



## ACCOUNTABLE PLAN FOR MINISTRY EXPENSES

### The Importance of an Accountable Plan and How to Implement It

An Accountable Plan appropriately enables the church, rather than the minister, to pay for ministry job-related expenses. It ends the traditional but inappropriate practice of the church requiring the minister to pay job-related expenses from salary or expense allowances without any accountability. Setting up an Accountable Plan generally does not cost the church anything and it saves the minister considerable tax dollars. Quite often, it simply requires restructuring the ministry support package to clearly identify that portion the church intends the minister to use to pay ministry expenses – and the minister accounts to the church for those expenses. The tax law references for the Accountable Plan are Internal Revenue Code Sections 62(a)(2), 162(a) and 274 and Federal Tax Regulations 1.162-2, 1.162-17 and 1.274-5.

The business world has long recognized the appropriateness of paying or reimbursing job related costs for on-the-job transportation, out-of-town business travel, supplies, books, seminars, continuing education, job training, tools, equipment, uniforms, business phone calls, business meals and business entertainment. Business employers understand that these are ordinary and necessary business expenses, not personal expenses of their employees. In contrast, churches and other religious organizations have not always paid job related ministry costs, at least not fully. Ministers often pay many of these church business expenses from expense allowances, without accounting to the employer, or from salary. This reduces the minister's personal income and forces the minister to pay considerable unnecessary and avoidable tax.

Setting up an Accountable Plan is simple. The first step is for the employer to adopt a written policy statement. The second step is for the employer to provide the funding. The third step is for the minister to account to the church, in a timely and proper manner, for all ministry expenses.

### ADVANTAGES OF AN ACCOUNTABLE PLAN

An Accountable Plan that pays for or reimburses **all** ministry expenses will:

- 1. Properly Identify Ministry Expenses as Church Business Expenses.** An Accountable Plan educates church lay leaders and church members that ministry expenses are church business expenses, not personal expenses of the minister. Ministry compensation is clarified and improved when ministry expenses are clearly identified and fully reimbursed.
- 2. Avoid the 50% Business Meals and Entertainment (50% BME) Loss.** Only 50% of the *unreimbursed* cost of business meals and entertainment is deductible as a business expense on an individual's tax return. Due to the personal and family nature of ministry, this is usually the second highest cost for most ministers. Only business use of a car is typically a greater cost. A minister loses 50% of the costs for business meals and entertainment if these are not paid or reimbursed by the church. This 50% loss does not occur when these expenses are paid by the church under an Accountable Plan.

3. **Avoid the Section 265 Proration Loss.** Internal Revenue Code section 265 prohibits deduction of expenses incurred to earn tax free income. Three tax court cases have applied this ruling to reduce ministry expenses in relation to the tax free nature of ministry housing (Deason in 1964, Dalan in 1988, McFarland in 1992). These tax court cases require that any unreimbursed expenses which ministers deduct on their tax return be reduced by the same percentage that their housing is to their total ministry income. For example, a minister earning \$35,000, of which \$15,000 is housing allowance, will lose the deduction of 43% ( $\$15,000 \div \$35,000 = 43\%$ ) of all unreimbursed ministry expenses. Extending this example, if there were \$6,000 in ministry expenses, then \$2,580 are not deductible. That minister, in 15% Federal and 5% state income tax brackets, will pay \$516 more tax. An Accountable Plan eliminates this extra and unnecessary tax.

4. **Avoid the 2% Adjusted Gross Income (2% AGI) Loss.** A major disadvantage of employee status is that “unreimbursed employee expenses” are deductible as “miscellaneous itemized deductions” on Schedule A of one’s tax return. As such, a minister may only deduct those expenses in excess of 2% of his or her “adjusted gross income.” For a married person, that’s the combined adjusted gross income of husband and wife. For example, \$30,000 AGI x 2% = \$600 loss of expense deductions. This loss is avoided when ministry expenses are paid by the church under an Accountable Plan.

