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Legal Services Office

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TO: Legislative Council

FROM: Jaret R. Coles, Deputy Director of Legal Services

RE: Decision Points to Supplement “Federal Income and Employment Tax on Legislator Reimbursements” Legal Memorandum

The memorandum entitled “Federal Income and Employment Tax on Legislator Reimbursements” (Tax Memo) is a detailed legal document that explains the type of documentation that is needed to receive a tax-free reimbursement that complies with federal tax law. The memorandum does not cover the right to know under the Montana Constitution, which is a separate consideration.

The decision points for the Council to consider are as follows:

1. **Should a legislator be required to submit invoices and expense reports for expenses that can be reimbursed on a tax-free basis under federal tax law?**
    a. If the answer is yes, the IRS requires detailed reporting using what is called an accountable plan. (Tax Memo, p. 6) There are deadlines associated with getting receipts back to LSD. (Tax Memo, pp. 11-12)
        i. The tax-free expenses include:
            1. mileage and lodging using the state rates for legislative business; (Tax Memo, pp. 6-7)
            2. meals at the state rate for travel; (Tax Memo, pp. 6-7)
            3. laptops, cell phones, and calling plans to the extent the amount reimbursed does not exceed the cost of the equipment and cell phone plan; (Tax Memo, pp. 8-9)
            4. an allocated amount of Internet expenses for the portion of the Internet bill that is for legislative business and not personal use. (Tax Memo, p. 10)
    b. If the answer is no, then all expense reimbursements are subject to income and employment taxes. The IRS does not allow tax-free reimbursements unless an accountable plan is utilized. (Tax Memo, p. 6)

2. **Should a "stipend" be allowed for miscellaneous expenses without the need to provide receipts that satisfy IRS rules?**
    a. If the answer is yes, then the same amount should be offered to all legislators and be subjected to wage withholding. The bill draft should not allow a member to pick between a stipend or a reimbursement. (Tax Memo, pp. 4-5)
        i. The IRS does not allow an employee to pick between a stipend and a reimbursement. If a member is allowed to choose between a stipend and a reimbursement, the IRS classifies the amount available as a stipend as taxable income using a "wage recharacterization" theory. (Tax Memo, pp. 4-5)
        ii. **FOLLOW-UP: If the answer is yes, does the Council desire an accounting of how the stipend was spent to be submitted to LSD for the purpose of informing the public how the state funds were expended in addition to proving the stipend is not compensation?**
            1. **Article II, section 9. Right to know.** No person shall be deprived of the right to examine documents or to observe the deliberations of all public bodies or agencies of state government and its subdivisions, except in cases in which the demand of individual privacy clearly exceeds the merits of public disclosure.
            2. **Article V, section 5. Compensation.** Each member of the legislature shall receive compensation for his services and allowances provided by law. No legislature may fix its own compensation.
    b. If the answer is no, then the bill draft would not include a stipend provision.

3. **Does the Council desire to have any expenses reimbursed that do not qualify under an IRS accountable plan?**
    a. Some expenses do not qualify for tax-free reimbursement, but can be reimbursed by LSD and are subject to income and employment taxes. For example, home security cameras and home security expenses do not qualify under IRS rules. (Tax Memo, pp. 10-11)
    b. Expenses that do not qualify under IRS rules are subject to withholding.
    c. The amount of expenses that can be reimbursed that do not satisfy IRS accountable plan rules should be the same for all members to avoid "wage recharacterization". (Tax Memo, pp. 4-5)