

Business Related Expenses

If you are an *employee*, you may be able to deduct your work-related expenses as an itemized deduction on Form 1040, Sch. A¹. If you are a *self-employed individual* who qualifies to report their income on Form 1040, Sch. C you may be able to deduct your work-related expenses as itemized deductions. If you are an *employer*, you are be able to reimburse your employees work-related expenses. In each case however, you must meet certain minimum substantiation rules and deductions or expenses may be subject to limitations to be allowed.

Why is this important? Because knowing this, and taking the right steps to act on it, can save employees and individuals substantially each year in taxable wages and/or taxes when filing their annual personal tax returns.

What is deductible and what is not

Although commuting costs are not deductible, some local transportation expenses are. Deductible local transportation expenses include the ordinary and necessary expenses of going from one workplace (away from the residence) to another. If you have an office in your home that you use as your principal place of business for your employer, you may deduct the cost of traveling between your home office and work places associated with your employment. You may deduct the cost of going between your residence and a temporary work location outside of the metropolitan area where you live and normally work. If you have one or more regular work locations away from your residence, you may also deduct the cost of going between your residence and a temporary work location in the same trade or business within your metropolitan area.

Other travel expenses, the cost of continuing professional education, professional association fees and dues, professional journals and magazines subscriptions, the cost of cell phones and related communication devices when used in the performance of your business duties may also be deductible. Finally, business meals & entertainment expenses and business gift expenses may be deductible but are subject to certain limits.

Recordkeeping

You must keep records to prove the expenses you deduct. If your employer reimbursed you or gave you an advance or allowance for your employee business expenses under an “accountable” reimbursement plan, the payment should not appear as income on your Form W-2. You do not include the payment in your income, and you may not deduct any of the reimbursed amounts on your personal return.

By law, employees are only permitted to deduct their unreimbursed business expenses and business expenses reimbursed under a "non-accountable" church reimbursement plan to the extent that such expenses exceed 2% of adjusted gross income. Consequently, for many employees and ministers their

¹ Minister's normally are not qualified to report their ministerial earnings on Sch C of their Form 1040 and thus are subject to the same expense reimbursement rules as other regular employees.

ability to actually gain any tax advantage from the reporting of these unreimbursed expenses can be severely limited. The good news is that these adverse results can be eliminated entirely if a ministry simply adopts an accountable reimbursement plan. If a ministry adopts an accountable plan, none of the ministry's reimbursements for business expenses need to appear on the employee's W-2 and there are no expenses for the employee to deduct on Form 1040. The employee, in effect, reports to his or her employer rather than to the IRS. This is the ideal way for ministries to handle the business expenses of clergy and any other ministry worker.

If your employer has an accountable reimbursement policy in place and reimburses certain business related business expenses but, you fail to seek reimbursement for these expenses under the policy, you are prohibited from including these expenses on your Form 1040 as unreimbursed employment related expenses. The rationale here is that for a business expense to be deductible it must be "ordinary and necessary." Thus, if an employee voluntarily chooses not to seek reimbursement for an expense from an employer, the presumption by the Courts is that the expense was not necessary. The mere fact that an employee is entitled to reimbursement from his/her employer for an expenditure made in connection with their status as an employee means that no business deduction is allowed).²

Accountable Reimbursement Plans

To be an accountable plan, your employer's reimbursement or allowance arrangement must include all three of the following rules:

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

These rules are discussed in greater detail in IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.³

If your employer's reimbursement arrangement does not meet all three requirements, it will be considered a "non-accountable" plan under current IRS regulations and the payments received are required to be included in the wages shown on the employee's Form W-2 by your employer. Regardless however, employees must report the payments as income, and then must complete Form 2106 (PDF), Employee Business Expenses, or Form 2106-EZ (PDF), Unreimbursed Employee Business Expenses, and itemize the deductions if they wish to deduct the expenses. (See Publication 463 for detailed information on employer reporting requirement for business expenses and how employees are required to report these expenses on your tax return). If your actual expenses exceed the federal rate, you may itemize your deductions to deduct the excess.

² Williams, 95-2 USTC 50,349 (D. Ind. 1995); Onstott v. Commissioner, 41 T.C.M. 827 (1981)

³ A copy of a sample accountable reimbursement policy that can be used to establish a plan at your organization can be found on the CMA bookstore. The policy is free to current CMA members.

In closing, keep in mind the fact that having an accountable reimbursement policy in place and using it to reimburse employees for qualifying business related expenses can be a useful tool for your employment compensation program. Effectively reducing an employee's annual income while providing them the benefit of having their out of pocket business related expenses reimbursed by the organization is another way for helping your organization attract and retain the best qualified staff for your organization.

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