

# Accountable Reimbursement Plan

When determining how to handle ministry-related expense reimbursement for Pastors, Churches should set up an Accountable Reimbursement Plan. Ministry-related expenses are, quite simply, expenses that the Pastor incurs while doing ministry or the Church's business. Common examples include:

- Auto mileage and other travel expenses
- Dues (tithe) to district/denomination
- Meals
- Entertainment/Hospitality
- Cell Phone
- Gifts
- Education (tuition and books)
- Home office (computer, printer, supplies, etc.)
- Religious books and publications
- Daycare (ministry related)

If a Church does not have an Accountable Reimbursement Plan in place, but instead pays a Pastor an allowance for their expenses (i.e. auto or cell phone allowance), then those reimbursements are considered wages and are taxable to the Pastor. An Accountable Reimbursement Plan is a way for the Church to establish a reimbursement budget and allows the Pastor to turn in expense reports (see Exhibit 1) that the Church uses to reimburse the Pastor. Ministry related expenses that are reimbursed through an Accountable Reimbursement Plan are not reported as taxable income to the Pastor.

## Establishing an Accountable Reimbursement Plan

An Accountable Reimbursement Plan is a policy adopted by the Church (see Exhibit 2) that defines the terms, conditions, and tax rules related to tax deductible ministry-related expenses that are incurred by its employees. As with most things established by the IRS, there are specific requirements that must be met – an Accountable Reimbursement Plan must:

- Define the reimbursement policy, or expense allowance arrangement, to require that employee's substantiate their expenses and return any excess amounts received. If payments for wages and reimbursements are combined, the

reimbursement amount must be specifically identified, or made in a separate payment.

- Require written evidence that includes the amount, date, location, and business purpose of all expenses. It must also require receipts for lodging expenses and any other expenses that exceed \$75.
- Require the reasonable calculation of any money advanced so as not to exceed the anticipated expenditures.
- Require expenses to be substantiated and any excess reimbursement be returned to the Church within a “reasonable period of time”. The IRS has established the following reasonable time frames for Accountable Reimbursement Plans:
  - Advance payments should be made no more than 30 days before reasonably anticipated expenses are paid or incurred.
  - Substantiation of expenses should be received within 60 days after the expense was paid or incurred;
  - Return of excess amounts received should be completed within 120 days after the expense was paid or incurred.

### **How an Accountable Reimbursement Plan works.**

Without an Accountable Reimbursement Plan, the ministry-related expenses that a Pastor incurs will have a negative impact on their taxable income. Few, if any, other employees are expected to incur business related expenses without reimbursement from their employers. However the Church world is different. Many churches cannot afford the ministers salary let alone reimburse the minister for expenses incurred in the ministry.

The following example will demonstrate how an Accountable Reimbursement Plan can impact a Pastors taxable income and the resultant taxes they owe to the IRS.

Pastor Jerry was hired at Journey Church. The Board agreed that the cost of this ministry position was \$78,000. The Church has determined that they are not in a position to reimburse Pastor Jerry for his expenses in addition to the \$78,000 set aside as the cost of the position. Pastor Jerry has not elected to exempt out of Social Security.

It is anticipated that Pastor Jerry will incur the following ministry related expenses:

Auto expense – 16,000 miles (IRS guidelines allow .555/mile in 2013)	\$8,880
Tithe/Dues to district	\$7,800

Misc. Supplies	<u>\$1,320</u>
Total unreimbursed expenses	\$18,000

By structuring Pastor Jerry's compensation to include an Accountable Reimbursement Plan as a part of the ministry position, the \$78,000 the Board has set aside as the cost of the position is reduced by this \$18,000, leaving \$60,000 remaining for housing, salary, and other items.

The \$18,000 can be divided by the number of pay periods or be paid monthly, **but it must be paid as a separate item.** It should not be included as an item on his paycheck. A separate check should be issued and receipts documenting the expenses incurred must be required for payment. The impact of structuring Pastor Jerry's compensation plan in this way is that when Pastor Jerry prepares his personal tax return, he will not report his ministerial expenses on his tax return. Pastor Jerry will save the income and self-employment taxes he would otherwise incur.

### **The Tax Impact of not having an Accountable Reimbursement Plan**

Because most Pastors have a housing allowance that is considered non-taxable income for federal income tax purposes, in the absence of an Accountable Reimbursement Plan, their ability to deduct allowable business expenses on their federal income tax return is further impacted by IRS regulations.

