

2018 LEGISLATORS' TAX GUIDE



THE ALABAMA SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS
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The Alabama Society of Certified Public Accountants expresses appreciation to Kevin L. Ruland, CPA, partner in Ruland and Ruland, CPAs, LLC of Mobile, for updating the Legislators' Tax Guide each year.



Jeannine P. Birmingham, CPA, CAE
President and CEO

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Dear Alabama Legislator:

This Tax Guide is provided to you on a complimentary basis by the Alabama Society of Certified Public Accountants, a professional society consisting of approximately 6,200 members. We appreciate our legislators and the difficult service you perform, and hope this guide will be helpful in answering some of your tax questions.

As you know, tax laws are continually changing. For this reason, this guide should not replace professional advice in preparation of your tax returns. It emphasizes information and records you should maintain to facilitate preparation of your returns to your maximum advantage. Its use should be restricted to guidance regarding certain laws relating to legislators. More complicated questions should be referred to your Certified Public Accountant.

Lynne Bozeman, CPA
ASCPA Chair

Jeannine P. Birmingham, CPA, CAE, CGMA
President and CEO

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INTRODUCTION

The purpose of this tax guide is to examine federal and Alabama tax aspects of payments received from the state by Alabama legislators. Conclusions reached for federal taxation purposes usually will apply for State of Alabama taxes on income. By virtue of the provisions of Sec. 29-1-8.1, Code of Alabama 1975, the State Department of Revenue must accept and follow the travel expense provisions of the U.S. Internal Revenue Code as amended by the Economic Recovery Tax Act of 1981 for state legislators.

This guide is intended to deal only with the tax consequences under federal and Alabama tax laws of legislators' per diem, expense, and mileage receipts as elected officials, and does not cover any personal tax matters (such as capital gains or losses, rental income and expenses, salary from private employment, or business income and expenses).

Unreimbursed legislative expenses are no longer deductible for Federal Income Tax purposes after 2017. The 2017 Tax Cuts and Jobs Act suspends the deduction for these and other miscellaneous itemized deductions until after 2025.

For Alabama state tax purposes all unreimbursed allowable legislative expenses are treated as miscellaneous itemized deductions and are deductible to the extent that the legislator's total miscellaneous itemized deductions exceed 2% of the Alabama adjusted gross income.

In January 2019, the state comptroller furnished each legislator with a form W-2, which reports salary and expense reimbursement in Box 1 "Wages, Tips, Other Compensation".

Starting January 1, 2015, legislators' compensation was covered for Social Security and Medicare withholdings.

CAMPAIGN EXPENSES AND CONTRIBUTIONS

Campaign contributions, including proceeds of testimonial or fund-raising dinners, received by or on behalf of a candidate are not taxable to the candidate if used exclusively for campaign purposes. Any campaign funds used by the candidate for any personal purpose are taxable to the candidate unless the candidate can show an unrestricted gift was intended.

Political contributions are considered used for campaign purposes if they are:

1. Used for generally recognized campaign expenses,
2. Contributed to a committee of the candidate's party, or
3. Used to reimburse the candidate for out-of-pocket expenses paid during the current or last previous campaign.

Detailed records should be maintained to enable the candidate to account for the receipt and disbursement of contributions. In the absence of showing funds were used for campaign purposes, such disbursements will be included in the gross income of the candidate. Separate bank accounts should be maintained for campaign funds. If contributions are commingled with personal funds so as to render tracing or identification impracticable, the contributed funds will be presumed to have been diverted to personal use at the time commingled, and so taxable to the candidate at that time.

If a political committee, organization or fund formed to manage your campaign contributions and expenses has taxable income of more than \$100, it should file federal Form 1120-POL and State of Alabama Form 20 annually on or before March 15th. A newsletter fund is treated as a political organization. Taxable income is defined as gross income (excluding exempt function income) less a deduction of \$100 and deductions directly connected with the production of gross income. Exempt function income is campaign contributions, membership dues or fees from members of a political organization, proceeds from political fund raising events, and other similar income as defined by Regulation Section 1.527-3. Therefore, gross income is generally income earned on invested campaign funds. The 2018 taxable income of the campaign committee is taxed at a flat 21% rate for federal purposes (was 35% pre-2018).

