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DATE: January 26, 2006
TO: All Legislators
FROM: Ann M. Ver Heul
RE: 2005 Legislators' Business Expense Deductions Pursuant to Tax Home Provision

DIVISIONS

LEGAL SERVICES
 RICHARD L. JOHNSON

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FISCAL SERVICES
 HOLLY M. LYONS

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COMPUTER SERVICES
 GLEN P. DICKINSON

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ADMINISTRATIVE SERVICES
 TIMOTHY C. FALLER

I. 2005 Federal Business Expense Deductions for State Legislators

Internal Revenue Code Sec. 162(h), relating to travel expenses of state legislators, allows state legislators whose district homes are more than 50 miles from the state capitol a per diem deduction on their federal returns for business expenses incurred while at the capitol.

The maximum per diem which is allowed as a deduction for legislators pursuant to Internal Revenue Code Sec. 162(h) is determined by the per diem rate for federal employees in Des Moines, as determined by the General Services Administration, for the tax year in question. For tax year 2005, the applicable federal per diem rates were as follows:

January 1, 2005 – September 30, 2005: \$105.00 per day

Ratio: \$70.00 - Lodging

\$35.00 - Meals

October 1, 2005 – December 31, 2005: \$117.00 per day

Ratio: \$73.00 - Lodging

\$44.00 - Meals

Please note: New federal per diem rates issued by the General Services Administration now take effect on October 1 of each year. The rates for Iowa changed on October 1, 2005. It is possible that there may be a rate change later this year for part of 2006.

LEGAL SERVICES

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A. The actual per diem amount provided to you by the State (expense of office), which is \$86.00 per day, is not includable in gross income because it is considered a reimbursement for business expense. This per diem is excludable from your gross income for each day the legislature was in session (including periods of four consecutive days or less when the legislature was in recess). For 2005, the legislature was in session for 131 calendar days, but legislators were paid expense of office per diem for 110 calendar days for the regular session. This amount, which is \$9,460.00, is not included in your gross income because it is “deemed substantiated” as a reimbursed business expense pursuant to Internal Revenue Code Sec. 162(h).

B. If you itemize deductions, the unreimbursed excess of the allowable amount under Sec. 162(h) from January 1, 2005, through September 30, 2005, is \$19.00 per day. This amount is deductible along with other itemized deductions if the total of all miscellaneous itemized deductions exceeds 2% of your adjusted gross income. In order to determine the deductibility of this unreimbursed portion of the allowable per diem, the excess amount is allocated between meals, and lodging and other travel expenses, in accordance with the federal per diem reimbursement rules for travel in the United States.

From January 1, 2005, through September 30, 2005, which is the period of time during which you received expense of office, the ratio for Iowa is that 67% of the amount is allocated to lodging and other travel expenses and 33% of the amount is allocated to meals. Since the state per diem rate is \$86.00 per day, the unreimbursed excess amount is \$19.00 for this expense period. Using the federal ratio, the following allocation is applicable:

Unreimbursed Amount	Lodging	Meals
\$19.00	\$13.00	\$6.00

1. Of the amount allocated to lodging and other travel expenses (\$13.00), the amount is fully deductible by legislators who itemize, along with all other miscellaneous itemized deductions, subject to the fact that it, along with all other miscellaneous itemized deductions, must meet a floor of 2% of the taxpayer’s adjusted gross income.

2. For state legislators, the amount allowable for meals is the federal per diem allocation (\$6.00) less \$2.00 per legislative day. Of this amount, 50% is deductible by legislators who itemize, as an employee business expense, subject to the fact that it, along with all other miscellaneous itemized deductions, must meet a floor of 2% of the taxpayer’s adjusted gross income.

These unreimbursed amounts do not require substantiation.

C. If you itemize deductions, you are entitled to a deduction for each day that the legislature was in session (including periods of four consecutive days or less when the legislature was in recess) for which you did not receive expense of office. In 2005, the legislature was in session for 21 calendar days during the regular session, for which legislators did not receive expense of office. If you itemize deductions, you are entitled to a deduction for each of those 21 days.

If you itemize deductions, you are also entitled to a deduction for each day that your presence was recorded at a committee meeting during the interim. This information is provided to you by the Chief Clerk’s Office or by the Senate Finance Clerk and will indicate the number of days your presence was recorded at a committee meeting during the interim. The interim per diem payments which you received (\$86.00 per day) are treated as taxable wages on your W-2 form due to the statutory language which authorizes them.

These unreimbursed federal per diem amounts of \$105.00 or \$117.00 per day must be allocated between lodging and other travel expenses, and meals in accordance with the ratio for such expenses under the federal per diem reimbursement rules for travel in the United States. Since the unreimbursed amount is \$105.00 per day for the period from January 1, 2005, through September 30, 2005, and \$117.00 per day for the period from October 1, 2005, through December 31, 2005, the following allocation is applicable:

Unreimbursed Amount	Lodging	Meals
\$105.00	\$70.00	\$35.00
\$117.00	\$73.00	\$44.00

1. Of the amount allocated to lodging and other travel expenses (\$70.00 or \$73.00), the amount is fully deductible by legislators who itemize, along with all other miscellaneous itemized deductions, subject to the fact that it, along with all other miscellaneous itemized deductions, must meet a floor of 2% of the taxpayer's adjusted gross income.