**Without** an Accountable Reimbursement Plan, the process for determining how much of a Pastors ministry related expenses is as follows:

**Step 1** – Divide the allowable housing allowance or fair rental value of the parsonage by the total ministry income to get the nontaxable income percentage.

Total ministry income includes salary, fees, and expense allowances plus the allowable housing allowance or fair market value of the parsonage.

**Step 2** – Multiply the total ministry-related expenses times the nontaxable income percentage from Step 1 to get the expenses allocable to nontaxable income which is not deductible.

The following example, provided by the IRS, illustrates the computation:

#### **Example**

Fred receives a salary of \$36,000, an exempt housing allowance of \$18,000, and an auto expense allowance of \$6,000 for his services as an ordained minister. Fred incurs the following business:

Auto	\$7,150
Vestments	\$350
Dues	\$120
Publications and supplies	<u>\$300</u>
Total Expenses	\$7,920

Fred's nondeductible expenses are computed as follows:

**Step 1** - \$18,000 housing allowance/Nontaxable Income divided by \$60,000 total ministry income (\$36,000 salary, \$18,000 housing allowance and \$6,000 car allowance) equals 30% nontaxable income percentage.

**Step 2** – Total business expenses of \$7,920 times 30%, the nontaxable income percentage, equals \$2,376 as the nondeductible expenses.

Fred's deductible expenses are reported on Schedule A as miscellaneous deductions because as an employee of the Church he is issued a W-2. These expenses, along with any other miscellaneous deductions are subject to a further reduction of 2 percent of his adjusted gross income. Assuming his adjusted gross income is \$42,000 (\$36,000 salary plus \$6,000 car allowance), Fred's deductible ministry related expenses would be:

Total Business Expenses	\$7,920
Less: non-deductible portion of 30%	(\$2,376)
Less: 2% of adjustable gross income	<u>(\$840)</u>
Total deductible ministry related expenses	\$4,704

In this case, Fred would pay state and federal income taxes on \$3,216 that could have been avoided had his church established an Accountable Reimbursement Plan!

### **Pastor Jerry**

Let's look at how Pastor Jerry would be affected by Journey Church not establishing an Accountable Reimbursement Plan:

You will recall that Pastor Jerry's total compensation package is \$78,000 and we assume he has \$30,000 allocated as his housing allowance. In the absence of an Accountable Reimbursement Plan, the remaining \$48,000 is his salary - for this example, it is also his adjustable gross income.

Step 1 - \$30,000 housing allowance/Nontaxable Income divided by \$78,000 total ministry income equals 38% nontaxable income percentage.

Step 2 – Total business expenses of \$18,000 times 38% nontaxable portion equals \$6,840 as his nondeductible expenses.

Total Business Expenses	\$18,000
Less: non-deductible portion of 38%	(\$6,840)
Less: 2% of adjustable gross income	<u>(\$960)</u>
Total deductible ministry related expenses	\$10,200

Assuming a 15% tax rate, Pastor Jerry would pay federal income tax on the \$7,800 (\$18,000 total ministry related expenses less \$10,200 deductible ministry related expenses) of nondeductible ministry related expenses of \$1,170 – that’s additional federal income tax that Pastor Jerry will have to pay because there was no accountable reimbursement plan!

Note: Many people treat the tithe to the organization as a charitable expense and not as a dues or business expense. This can cause the Pastor to pay 15.3% self-employment tax on the amount of the tithe or dues. Also note that all unreimbursed expenses should be subtracted from total social security taxable income before calculating the self-employment tax.

<b>No Accountable Reimbursement Plan</b>		<b>Accountable Reimbursement Plan</b>	
Gross Income	\$78,000	Gross Income	\$60,000
Deductible ministry expenses	\$10,200	Deductible Ministry Expenses	\$0
Adjusted Gross Income	\$67,800	Adjusted Gross Income	\$60,000
15% tax	\$10,170	15% tax	\$9,000

This resource is compliments of: Payroll for Pastors  
 6535 Green Bay Road  
 Kenosha, WI 53142  
 (636) 944-1040  
[www.PayrollforPastors.com](http://www.PayrollforPastors.com)

