

# New Hampshire Legislators' 2018 Federal Income Tax Guide

**NEW HAMPSHIRE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS**

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CERTIFIED PUBLIC ACCOUNTANTS**



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## INTRODUCTION

The New Hampshire Society of Certified Public Accountants is pleased to present this 2018 Federal Income Tax Guide prepared for members of the New Hampshire General Court.

This guide deals only with federal income tax laws and generally only as they relate to your position as an elected official. It is not intended to cover all tax matters related to an individual's tax return. Most items of a personal nature such as medical expenses, interest, tax expenses and charitable contributions are not covered. Some items regarding recent tax highlights are included, not because of their relevance to your position as a legislature, but because they are sufficiently notable issues for all taxpayers and the author believed they warranted reference.

Emphasized throughout is the importance of record keeping. The burden of proving the appropriateness and extent of deductibility is on the taxpayer. For tax questions and for assistance in preparation of your tax return, we suggest that you contact your tax advisor.

## 2018 TAX HIGHLIGHTS

In December 2017, Congress passed the Tax Cuts and Jobs Act (TCJA). This is perhaps the most extensive update to the tax code since 1986. Its effect is so broad that it generally affects almost all individual and business taxpayers. This material is intended to be used for informational purposes only and is limited in its content. The authors do not provide this information as, and it should not be interpreted as, tax, legal or accounting advice for any individual's specific circumstance.

Because of the complexity of the information involved, the expectation of additional and continued regulations and guidance on tax law, and the unique situations for taxpayers, before action is taken or decision not to act is made, specific legal or tax advice should be sought out based upon the relevant circumstances and no reliance should be placed on the statements made in this guide. Most items referenced below in the TCJA are effective beginning after December 31, 2017 and end by January 1, 2026.

### New income tax rates & brackets

Tax brackets have been updated as follows:

<b><u>Rate</u></b>	<b><u>Individuals</u></b>	<b><u>Married Filing Jointly</u></b>
10%	Up to \$9,525	Up to \$19,050
12%	\$9,526 to \$38,700	\$19,051 to \$77,400
22%	38,701 to \$82,500	\$77,401 to \$165,000
24%	\$82,501 to \$157,500	\$165,001 to \$315,000
32%	\$157,501 to \$200,000	\$315,001 to \$400,000
35%	\$200,001 to \$500,000	\$400,001 to \$600,000
37%	over \$500,000	over \$600,000

#### Standard deduction increased

The standard deduction is increased to \$24,000 for married individuals filing a joint return, \$18,000 for head-of-household filers, and \$12,000 for all other taxpayers. These amounts are adjusted for inflation in tax years beginning after 2018.

#### Personal exemptions suspended

The deduction for personal exemptions is effectively suspended because the statutory exemption amount is reduced to zero.

#### Kiddie tax modified

A child's taxable earned income is taxed under the rates for single individuals, and unearned income is taxed according to the brackets applicable to trusts and estates.

#### Child tax credit increased; partial credit for non-child dependents

The child tax credit is increased to \$2,000. The income level at which the credit phases out is increased to \$400,000 for married taxpayers filing jointly (\$200,000 for all other taxpayers) (not indexed for inflation). The amount of the credit that is refundable (assuming certain earned income tests are met) is increased to up to \$1,400 per qualifying child, and this amount is indexed for inflation, up to the \$2,000 base credit amount. In addition, a \$500 nonrefundable credit is provided for certain other dependents, including children over 16 and other family members.

#### State and local tax (SALT) deduction limited

Except as described below, state, local, and foreign property taxes, and state and local income and/or sales taxes, are generally only deductible when paid or accrued in carrying on a trade or business.

However, a taxpayer may claim an itemized deduction of up to \$10,000 (\$5,000 for married taxpayers filing separately) for the aggregate of (i) state and local property and income taxes. Foreign real property taxes may not be deducted.

#### Mortgage interest deduction limited

With some exceptions, the deduction for home mortgage interest is limited to interest on up to \$750,000 (\$375,000 for married taxpayers filing separately) of acquisition indebtedness and the deduction for interest on home equity indebtedness initially appeared as though it was suspended. However, the IRS issued News Release 2018-32 which states "that despite newly-enacted restrictions on home mortgages, taxpayers can often still deduct interest on a home equity loan, home equity line of credit (HELOC) or second mortgage, regardless of how the loan is labelled."

#### Medical expense deduction threshold temporarily reduced

The threshold on medical expense deductions is reduced to 7.5% of adjusted gross income (AGI) for all taxpayers for 2017 and 2018.

#### Alimony deduction by payor/inclusion by payee suspended

For any divorce or separation agreement executed after Dec. 31, 2018 (or executed on or before Dec. 31, 2018 but modified later if the modification expressly provides that the Act rules apply), alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse.

### Itemized Deductions

The deduction for miscellaneous itemized deductions that are subject to the 2%-of-AGI floor is suspended.

### Moving expenses deduction suspended

The deduction for moving expenses is suspended, except for members of the Armed Forces on active duty who move pursuant to a military order and incident to a permanent change of station.

### Deduction for living expenses of members of Congress eliminated

Members of Congress cannot deduct living expenses when they are away from home.