A candidate's campaign expenditures from his own resources are not deductible for income tax purposes. This is true even though a public office is defined by the Internal Revenue Code and the regulations issued thereunder as a "trade or business", and ordinary and necessary expenses incurred in a trade or business are normally deductible. In 1962, Congress enacted a section of the Internal Revenue Code disallowing all deductions (whether business or itemized) for expenditures in any political campaign for a candidate for public office.

TAX HOME

The first requirement for the deductibility of travel expenses, meals, and lodging is that such items must be incurred "away from home". Consequently, the meaning of the word "home" is important because it serves as the starting point in computing deductible expenses.

The Internal Revenue Service has consistently defined "home" to mean the principal place of business, employment, or post of duty, regardless of where the family residence is maintained. The courts have generally supported the I.R.S. definition and application of the word "home".

The Tax Reform Act of 1976 provided that for years before 1976 a state legislator was permitted to elect to treat his or her legislative district as his or her "tax home", thereby permitting the deductibility of travel and living expenses incurred in connection with the business of being a state legislator (even though the I.R.S. definition of "tax home" was not otherwise met).

The Economic Recovery Act of 1981 extended the above election provision to the years 1976 through 1980; also, it provided that for 1981 and subsequent years only those state legislators whose homes are more than 50 miles from the capitol building are permitted to make the "tax home election".

Legislators who live more than 50 miles from the capitol building may make the “tax home” election for 1981 and subsequent years. Those legislators whose place of residence is 50 miles or less from the capitol building will be governed by the more restrictive I.R.S. definition and criteria for tax deductibility of travel, meals, and lodging costs for 1981 and subsequent years, so if the capitol is the principal place of business of a legislator, it is his “tax home”.

The Internal Revenue Service has issued permanent regulations regarding the “tax home” election. The election is validly made only by attaching a statement to the tax return (or amended return) containing:

1. Name, address in the legislative district represented, and social security number.
- 2.. The number of legislative days during the tax year in which the taxpayer was a state legislator.
3. The federal per diem rate for the state capitol (and the state per diem rate if greater).
4. The distance from the taxpayer’s residence in his legislative district to the state capitol building.
5. An election that the place of residence within the legislative district shall be considered as the “tax home”.
6. Any changes during the year in per diem rates or residence, noting appropriate periods.

To insure the “tax home” issue will not arise, each legislator who lives more than 50 miles from the capitol building and who will use the “per diem” method for travel expenses should attach a statement to his or her tax returns as follows:

“Pursuant to the provisions of § 162(h) of the U.S. Internal Revenue Code, election is hereby made that my place of residence shall be considered my home for the tax year 2018. My residence throughout the year was 123 Magnolia Avenue, Anywhere, Alabama, which is within my legislative district and is XX miles from the state capitol building. There were XX days during the year in which I was a state legislator and the legislature was in session. The federal per diem rate for the state capital city of Montgomery was \$144 for travel between January and September 30, and \$149 for travel between October and December 31, 2018 (which is greater than the state per diem rate)”.

(Name)

(Address)

(Social Security Number)

INCOME AND THE W-2

Legislators should keep a calendar or diary of days they attended interim committee meetings and out of state meetings and conventions.

Payments made to legislators from the State of Alabama fall into two categories 1) salary and 2) expense reimbursement. During 2018, legislators' salaries increased slightly. Determination of expense reimbursement amounts and how they are reported to the legislator are important in calculating the legislator's allowable deductions. Effective after the general election November 4, 2014 new legislative terms, compensation and expense reimbursements began. This was a substantial change in legislative compensation methods and every legislator's W-2 will be unique to their situation.

1. Salary. Legislators are paid a salary of \$46,257 (will increase to \$48,123 in 2019).
2. Expense reimbursement. The payments to legislators in this category are either taxable (included in the W-2), or non-taxable (a reimbursement that is not included in the W-2).
3. The following is a synopsis of the Legislator's Salary and Expense payments that they may receive:

LEGISLATIVE PAY AND EXPENSE

(Excerpt from the 1/5/2015 briefing with updates as needed)

Events

Constitution Article IV, Section 49.01 adopted. (Amendment 871, ratified 12/13/12).

