95TH CONGRESS
2d Session
SENATE
REPORT
No. 95-779

TAX STATUS OF FUNDS EXPENDED BY A POLITICAL COMMITTEE: DEDUCTION FOR SENATORIAL EXPENSES INCURRED WHILE LIVING AWAY FROM HOME

MAY 2 (legislative day, APRIL 24), 1978.—Ordered to be printed

Mr. LONG, from the Committee on Finance, submitted the following

REPORT

[Pursuant to section 302 of S. Res. 110, 95th Congress, after consultation with the Committee on Appropriations]

BACKGROUND

Under section 302 of Senate Resolution 110, which established a Code of Official Conduct, the Committee on Appropriations and the Committee on Finance were directed to review two areas of the tax laws and report the results of the review, with recommendations, to the Senate. The language of the directive is as follows:

> I. The Committee on Appropriations, in consultation with the Committee on Finance, shall review the provisions of the Internal Revenue Code of 1954 relating to the tax status of funds expended by a political committee to defray ordinary and necessary expenses of a Member, the regulations prescribed thereunder, and the rulings made with respect thereto.
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> II. The Committee on Finance, in consultation with the Committee on Appropriations, shall review the amounts deductible for senatorial expenses incurred while living away from home pursuant to section 31c of title 2, United States Code and section 162 of the Internal Revenue Code of 1954, so that the same will more adequately relate to actual living expenses incurred by a Member in connection with the performance of his official duties.

This report is in response to the Senate's directive. Pursuant to our review of this matter, it is proposed that legislation be enacted to implement the recommendations made below.

I. Tax status of funds expended by a political committee to defray ordinary and necessary expenses of a Member

A. Present law

1. Tax status of political organizations (sec. 527 of the code).—Present law provides special tax treatment for an organization (including a fund established by a Member of Congress) which qualifies as a "political organization." If an organization qualifies as a "political organization," it will not be taxed on "exempt function income" but will be taxed on all income other than "exempt function income."

Generally, to qualify for this special tax treatment, the organization must be organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures for the promotion of an individual for public office.

In determining whether the "primary purpose test" for operations is met, the regulations proposed by the Treasury Department § 1.527-2 (a) (4) state that one of the principal factors is the relationship of the exempt function expenditures to total expenditures. The proposed regulations further provide that an organization does not meet the primary purpose test if the organization spends more than an "insubstantial amount" on activities which are neither exempt function activities [1] nor qualifying activities.[2] The proposed regulations do not set forth a percentage for exempt function expenditures (for instance, 50 percent or 75 percent) which, if met or exceeded, would insure the organization's qualification.

Where an organization has dual purposes, it is to be considered a political organization only to the extent that it maintains a segregated fund for use only for exempt function purposes. Thus, for example, if an organization is organized and operated both for exempt function purposes and to reimburse a Member of Congress for ordinary and necessary trade or business expenses, the organization must maintain a segregated fund for exempt function purposes in order to have that portion treated as a political organization.

Amounts expended by an exempt political organization for exempt functions are not treated as income to the individual on whose behalf the expenditures are made. Likewise, if the organization contributes amounts to another exempt political organization or exempt public charity or transfers amounts to the U.S. Treasury or any State or local government, no taxable income to any individual or organization results. Incidental amounts used by the organization to benefit the candidate are not treated as diversions for a candidate's personal use so long as relatively minor in amount and connected with the campaign; and thus there is no taxable income to the candidate. (Examples are payments for transition expenses, including staff salaries, and meals for the candidate and the candidate's staff.) Unexpended funds held by a political organization which has ceased to engage in exempt functions and cannot reasonably be expected to engage in exempt

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[1] Exempt function activities mean activities engaged in to influence or attempt to influence, the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed.

Reference to the proposed regulations indicates neither agreement nor disagreement with those regulations.

[2] "Qualifying activities" for these purposes include activities engaged in after an election which reasonably relate to preparations for the next applicable political campaign or to winding up the last campaign. (Proposed Treas. Regs. § 1.527-2(a)(6))

functions in the future, may, under the proposed regulations, be treated as expended for the personal use of the candidate or other person left in control of the funds.

