16. Employee Business Expenses

Basically there are two methods being used for handling the reimbursement of employee business expenses. The first method is an accountable reimbursement arrangement. The second method would be a nonaccountable reimbursement arrangement.

Accountable Reimbursement Arrangement
Under the accountable reimbursement method the pastor or lay employee is reimbursed for such out of pocket expenses as mileage, out-of-town travel, and other miscellaneous expenses he may incur related directly to his employment. Normally the pastor submits a check request showing his back-up documentation supporting the expenses. The treasurer then issues him a check in reimbursement.

This method of handling employee business expenses is the most favored because the reimbursement is not seen as compensation. The reimbursement amounts do not show up on the W-2, nor does the pastor need to claim the deduction for them on his tax form.

Your reimbursement policy must be put in writing. The IRS allows only a certain amount per mile reimbursement. Certain other expenses may need caps or limits put on them. Other expenses may need prior council approval before your pastor incurs the expense. Also, the reimbursements must be made on a timely basis – usually thought of as within 60 days.

Nonaccountable Reimbursement Arrangement
Some congregations make use of a nonaccountable method for reimbursing their pastor's expenses. In this situation the pastor is given a monthly cash allowance for car expenses, book expenses, pastoral expenses or whatever. Call it what you like, but whenever a congregation hands money over to their employee without requiring any accounting for it, the IRS calls it taxable wage and requires that these allowances (with the exception of the housing allowance) be shown as wages on the W-2 form. The pastor can then deduct her expenses on Form 2106, but these now flow through to Schedule A and are limited by a floor of two percent of her adjusted gross income.

Hybrid Method

One other method for handling employee business expenses can occur which combines the two aforementioned methods. In this case the congregation gives the pastor a monthly allowance but then requires a periodic accounting of what this allowance was used for. If the total allowance can be substantiated or if only a portion of the allowance can be substantiated but then the unsubstantiated amount is paid back to the congregation (the pastor keeping funds for only the amount that can be documented), then the IRS views this as an accountable reimbursement method and the allowance that the pastor actually received does not need to be shown on his W-2. If, however, he is not required to repay the unsubstantiated amounts of the allowance, the entire allowance is seen as taxable wage and must be shown on the W-2. The pastor can then claim the deduction of those business expenses on Form 2106.

This method may help the pastor out in that he need not be digging deep into his own pockets to pay for expenses that ultimately are the responsibility of the congregation. This method though may require a bit more work from the congregational treasurer and may mean that certain tax filing requirements cannot be accomplished until the final accounting for the allowances is complete.

Unreimbursed Expenses

Some congregations choose not to reimburse their pastor or lay employee for business expenses. This of course has direct impact on his personal income if he is constantly using a portion of his salary to do the church's business. This is not acceptable. There is very little tax relief in such a situation as now all employee business expenses can only be deducted on the Schedule A (which many taxpayers cannot file) and they can be taken only to the extent that they exceed 2% of the adjusted gross income of the pastor.