General Election November 4, 2014

New legislative terms, compensation and expenses begin November 5. Section 4(a) directs that compensation and expense provisions of Amendment 871 are to be effective with the terms commencing immediately after the 2014 General Election.)

Compensation Issues

- Legislators are paid in equal semi-monthly installments on the 15th and last day of each month (GHRs pay cycle semi-monthly current. **Code Section 36-6-1(b)**: "... elected officials ... whose pay is based on an annual salary ... shall be payable in equal, semi-monthly installments on the fifteenth and last day of each month.")
- **Const. Section 49.01**, Section 2. Annual compensation will be set:
 - o Alabama median annual household income
 - o Ascertained by the State Personnel Board (Board)
 - o Updated January 1 each year
 - o Board meeting on October 22, 2014 ascertained the annual amount to be \$42,849.00 for the period November 5, 2014 until December 31, 2015 (updated amounts for 2018 were \$46,257 and 2019 will be \$48,123).
 - o Semi-monthly installment for 2018 was \$1,927.38 and 2019 will be \$2,005.13.
 - o Legislators elected on November 4 will be paid a partial pay period (November 5-15) \$1,309.33
- W-2 reportable earnings will include taxable travel
- Withholding will be as follows:
 - o Federal withholding based on employee W-4
 - o State withholding based on employee A-4
 - o Medicare tax rate .0145 (1.45%)
 - o Social Security Tax (FICA) .0620 (6.20%) effective January 1, 2015

Expense Reimbursement

- **Const. Section 49.01 Section 3.(f)** - President of the Senate and Speaker of the House are to jointly promulgate rules for reimbursement pursuant to the Ala. Administrative Procedures Act.
 - o **Const. Section 49.01 Section (3)** - Reimbursement is permitted for the following:

- o Travel Expenses incurred for travel on official business will be “...in same amount and at the same rates as for state employees traveling in the service of the state under state law, rules, and policies, ... for a member of the Legislature, only if the travel is to a place outside his or her district.
- o **Section 3.(b)(l)**. Member can be reimbursed for transportation from place of residence to seat of government. **Section 3.(d)**.No per diem for member who resides less than 50 miles from the seat of government.
- o Actual Expenses other than travel expenses, incurred in the performance of official duties are reimbursable subject to the provisions of this Section. **Section 3.(b)(2)**.
 - “Joint Regulations” must define “actual expenses”.
 - Furnishings, equipment or any other tangible goods (goods that can be touched) for which a member is reimbursed will be state property.
- o Expenses For Each Presiding Officer as authorized by Act 1971-1196. **Section 3(b)(3)**.
 - Reimbursement under Section 3.(b)(l) and (2) ... only upon determination of the presiding officer of the member’s chamber that the travel or expense is incurred in the service of the state. Reimbursement based on submission of a signed voucher in same manner as a state employee. **Section 3.(c)**.

Taxable Travel is included in the Legislator’s W-2 and generally includes all non-overnight per diem reimbursements by the state to the Legislator and varies depending on how long the legislative session lasts on a particular day.

Non-taxable Travel is NOT included in the Legislator’s W-2 and includes all mileage reimbursements and any overnight per diem that is paid by the State (generally \$85-\$100 per day). Mileage was reimbursed to Legislators at the rate of 58 cents per mile during 2018.

TRAVEL EXPENSES

For 2018 Alabama Returns Only (N/A for Federal):

Amounts spent for unreimbursed business travel, including travel fares, meals, and lodging, and other expenses incidental to such travel, when incurred away from home on business, are tax deductible to the extent they are reasonable and necessary in the conduct of one's business and directly attributable to it. The cost of unreimbursed travel while on legislative business are tax deductible, subject to certain limitations. Expenses of a legislator's spouse or other family members are not deductible unless it can be definitely established that the presence of those individuals has a bona fide business purpose. The performance of incidental services by a spouse does not satisfy this business purpose requirement.

All allowable unreimbursed travel expenses are reported on federal Form 2106, Employee Business Expenses, and are classified as miscellaneous itemized deductions for state tax purposes. Total miscellaneous itemized deductions must be reduced by 2% of adjusted gross income.