### Repeal of the Affordable Care Act (ACA) individual mandate

The Act permanently repeals the Individual Mandate by providing that for months beginning after Dec. 31, 2018, the amount of the individual shared responsibility payment is reduced to zero.

### Individual Alternative Minimum Tax (AMT) retained, with higher AMT exemption amounts

The Act increases the amount of an individual's alternative minimum taxable income (AMTI) that is exempt from AMT-the "AMT exemption" amounts.

### Estate and gift tax retained, with increased exemption amount

The Act doubles the base estate and gift tax exemption amount from \$5 million to \$10 million.

### Corporate tax rates reduced

The corporate tax rate has been updated from a graduated rate up to 34% to a flat 21% rate.

### Corporate alternative minimum tax repealed

### Increased Code Section 179 expensing

The maximum amount a taxpayer may expense under Code Sec. 179 is increased to \$1 million, and the phase-out threshold amount is increased to \$2.5 million.

### Qualified real property

The definition of Code Sec. 179 property is expanded including roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

### Bonus Depreciation

A 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023. It is phased out over later years.

### Luxury automobile depreciation limits increased

\$10,000 for the year in which the vehicle is placed in service, \$16,000 for the second year, \$9,600 for the third year, and \$5,760 for the fourth and later years in the recovery period.

### Recovery period for certain real property improvements is shortened

For property placed in service after Dec. 31, 2017, the separate definitions of qualified

leasehold improvement, qualified restaurant, and qualified retail improvement property are eliminated, and a general 15-year recovery period and straight-line depreciation are provided for qualified improvement property. Thus, qualified improvement property placed in service after Dec. 31, 2017, is generally depreciable over 15 years using the straight-line method and half-year convention.

#### Limits on deduction of business interest

For businesses where a three-year average of annual gross receipts exceeds \$25 million generally is subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. The business interest limitation generally applies at the taxpayer level. However, for partnerships and S corporations, the limitation applies at the entity level.

#### Modification of net operating loss (NOL) deduction

The two-year carryback and the special carryback provisions are repealed. NOLs generally can be carried forward indefinitely. The NOL deduction is generally limited to 80% of taxable income

#### Domestic production activities deduction repealed

#### Like-kind exchange treatment limited

The rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property that is not held primarily for sale.

#### Five-year write-off of specified research or experimentation expenses

For amounts paid or incurred in tax years beginning after Dec. 31, 2021, "specified R&E expenses" must be capitalized and amortized ratably over a 5-year period. Specified R&E expenses subject to capitalization include expenses for software development, but other specific expenses are excluded.

#### Employer's deduction for fringe benefit expenses limited

Deductions for entertainment expenses are disallowed.

The current 50% limit on the deductibility of business meals is expanded to meals provided through an in-house cafeteria or otherwise on the premises of the employer; and deductions for employee transportation fringe benefits (e.g., parking and mass transit) are denied, but the exclusion from income for such benefits received by an employee is retained.

#### Employee achievement awards

For amounts paid or incurred after Dec. 31, 2017, "tangible personal property" that can be excludible employee achievement awards doesn't include cash or cash equivalents; gifts cards, coupons, or certificates; vacations, meals or lodging; or certain other non-tangible personal property.

#### Deduction for local lobbying expenses eliminated

For amounts paid or incurred after Dec. 21, 2017, the deduction for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments) is eliminated.

#### Credits

Modifications have been made relative to various credits including Orphan drug credit, Rehabilitation credit and a new credit for employer-paid family and medical leave.

#### Accounting methods

The limitations for using cash method of accounting have been changed, including for taxpayers that satisfy a \$25 million gross receipts test., regardless of whether the purchase, production, or sale of merchandise is an income-producing factor.

#### New deduction for pass-through income

The Act adds a new deduction for noncorporate taxpayers for qualified business income—also referred to as the "pass-through deduction." The deduction reduces taxable income, rather than adjusted gross income (AGI), but is available to taxpayers who take the standard deduction.

The deduction is generally 20% of a taxpayer's qualified business income (QBI) from a partnership, S corporation, or sole proprietorship **but is subject to limitations** including, (but not limited to) amounts related to individual income levels, amounts associated with wages and property on the pass-through business, and taxpayers in service related businesses, (health, law, accounting, etc.)

#### Repeal of partnership technical termination

The Act repeals the "technical termination" rule of Code Sec. 708(b)(1)(B)—i.e., the rule that a partnership is considered as terminated if there is a sale or exchange of 50% or more of the total interest in partnership capital and profits within any 12-month period.

#### Deduction for foreign-source portion of dividends

The Act provides for an exemption (referred to here as a deduction for dividends received, or DRD) for certain foreign income.

No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD. The DRD is available only to C corporations that are not regulated investment companies (RICs) or real estate investment trusts (REITs).

#### Current inclusion of global intangible low-taxed income (GILTI)

A U.S. shareholder of any Controlled Foreign Corporation (CFC) has to include in gross income its global intangible low-taxed income (GILTI)—i.e., the excess of the shareholder's "net CFC tested income" over the shareholder's "net deemed tangible income return" (10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder). The GILTI is treated as an inclusion of Subpart F income for the shareholder. Only an 80% foreign tax credit is available for amounts included in income as GILTI, and no carryback or carryforward is allowed.

