

Auto and Other Business Expense Reimbursements

P&B MEMO 11



Pensions and Benefits USA
Church of the Nazarene



Importance of Full Reimbursement

For years it has been a significant income tax advantage for church employees to have ministry-related expenses reimbursed by the church. The best way to do this has been through use of an accountable reimbursement plan, which put an entire dollar back in the employee's pocket for every dollar spent on eligible business expenses. It used to be that even if you did not have a formal plan, a minister could itemize unreimbursed expenses on Schedule A, although the benefit would be significantly less than what had been spent.

With the passage of the Tax Cuts and Jobs Act of 2017, we are in a new world for unreimbursed business expenses. Employer-related business expenses that are not reimbursed are simply not deductible at all for income tax purposes. This is because the Miscellaneous Deductions section of Schedule A was eliminated for 2018 and later years.

So now, the importance of reimbursing an employee's church-related business expenses is vital. Without tax-free reimbursement under an accountable plan, employees will not recoup any of these expenses.



Idea!

Set up an "accountable reimbursement plan" to maximize tax-free reimbursements.



IRS Regulations

Requirements for business expense reimbursements are based on IRS Regulation 1.62-2(d)(3). These requirements apply to every church and affect all employees. They are not optional—they must be followed, or the church employee may pay significantly greater amounts of unnecessary taxes.

The IRS regulations require that business reimbursements be included on Form W-2 as taxable income to the individual unless paid through an accountable reimbursement plan which has been formally adopted by the church board. The requirements for the accountable reimbursement plan are three-fold:

1. The church may reimburse only those business expenses that an employee substantiates within 60 days of the expenditure with receipts and/or in writing as to the date, amount, place, and business nature.
2. The employee must return any excess reimbursements (i.e., unused expense advances) within 120 days of the expenditure. The excess reimbursement may not be treated as a bonus or gift.
3. Any advance must be made within 30 days of when the expense is paid or incurred.

Form W-2 income cannot simply be reduced after-the-fact. In other words, the IRS will not allow reimbursements to be paid through a retroactive reduction of salary. In order for reimbursements to be paid and qualify under an accountable reimbursement plan, properly substantiated expense reimbursements must be paid separately from the employee's salary. The salary amount and the accountable reimbursement plan must be established in advance of payment. If the church establishes a dollar limit on the expense plan (instead of reimbursing 100% of expenses), any balance remaining in the expense plan at year-end should remain with the church. The payment of the balance to the employee makes all payments made to the employee under the plan during the year reportable as taxable income on Form W-2.

Remember!

Business reimbursements must be included on Form W-2 as taxable income unless they are paid through an accountable reimbursement plan which has been formally adopted by the church.



Caution!

The IRS will not allow reimbursements to be paid through a retroactive reduction of W-2 salary.



Transportation, Travel, and Other Business and Professional Expenses

Most church employees incur business transportation and travel expenses while conducting the ministry of the local church. Many churches are careful to reimburse their employees in full for these expenses, properly recognizing them as local church operating expenses.

Often, church employees also incur business and professional expenses in their ministry. Examples include: business-related entertainment, professional books and magazines, memberships and dues in professional organizations, stationery and supplies, etc. Normally, the church board recognizes these as necessary for the work of the church and views them as local church expenses, and the employee should be reimbursed in full. If these expenses are paid properly through an accountable reimbursement plan, the IRS says they are not reportable as income.

For example, reimbursable phone expenses may include long-distance calls, a second phone line, special equipment, and services such as call-waiting if there is a business relationship. Basic local service charges (including taxes) for the first line in the home are not considered a business expense.

Likewise, qualifying educational expenses may be reimbursed in full under an accountable reimbursement plan. Typical expenses include tuition, books, supplies, transportation away from your hometown, meals, lodging (if necessary to be away from home overnight to attend classes), and correspondence courses. Qualifying educational expenses are those incurred to meet the requirements of your church to keep your present position, or to maintain or improve skills in your present employment. Expenses do not qualify, even though these requirements are met, if the education is required for you to meet the minimum educational requirements of your occupation, or part of a program of study that will qualify you for a new occupation. For example, a minister who has not been gainfully employed as a minister will not be able to count his or her seminary education. However, a pastor who is obtaining additional education likely will qualify.

You must not be absent from your profession for more than a year. The IRS considers it a career change if you work a secular job for more than a year while obtaining additional education. Also, travel costs claimed as a form of education (e.g., a trip to the Holy Land) do not qualify. However, enrollment in a formal course of study overseas may qualify.

Remember!

The IRS allows churches to reimburse employees for business and professional expenses tax-free if the reimbursements are paid through an accountable reimbursement plan.



Caution!

Education expenses incurred for meeting the minimum qualifications of your occupation are not reimbursable.



The Automobile Allowance Method

Probably the largest business expense for a minister is the auto expense. Some churches continue to provide a nonaccountable car allowance. However, the IRS says such nonaccountable allowances are to be reported as income on Form W-2.



Caution!

A nonaccountable car allowance must be reported as income on Form W-2.

The Automobile Reimbursement Method

A good plan is for the church board to adopt an accountable reimbursement plan and include auto expense reimbursement on a business mileage basis. Actual auto expenses may be reimbursed; however, the simplicity of using the Standard Mileage Rate is compelling.

If you account to your church for all your business miles and are reimbursed at the Standard Mileage Rate, the reimbursement is not included as income on Form W-2. Records providing evidence for business miles are provided by you to the church treasurer to support the reimbursement. The IRS can supply details about accounting and record keeping for reimbursements at [irs.gov](https://www.irs.gov) (800-TAX-FORM).



