General rules and principles

Legislators are generally treated for federal and state income tax purposes like any other state government employee. This is particularly true for members who live in the metropolitan area.

One special “tax home” rule applies under section 162(h) of the I.R.C. This rule affects members:

- Whose in-district residence is more than 50 miles from the state capitol; and
- Who make an annual election under its provisions.

Tax home

The location of your tax home is critical because living expenses while on business “away from home” (overnight stay or meeting the substantial sleep and rest rule) are deductible. Otherwise, living expenses are not.

The IRS has generally considered the tax homes of legislators to be the state capitol – i.e., the place where they (under normal tax principles) conduct most of their business.

The IRS won a case in 1976 involving a Michigan legislator who contended his tax home was in his legislative district (Detroit), although he spent most of his time in Lansing. *Montgomery v. Comm’r of Internal Revenue*, 532 F.2d 1088 (6th cir. 1976).

Section 162(h)

Congress responded to the IRS's victory in *Montgomery* by enacting section 162(h) in 1981.

Section 162(h) does two separate and important things:

- It provides special tax home rules for certain state legislators.
- It allows a flat dollar amount per day deduction for legislators who qualify under its terms and who elect to use it.

Policy basis likely is to make sure that the tax system reflects the higher out-of-pocket costs incurred by legislators who must maintain two residences to serve and to do this in a relatively easy-to-administer way.

Longstanding rule (dating back to the 1954 Code) deemed the tax homes of members of Congress to be in their districts. Section 162(h) provides a sort of parity for state legislators.

Which legislators qualify?

To qualify for section 162(h) treatment, a member's in-district residence must be more than 50 miles from the state capitol (i.e., the building).

- Distance is measured by “shortest of the more commonly traveled routes between the two points.”

Status as a member starts when the member takes the oath of office and ends when the term ends.

Members must elect section 162(h) treatment. This is done when filing their returns for the taxable year by attaching a statement.

What does section 162(h) allow?

A qualified state legislator is allowed to treat their in-district residence as his or her “tax home.” This has the potential to make expenses incurred while attending to legislative business in St. Paul as expenses that are “away from home” – i.e., they may (likely will be) deductible travel expenses, rather than non-deductible personal consumption or living expenses.

It provides a fixed, flat dollar amount deduction for each defined legislative day. This amount is based on the per diem allowance that the General Services Administration (GSA) sets for the state capital city (St. Paul) for federal employees who are in travel status.

- Federal law allows a state to set a slightly higher per diem (10% > than the GSA amount); Minnesota has never done that.
- The per diem approach simplifies record keeping.

What days qualify as legislative days?

The legislature meets in session.

The legislature is in session and has not adjourned for longer than four days.

The legislator's presence is formally recorded at a meeting of a committee of the legislature (e.g., during interim).

- Committees are defined as committees that are charged with conducting the business of the legislature (e.g., to which bills are referred or which are authorized to conduct inquiries into matters of public concern).

Special rules apply for pro forma legislative sessions, which Minnesota does not do.

What are the MN per diem amounts?

The GSA has set the federal employees per diem for St. Paul and Minneapolis for FY 2017 at \$209. The amount is adjusted each federal fiscal year (starts October 1st). The amount for FY 2016 was \$204.

This amount is divided into two separate parts, one for lodging and one for meals and incidental expenses. The respective amounts for CY 2017 for St. Paul are \$145 and \$64.

The separate amounts are important for legislators who claim the deduction, since only one-half of the amount for meals and entertainment can be claimed as a business expense deduction.

How are section 162(h) amounts claimed?

State legislators would typically claim the per diem amount for their legislative days as employee business expenses.

To use this deduction, a member must:

- Itemize deductions (i.e., have total itemized deductions, such as mortgage interest, charitable contributions, state and local taxes and so forth that exceed the applicable standard deduction allowance).
- Have total miscellaneous itemized deductions (such as employee business expenses) that exceed 2% of their adjusted gross income.
- Deduct only one-half of the allowance for meals (federal law assumes that one-half of meal expenses are essentially personal consumption and should not be deducted).

Accountable plan option

- An employer with an accountable plan for providing employee fringe benefits can treat expenses reimbursing section 162(h) electing and qualifying members as nontaxable fringe benefits under its accountable plan.
- The House of Representatives has done this since the middle 1990s based on recommendations provided by a CPA firm that the legislature retained to evaluate this issue.
- Under this approach, the limitations on itemized deductions are avoided and members also do not pay FICA tax on the amounts – if their expense payments (i.e., per diem and housing) do not exceed their section 162(h) allowances.
- Creates additional administrative tasks for the employer – i.e., the need to monitor the number of legislative days for each electing member, determine that the amounts paid do not exceed the federal limits, and then report year-end amounts to members so they can claim deductions for the balance of section 162(h) amounts.