#### Base erosion and anti-abuse tax

The Act establishes a base erosion minimum tax to prevent companies from stripping earnings out of the U.S. through payments to foreign affiliates that are deductible for U.S. tax purposes.

### **Retirement Contributions for 2018 (Depending on Income Levels)**

Traditional IRA - \$5,500

Catch up Contributions (Over age 50) \$1,000

- 401(K) - \$18,500
- Simple Plans - \$12,500

## **BUSINESS EXPENSES**

### **IRS Determined That State Legislature Members Are Not Eligible to Deduct Their Employee Business Expenses Above the Line.**

Section 62(a)(2)(C) was added to the Internal Revenue Code in 1997. It allows state and local government officials who are "compensated in whole or in part on a fee basis" to deduct unreimbursed employee business expenses from adjusted gross income (e.g., as an above the "line" deduction and not as an itemized deduction). When Congress enacted Section 62(a)(2)(C), it was not clear whether this favorable tax treatment was available for members of a state legislature. In October 1999, the IRS Chief Counsel's Office released Chief Counsel Advice 199939001 that concludes that state legislators are not compensated in whole or in part with a fee for purposes of qualifying for this deduction. Therefore, for 2017, state legislators are limited and might deduct unreimbursed business expenses, but only as miscellaneous deduction on Schedule A, subject to the 2 percent floor and not above the line. However, for 2018, under the new TCJA, miscellaneous itemized deductions are no longer available, and it would appear these expenses are now non-deductible.

### **Travel Expenses.**

As a state legislator, you are an employee of the State and all mileage and automobile allowances paid to you by the State should be included in your W-2 Form. For 2017, as an employee, you might be able to take a miscellaneous itemized deduction for your employee business expenses on Form 2106 -Employee Business Expenses, however for 2018 under the TCJA, miscellaneous itemized deductions are no longer available.

### **Travel Expenses - Tax Home**

For 2017, when expenses are potentially deductible as a miscellaneous itemized deduction, the determination of your "tax home" is essential because a taxpayer could deduct travel and overnight business expenses only when away from his/her tax home, provided the expenses are reasonable and necessary to the taxpayer's business. For income tax purposes, your "tax home" is generally your regular place of business. It is not necessarily the same as your domicile or residence. Your tax home is determined in light of all facts and circumstances relative to you as a taxpayer. Although generally your legislative district is your tax home, there are situations where this may not be true. If, for example, your duties as a state legislator require your presence in Concord most of the year and your income as a legislator is your main source of income, Concord would probably be determined to be your "tax home" for travel expense purposes since it is the location of your principal place of employment. The result of a determination that Concord is your "tax home" is that your living expenses while in Concord, and your travel expenses from your home to Concord, would not be tax deductible. However, in this situation, you should be able to deduct traveling expenses incurred on overnight business trips to the area that you represent, even though that is where you maintain your family residence.

A special election is available under section 162(h) to full-time state legislators whose residence is more than 50 miles from the State capitol building in Concord that affects deductibility of the cost of meals, lodging, laundry and other incidental travel expenses incurred while away from "home" on legislative business. An eligible state legislator may elect to have the legislative district he/she represents treated as his/her tax home. State legislators who live 50 miles or less from the state capitol building cannot make this election. The consequences of making the election include a limitation on the maximum amount that you may claim as travel expenses. A state legislator that has made the section 162(h) election is allowed a deduction equal to the greater of (1) the per diem allowance for employees of the executive branch of the federal government while traveling on government business or (2) the equivalent allowance for employees of the legislator's state, but not more than 110 percent of the federal allowance. This amount is multiplied by the number of "legislative days" during the year. A "legislative day" is any day on which the legislature was in session (including any day in which the legislature was not in session for a period of 4 consecutive days or less), or on which the legislature was not in session but the physical presence of the individual was formally recorded at a meeting of a committee of the legislature. The election applies to all travel expenses incurred by a legislator in pursuit of his/her trade or business as a legislator, including travel expenses incurred when the legislature is not in session. You make the election by attaching a statement to your tax return. A sample election is contained at the end of this guide.

## **Business Travel**

For 2017, travel expenses, other than commuting, that are incurred by a legislator in connection with efforts "to ascertain, assess and advance the interests of constituents" that are directly related to his/her trade or business as a state legislator may be deductible. Expenses incurred "in connection with personal and party aggrandizement" are not deductible. In addition, speeches given and conventions attended for political or social purposes are considered unrelated to the legislator's trade or business, and any expenses incurred with respect to these activities are not deductible. If you have a separate business in addition to that as a state legislator, you may also deduct the cost of non-reimbursed travel between two places of business (i.e., State Legislature and the other place of business or occupation) provided the trips are necessary to conducting business at both locations (See Recordkeeping). You may not deduct travel expenses for a spouse, dependent or other individual accompanying the taxpayer (or employee) unless (1) the spouse, etc., is an employee of the taxpayer, (2) the travel of the spouse, etc., is for a bona fide business purpose, and (3) the expenses would otherwise be deductible by the spouse, etc. If you travel by bus, airplane, or taxi, you cannot also deduct mileage you would have incurred had you driven an automobile. In addition, you cannot claim any mileage expense for travel if you ride with someone else and do not directly incur any travel expenses yourself.