You should fully document the deduction (date, place, paid receipt, etc.). Out-of-pocket travel expenses which are fully reimbursed are not deductible. Unreimbursed business meal costs are only 50% deductible, and all costs, including 50% of meals, are miscellaneous itemized deductions.

The legislator is also entitled to a deduction for the cost of meals for constituents or other persons paid by the legislator as long as directly related to legislative business in Montgomery. However, only 50% of the cost of meals and entertainment qualifies and only unreimbursed expenses are allowed.

Transportation expenses, including fares, mileage, and/or automobile expenses, are deductible while the legislator is away from home on business, unless the legislator has been reimbursed.

Automobile expenses can be in the form of the standard mileage rate (58 cents for 2018), or the legislator may itemize actual automobile expenses. To itemize car expenses it is necessary to determine the total amount of such expenses (depreciation, gas, oil, repair, maintenance, insurance, etc.) and apply the business percentage. The business percentage is computed by dividing total business automobile miles during the year (reduced by total miles reimbursed by the state) by total automobile miles during the year.

Regardless of which method is used to calculate automobile expense, the Legislator should only be considering expenses that have not been reimbursed by the state.

	Year placed in service					
	<u>2006</u>	<u>2007</u>	<u>2008- 2009</u>	<u>2010- 2011</u>	<u>2012- 2017</u>	<u>2018</u>
1st year	\$2,960	\$3,060	\$2,960	\$3,060	\$3,160	\$10,000
2nd year	\$4,700	\$4,800	\$4,800	\$4,900	\$5,100	\$16,000
3rd year	\$2,850	\$2,850	\$2,850	\$2,950	\$3,050	\$9,600
4th year (and each succeeding year)	\$1,775	\$1,775	\$1,775	\$1,775	\$1,875	\$5,760

Automobiles placed in service in 2018 and used more than 50% for business are depreciated over five years using the two hundred percent declining balance method with a half year depreciation for the year the car is placed in service. However, the maximum dollar limits in the above table will apply. Please note that other special rules may apply if your vehicle's loaded gross vehicle weight exceeds 6,000 pounds. See your Certified Public Accountant for more details.

Automobile expenses incurred in a legislator's home district are deductible provided a business purpose for travel can be established. Considerable travel may be required of the legislator within the district to attend civic functions, political events, or other matters related to his or her legislative duties. The cost of travel between two places of business is deductible, provided such trips are necessary to discharging business at both locations.

Other transportation expenses, to the extent not reimbursed, such as parking fees, tolls, and taxi fares, or other transportation from the hotel or motel in Montgomery to the state capitol, are tax deductible; these expenses are not considered commuting expenses (which are not deductible). Other travel expenses in Montgomery are tax deductible if the purpose of the travel is directly related to being a member of the Alabama legislature, provided they have not been reimbursed.

Legislators should maintain records to distinguish between travel expenses related to legislative matters, travel expenses attributable to serving the legislator's constituency (deductible as miscellaneous itemized deductions for federal and state tax purposes), campaign travel expenses or personal expenses (not tax deductible), and expenses for other business (deductible for adjusted gross income). Legislators should also maintain records relating to the expenses that are reimbursed to them. Reimbursed expenses are not deductible by the legislator.

OFFICE EXPENSES

For 2018 Alabama Returns Only (N/A for Federal):

Office expenses are reported on federal Form 2106 and treated as miscellaneous itemized deductions on both federal and state returns.

Although expenses of personal living quarters cannot ordinarily be deducted, if the property is used for both business and personal use, a portion of the expense is possibly deductible as a business expense. Such an apportioned deduction is available to a legislator who regularly uses a part of his home exclusively as an office for legislative matters. Occasional or incidental use does not qualify for the deduction. In general, the basis of apportionment between business and personal expenses is the relative value of the space occupied for each purpose; however, any reasonable method of allocation is acceptable.

Since the State of Alabama does not furnish office facilities to legislators in their home districts, many duties of legislators are carried on at their personal residences (such as receiving and making telephone calls, reading and analyzing legislation, writing letters, seeing constituents, and performing other legislative related duties). However, an office deduction will be allowed only for the portion used exclusively and on a regular basis as the principal place of conducting his or her legislative business, and/or used *exclusively and on a regular basis* as a place of business in legislative district for seeing constituents and other on legislative business.