2. For state legislators, the amount allowable for meals is the federal per diem allocation (\$35.00 or \$44.00) less \$2.00 per legislative day. Of this amount (\$33.00 or \$42.00), 50% is deductible by legislators who itemize, as an employee business expense, subject to the fact that it, along with all other miscellaneous itemized deductions, must also meet a floor of 2% of the taxpayer's adjusted gross income.

Once again, these unreimbursed amounts do not require substantiation.

D. Attached to this memo is a form for a "Statement of Election of Tax Home Pursuant to Internal Revenue Code Sec. 162(h)". If this form is completed and attached to your income tax return, you should be in compliance with the proposed tax regulation 26 C.F.R. Sec. 1.162-24, which requires any state legislator who makes a tax home election under Sec. 162(h) for the taxable year to attach such a Statement of Election to the income tax return.

E. In past years I have provided you with some information concerning the Federal Taxpayer Relief Act of 1997. It appeared that Section 975 of the Act, which amended 26 U.S.C. Sec. 62, might provide an above-the-line deduction for travel expenses of state legislators while they are at the state capitol if they were paid in whole or in part on a "fee basis".

According to NCSL, the IRS has been inconsistent in its interpretation of Section 975 and the definition of "fee basis". That is, some legislators have been allowed above-the-line deductions pursuant to Section 975 and some such deductions have been disallowed.

However, an IRS Chief Counsel's Office Advice Memorandum issued in 1999 and a subsequent IRS information letter published in 2002, indicate that state legislators are not compensated on a "fee basis" and thus are not allowed to deduct their unreimbursed employee business expenses above-the-line on their federal tax returns. These expenses can only be considered as miscellaneous itemized deductions and are subject to the 2% floor. A copy of an NCSL memorandum concerning this issue is attached.

Neither NCSL nor I provide tax advice on how individual legislators should file their tax returns. The purpose of this memo is simply to make you and your tax preparer aware of tax provisions which may apply

to Iowa legislators. NCSL will provide background information on Section 162(h) and Section 975 of the Taxpayer Act of 1997 upon request. NCSL can be reached at 303/856-1557.

II. 2005 State Business Expense Deduction for State Legislators

Iowa Code section 422.7(10) provides that state legislators who live more than 50 miles from the state capitol may claim the same deductions on their Iowa income tax returns for expenses incurred for meals and lodging as are allowed for federal income tax purposes.

State legislators who live 50 miles or less from the state capitol may claim deductions at a rate of \$50.00 per "legislative day". However, state legislators may choose to itemize deductions for expenses incurred for meals and lodging. Based on the language of Iowa Code section 422.7(10), it appears that the deduction of \$50.00 per day is available for each day the legislature was in session, including periods of four consecutive days or less when the legislature was in recess and for each day the legislator's presence was reported at a committee meeting during the interim as is true under the federal provision.

III. Miscellaneous Business Expense Deductions

Please note that in 2005 you received constituent pay in the amount of \$200.00 per month. This constituent pay is included in taxable wages on your W-2 form and is also deductible as a business expense provided that you can substantiate the expenditures with receipts and a daily log listing the time, place, purpose, and amount of each expense claimed. You also received payments for mileage and taxable meals. If these amounts are direct reimbursement for expenses which you have already substantiated, they are also deductible as business expenses.

IV. Legislator W-2 Forms

Jean McPherson, from Centralized Payroll at the Iowa Department of Administrative Services, has provided an explanation of the information contained on legislators' W-2 Wage and Tax Statement for 2005.

If you or your tax preparer have any questions about the information contained in my memo, please feel free to call me. My telephone number is 515/281-3837.

CC: Iowa House: Representatives and Former Representatives
Chief Clerk
House Finance Clerk

CC: Iowa Senate: Senators and Former Senators
Secretary of the Senate
Senate Finance Clerk

0535RR

**STATEMENT OF ELECTION OF TAX HOME
UNDER INTERNAL REVENUE CODE SECTION 162(h)**

TAXABLE YEAR: 2005

TAXPAYER'S NAME _____

SOCIAL SECURITY NUMBER _____

ADDRESS (within legislative district represented): _____

NUMBER OF LEGISLATIVE DAYS: 131

FEDERAL PER DIEM RATE FOR STATE CAPITOL:

January 1, 2005 - September 30, 2005 \$105.00

October 1, 2005 - December 31, 2005 \$117.00

**DISTANCE IN MILES BETWEEN TAXPAYER'S RESIDENCE WITHIN
LEGISLATIVE DISTRICT REPRESENTED AND CAPITOL BUILDING OF THE
STATE:** _____