

A new calendar year has begun and it's time to make sure your house is in order regarding the handling of reimbursements. The best system for caring for reimbursements is the accountable reimbursement system. In this type of reimbursement system, all reimbursements must be substantiated by receipts in a timely manner.

To meet the standards of an accountable reimbursement system, all of the following four rules must be met:

1. Business connection. The expenses must have a business connection – that is, expenses must be paid or incurred while performing services as an employee of the church.
2. Adequate accounting. Expenses must be adequately accounted for to the church by receipt within a reasonable period of time (not more than 60 days after an expense is incurred).
3. Returning excess reimbursements. If the employee receives reimbursement in excess of the actual, substantiated expense, the employee must return an excess reimbursement or allowance within a reasonable period of time (not more than 120 days after an excess reimbursement is paid). An excess reimbursement or allowance is any amount paid that is more than the business-related expenses adequately accounted for to the employer.
4. Reimbursements not made out of salary reductions. The income tax regulations caution that in order for an employee's reimbursement arrangement to be accountable, it must meet a reimbursement requirement in addition to the three requirements summarized above. The reimbursement requirement means that an employer's reimbursements of an employee's business expenses come out of the employer's funds and not by reducing the employee's salary.

Richard Hammer - Church & Clergy Tax Guide 2009, page 304.

When substantiating expenses, receipts must contain:

- date
- amount
- place
- business purpose (lunch with parishioner, visitation, etc.)

What trips up many churches is how they handle expense accounts. Say the church establishes a mileage reimbursements account for the pastor of \$3,000. At the end of the year, the pastor has only substantiated mileage expenses of \$2,500 but the church gives the pastor the remaining \$500 anyways. This violates the accountable

reimbursement system and causes the entire \$3,000 to become tax income to the pastor.

If the church establishes a mileage reimbursement account for the pastor for \$3,000 and he/she receives \$250 monthly and does not substantiate the mileage and does not return any excess amount received, this violates the accountable reimbursement system. In this case the entire \$3,000 is taxable income to the pastor.

To help keep expense reimbursements within the accountable reimbursement system guidelines, implement the following:

- Do not reimburse until expenses are substantiated.
- Make sure expense receipts include date, name, amount, and reason for expense.
- Make sure expenses are substantiated within 60 days.
- Make sure excess reimbursements are returned to the church within 120 days.
- Do not give un-used expense funds to the employee.