In summary: to deduct home office expenses, a legislator must use the space exclusively and regularly:

- 1) as a principal place of business,
- 2) as a place to meet or deal with constituents in the normal course of business, or
- 3) "in connection with" the business if the space is a separate structure from the residence.

Expenses relating to the maintenance of an office in one's personal residence include the following:

1. Rent or depreciation. If the personal residence is rented, the business portion (percentage) of the rental paid represents the deductible amount. If the residence is owned by the legislator, then the deduction is in the form of depreciation. The amount of depreciation is computed by determining the cost of the home after deducting land cost (or the fair market value of the home at the time a portion was converted to office use, if the fair market value is less than cost) and applying the business use percentage (based on space occupied or some other reasonable allocation) to determine the depreciable amount. This amount is depreciated using prescribed tables issued by the IRS, depending on date placed in service.

An optional safe-harbor election can be made for home offices. The rules governing home office qualifications must still be met. However, tax payers may elect to use \$5 per square foot times the square footage of the office space in lieu of prorating items 1, 2 and 5. The safe-harbor deduction cannot exceed \$1,500 (maximum of 300 s.f.)

2. Utilities and insurance. The cost of utilities and insurance for the home may be apportioned to business use on the basis of the applicable business use percentage. For example, if the total utilities and insurance cost for the year is \$1,200 and if 1/6 of the home is utilized for office space, then the deduction for this expense would be \$200.
3. Maintenance and repairs. Any maintenance or repair costs (such as cleaning or painting) applicable to the particular space utilized as an office is deductible expense for that particular year. Permanent type improvements in the office area, such as carpeting or bookcases, represent capital expenditures and may be depreciated based on the IRS's prescribed tables (with no allocation between business and personal).
4. Equipment. Office equipment and furniture such as desks, file cabinets, typewriters, adding machines, and similar items, used *exclusively* for legislative matters may be depreciated over their respective estimated lives and such depreciation is fully deductible.
5. Mortgage interest and real estate taxes. These also must be prorated based on the business use percentage.

If a legislator rents an office in his or her district and it is used exclusively for legislative purposes, the entire cost of operating and maintaining the office is deductible. The cost of secretarial assistance related to legislative duties is deductible. Campaign expenses are not deductible, so apportionment between legislative expenses and campaign expenses may be necessary.

The cost of long distance telephone calls for state business is deductible, as would be the cost of a separate phone used exclusively for legislative business.

OTHER EXPENSES

For 2018 Alabama Returns Only (N/A for Federal):

Certain additional expenses, when incurred solely for legislative purposes and provided they meet the "reasonableness" test and the "ordinary and necessary" criteria, may be tax deductible.

Stationery, office supplies and postage relating to the business of being a legislator are deductible as a business expense.

The cost of obtaining additional publications because you are a legislator, such as special papers in the legislative district, and political publications necessary to improve one's position as a legislator are tax deductible.

The expense of a legislator's newsletters are tax deductible. Advertisements, other than campaign ads, in trade journals or magazines published by organizations in the legislator's district are also deductible.

Entertainment expenses directly related to the business of being a legislator are tax deductible, subject to the rules and limitations mentioned under the travel expense section. The cost of meals in a meeting with a constituent regarding a state problem, or the cost of certain other elected officials (such as city or county officials of one's legislative district) primarily for the purpose of maintaining communications with them or to explore each other's problems and/or determine common solutions, are tax deductible. The legislator should document the cost and business purpose of all entertainment expenses. Proof is required to establish the business purpose and benefits obtained or expected to be obtained.

Dues paid to an organization (such as a civic club or political organization) that a legislator belonged to BEFORE being elected, will generally not be tax deductible business expenses. Dues paid by a legislator who joins such an organization AFTER being elected, may be tax deductible – as long as membership in the organization is instrumental in his or her being a legislator.

The cost, including postage, of Christmas cards to community or political leaders is advertising, related directly to the business of being a legislator and is tax deductible.

Documented dry cleaning and laundry expenses incurred by legislators when they are in travel status (i.e., away from home on legislative business) are tax deductible.