5. **Avoid the Itemized Deduction Limitation Loss.** When filing his or her tax return as an employee, unreimbursed ministry expenses remaining *after applying the three limitations above*, are deductible only if the minister can itemize deductions. This particularly hurts ministers who rent or live in parsonages. They usually cannot itemize deductions. Payment or reimbursement of ministry expenses by the church under an Accountable Plan avoids this major loss!

A minister does not avoid completely the last two limitations by filing a tax return as a self-employed person, utilizing Schedule C, to deduct ministry expenses. The IRS is aggressive, during audits, about changing ministers to employee status since the U. S. Tax Court *Weber* ruling. Furthermore, it is often to the minister’s advantage to be classified as a church employee. Employee status, verified by the church issuing a Form W-2 instead of Form 1099-MISC, assures that the minister is qualified for medical insurance as a tax free benefit. It also makes the minister eligible for the tax free benefit of a medical reimbursement plan. (NOTE: Even when a minister is an employee for income tax purposes, *ministry income is self-employment income for Social Security purposes*. This is true of all ministers except government employed chaplains.)

6. **Reduce Audit Risk.** Most ministers who are audited have been selected for audit because of unreimbursed job expenses claimed on their tax returns. When expense accounting is made to the church, instead of the IRS, it eliminates this cause of audit selection. Timely and documented expense accounting is required by an Accountable Plan.



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## HOW TO SET UP AND ADMINISTER AN ACCOUNTABLE PLAN

There are four important elements to a church's Accountable Plan: (1) the payment of expenses must be for ordinary and necessary expenses for job performance, (2) there must be a written policy or plan, (3) the employer must allocate expense funds that are distinct from personal compensation, and (4) the employee must account for expenses in a timely and proper manner.

The attached sample Policy Statement will accomplish the first two requirements. A proper structuring of the ministry support package will accomplish the third. (How much to allocate for expenses? The minister's last two or three tax returns will tell!) The attached sample Minister's Expense Report form will enable timely and proper reporting. The minister submits the expense reports, with supporting documentation, to the church treasurer.

The church may make direct payments for ministry expenses, may provide a credit card to the minister, may reimburse the minister upon receipt of expense reports, may give the minister a monthly expense allowance and then receive reports on how the allowance was used, may give an advance for specific events and receive a follow up expense report, or any combination of these.

The minister must make a timely accounting. If expenses are reimbursed to the minister, after the minister has paid them from personal income, quarterly expense accounting is the required minimum. Monthly reporting is highly encouraged. If a monthly expense allowance is paid to the minister, monthly reporting is necessary. If an advance is paid to the minister to cover expenses for a particular event or business trip, the minister must submit an expense report within 60 days. Any unused portion of the advance must be repaid within 120 days. Whatever procedure the church uses to pay or reimburse expenses, the money allocated for paying ministry expenses belongs to the church, not to the minister. Any "left over" expense funds cannot be paid to or retained by the minister as personal compensation. They may be carried forward by the minister with the stipulation that they be used only for job expenses.

Expenses that exceed the amount allocated for this purpose may not be paid or reimbursed by a "salary reduction." For example, if \$6,000 is budgeted for the year but the minister actually spends \$6,700 by year end, the extra \$700 cannot be treated as a reimbursement by simply reducing the minister's salary by \$700. The church may reimburse the extra \$700 from church funds or allow the minister to carry the expenses forward.

There is no requirement in tax rules for special year end accounting. If a monthly allowance is paid to the minister, and expenses accumulate in excess of the funds allocated, the church may allocate additional funds for reimbursement, or the expenses may be carried forward. If there is an unused portion of a monthly expense allowance, it may be carried forward with the restriction that the minister can use these funds only for ministry expenses. They cannot be converted to personal income.