Any diversion of campaign funds for purposes other than exempt functions becomes taxable income to the person on whose behalf the funds are spent at the time of diversion, that is, the person benefitted. Thus, if an exempt political organization uses funds that are segregated for use only for exempt functions to reimburse or directly pay the expenses of a Member of Congress for ordinary and necessary trade or business expenses, the expenditure is treated by the IRS as income to the Member, but an offsetting deduction is allowable to the extent the expense qualifies as an ordinary and necessary trade or business expense. Ordinarily, the expenditure treated as income and the offsetting deduction will occur in the same taxable year.

2. Federal Election Campaign Act (FECA).—Under present law, all contributions to a candidate or a political committee are subject to the Federal Election Campaign Act of 1971. Under that act, the amount of the funds received and the expenditures of the funds must be reported to the Federal Election Campaign Commission and are subject to disclosure. The Federal Election Campaign Act permits a political committee to pay ordinary and necessary expenses incurred by a Member in connection with his duties as a holder of a Federal office. (2 U.S.C. 439(a))

3. Senate Code of Official Conduct.—Senate Rule XLVI, adopted as part of the Senate Code of Official Conduct (S. Res. 110) on April 1, 1977, prohibits a Member from maintaining or having maintained for his use an unofficial office account. Under the provisions of this rule, expenses incurred by a Member in connection with his official duties may be defrayed only from: (1) personal funds of the Senator; (2) official funds specifically appropriated for that purpose; (3) funds derived from a "political committee" (as defined in section 301 (d) of the Federal Election Campaign Act of 1971 (2 U.S.C. 431); and (4) funds received as reasonable reimbursements for expenses incurred in connection with services provided to the reimbursing organization. The Rule also forbids the conversion to the personal use of any Member of a contribution (as defined in section 301(e) of the Federal Election Campaign Act of 1971 (2 U.S.C. 431)). For this purpose, "personal use" does not include reimbursement of a Member's expenses in connection with his official duties. Thus, the Senate Code of Official Conduct allows a political organization, subject to the FECA, to reimburse Members' expenses incurred in connection with "official duties."

B. Problem

Under present tax law (sec. 527 of the code), no more than an insubstantial amount of the funds of an exempt political organization can be used to defray ordinary and necessary trade or business expenses of a Member. If more than an insubstantial amount is used to defray ordinary and necessary expenses of a Member, the political organization would no longer be treated as exempt from tax.

If the political organization is not exempt, any contribution to the political organization over which the Member has control (whether or not the contribution is for campaign purposes) may be included in the income of the Member in the year in which received. If the

Member uses those contributions to defray ordinary and necessary business expenses, the income tax consequences would "wash" (i.e., income with an offsetting deduction), but only if all the amounts received in a taxable year are spent by the end of that taxable year and the Member itemizes his or her deductions.

Even if the political organization (or segregated fund of a political organization) is exempt because it does not expend more than an insubstantial amount for nonexempt functions, the Member must include in his gross income all campaign contributions over which he has control that are not placed in a segregated fund for campaign purposes. In addition, any amount segregated for campaign purposes but actually expended for nonexempt functions (including expenditures to defray ordinary and necessary business expenses) is treated by the IRS as a diversion for personal use and, therefore, included in a Member's gross income (with an offsetting itemized deduction being allowed if the expenditure is an ordinary and necessary business expense of the Member and the Member itemizes deductions).

C. Committee recommendation

The committee recommends that section 527 be broadened to provide that the exempt functions of a political organization include expenditures for the ordinary and necessary business expenses incurred by a Member in the course of the performance of his or her official duties. The "ordinary and necessary" standard should be that employed under section 162 of the code. Thus, the organization should lose its exempt status only if more than an insubstantial amount of its funds are spent on other than political activities and the "ordinary and necessary" expenses of the Member.

As in the case of contributions for campaign purposes, contributions for ordinary and necessary expenses of the Members should not be income to him in the year they are received. Instead, the taxability of such contributions should be treated under the following rules: Where the ordinary and necessary expenses incurred by the Member equal the payment by the organization, the Member should neither include the payment in his gross income nor be allowed a deduction for the expense, since the expenses and the reimbursements cancel out each other. Where the expenditures by the organization to defray the Member's expenses exceed his ordinary and necessary business expenses, then the Member should have taxable income to the extent of the excess. In addition, all of the usual rules which apply to section 162 expenses (i.e., ordinary and necessary) should apply to reimbursements by the organization, as should the current reporting and disclosure rules. Congress may also wish to clarify what is and what is not an "ordinary and necessary" business expense of a Member.