Telephone costs related to business are deductible. This includes a telephone installed for business use, answering services or tape recording devices for messages, and long distance business calls. If accurate records are kept, a part of the cost of your personal telephone at home may be deductible, to the extent used for business.

RECORDS

Estimates are not acceptable in substantiating deductions for travel, entertainment, or other business expenses. The taxpayer is required to substantiate "by adequate records or by sufficient evidence corroborating his own statement" all travel, entertainment, and business gifts, including the amount, business purpose, and the business relationship.

Substantiation rules for travel, entertainment, and business gifts are summarized as follows:

1. What to prove.

A. **Travel.** Legislators claiming a deduction for travel expenses must be prepared to prove:

- (1) The amount of each expenditure for travel away from home. The daily cost of expenditures incidental to the travel may be grouped in reasonable categories (gas and oil, taxi fares, tips, etc.).
- (2) The time spent on business away from home, including dates of departure and return.
- (3) The city or place where expenses were incurred.
- (4) The business reason for the travel.
- (5) Amounts reimbursed must be subtracted from #(1) above.

B. **Entertainment and business gifts.** Legislators claiming a deduction for entertainment and/or business gifts must be prepared to prove:

- (1) The amount of each separate expenditure, except incidental costs (such as taxi fares, telephone calls, and tips) may be grouped on a daily basis.
- (2) The date of the expenditure.
- (3) The place of the expenditure, with a description of the entertainment (dinner, etc.).
- (4) The business reason for the entertainment, including the nature, date, duration, and place of any business discussion or activity which preceded or followed the entertainment, and the identity of the persons entertained.
- (5) The business relationship with the person entertained.
- (6) The deduction for business gifts is limited to \$25 a person each year.
- (7) Amounts reimbursed must be subtracted from #(1) above.

2. Kind of proof. Each element of proof required must be “by adequate records and sufficient corroborating evidence”. The term “adequate records” means an account book, a diary, or an expense statement, with entries made at or near the time of the expenditure. Documentary evidence generally consists of receipts, paid bills, and canceled checks for all expenses of lodging or meals away from home, and for any other expenditure of \$75 or more for expenses incurred on or after October 1, 1995. Documentary evidence will generally be adequate where it shows the amount, date, place, and kind of expenditure. Each expenditure must be shown separately, and not aggregated. However, “concurrent or repetitious expense items of a similar nature” may be grouped together on a daily basis (e.g., meals, trips, etc.).

The records and related documentary evidence supporting the claimed deductions must be retained during the period the tax return is subject to audit. Normally, this limitation period is three years from the due date of the return (or three years from the date of filing if the return was filed after the due date). However, the limitations period is longer if the taxpayer consents to an extension, or if there has been a substantial understatement of income. Also, civil fraud completely eliminates the statute of limitations for assessment of additional tax.

To adequately prove deductions for travel and related expenses, legislators are strongly encouraged to maintain a diary each year to make appropriate entries or notations concerning such expenses at or about the time of the occurrence of the events.

The contemporaneous record keeping requirements of the 1984 Tax Act for use of personal cars were retroactively repealed but “adequate records” of automobile expenses must be kept. What is “adequate” may vary with circumstances, but a log of business trips showing mileage, reason for trip, and notation of odometer readings at start and end of year should suffice to support deduction of car expenses, provided that if you do not use the standard mileage allowance, your log should show all car expenses, and all receipts should be kept. A statement attached to your tax return should show (1) the date your car was placed in service, (2) the number of miles it was driven during the year and the number of business miles driven, (3) the resulting business use percentage, (4) that you have evidence to support the business use, and (5) whether that evidence is written. Form 2106 may be used to provide this information for state tax purposes.

For 2018 Returns:

IMPORTANT

The Tax Cuts and Jobs Act passed by Congress and signed into law by President Trump on December 22, 2017 includes sweeping changes. We recommend you contact your Alabama CPA for any particular questions you may have regarding your taxes for 2018 and 2019.

In particular, of importance to most legislators, will be the treatment of your unreimbursed business expenses. These are no longer deductible on your Federal Tax Return for 2018 and other provisions may impact you as well.

As of the date of this publication, Alabama has not yet released final tax forms.

NOTES

www.ascpa.org
1041 Longfield Court
Montgomery, Alabama 36117
334-834-7650