## **AUTOMOBILE EXPENSE**

### **Legislator Mileage Reimbursement**

Legislators can select one of two methods of reimbursement for travel to the State House for legislative business. Selection is made on the New Hampshire General Court Mileage Card. Under the federal method, travel is reimbursed for actual mileage from the legislator's home to the State House at the federal mileage rate. **The rate for 2017 was 53.5 cents**

**and the rate for 2018 is 54.5 cents.** Under the state method, the travel reimbursement is based on each day of attendance at a rate established by New Hampshire law. The daily rate is 38 cents per mile for the first 45 miles and 19 cents per mile thereafter (RSA section 14:15-a). Income tax and payroll tax treatment depends on which of the two methods you select. Payments under the federal method are considered an expense reimbursement. Therefore, they are not taxable compensation and are not subject to income taxation or FICA taxation. In addition, the payments are not reported on Form W-2. Payments under the state reimbursement method do not qualify as an expense reimbursement. Therefore, they are taxable compensation and are subject to income taxation and FICA taxation. The payments are reported on Form W-2.

## **LIVING EXPENSE (Hotel and Meals Expense)**

For 2017, you might deduct the actual amount paid for lodging, including any taxes and service charges, for hotels, motels and other similar establishments while in Concord and away from your residence ("tax home"). If you pay a fixed monthly rate, that entire amount may be deductible as long as you pay it, and it is for providing a place to stay while you are away from your "tax home" on business. Instead of deducting actual costs, you may deduct a standard amount for meals and lodging established by the IRS. The IRS adjusts these standard amounts periodically.

The amount deductible under the standard may be the greater of the state per diem amount or the federal per diem amount for Concord for each "legislative day" you have during the calendar year. The state rate cannot exceed 110 percent of the federal per diem rate. A legislative day is any day that the Legislature is in session (including recess periods of four consecutive days or less), or any day the Legislature is not in session but for which your presence is formally recorded at a meeting of a legislative committee or other legislative related business meeting. New Hampshire maximum federal 2017-2018 per diem deduction for business travel, can be found at <https://www.gsa.gov/portal/content/103168>, some amounts are subject to seasonal change, but generally as follows:

**FY 2018 Per Diem Rates - Effective October 1, 2017**

STATE	DESTINATION	COUNTY/LOCATION DEFINED	SEASON BEGIN	SEASON END	FY18 Lodging Rate	FY18 M&IE
NH	Concord	Merrimack			\$102	\$59
NH	Conway	Carroll	October 1	February 28	\$130	\$54
NH	Conway	Carroll	March 1	June 30	\$116	\$54
NH	Conway	Carroll	July 1	August 31	\$158	\$54
NH	Conway	Carroll	September 1	September 30	\$130	\$54
NH	Durham	Strafford	October 1	April 30	\$104	\$54
NH	Durham	Strafford	May 1	August 31	\$121	\$54
NH	Durham	Strafford	September 1	September 30	\$104	\$54
NH	Laconia	Belknap	October 1	October 31	\$142	\$69
NH	Laconia	Belknap	November 1	May 31	\$116	\$69
NH	Laconia	Belknap	June 1	September 30	\$142	\$69
NH	Lebanon / Lincoln / West Lebanon	Grafton / Sullivan			\$131	\$64
NH	Manchester	Hillsborough			\$107	\$64
NH	Portsmouth	Rockingham	October 1	June 30	\$116	\$59
NH	Portsmouth	Rockingham	July 1	August 31	\$158	\$59
NH	Portsmouth	Rockingham	September 1	September 30	\$116	\$59

The per diem rate deduction for meals must be reduced by 50 percent similar to the treatment of other meal and entertainment expenses. In addition, otherwise deductible travel fares, telephone, fax charges and local transportation expenses are deductible. Only 50 percent of the cost of meals paid by you is an allowable deduction provided the expense relates to your legislative business. The cost of meals subject to the 50 percent disallowance includes tax and tips. You are also required to substantiate the amount, time and place, business purpose and relationship of the expense to your business. An exception to the above rule is that 100% of the cost is deductible for meals provided by a professional league that is tax exempt, or that are an integral part of a qualified banquet provided you attend, or have an employee attend. To the extent the meal is lavish or

extravagant, the deduction is further limited. Transportation costs incurred are one hundred percent deductible.

## OFFICE EXPENSES

Generally, for 2017, you may not deduct costs of your home as business deductions. For 2018, given these costs were previously deducted as unreimbursed employee business expenses on Schedule A, these costs are no longer deductible.

For 2017 you may be able to apportion certain expenses of running your home to business use and deduct them on your income tax return as business expenses in connection with your position as a legislator.

The following is relative to deductible expenses for home office expenses for the period ending 12/31/17.

An office in home must be used exclusively for business purposes. This means that using only a part of a room as an office (one corner, for example), or sometimes using a room for personal purposes (such as watching TV), will disqualify the room as an office in home. To qualify:

1. The office must be used exclusively to conduct administrative or management activities for the taxpayer's trade or business; and
2. There must be no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities.