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## CHURCH BUDGETING AND ACCOUNTING FOR MINISTRY EXPENSES

Ministry expenses belong in that part of the church budget covering church administrative or business expenses. They are not personnel or compensation expenses. There are a variety of expenses in the general category of “ordinary and necessary” expenses incurred for the performance of ministry. For budgeting and accounting purposes, this can be identified simply as one line item in a church budget such as “Ministry Expense Allowance” or “Ministry Expense Fund.” Another option, in recognition that business use of an auto is usually the major expense, is to list two categories such as “Automobile Allowance” and “Ministry Expense Allowance.” While there is no need, for tax purposes, to list more than a single line item, churches may elect to do so for internal accounting purposes.

**Auto expenses** refer to the cost for **business** use of a personal auto. These may be reimbursed per business mile or by actual cost. The simplest and usually most cost effective method is to use the annual IRS “standard mileage rate.” This rate covers all ownership and operating expenses except parking and tolls and, for self-employed persons, the business portion of auto loan interest. The year 2012 standard mileage rates are 55.5¢.

**Entertainment expenses** include meals and refreshments provided for church members, visitors and guests. Restaurant costs are actual costs, including tips. This includes the minister’s spouse if her or his presence is essential to the ministry purpose of the meeting. Home entertainment is more economical than restaurant costs. This saves money for the minister and the church. Due to the personal and family nature of ministry, it usually is more conducive to pastoral care.

*The attached document and forms may be used for teaching purposes by the person receiving this document directly from Clergy Advantage®, Inc. These forms may not be distributed or used for any other purpose.*

1. *Sample Policy Statement for an Accountable Plan*
2. *Ministry Expense Report Form*
3. *The Church’s Financial Support Package for Ministry*



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## ACCOUNTABLE PLAN FOR MINISTRY EXPENSES

It is the policy of \_\_\_\_\_ Church to provide from church funds the ordinary and necessary expenses of ministry that are incurred for the benefit of the church. The church recognizes the professional nature of ministry and recognizes the right of ministers to use professional judgment in incurring ministry expenses within the guidelines set by this policy and the funds allocated for payment or reimbursement of expenses.

Ordinary and necessary expenses of ministry include, but are not limited to, the following: on-the-job transportation; out-of-town travel for church assemblies, conferences and continuing education; other professional continuing education locally and by correspondence; professional materials (books, magazines, journals, papers, tapes, films, office supplies, etc.); business meals, entertainment and gifts for conducting church business and developing pastoral relationships; dues and fees for memberships in religious, professional and civic organizations; business use of the telephone; professional equipment (communion, office, library, audio-visual, music, etc.); professional and liability insurance; legal and professional services; 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 expected and is vital to the church's ministry.

The church, at its discretion, may pay ministry expenses by direct billing to the church, by reimbursement upon receiving reports with receipts and vouchers from the minister, by paying an expense allowance, and by paying an advance for a specific event or activity. Payment is subject to the availability of funds and to the timely and proper accounting by the ministers and staff.

The minister(s) and staff members are accountable to the church by properly reporting all ministry expenses. Proper reporting includes the filing of periodic expense reports with substantiating records, receipts and personal statements showing dates, amounts and business purposes.

When expenses are reimbursed, reporting monthly is encouraged but must at least quarterly. When an allowance is prepaid on a monthly basis for recurring expenses, monthly accounting is required by the end of the following month. Excess expenses may be reimbursed, if funds are available and approved, or carried forward. Any unused portion of a monthly allowance may be carried forward to apply against expenses incurred the next reporting period. When an advance is given for the expenses of a specific event or activity, an accounting is required within 60 days. Any unused portion of an advance must be repaid to the church within 120 days.

This policy is established in accordance with Internal Revenue Code Section 62(a)(2)(A) and Federal Tax Regulations 1.162-17(b) and 1.274-5(e)(4). It shall remain in effect until amended or rescinded.

