Chapter 6: Business Expenses

INTRODUCTION **100**
Accountable Plan/Direct Reimbursement of Expenses 110
Direct Reimbursements to Volunteers 111
Cash Allowances 115
Record Keeping 120
Unreimbursed Business Expenses 125
Business Deduction Limitations 130
Automobile Expenses 135
Transportation Expenses 136
Moving Expenses 140

QUICK REFERENCE

	2018	2017
Standard business mileage rate	¢	53.5¢
Medical/moving mileage rate	¢	17¢
Charitable mileage rate	¢	14¢

* 2018 rates will be released by IRS sometime closer to January. We will update and post new rates at www.lcms.org/resources.

6.100: Introduction

The manner in which “business” expenses are treated on a federal income tax return depends on whether the expenses are reimbursed by the employer and whether the reimbursement is a fixed cash allowance *(“cash allowance”)* or a dollar-for-dollar reimbursement *(“direct reimbursement”)* under which the employee accounts adequately to the employer for the expenditures.

Cash allowances paid to the employee without a required accounting of expenses to the employer are includable as income on Form W-2, not deductible for non-itemizers, and deductible as an itemized deduction on Schedule A of Form 1040 only if they exceed 2 percent of adjusted gross income *(when added to other miscellaneous itemized deductions)*.

Business expenses for which the employee receives a direct reimbursement following an adequate accounting of expenses are not includable as income.

6.110: Accountable Plan/Direct Reimbursement of Expenses

The direct reimbursement method is an understanding between the employee and the congregation or other employer that expenses for local transportation, out-of-town travel and other expenses related to employment, such as the expense of maintaining a library, will be directly reimbursed upon presenting proof of personal payment for those items. The direct reimbursement method is the most favorable because tax regulations permit the congregation or other employer not to report the reimbursement as compensation paid to the employee on Form W-2 and also permit the employee not to report the reimbursement as income on Form 1040.

When the congregation or other employer begins to use direct reimbursement, they must adopt a resolution outlining the terms of the Accountable Reimbursement Policy.

The following resolution is suggested:

The following resolution was adopted by the ______ __________________Church, (organization), in its Voters' Assembly/Board meeting held on (date)__________.

It is hereby resolved, that the ____________________ Church adopt an Accountable Plan Reimbursement Policy which is in accordance with income tax regulations 1.162-17 and 1.274-5T(f), as described in the following terms and conditions:

1. Any minister or other employee who is employed now or hereafter shall be reimbursed for any ordinary and necessary business and professional expense incurred on behalf of the Church only if the following conditions are satisfied: (1) The expenses are reasonable in amount; (2) The employee documents the amount, time and place, business purpose and business relationship of each expense with the same kinds of documentary evidence as would be required to support a deduction of the expense on the person's federal income tax return; and (3) the employee documents such expenses by providing the Church treasurer with an accounting of such expenses no less frequently than monthly. In no event will an expense be reimbursed if substantiated more than 60 days after the expense is paid or incurred by the employee or bona fide volunteer (including a director or officer).

   It is understood that the above conditions are in large part taken from income tax regulation 1.274-5T(f), which provides that—

   “an adequate accounting means the submission to the employer of an account book, diary, statement of expense, or similar record maintained by the employee in which the information as to each element of expenditure (amount, time and place, business purpose and business relationship) is recorded at or near the time of the expenditure, together with supporting documentary evidence, in a manner which conforms to all the ‘adequate records’ requirements.”

TREASURERS:
INSIST ON DOCUMENTATION FOR ALL BUSINESS EXPENSES.

2. Reimbursements shall not be paid by increasing paychecks by the amount of business expense reimbursements. Rather all such reimbursements shall be separately paid out of church funds.
3. Reimbursable business and professional expenses include local transportation, overnight travel (including lodging and meals), entertainment, books and subscriptions, education, vestments and professional dues.
4. The church shall not include on the employee's Form W-2 the amount of any business or professional expense properly substantiated and reimbursed according to the preceding paragraphs. The employee should not report the amount of any such reimbursement as income on his/her Form 1040.
5. Any church reimbursement that exceeds the amount of business or professional expenses properly accounted for by an employee according to the terms of this reimbursement policy must be returned to the church within 120 days after the associated expenses are paid or incurred and shall not be retained by the employee.
6. If, for any reason, the church's reimbursements are less than the amount of business and professional expenses properly substantiated by an employee, the church will report no part of the reimbursements on the employee's Form W-2, and the person may deduct the unreimbursed expenses as may be allowed by law.