Remember!

The simplest method for automobiles is full reimbursement at the Standard Mileage Rate.

The Church-Owned Automobile

Some churches provide staff members with the use of a church-owned vehicle. When an employee uses a church-owned vehicle for both business and personal use, certain procedures are required for tax purposes. (Personal use generally includes commuting between home and the church.)

The employee must keep adequate records of business use miles for which the church-owned car is driven. These records should indicate date, purpose, destination, and miles for all business transportation/travel. It is not enough to just keep a tally of personal use miles. The total miles the car is driven during the year should be determined based on odometer readings at the beginning and end of the year. Total miles driven, less business miles, provides the number of personal miles on which to determine personal use value.



Caution!

Detailed auto records must be kept for a church-owned automobile, including odometer readings for the year and an accurate description of business mileage.

If the employee fully reimburses the employer for the value of the personal use of the vehicle, then no value would be reported as taxable income on Form W-2. Otherwise, the value of personal use of a church-owned vehicle is a taxable benefit to the employee and must be included on an employee's Form W-2. Income tax is not required to be withheld for lay employees as long as the employer advises all employees that no withholding will be done for the value of the benefit. Notification must be made by January 1 of the year in which no withholding will be done. FICA Social Security taxes must be withheld on the full amount of the value added for each affected staff member who is not ordained or district-licensed.

The value of the availability of a church-owned vehicle to be added to Form W-2 (or reimbursed to the employer by the employee) is the cost to the employee of renting or leasing a comparable vehicle. The IRS has standard tables which determine the Annual Lease Value of a vehicle based on the vehicle's Fair Market Value. The value of the fuel used is another benefit that must be added if the church pays for the fuel. An employer should contact the IRS ([irs.gov](https://www.irs.gov)) and request the most recent information when determining these values for tax and income reporting purposes (IRS Publication 535, *Business Expenses*).

Likewise, the church board and staff of any church providing vehicles to employees for both personal and business use will want to work closely with their personal tax advisors to make certain the value of the benefit is determined and reported properly.

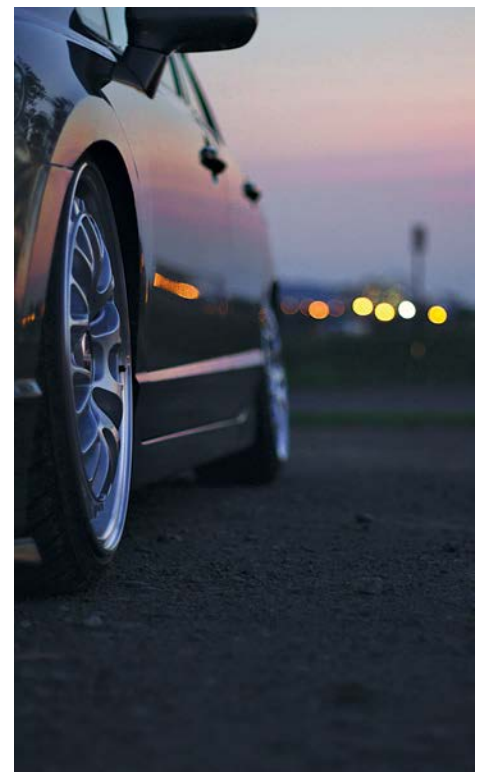
Caution!

If a church employee does not reimburse the church for personal mileage of a church-owned vehicle, the value of the personal use must be declared as income on Form W-2.



See:

IRS Publication 535 for information on determining lease and fuel values for personal use of a church-owned vehicle.



Documentation of Mileage

Regardless of the method in which auto expenses are handled, accurate and detailed written records are essential to document the following: the amount of expense and/or mileage, the time and place of transportation/travel, and the business purpose. The taxpayer is required to have adequate records or sufficient evidence to support the taxpayer's own statement. The best method is to keep a detailed daily log.



Remember!

Accurate and detailed written records are essential.

Depreciation Restrictions

Rules governing depreciation deductions for automobiles continue to change. Certain transition rules may be applicable to some situations. If you are using depreciation under the actual expense auto deduction rules, work closely with your personal tax advisor.

Conclusion

All business and professional expenses should be reimbursed in full to each employee through an accountable reimbursement plan adopted by the church board which results in the proper substantiation to the church of all reimbursements. This method is IRS-approved, is least costly in taxes, and is the easiest for the church and employee to use with regard to record keeping and tax forms.



Here are other P&B Memos that might be helpful.

- MEMO # 1: *Housing for Your Pastor: Parsonage or Housing Allowance?*
- MEMO # 2: *Church Employees or Independent Contractors?*
- MEMO # 3: *Tax and Reporting Procedures for Congregations*
- MEMO # 4: *Strategies for Structuring Ministerial Compensation*
- MEMO # 5: *Minimizing Income Taxes for Church Employees*
- MEMO # 6: *Housing Allowance in Retirement*
- MEMO # 7: *How Much Do We Pay the Minister?*
- MEMO # 8: *The Annual Church Audit*
- MEMO # 9: *Workers' Compensation Laws and the Local Church*
- MEMO # 10: *Can Ministers Opt Out of Social Security?*
- MEMO # 12: *Who Is a Minister for Tax Purposes?*
- MEMO # 13: *The Minister's Housing Allowance*

The information contained in this memo series is of a general nature reflecting USA Nazarene Church polity. It is not offered as specific legal or tax advice. Each person, local church board, and district should evaluate their own unique situation in consultation with their local legal and tax advisors.



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