To determine whether a home office is a taxpayer's principal place of business, a comparative analysis of a taxpayer's activities at various business locations must be done. The primary factors considered in this comparison are: (1) the relative importance of the activities performed at each business location, and (2) the amount of time spent at each location, i.e., the amount of time spent at the home compared with the amount of time spent in each of the other places where business activities occur. In addition, a legislator must establish that the use of the home office is for the convenience of his or her employer (the State). If these conditions are present, then the **deduction is limited to your gross business income less deductions allowable regardless of use** (i.e., taxes and interest). To claim this deduction, you need to complete Form 8829, Expenses for Business Use of Your Home. The miscellaneous itemized deduction is further limited if total miscellaneous itemized deductions are less than 2 percent of adjusted gross income. There is also no tax benefit if you do not claim itemized deductions on your tax return.

Taxpayers may elect a safe harbor method for computing their home office deduction, as opposed to computing and documenting their actual expenses. Taxpayers with a qualified home office using the safe harbor option may deduct \$5.00 per square foot for up to 300 square feet for a maximum deduction of \$1500. Taxpayers can change methods from year to year without IRS consent.

**Depreciation of your home:** The annual depreciation for business use of your home is determined by multiplying the cost allocated to the portion (percentage) of

your home used for business (excluding the land) by the depreciation percentage contained in tables published by the Internal Revenue Service. Computers, office equipment and furniture such as a desk, file cabinet, computer and similar items (other than those furnished by the State) may also be depreciated over their applicable recovery periods. The current depreciation rules are complex. Please refer to IRS Publication 534, Depreciation, and IRS Publication 946, How to Depreciate Property, for complete details. IRS Publication 587, Business Use of Your Home, has a worksheet for figuring your deduction for use of a home office.

**Rent:** If you are renting your residence, you may deduct the business portion (percentage) of your rent.

**Utilities and Insurance:** You may apportion these costs based on the percentage of square footage of your residence you use as an office. A special rule discussed below may further limit your deduction for telephone expense.

**Maintenance Expenses:** You may deduct any maintenance expenses to keep up the business room or area. Examples of such items include cleaning and painting. However, expenses related to carpentry work performed to install bookcases or make similar improvements, as well as the installation of carpeting in this room are capital expenses which may be depreciated over the appropriate recovery period.

Be careful that the use of the home office is not for non-business activities such as campaign promotion.

**Part-time Help:** If you hire a secretary, clerk or aide to assist you in legislative matters, the compensation paid is deductible for 2017. However, for 2018 this deduction would not be allowed because deductions for unreimbursed employee business expenses are no longer allowed. You must obtain federal and state employer identification numbers and pay the proper federal and state payroll taxes. In most situations, amounts paid to individuals for services are considered employee wages subject to the payroll tax laws. However, there are some exceptions, such as in the case of an independent contractor. Be aware that the IRS aggressively looks for misclassification of employees as independent contractors. In addition, the NH Department of Labor and the NH Department of Employment Security may also seek to reclassify independent contractors as employees. If you have volunteer help working on legislative matters, and you incur no out-of-pocket expense, then of course there is no tax deduction.

If you pay some office expenses out of campaign contributions, you have to exclude those expenses from your own federal tax return, since you personally would not have incurred an out-of-pocket expense. If campaign contributions used for office expenses exceed the campaign-related costs of operating the office, then such excess is includable in taxable income. If the campaign-related office expenses exceed campaign contributions, such excess is not deductible. You should always maintain detailed records of all receipts from sources other than yourself to determine whether your expenses exceed your income, or vice versa.

**Sale of Primary Residence:** In 1997, the rules on recognition of gain from the sale of a primary residence changed, from the old "roll-over" of gain approach with a once-in-a-

lifetime exclusion, to a new exclusion of gain that can be utilized once every two years (\$500,000 or \$250,000, depending on marital status). Although this is an improvement for taxpayers, it caused concern regarding whether utilizing an office-in-home might reduce the ability to take full advantage of the exclusion, potentially causing some ratable portion of a gain to be taxable.

In 2003 the IRS issued regulations that provide if there is an otherwise excludable gain on the sale of a primary residence, the gain will be recognized only to the extent of prior depreciation deductions claimed, if an office is part of the same dwelling unit. If the office is a separate building on the property, the gain must be recognized in an amount proportionate to the bases in the properties. This may discourage you from taking an office in home deduction for a separate structure, since it may reduce your ability to shelter gain on a later sale.

## **LOBBYING EXPENSE DEDUCTION DISALLOWED**

No business deduction is allowed for costs to influence state legislation. A similar rule applies to costs to influence Federal legislation and for direct communication with certain Federal executive branch officials in an attempt to influence those persons. Current rules disallow certain other lobbying efforts. Special disallowance and excise tax rules apply to tax-exempt organizations (other than a charitable organization) that engage in lobbying or political activities.

## **CAMPAIGN CONTRIBUTIONS**

Any excess of campaign contributions over campaign expenses is income to the political candidate. Political contributions are not taxable to the political candidate by or for whom they are collected if they are used for expenses of a political campaign or some similar purpose. State campaign finance laws require excess funds be transferred to a Party Committee, a political committee organized for ongoing political activities, returned to contributors on a pro rata basis, or contributed to a tax exempt charity. If you comply with state laws, you are not taxed on any excess.