Adopted by official action of the church this date: \_\_\_\_\_, 20\_\_\_\_

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



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# 2014 MINISTRY EXPENSE REPORT

For the period from \_\_\_\_\_ to \_\_\_\_\_ 2014

Minister \_\_\_\_\_ Church \_\_\_\_\_

**1. AUTOMOBILE BUSINESS EXPENSES:**

- a. Use of personal car:
    - Business miles \_\_\_\_\_ at 56¢ per mile \_\_\_\_\_
  - b. Use of church car: Personal cost \$ \_\_\_\_\_  
times \_\_\_\_\_% actual business use \_\_\_\_\_
  - c. Business parking fees/tolls \_\_\_\_\_
- SUBTOTAL AUTOMOBILE EXPENSES \$ \_\_\_\_\_

**2. MINISTRY PROFESSIONAL EXPENSES:**

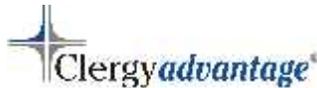
- a. Professional and liability insurance \_\_\_\_\_
  - b. Interest on ministry equipment purchases \_\_\_\_\_
  - c. Legal and professional services \_\_\_\_\_
  - d. Office expense \_\_\_\_\_
  - e. Equipment repair/maintenance \_\_\_\_\_
  - f. Books, materials, supplies for ministering \_\_\_\_\_
  - g. Travel away from home overnight for assemblies, conventions and continuing education:
    - 1) Air/train/bus/taxi/car rental \_\_\_\_\_
    - 2) Registration/tuition/materials \_\_\_\_\_
    - 3) Lodging/tips/laundry/cleaning \_\_\_\_\_
    - 4) Meals \_\_\_\_\_
  - h. Business meals and home entertainment \_\_\_\_\_
  - i. Business Phone Calls, Cell Phone, Internet Access \_\_\_\_\_
  - j. Dues to religious and civic organizations \_\_\_\_\_
  - k. Business gifts to staff, members and other ministry-related persons (\$25 maximum per recipient) \_\_\_\_\_
  - l. Continuing education – local/correspondence \_\_\_\_\_
  - m. Local church & ministry meetings \_\_\_\_\_
  - n. Clergy vestments – purchase and cleaning (robes, stoles, etc., not business suits) \_\_\_\_\_
  - o. Equipment purchases and payments \_\_\_\_\_
  - p. Other: \_\_\_\_\_
- SUBTOTAL MINISTRY PROFESSIONAL EXPENSES \_\_\_\_\_

**3. TOTAL AUTO AND MINISTRY PROFESSIONAL EXPENSES \$ \_\_\_\_\_**

- 4. Plus unreimbursed expenses from previous reporting period \_\_\_\_\_
- 5. Minus prepaid expense allowances received this reporting period (\_\_\_\_\_)
- 6. Minus unused expense allowance from previous reporting period (\_\_\_\_\_)
- 7. EXCESS EXPENSES or (UNUSED ALLOWANCE) this reporting period \$ \_\_\_\_\_

Excess expenses may be carried forward to the next reporting period. The unused portion of an expense allowance may be retained for expenses occurring during the next reporting period but may not be retained for personal use.

Signatures: \_\_\_\_\_  
Minister Church Treasurer/Officer



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## Planning Worksheet

# THE CHURCH'S FINANCIAL SUPPORT PACKAGE FOR A MINISTER

	CURRENT	CHANGE	PROPOSED
<b>CHURCH BUSINESS EXPENSES</b>			
Auto Expenses (Recurring)	_____	_____	_____
Professional Expenses (Recurring)	_____	_____	_____
Professional Expenses (Occasional)	_____	_____	_____
Total Expenses	\$ _____	\$ _____	\$ _____

### MINISTER'S BENEFITS

Medical Insurance Premiums	_____	_____	_____
Health Reimbursement Arrangement	_____	_____	_____
Group Term \$50,000 Life Insurance Premium	_____	_____	_____
Disability Insurance Premium	_____	_____	_____

*The following benefits usually are based on salary, housing and rental value of parsonage.  
Unless set in a different manner by your denomination, first complete the Ministry Pay section below.*