In the development of legislation, Congress will have to decide whether the existing credit or deduction allowed for campaign contributions should be extended to contributions that are used to defray ordinary and necessary business expenses incurred by a Member. If it decides not to extend the credit or deduction to funds used for ordinary and necessary business expenses of a Member, a mechanism must be established to prevent use of contributions received for campaign purposes (for which a deduction or credit is allowable)

from being used to defray the ordinary and necessary expenses of a Member.

II. Amounts deductible for Senatorial expenses incurred while living away from home

A. Present law

Under present law, an individual is allowed a deduction for traveling expenses (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business (sec. 162(a)).[3] These expenses are deductible only if they are reasonable and necessary in the taxpayer's business and directly attributable to it. "Lavish or extravagant" expenses are not allowable deductions. In addition, no deductions are allowed for personal, living, and family expenses except as expressly allowed under the code (sec. 262).

Generally, under section 262, expenses and losses attributable to a dwelling unit which is occupied by a taxpayer as his personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provisions of the tax law (secs. 163, 164, and 165).

A taxpayer's "home" for purposes of the deduction for traveling expenses generally means his principal place of business or employment. Where a taxpayer has more than one trade or business, or a single trade or business which requires him to spend a substantial amount of time at two or more localities, his "home" is held to be at his principal place of business.

In 1952, a provision was adopted with respect to the living expenses paid or incurred by a Member of Congress (including a Delegate or Resident Commissioner). Under these rules, the place of residence of a Member of Congress within the congressional district which he represents in Congress is considered his tax home. However, amounts expended by the Member within each taxable year for living expenses are not deductible in excess of $3,000. Therefore, a Member of Congress (who does not commute on a daily basis from his congressional district) [4] can deduct up to $3,000 plus amounts deductible in any event, such as interest, taxes, certain business meals, et cetera, of his expenses of living in the Washington, D.C., area.

B. Problem

The $3,000 limitation on the deductions for living expenses of Members appears to be inadequate in view of the increase in the cost of living in the Washington, D.C., area. If the $3,000 amount was adjusted to reflect the increase in the Consumer Price Index (all items) since 1952, the adjusted amount would be approximately $6,800 as of June, 1977. Further, in the case of a businessman (other than a Member of Congress), if an employer reimburses an employee for subsistence or provides an employee with a per diem allowance in lieu of subsistence, the employee may generally deduct (as an offset)

[3] The committee may wish to provide that if the donor specifically states that he is not going to claim a credit or deduction with respect to a contribution (even though a credit or deduction would otherwise appear to be allowable), then that contribution could be used for section 162 purposes.

[4] Under the "overnight rule," travel away from home expenses (as distinguished from transportation expenses) generally cannot be deducted unless the taxpayer is away from home on business overnight.

up to $44 per day for subsistence expenses incurred in connection with travel away from home without the requirement of substantiation.

C. Committee recommendation

The committee recommends that the present $3,000 limitation for living expenses be modified to reflect the increased cost-of-living and to more generally accord with the limitation imposed upon business employees generally. The existing limitation (section 162(a) of the code) should be increased to an amount equal to $44 per day multiplied by the number of days the Member was away from his home (i.e., his district) on legislative business.

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The Committee on Appropriations submitted the following letter in connection with this report.

U.S. SENATE,
COMMITTEE OF APPROPRIATIONS,
Washington, D.C., April 5, 1978.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The report of your committee relating to the requirements of section 302(a) of Senate Resolution 110 (tax status of funds expended by a political committee to defray ordinary and necessary expenses of a Member) and section 302(b) of Senate Resolution 110 (amounts deductible for senatorial expenses incurred while living away from home) is returned herewith for appropriate disposition by your committee.

This committee recognizes the requirements of Senate Resolution 110 and that the subject of the "living expense tax deduction for Members" orginated in the Legislative Branch Appropriation Act, 1953, (Public Law 82–471, approved July 9, 1952) but since these are Internal Revenue matters, they are items more appropriately within the authority and jurisdiction of your committee and not that of the Committee on Appropriations.

Therefore, for purposes of compliance with Senate Resolution 110, please consider the requirement for "consultation" with this committee to have been accomplished.

Sincerely,

WARREN G. MAGNUSON, *Chairman.*

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