# PASTOR'S EXPENSE REPORT

Name \_\_\_\_\_

Date \_\_\_\_\_

## 1. AUTOMOBILE EXPENSES

- a. Business miles times standard  
rate of \_\_\_\_\_ per mile \$ \_\_\_\_\_
- b. Parking fees, tolls, local fares \$ \_\_\_\_\_

TOTAL AUTOMOBILE EXPENSES 1(a) + 1(b) \$ \_\_\_\_\_

## 2. Professional Expenses

- a. Travel away from home overnight
- 1. Fares (air/train/bus/taxi) \$ \_\_\_\_\_
  - 2. Car rental \$ \_\_\_\_\_
  - 3. Lodging \$ \_\_\_\_\_
  - 4. Meals \$ \_\_\_\_\_
  - 5. Registration and materials \$ \_\_\_\_\_
  - 6. Telephone, fax, postage \$ \_\_\_\_\_
  - 7. Tips, laundry, cleaning \$ \_\_\_\_\_

SUB-TOTAL 2(a) 1 - 7 \$ \_\_\_\_\_

- b. Entertainment at restaurant/home \$ \_\_\_\_\_
- c. Continuing education \$ \_\_\_\_\_
- d. Local church conferences \$ \_\_\_\_\_
- e. Dues to religious & civic groups \$ \_\_\_\_\_
- f. Books and publications \$ \_\_\_\_\_
- g. Supplies for ministering \$ \_\_\_\_\_
- h. Cell phone \$ \_\_\_\_\_
- i. Business gifts \$ \_\_\_\_\_
- j. Vestments (not suits) --  
purchase and cleaning \$ \_\_\_\_\_
- k. Child care (ministry related) \$ \_\_\_\_\_
- l. Equipment repair/maintenance \$ \_\_\_\_\_
- m. Equipment purchase payments \$ \_\_\_\_\_
- n. Church and ministry meetings \$ \_\_\_\_\_
- o. Miscellaneous (describe) \$ \_\_\_\_\_

SUB-TOTAL 2(b) - 2(o) \$ \_\_\_\_\_

TOTAL PROFESSIONAL EXPENSES \$ \_\_\_\_\_

TOTAL EXPENSES \$ \_\_\_\_\_

All receipts are enclosed and all non-receipted records are either enclosed or available for inspection to verify all reported expenses. This report received, verified and filed in church records.

Signature: \_\_\_\_\_  
Minister

\_\_\_\_\_  
Church Treasurer/Officer

**Policy Statement**

**MINISTRY EXPENSE REIMBURSEMENTS**

It is the policy of \_\_\_\_\_ Church to reimburse the pastor and other professional staff members for all ordinary and necessary expenses required for the performance of ministry within and on behalf of the church. This will be in accordance with the regulations governing an accountable reimbursement plan, as set forth in IRS Regs. 1.162-17 and 1.274-5(d).

Expenses that are considered by the church to be ordinary and necessary for the performance of ministry include, but are not limited to, the following: on-the-job transportation, out-of-town travel to church conferences and assemblies, professional continuing education, professional materials, (books, magazines, journals, papers, tapes, films, office supplies, etc.), professional entertainment and gifts for conducting church business and developing pastoral relationships, professional dues and fees for memberships in religious and civic organizations to represent the church in religious and civic affairs, telephone, professional equipment (communion, office, library, audiovisual, etc.) and the purchase and cleaning of clergy vestments. Child care expenses are considered to be ordinary and necessary when incurred to enable both minister and spouse to attend church functions for which the presence of the spouse is important to the continuing ministry of the church.

The church, at its discretion, may elect to pay such expenses by direct billing or upon receiving receipts and vouchers from the minister or by paying the minister an expense allowance in advance. When an advance allowance is given, the minister is accountable to the church by documenting how the allowance was used (business purpose, date, and amount of each expense). Such documentation includes the filing of periodic expense reports, no less than quarterly, with substantiating records, receipts and statements. Excess reimbursements need to be repaid to the Employer (church) within 120 days, or additional expenses substituted within 60 days.

The church recognizes the professional nature of ministry and recognizes the right of the minister to use professional judgment when incurring ministry expenses.

The church has the right to limit the amount of ministry expense reimbursements.

This policy remains in effect until amended or rescinded.

Adopted by the church on this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_\_.

Church Officer: \_\_\_\_\_  
Signature Title