Social Security Allowance (15.3% of Salary, Housing and Parsonage Rental Value, including utilities)	_____	_____	_____
Retirement (____% of Salary, Housing, Parsonage Rental Value and & Social Security Allowance)	_____	_____	_____
Total Benefits	\$ _____	\$ _____	\$ _____

### MINISTER'S PAY

Housing (Cash)	_____	_____	_____
Salary (Cash)	_____	_____	_____
Total Pay	\$ _____	\$ _____	\$ _____

Total CHURCH COST	\$ _____	\$ _____	\$ _____
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Memo: Rental Value of Parsonage including utilities ( \_\_\_\_\_ ) ( \_\_\_\_\_ ) ( \_\_\_\_\_ )



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## The Church's Financial Support Package for a Minister

The three planning goals are: (1) to determine the church's total cost for ministry services, (2) to determine how much of that cost is actual pay for the minister to live on, and (3) to minimize taxes for the minister.

The three planning steps, in order, are: (1) to provide in full for job related expenses, (2) to provide appropriate benefits, and (3) to determine the appropriate amount of pay. If the church does not provide in full for expenses nor provide for benefits, the minister must make up the difference from salary – which increases taxes, reduces family income and creates a false perception of how much the minister is paid.

**CHURCH BUSINESS EXPENSES.** Set up an Accountable Plan to handle ministry expenses. The key aspects of an Accountable Plan are that the church provides expense funds that are separate from the minister's salary and a written policy that requires the minister to account to the church. A minister must account to the church at least quarterly, but monthly is highly recommended. The church may pay expenses directly, reimburse the minister after expenses are incurred, pay a monthly allowance to the minister for recurring expenses, pay an advance to the minister for special events, or a combination of these. The simplest method for the church is to pay a monthly allowance to the minister for auto and other recurring ministry expenses. For occasional expenses like conferences, conventions, and continuing education, the church may allocate funds for direct payment or advances. Use actual costs to compute expenses except for the auto. While actual auto expenses can be used, the simplest method is to use the allowable IRS standard mileage rate. Whether using actual costs or the standard mileage method, only business use is considered.

**MINISTER'S BENEFITS.** The church can provide certain tax-free benefits and certain tax-deferred benefits. Premiums for medical insurance which covers the minister and dependents is tax-free. Reimbursement of medical expenses not covered by insurance is also tax-free – but this plan must be in writing and must abide by nondiscrimination rules. The only life insurance that can be provided as a tax-free benefit is a group plan for term insurance that has a face value of \$50,000 or less. The church may provide disability insurance to protect itself if the minister becomes disabled. However, if the church pays the premiums, the minister's disability income will be taxable. That income will not be taxable if the minister pays the premiums. A Social Security Allowance is a special matter. A minister is self-employed for Social Security purposes. The Social Security Allowance is taxable income and is reported to the IRS as salary. It is distinguished from salary here in order to identify clearly this amount as a benefit to meet future needs rather than as pay to meet current living needs. Even if the minister has elected exemption from Social Security, build in the allowance for two reasons – this is money the minister should be using for alternative programs and the next minister may be paying into Social Security. Retirement plan contributions that are made by the church are tax-deferred.

**MINISTER'S PAY.** Pay consists of salary and that part of salary officially designated for housing costs. The minister is entitled to a housing allowance whether renting, purchasing or living in church-owned housing. Tax rules say the allowance can be used for rent, purchase and "expenses directly related to providing a home." This is very comprehensive. The church must designate an amount but that designation is not limited to a percentage of salary or a specific dollar amount. The best procedure is to ask the minister to submit a request based on anticipated costs. Then designate an amount to cover all anticipated costs. Note that the IRS developed a formula that is not in tax law --fair rental value including furnishings, plus utilities. If the IRS audits a minister and thinks the documented amount the minister excludes is excessive, the IRS may impose this limitation on the minister. The minister then must accept the lower limitation or challenge the IRS. This is a matter between the minister and the IRS. The church is not affected.



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