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

1. Utilized for generally recognized campaign expenses regardless of when incurred;
2. Contributed to a committee of the candidate's party; or
3. Used to reimburse the candidate for his/her out-of-pocket campaign expenses.

Excess campaign expenses are not deductible. Because of this, it is very important for the legislator to distinguish between those expenses which are directly related to a campaign for re-election (that are not deductible) and those expenses which are directly attributable to serving the legislator's constituency (that are deductible in 2017).

## **CAMPAIGN EXPENSES**

No deductions are allowed for expenditures in any political campaign of a candidate for public office. In addition, regardless of the result of the election, a candidate is not allowed a deduction for expenses for attending political conventions, contributions to the political party which sponsored the candidacy, expenses of campaign travel, campaign advertising, the expenses of successfully defending a position in a contested election, filing fees or the cost of legal fees paid in litigation over redistricting. Furthermore, none of these expenses may be amortized as capital expenditures over the term of the office. In addition, you cannot deduct the cost of any defamation litigation for allegations resulting from or during the campaign.

## **NEWSLETTER FUND**

A newsletter fund is a fund created by a person who holds, has been elected to, or is a candidate for nomination or election to, any federal, state, or local elective public office. The individual must use this fund exclusively for the preparation and circulation of the individual's newsletter. For purposes of the definition of a newsletter fund, a candidate is anyone who publicly announces his or her candidacy for election or nomination to public office and meets all legal requirements to hold said office. A newsletter fund is an exempt political organization for federal tax purposes. The most notable variation from this treatment is that newsletter funds are not allowed the \$100 deduction granted to political organizations.

The exempt function of the fund consists of the preparation and circulation of the newsletter. Secretarial services, printing, addressing, and mailing are treated as preparation and circulation expenditures of the fund. If assets of a newsletter fund are used for anything other than the exempt purpose of the fund, the amount used and all future contributions are considered to be used as personal expenditures of the individual who established the fund and likely treated as taxable income. At which time a newsletter fund ceases to prepare and circulate a newsletter any assets left in that fund that are not contributed to a tax-exempt organization, deposited in the general fund of the U.S. Treasury or any state or local government, or contributed to another newsletter fund, shall be treated as expended for the personal use of the individual which would then likely be taxable income.

## **ADVERTISING EXPENSES**

Section 7701(a)(26) of the Internal Revenue Code states that expenses incurred in the performance of the functions of a public office are deductible trade or business expenses under Section 162. Therefore, the costs of advertising are deductible if you pay for the ads and they are a necessary part of your business. If these deductions are related to your work as a legislator and were deducted as unreimbursed employee business expenses, then these are no longer available after 12/31/17. Typical advertisements related to the performance of the functions of a public office are communications with your constituency that inform them of affairs of the state government and your own official actions. In addition to these costs the expense of providing constituents with pens, paper, and other items related to the business of properly serving your constituency are deductible. However, it is advisable that advertising expenses incurred during a campaign period be paid for out of campaign contributions rather than personally. This is because advertising expenses paid

from personal funds during a campaign are not deductible.

## **ENTERTAINMENT EXPENSES**

In 2018, entertainment expenses are no longer deductible. In 2017, Entertainment expenses are subject to a general fifty percent deduction limitation. In addition to this limitation, taxpayers must keep detailed records to establish the deductibility of entertainment expenses. Your records should include the amount spent, the date, the place of entertainment, the business reason for the entertainment, your business relationship to the person entertained, and receipts for each expenditure greater than \$75. If the expense does not have a business purpose or there is not a business relationship with the person entertained the expense will not be deductible. Furthermore, a business conversation must take place contemporaneously with the entertainment event. Other specific restrictions prevent the deduction of expenses with respect to an entertainment, recreation, or amusement facility. In particular, you cannot deduct the cost of a vacation home and related expenses even if you use the home to entertain for business purposes. However, expenses for interest, taxes and casualty losses associated with the vacation home may still be deductible as itemized deductions.

## **TELEPHONE EXPENSES**

The charge (including taxes) for basic local telephone services with respect to the first telephone line for any residence is a personal nondeductible expense. For 2018, telephone expenses as unreimbursed employee business expenses are no longer deductible. For 2017 calls charged in excess of those covered by the basic rate are a deductible expense if they are business calls. If you have a second telephone installed exclusively for business use, the entire cost of this telephone is deductible. All long distance telephone calls and telegrams that relate to legislative business are a deductible expense. An answering service or recording device for telephone messages is also deductible if related directly to business. The 2010 Small Business Act removes cellular phones from the category of listed property. Thus, the heightened substantiation requirements and special depreciation rules that apply to listed property no longer apply to cellular phones. To support a deduction for cellular phones, you need only substantiate their cost. Deductions are available only to the extent you use the cell phone for legislative business. You may depreciate the cost of an answering machine or cellular phone based on the percentage used for business.

