

# How Churches Pay for Ministry Related Expenses

## 1. An Allowance or Non-Accountable Reimbursement

When a church covers ministry related expense using an allowance or a non-accountable reimbursement, all those payments must be included with taxable salary on an employee's W-2 and reported as taxable income.

Unreimbursed expenses may be "deductible" by the minister as a miscellaneous deduction when doing taxes. But the amount of the deduction may be reduced in three different ways:

- The deductible amount for ministers is reduced by the percentage of total compensation that consists of tax-exempt minister's housing. ("Deason Rule") *For example, if 40% of a minister's compensation is tax-free housing, then 40% of the expenses are not deductible.*
- All miscellaneous deductions are reduced by 2% of a person's Adjusted Gross Income.
- If the standard deduction is used by a minister, no expenses can be deducted for income taxes.

### RESULTS OF USING AN EXPENSE ALLOWANCE:

- A. Employees WILL pay income tax on some of the expense money and many employees will end up paying income tax on all expense allowance money.
- B. Expense allowances are often perceived incorrectly as part of an employee's "pay package."

## 2. An Accountable Reimbursement Plan

A well-structured accountable reimbursement plan for ministry related expenses allows a church to correctly recognize those costs as "expenses", not "pay". If done correctly as outlined below, amounts paid to reimburse church employees for expenses incurred in doing their job are non-taxable.

- A. To cover employee's expenses incurred in doing their jobs, the church should adopt an Accountable Reimbursement Plan as a matter of church policy. *See the link to the sample policy.*
- B. The policy should specify that the IRS mileage rate for business related miles should be used.
- C. The policy must follow IRS requirements to qualify as an accountable reimbursement plan:
  - a. The expense must have a business purpose. (Personal or commuting miles are NOT to be included.)
  - b. There must be written substantiation (daily accounting of business expenses reported to the church) within a reasonable time. (Generally 60 days) *See the link to the sample form.*
  - c. The return of amounts in excess of substantiated expenses must be required. (Within 120 days after the expenses are incurred)
  - d. Salary Reduction or similar adjustments to compensation may NOT be used to fund the reimbursement of ministry related expenses.
- D. Budgeted expense funds not used for accountable expense reimbursement are retained by the church.
- E. Expense payments that comply with all the above requirements are NOT reported as taxable income.
- F. In a printed budget, expenses should be listed in a different budget section from staff compensation and benefits. This helps the church have a correct perception of the expenses reimbursing what it costs to do the job rather than appearing to be part of the compensation.

Links are also available on the website to the following two forms that will be helpful in administering an Accountable Reimbursement Plan for Expenses:

"Sample Church Expense Reimbursement Policy"  
"Ministry Related Expense Form"