7. Under no circumstances will the church reimburse an employee for business or professional expenses incurred on behalf of the church which are not properly substantiated according to this policy. The church and staff understand that this requirement is necessary to prevent this reimbursement plan from being classified as a "nonaccountable" plan, which would then require the reporting of all such reimbursements as taxable income on Form W-2.
8. All original receipts and other documentary evidence used by an employee to substantiate the business nature and amount of his/her business and professional expenses incurred on behalf of the church shall be retained by the employee. The church may, at its election, make copies of such evidence.

A standard "expense" voucher should be developed for use by the congregation. The following example can be used or modified to meet the needs of the congregation or organization.

First Lutheran Church
2743 Concordia Drive, St. Louis, MO 63122

EXPENSE REIMBURSEMENT VOUCHER

Date ________________
Name ____
Address ____
City ________________ State _____ ZIP _______________

Business Purpose ______________________________

____

Travel Expense:
Auto Expense______________@ $.??/mile______
(Mileage log should be attached)

Other Expenses: _______________ _______________
Other Expenses: _______________ _______________
___________________________ _______________
___________________________ _______________

(Receipts attached)
TOTAL EXPENSES _____________

Signature ______________________________________

Approved by _______Acct # _________ Amt $ _________
Approved by _______Acct # _________ Amt $ _________

6.111: Direct Reimbursements to Volunteers

Organizations that reimburse volunteers for business expenses incurred while performing service, including their transportation expense at the standard business mileage rate, can do so without including any portion of it in their income if the volunteers follow the same rules as employees' reimbursements under an accountable plan. In order to receive mileage reimbursement, they must account for the time, purpose, and number of miles driven for each trip. Refer to 6.110 for the rules that must be followed.

6.115: Cash Allowances

If, instead of a dollar-for-dollar reimbursement of expenses, the congregation grants a cash expense allowance to an employee with no substantiation requirement, the amount paid by the congregation to the employee must be reported on the employee's Forms W-2 and 1040. The employee must complete Form 2106, "Unreimbursed Employee Business Expenses," in order to deduct his/her business expenses. They are deductible as miscellaneous itemized deductions on Schedule A of Form 1040 only if they exceed 2 percent of adjusted gross income.

6.120: Record Keeping

Whether the direct reimbursement method or the cash allowance method is adopted by the congregation to reimburse the employee for employee business expenses, it is important to maintain adequate records in order to support either the exclusion of the reimbursement from income or the deductibility of such amounts from expense allowances included on Form W-2 as income.

6.125: Unreimbursed Business Expenses

If the employer does not pay for the employee's business expenses, they may be able to claim a deduction for such expenses.

Employee business expenses other than reimbursed expenses (paid for by the employer through the cash allowance or direct reimbursement method) are allowed as miscellaneous itemized deductions to the extent that they exceed 2 percent of adjusted gross income when added to other deductions in that category. The deduction is calculated on Form 2106.

6.130: Business Deduction Limitations

The IRS has taken the position that the pro rata portion of unreimbursed business expenses attributable to amounts of income of a minister that are excluded from tax as a housing allowance are not allowed as deductions. It is not clear whether the IRS would take a similar position on reimbursed expenses. Each individual should consult their tax adviser regarding this question if they receive a housing allowance.

For example: Pastor Schmidt receives compensation of $28,200—of which $9,600 (34 percent of $28,200) is tax-exempt housing allowance—and incurs unreimbursed business expenses of $1,000. He is limited to a miscellaneous deduction of $660 (66 percent of $1,000). The $340 (34 percent of $1,000) is prohibited because it was directly attributable to tax-exempt income, and its deduction would otherwise amount to a "double deduction." Further, the $660 miscellaneous deduction is only allowed if he itemizes his deductions (Schedule A) and to the extent that it exceeds 2 percent of his adjusted gross income. The partial disallowance of a business deduction affects only his calculation of taxable federal income. For purposes of figuring his self-employment tax, he can use the entire amount of unreimbursed business expenses to reduce his income.