## **DUES AND MEMBERSHIP EXPENSES**

You may not deduct amounts paid for membership in any club organized for business, pleasure, recreation, or other social purpose. Such clubs include, but are not limited to, country clubs, golf and athletic clubs, airline and hotel clubs and business luncheon clubs. While membership dues are not deductible, specific expenses incurred at a club, such as a business meal, will still be deductible for 2017 if they meet the requirements or business meals and entertainment discussed above (subject to 50 percent disallowance for meals and entertainment). Dues for professional associations and civic organizations are deductible in 2017 to the extent you use them for business purposes. Examples include bar

associations, medical associations, business leagues, trade associations, chambers of commerce, real estate boards and civic or public service organizations such as Rotary, Kiwanis, Lions, Exchange Clubs.

## **OTHER EXPENSES**

You might incur many other expenses because of your position as a member of the Legislature. Some of these expenses deductible for 2017 include the following:

1. Stationery and postage relating to mail concerning your business as a member of the Legislature.
2. Any other necessary office supplies to maintain your office and serve your constituency.
3. The cost of obtaining additional newspaper and magazine publications that are necessary because of your position as a state legislator. If you have incurred these expenses for personal reasons, the cost is not deductible.
4. The cost of a newsletter sent to constituents.
5. Fees paid to Certified Public Accountants and other tax professionals are generally deductible, to the extent such fees and other miscellaneous itemized deductions collectively exceed 2 percent of adjusted gross income.
6. Education expenses necessary for you to maintain and improve your skills as a legislator.

## **RECORDKEEPING**

Estimates are not acceptable. All taxpayers must "substantiate by adequate records or sufficient evidence corroborating his/her own statements" all expenditures for travel, entertainment and gifts. Receipts, canceled checks and books of record must support other business expenses. In every case, you must substantiate the business nature of the expense. You should err on the side of keeping more documentation than is required, rather than not enough.

### **Travel expenses should be recorded as follows:**

1. The amount spent daily for transportation, meals, lodging, etc. You may aggregate such expenses in reasonable categories such as gasoline and oil, taxis, meals, etc.
2. The dates of departure and return, and the number of days spent on business.
3. The destination or locality of the travel designated by the name of a city, town or similar description and business miles driven.
4. The business purpose of the trip or the business benefit derived or expected to be derived as a direct result of the travel.
5. Records to show when you started to use your car for business and the cost or other basis of the car at that time. In addition, you must record the total number of business miles you drove your car during the year and the total number of miles you drove your car while you owned it. Odometer readings on January 1 and December 31 of each year are strongly recommended.

**Entertainment expenses should be recorded as follows:**

1. The amount and description of the activity, including a description (i.e., "dinner" or "theater") of each separate expenditure. However, you may aggregate incidental items such as taxi fares and telephone calls on a daily basis.
2. The time and place where the entertainment was provided.
3. The business purpose of the activity, including a description of any business benefit derived or expected, and the nature of any business discussion with the person entertained.
4. The business relationship of the person or persons entertained. This may be indicated by name, title, occupation or other designation sufficient to establish the relationship. If you entertain a relatively large group of persons, you need not record the names of each individual present if a class designation would suffice to indicate the business relationship. However, members of the class must be readily identifiable. If the entertainment is "associated with" (directly preceding or following a business meeting or discussion) rather than directly related to "the active conduct of your business" of being a legislator, you must also record:
  - a. The date and duration of the business discussion which preceded or followed the entertainment;
  - b. The place where the business discussion was held;
  - c. The nature of the discussion, its purpose and the benefit derived or expected from the discussion; and
  - d. The identity of the persons entertained who participated in the business discussion. Generally, certain types of entertainment expenses are not considered to meet the directly related to "the active conduct of your business" test:
    1. Where the taxpayer is not present;
    2. At nightclubs, theaters, sporting events, or social gatherings;
    3. At cocktail lounges or country clubs;
    4. On hunting or fishing trips or on yachts or pleasure boats;
    5. Where the group entertained includes persons other than business associates.

Taxpayers may prove that these entertainment expenses relate directly to their trade or business by establishing that a substantial business discussion occurred during the entertainment.

**Business gifts should be recorded as follows:**

1. The cost and a description of the gifts.
2. The date the gift was made;
3. The business reason for, or the benefit derived or expected as a result of, the gift; and
4. The relationship of the recipient to you, including his/her name, title or other designation sufficient to establish such relationship.

The deduction for gifts is limited to \$25 per donee per year.

It is not necessary to record the recipient's name in certain situations if the business relationship of the gift is clear and if it is apparent that you are not attempting to avoid the \$25 per donee limitation.

Thus, if you purchase a large number of inexpensive tickets to a local high school basketball game, and distribute one or two of them to a large number of constituents, you need not record the names of the recipients. However, you must still substantiate the cost, date, description and business purpose of the gift. You must record the above elements for each "separate expenditure".

Generally, a single payment for goods, services or facilities will be a separate expenditure. Where you entertain a guest at dinner and the theater, the payment for the meal and the payment for the tickets are deemed to constitute separate expenditures, each of which must be individually recorded. If you hold season or series tickets to an event, you must treat each ticket in the series as a separate item and record the use of each entertainment for gift purposes.

You may treat concurrent or repetitious payments made during the course of a single event that are of a similar nature as a single expenditure. For example, rounds of drinks, which are paid for separately during an evening's entertainment at one place, may be treated as a whole.

