Allowance Accounts for Pastors

By Rollie Dimos

Q: We want to give our pastor an allowance account that he can use for hospitality, benevolence, and other ministry expenses. We've been told this fund might be taxable to our pastor. Is that true?

A: Many churches will allow the lead pastor to control an allowance account for certain ministry expenses. Depending on how these funds are maintained and controlled will determine whether the funds will be taxable or nontaxable to the pastor.

Whether allowance accounts will be taxable or nontaxable depends on whether the church adheres to an accountable reimbursement plan.

Accountable Plans

Expense allowances in a church environment may include monthly allowances to offset costs for an automobile or cell phone; to purchase ministry resources, to cover hospitality expenses, or provide funds for immediate benevolence needs. The church can provide expense allowances two ways:

- The church may pay the pastor a monthly allotment to help pay for these expenses.
- The church may give the pastor access to a church fund to pay for these expenses as they arise.

How these funds are provided and accounted for, will determine whether these expense allowances are treated as compensation or pay to the pastor.

According to IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*, reimbursements paid under an accountable plan are not reported as compensation. However, reimbursements paid under nonaccountable plans are reported as compensation.

If these expenses are not properly accounted for under an accountable arrangement, it will result in taxable income for the pastor. For this reason, it is beneficial for churches to adopt an accountable reimbursement plan.

According to the IRS, the employer's accountable plan must include the following components:

1. Your expenses must have a business connection—that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.
2. You must adequately account to your employer for these expenses within a reasonable period of time.
3. You must return any excess reimbursement or allowance within a reasonable period of time.

Rule #2 states that the employee must adequately account for the expenses. This means that every purchase made from an expense account, or with expense allowance funds, must be supported with receipts and given to the employer.

As the IRS explains:

> One of the rules for an accountable plan is that you must adequately account to your employer for your expenses. You adequately account by giving your employer a statement of expense, an account book, a diary, or a similar record in which you entered each expense at or near the time you had it, along with documentary evidence (such as receipts)

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of your travel, mileage, and other employee business expenses.
You must account for all amounts you received from your employer during the year as advances, reimbursements, or allowances. This includes amounts you charged to your employer by credit card or other method. You must give your employer the same type of records and supporting information that you would have to give to the IRS if the IRS questioned a deduction on your return.

This is where many churches fail when giving an allowance to their pastor: they fail to require an adequate accounting. As a result, the expense allowance should be counted as taxable income for the pastor.

Common Expense Allowances

Since expense accounts, monthly allowances, or stipends could result in taxable income for the employee, here are some guidelines to ensure some common expense allowances are treated as accountable plans.

- Cell phone allowance. Some churches provide a monthly allowance to employees to help pay for, or help offset, the cost of a monthly cell phone plan. In 2010, the IRS clarified their guidelines on cell phones. The IRS concluded that if the employee has a substantial business need for the phone, an allowance up to the monthly cost of the phone plan can be treated as an accountable plan, and not taxable to the employee. However, several requirements exist, including the need to substantiate the cost and the business need for the cell phone. See this article on cell phones for additional guidance.

- Automobile allowance. An auto allowance is commonly used to offset the costs of staff members operating their own vehicle for ministry use. These payments are 100% taxable to the staff member if not reported under an accountable reimbursement plan. To be accountable, the church can reimburse the employee for actual costs with proper receipts. The church can also reimburse the employee by using the standard mileage rate, established each year by the federal government. The standard mileage reimbursement rate for operating a personal car for business use is 57.5 cents per mile in 2015. Even when using the standard mileage rate, proper substantiation must occur.

- Hospitality Allowance (Meals and Entertainment). Some churches create a hospitality fund and allow the pastor to access the fund whenever needed. Unless each expenditure is properly substantiated, the entire amount of this fund could be taxable to the pastor. Oftentimes, church ministry includes a meal function (i.e., discipleship meeting during lunch) or an entertainment function (i.e., youth bowling event). In order to be accountable, and therefore, nontaxable to the church employee, the IRS requires specific documentation. These expenses must be reported on by the employee and include the submission of receipts.

  For meals and entertainment, the IRS also requires the names of the people attending the event, the amount, the location, and an explanation of the business purpose of the function. For example, the receipt should document what was discussed during the meal that makes this related to the business of the church and not simply a personal meal.

For more information about accountable plans and substantiating automobile expenses and hospitality expenses, see IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*, at http://www.irs.gov/pub/irs-pdf/p463.pdf

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Rollie is the author of *Integrity at Stake: Safeguarding Your Church's Honor*, available at MyHealthyChurch.com. Using real-life fraud cases, *Integrity at Stake* helps churches assess their internal controls and minimize the risk of fraud.