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Dear Thomas:

Introduction

RockTheCapital.org (RTC) is a nonprofit, nonpartisan voter education organization formed after the Pennsylvania legislative, judicial and executive branches conspired to enact a compensation package in violation of a state constitutional provision which bans seated lawmakers from granting themselves a pay raise (RTC's state identification number is 84-1690253.)

To circumvent that legal prohibition (Article II § 8 of Pennsylvania's Constitution specifically prohibits members of the general assembly from receiving mid-term "compensation" increases) the increased salaries were disbursed as "unvouchered expenses".

Background

On July 7, 2006 at 2:00 a.m., the Pennsylvania House and Senate passed Act 44 increasing the salaries of officials in all three branches of government without public hearings, public debate or public knowledge.

As a result of public pressure created in part by RTC activities, the General Assembly passed and Governor Edward G. Rendell signed Act 72 of 2005 which repealed Act 44 on November 16, 2006. Act 72, however, did not require those who had received increased salaries to return the funds. As a result, lawmakers who accepted the "unvouchered expenses" will receive higher pension benefits.

In total 158 lawmakers accepted varying raises during the months of July through November, 2005.

The repeal also authorized a cost-of-living adjustment (COLA) of 3.6 percent for lawmakers and other public officials. The COLA took effect December 1, 2006.

By this letter RockTheCapital.org is requesting that the Pennsylvania Department of Revenue (PDR) state its position on the status of the increased income as it pertains to state liability through an Opinion(s) on several issues:

- 1) What is the Commonwealth's tax definition and liability of "unvouchered expenses"? Is compensation delivered through the mechanism of "unvouchered expenses" considered gross wages by the state? Do PDR tax definitions apply to state tax levies?
- 2) "Expenses" for tax purposes imply deductibility. Are these aforementioned "unvouchered expenses" tax deductible?
- 3) To be eligible for an unvouchered expense, taxpayers typically carry the burden of substantiating, recording and verifying expense accounts, and showing that the deduction is "ordinary and necessary expenses paid or incurred during the taxable year in carrying on" a trade or business. What accounting or reporting method, if any, might qualify this income as a legitimate expense?
- 4) Can those who accepted the increased pay avoid state tax liability by donating the income to charitable institutions?
- 5) Can expense "reimbursements" be considered both income for the purpose of a charitable donation, *and* a business expense for the purpose of a state tax deduction? If so, would the filer receive a double deduction?
- 6) If legislators are paying back the net amount of "unvouchered expenses" over several years, are they in violation of state rules on repayment of overpayment?
- 7) Does the PDR consider repayment plans over a certain period of time a loan? If so, should inputted interest be applied at the applicable state rate even if no interest is actually accruing?
- 8) Does avoided interest count as income for state tax purposes?
- 9) While we recognize that enforcement of the tax code generally ignores the legality of an individual's source of income and deductions, do the "public policy" implications of the instant matter outweigh the case decisions that support that doctrine?
- 10) Article II § 8 of Pennsylvania's Constitution specifically prohibits members of the General Assembly from receiving mid-term "compensation" increases, much like the 27th Amendment to the U.S. Constitution.

Does the mischaracterization of prohibited additional compensation as expenses lead to a bizarre result, i.e., that the very same monies are "expenses" for purposes of Pennsylvania law but are "income" for federal tax purposes?

11) If a legislator opts not to repay the “unvouchered expenses”, that amount can be applied towards his pension calculations and verified through the State Employees Retirement System.

Can the Pennsylvania Department of Revenue offer an Opinion on the implications of an increased pension benefits for those who accepted the increased salary and a repayment system that creates two classes of taxpayers? If so, please provide formal responses.

12) Is the PDR concerned that the mechanism in play creates a disincentive for legislators to pay back the “unvouchered expenses” or provide documentation on how the monies were spent?

Thank you in advance for your attention to these important matters.

Sincerely,

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