In some instances, you may aggregate certain kinds of expenses on a daily basis. The regulation permits you to treat as one expenditure the total meal expenses (breakfast, lunch and dinner) incurred in one day.

You may aggregate tips with the expense of the services to which they relate. Other expenses that you can group include gasoline and oil, taxi and telephone calls. Adequate records include diaries or account books.

It is required that the elements of expenditure be recorded "at or near the time" when the expense was incurred. Contemporaneous records have "a high degree of credibility not present with respect to a statement prepared subsequent thereto when there generally is a lack of accurate recall."

Although no special form of records must be maintained, it is clear that the IRS contemplates that the taxpayer will keep some form of journal or account book in which entries can be made on a daily basis. The degree of specificity of entries will vary with the facts and circumstances of each expenditure where documentary evidence is required, it is not necessary to make an entry, which duplicates information contained in the receipts if the receipts and journal complement each other in an orderly fashion. Again, where the business purpose of expenditure is evident from surrounding facts and circumstances, a written statement of such business purpose is not required. Confidential or highly sensitive information need not be recorded in a journal or account book. However, you should be ready to provide a contemporaneous record of the expenditure to the IRS.

A journal or account book standing alone is not sufficient substantiation in all circumstances. You must be prepared to produce documentary evidence (i.e., receipts, paid bills, etc.) in order to deduct:

- (1) Lodging expenses incurred while traveling away from home, and
- (2) Expenses in excess of \$75.

Documentary evidence supporting expenditures for transportation in excess of \$75 will not be required if it is not readily available and the expenses can be authenticated by fare schedules and mileage rates.

Usually, a receipt will suffice if it contains enough information to establish the amount, date, place and character of the expense. Thus, a hotel receipt must include the name, location, date and separate charges for lodging, meals, telephone, etc., if it is to serve as adequate substantiation of a business travel expense. Similarly, a restaurant receipt must indicate the name and location of the restaurant, the date and the charge for food, beverages and other items.

A canceled check will not ordinarily constitute adequate documentary evidence since it does not show in detail the specific items composing the total expenditure. If you make a long-distance telephone call to your home (a personal expense), a hotel receipt would usually indicate this fact while a canceled check would not. However, a canceled check, in connection with the bill, will typically be sufficient to substantiate the business nature of expenditure. The detail required provides the basis upon which you can allocate between personal and business expenses. Moreover, if expenses incurred with respect to certain persons (i.e., spouses) are not deductible, it is essential that evidence of their actual cost be available. Otherwise, they will be deemed to bear a proportionate share of the total charge.

#### **Retention of records:**

You must retain records and related documentary evidence in support of travel, entertainment and gift deductions during the period that your return is subject to audit. Normally, this period is the later of three years from the return due (or extended due date) or date the return is actually filed on which you claimed the deduction. However, the statute of limitations for audit/assessment is longer if 1) there is an extension, 2) there has been a substantial omission from gross income (generally six years from the return/extended due date), or 3) the assessment period is open indefinitely where a taxpayer fails to file a required return (Code Sec. 6501(c)(3)) or files a false or fraudulent income, gift or estate tax return with intent to evade tax. (Code Sec. 6501(c)(1)).

## **ESTIMATED TAX PAYMENTS**

Generally, Individuals must pay 25% of a “required annual payment” by Apr. 15, June 15, Sept. 15, and Jan. 15, to avoid an underpayment penalty. (When that date falls on a weekend or holiday, the payment is due on the next business day.) The required annual payment for most individuals is the lower of 90% of the tax shown on the current year's return or 100% of the tax shown on the return for the previous year. Certain high-income individuals must meet a more rigorous requirement. If the adjusted gross income on your previous year's return is over \$150,000 (over \$75,000 if you are married filing separately), you must pay the lower of 90% of the tax shown on the current year's return or 110% of the tax shown on the return for the previous year.

## **GLOSSARY OF IRS PUBLICATIONS RELATING TO THIS GUIDE**

These may be obtained free of charge from your local IRS office or may be ordered by calling IRS toll-free at 1-800-829-3676 or at the IRS Website [www.irs.gov](http://www.irs.gov). Many libraries

also will have reference copies that you may use.

1. Publication 17, Your Federal Income Tax for Individuals
2. Publication 463, Travel, Entertainment, Gift and Car Expenses
3. Publication 946, How to Depreciate Property
4. Publication 587, Business Use of Your Home

## **APPENDIX: ELECTION UNDER IRC § 162(h)**

### **STATE LEGISLATOR'S ELECTION TO TREAT RESIDENCE AS TAX HOME**

[Name]

[Address]

[Social security number]

Form 1040, Tax Year Ending 20XX

Taxpayer, a state legislator, who served in the New Hampshire (House/Senate) during the year ending above, elects to treat his residence, located at the address shown above, as his tax home pursuant to Code Sec. 162(h).

His place of residence is within the legislative district that he represents. The residence is more than 50 miles from the capital building of the State.

Taxpayers' signature:

Date:

### **FORM 2106 – EMPLOYEE BUSINESS EXPENSES**

To obtain Form 2106 as well as other forms and instructions, visit the IRS website <https://www.irs.gov/forms-pubs>. Adobe Reader is required to view each of these documents.