6.135: Automobile Expenses

Expenses incurred to operate a car owned or leased by the employee may be calculated based on the actual expenses incurred (such as gas, oil, repairs, depreciation, etc.) or based on an amount per mile as prescribed by the IRS. If an owner or lessee uses actual expenses, the total expense must be prorated between business and personal use (commuting). Lessees fully deducting the business use (percent) of their annual lease costs should be aware that if their passenger car's value at the beginning of the lease exceeds $19,000 (for 2016), a set amount must be included or "added back" each year to partially offset the entire lease deduction. For trucks and vans, this add-back is necessary if the vehicle's value exceeds $19,500 (for 2016). Inclusion amounts are listed in the appendix of IRS Publication 463. Unreimbursed business expenses (which include automobile expenses) are allowed as itemized deductions to the extent they exceed 2 percent of adjusted gross income.

6.136: Transportation Expenses

A taxpayer's costs of going between one business location and another business location generally are deductible; whereas, commuting between his or her residence and regular place of employment generally are nondeductible personal expenses. Special situations in which commuting expenses are deductible are as follows: (1) daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location outside the metropolitan area where the individual lives and normally works; (2) costs of daily travel between the residence and a temporary work location in the same trade or business, regardless of the distance, by a taxpayer who has one or more regular work locations away from the residence; and (3) costs of daily travel between the residence and another work location in the same trade or business, regardless of whether the other work location is regular or temporary and regardless of the distance, if the residence is the taxpayer's principal place of business.

Example: Pastor Ostermeyer's office is in the church and he regularly make visits at a nearby nursing home. The regularity in which he ministers at each of these locations causes them to be his regular places of business. Occasionally, he goes to the hospital to make sick calls. Pastor Ostermeyer's cost to go between home and church or home and the nursing facility are nondeductible personal commuting expenses to his regular place of business. However, his costs are deductible to travel between home and the hospital; between church and the hospital; between the nursing home and the hospital; or between the church and the nursing home.

For an employee, the tax treatment of the deduction depends upon whether the expense is reimbursed by the employer under an accountable plan or whether the expense is not reimbursed or reimbursed under a nonaccountable plan are deductible only as itemized deductions subject to the 2 percent floor on miscellaneous itemized deductions.

For more information related to deductible transportation costs, refer to IRS Publication 463, under Transportation.

6.140: Moving Expenses

Qualifying moving costs can only be excluded from taxable income when the employee's new main job location is at least 50 miles farther from home than the old job location. When no previous job exists to measure from, the 50-mile distance is merely that from home. Qualified moving expenses paid by the employer directly to a third party are not reportable. Payments paid directly to the employee under a qualified reimbursement plan are not reported as taxable income in Box 1 on the employee's Form W-2, however, are reported to the IRS in Box 12 of Form W-2 coded "P." (See 7.350 which provides details.)

Qualified moving expenses reported on Form 3903 include those reasonable costs to move the family and household goods, storage for 30 days after the move, costs to disconnect and reconnect utilities, and related transportation and lodging costs (not meals) while traveling to the new home. The standard mileage rate for qualified moving expenses is limited to $.17/mile. This rate may change for 2018. Amounts reimbursed in excess of the standard are considered unqualified.

If an employer reimburses the employee for qualified moving expenses under a nonaccountable plan, the amount reimbursed must be included in the employee's Form W-2. A nonaccountable plan includes a moving allowance that the employer pays without requiring the employee to adequately account for all expenses incurred and return the unspent portion within a reasonable period of time. In either that event or when an employee pays for these costs without being reimbursed, he/she can reduce taxable income on Form 1040 without having to itemize on Schedule A. For this purpose, the employee should retain receipts to back up his/her claim for reduction.

If an employer reimburses an employee for any unqualified moving expenses, these costs must be added to the employee's wages and are subject to income, Social Security and Medicare taxes paid by means of withholding or estimated payments.