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Reference: Remuneration Paid to Elected Officials

Dear [REDACTED]

This letter is written in response to your correspondence dated March 6, 2002, in which you ask whether remuneration paid to elected public officials (constables) is wages, subject to employment taxes and whether such elected official's unreimbursed business expenses are deductible under Internal Revenue Code § 62(a)(2)(C).¹

As a general matter, the Internal Revenue Service is not able to provide binding legal advice applicable to a particular taxpayer unless the procedure for issuing a formal opinion, as described in Revenue Procedure 2002-1, 2002-1 I.R.B. 1, is followed. Your request does not conform with the requirements of Revenue Procedure 2002-1 and, therefore, does not provide the necessary information to issue a formal opinion applying the Internal Revenue Code to your specific facts. However, we are able to provide you with the following general information regarding your question.

Wage Issue

Section 3401(a), pertaining to the collection of income tax at the source on wages, generally defines the term "wages" to include all remuneration, other than fees paid to a public official, for services performed by an employee for an employer.

Section 3401(c) defines the term "employee" to include an officer, employee, or elected official of the United States, a state, or any political subdivision thereof or the District of Columbia, or any agency or instrumentality of any of the foregoing.

¹ Hereinafter, cited statutory provisions refer to the Internal Revenue Code of 1986, as amended, unless otherwise specified.

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Wages paid for services performed by employees for employers are subject to taxation under the Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA") unless specifically excluded. If services performed by an employee of a state, political subdivision, or instrumentality thereof are not covered under an agreement pursuant to § 218 of the Social Security Act ("§ 218 Agreement"),² then wages paid to such employee are generally subject to FICA taxation only if the employee is not a member of a retirement system of such state, political subdivision, or instrumentality thereof pursuant to § 3121(b)(7)(F). If such employee is a member of a government retirement system, the employee's wages are subject to the medicare tax portion of FICA as provided in § 3121(u)(2) unless the employee has been continuously employed with such government employer since March 31, 1986 as required in § 3121(u)(2)(C).

Section 3306(c)(7) provides that services performed by employees of a state, political subdivision, or instrumentality thereof are excluded from the term "employment" for purposes of FUTA.

Section 1401 imposes taxes under the Self-Employment Contributions Act (SECA) on the self-employment income of every individual. Section 1402(b) provides generally that self-employment income means the net earnings from self-employment derived by an individual during any taxable year, subject to the exception for amounts in excess of the contribution base for the year. Section 1402(a) defines the term "net earnings from self-employment," in pertinent part, as the gross income of an individual from any trade or business carried on by him, less the income tax deductions that are attributable to such trade or business.

As a general rule, an individual performing the functions of a public office of a state, political subdivision, or instrumentality thereof is not carrying on a trade or business for self-employment tax purposes. See § 1402(c)(1). However, § 1402(c)(1) provides an exception to this general rule insofar as the functions of a public office of a state or political subdivision or instrumentality thereof do constitute a trade or business for self-employment tax purposes in cases in which (1) the functions are performed in a position compensated solely on a fee basis, and (2) the functions are not covered under a § 218 Agreement.

² 42 U.S.C. 418, as amended throughout chap. 42, (1970) ("§ 218 Agreement"). A § 218 Agreement is an agreement between a state, political subdivision, or instrumentality thereof and the Social Security Administration extending old-age survivors and disability insurance and hospital insurance coverage to employees of the state, political subdivision or instrumentality.

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Regulations § 1.1402(c)-2(b) defines the term "political office" as any elective or appointive office of a state, its political subdivisions, or a wholly owned instrumentality thereof.

Therefore, remuneration paid to a public official for the services performed for a public office is not subject to SECA unless the services are compensated solely on a fee basis, and such services are not covered by a § 218 Agreement. If the remuneration is not fee based, then it is wages subject to federal income tax withholding and FICA taxation.³

Revenue Ruling 74-608, 1974-1 C.B. 275, concerns an individual elected to collect the county, township, and school district taxes within his electoral district. The individual accounts for and turns over all the collected taxes to the treasurer of each taxing authority and is compensated from state funds based on a fixed percentage of the total amount collected. The ruling concludes that the remuneration an elected official receives in the form of a fee directly from the members of the public with whom he does business is actually a fee for purposes of § 1402(c)(1). However, when the remuneration is paid to an elected official by a government and no portion of the collected taxes belongs to him or may be retained by him as compensation, then the remuneration is not a fee under § 1402(c)(1). The revenue ruling concludes that since the individual does not receive his remuneration in the form of a fee directly from members of the public, he is not engaged in a trade or business and does not have net earnings from self-employment for purposes of § 1402.

Under current law, if an elected official receives remuneration directly from members of the public with whom he does business and such services are not covered by a § 218 Agreement, then such remuneration is considered a fee for purposes of § 1402(c)(1) and is subject to SECA tax. If, however, an elected official receives remuneration from a government and no portion of the amounts he collected may be retained by him as compensation, then such remuneration is not a fee under § 1402(c)(1) and is not subject to SECA. However, this amount is considered wages subject to federal income tax withholding and FICA taxation.

Deduction Issue

³ We note, however, that § 3121(b)(7)(F) provides that employees of states, political subdivisions, or wholly owned instrumentalities thereof who are members of a retirement system are exempt from the old-age survivors and disability insurance portion of FICA. Such employees may also be exempt from the hospital insurance portion of FICA if they were continuously employed by the state or political subdivision since March 31, 1986 or earlier.

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Section 62(a)(2)(C) provides that adjusted gross income is computed by subtracting from gross income deductions allowed by § 162, which consist of certain trade or business expenses paid or incurred with respect to services performed by an official as an employee of a state or political subdivision thereof in a position compensated in whole or in part on a **fee basis**.

The effect of § 62(a)(2)(C) is that public officials compensated in whole or in part with fees may deduct unreimbursed employee business expenses above the line, that is, without regard to the two percent floor imposed by § 67. Other public officials who receive non-fee compensation may deduct unreimbursed trade or business expenses allowed by § 162 below the line, that is, subject to the two percent floor imposed by § 67.

Conclusion

If an elected official receives remuneration directly from members of the public for whom he does business, and such services are not covered by a § 218 Agreement, then the remuneration is a fee and is subject to SECA taxes. If such elected official has unreimbursed business expenses as a result of performing such services, he may deduct them "above the line" pursuant to § 62(a)(2)(C).

In contrast, if an elected official receives remuneration from the government, then such remuneration is wages subject to federal income tax withholding and FICA taxation. If such elected official has unreimbursed business expenses as a result of performing such services, he may not deduct such expenses under § 62(a)(2)(C). He may only deduct such expenses as miscellaneous itemized deductions subject to the two percent floor.

If you have any questions, please do not hesitate to call
at (202) 622-6040.

Sincerely,
Lynne Camillo
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Office of Assistant Chief Counsel
(Exempt Organizations/Employment
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