

## TAX PRACTICES AND GOVERNMENT COMPLIANCE

**Overview.** This Transformation Ministries online document covers a list of most of the required tax and government compliance requirements. It is recommended that this document be reviewed periodically to stimulate thought as to whether or not further investigation should be initiated to assess compliance. It is recommended that the Sr. Pastor or church governing body recruit a church member with financial, tax and/or business background and delegate responsibility for investigating this area and providing recommendations.

As long as a church is using its facilities strictly for religious services and income is primarily from tithing and it uses a payroll company to assure all payroll taxes are paid and reported, there is a high probability the church is mostly in compliance with requirements.

Assuming a church has 501(c)(3) non-profit approved status, the specific areas that need to be investigated are an assessment as to whether paid workers are employees or contractors and uses of property versus tax exemption requirements. As a church grows all new uses of facilities, as employees are added and as new outreach initiatives are contemplated, the documents referred to in this report should be reviewed to assure compliance with requirements.

### **W-2 VS. 1099 (Employee and Independent Contractor Determination)**

Employee versus Contractor Determination. Refer to the IRS 20 point Checklist for Independent Contractor ([http://art.mt.gov/artists/IRS\\_20pt\\_Checklist\\_%20Independent\\_Contractor.pdf](http://art.mt.gov/artists/IRS_20pt_Checklist_%20Independent_Contractor.pdf)) to determine employee versus contractor status and then file the appropriate documents.

Another useful reference with more explanations for the 20 questions is provided by Synergistech Communications ([www.synergistech.com/20qs.shtml](http://www.synergistech.com/20qs.shtml)) and other websites that can be found on the Internet.

Basically if the person is responsible for profit or loss, has a financial investment in the entity providing the services, works for more than one firm and their services are offered to the general public they probably are an independent contractor. If the answer is yes to any of the other 16 questions which have to deal with the amount of control by the employer (guidance, equipment and facilities used, etc.), the person is likely an employee. For a final determination a church should consult the above IRS document to make a determination. If not obvious whether the person is or represents an independent contractor, it is recommended that a church document its justification relative to the 20 questions if it is taking the position that the person is an independent contractor.

### **FEDERAL COMPLIANCE REQUIREMENTS (See Tax Guide for Churches and Religious Organizations <http://www.irs.gov/pub/irs-pdf/p1828.pdf>)**

1. **501(c)(3) Status.** A church as a 501(c)(3) federal tax exempt organization must meet the following requirements.

- a. Organized and operated exclusively for religious, educational, scientific, or other charitable purposes.
- b. Net earnings may not inure to the benefit of any private individual or shareholder.
- c. No substantial part of its activity may be attempting to influence legislation.
- d. The organizations may not intervene in political campaigns
- e. The organization's purpose and activities may not be illegal or violate fundamental public policy.

Actions that jeopardize the tax-exempt status

- f. Inurement and private benefit
- g. Substantial lobbying activity
- h. Political campaign activity

2. **Unrelated Business Income Tax (UBIT).** Churches may engage in income-producing activities unrelated to their tax-exempt purpose, as long as the unrelated activities are not a substantial part of the organization's activities. However, the net income from such activities will be subject to UBIT if the following three conditions are met:
  - a. The activity constitutes a trade or business.
  - b. The trade or business is regularly carried on, and
  - c. The trade or business facility use is not substantially related to the organization's exempt purpose. The fact that the organization used the facility use income to further its charitable or religious purposes does not make the activity substantially related to its exempt purposes.
  - d. Exemptions. Even if an activity meets the above three criteria, the income may not be subject to tax if it meets one of the following exceptions:
    - i. Substantially all of the work in operating the trade or business is performed by volunteers,
    - ii. The activity is conducted by the organization primarily for the convenience of its members, or
    - iii. The trade or business involves selling of merchandise substantially of which was donated.
    - iv. In general, rents from real property, royalties, capital gains, and interest and dividends are not subject to the n business income tax unless financed with borrowed money.
  - e. Examples of unrelated business income
    - i. Rents for real property that is not owned (financed with borrowed money)
    - ii. Income from selling advertising in a church publication
    - iii. Sale of merchandise and publications if not substantially relate to the exempt purpose of the organization.
  - f. If a church has gross income of \$1,000 or more for any taxable year from the conduct of any unrelated trade or business, it is required to file IRS Form 990-T, Exempt Organization Business Income Tax Return.

For further details relative to use or lease government compliance refer to **FACILITY USE/LEASE COMPLIANCE REQUIREMENTS**.

**3. Employment Tax**

- a. Generally, churches and religious organizations are required to withhold, report and pay income and Federal Insurance Contributions Act (FICA) taxes for their employees
- b. FICA taxes consist of Social Security and Medicare taxes and must be paid and reported on wages for services performed
- c. Churches and religious organizations are not liable for Federal Unemployment Tax Act tax (FUTA)
- d. There are special rules for compensation of ministers: see tax guide for Churches and Religious Organizations for details

**4. Payment of Employee Expenses** (See tax guide for Churches and Religious Organizations for details)

A church or religious organization is treated like any other employer as far as the tax rules regarding employee business expenses. The rules differ depending upon whether the expenses are paid through an accountable or non-accountable plan, and these plans determine whether the payment for these expenses is included in the employee's income.

**5. Recordkeeping Requirements**

- a. Churches and religious organizations must keep maintain books of accounting and records necessary to justify their claim for exemption in the event of an audit.
- b. Churches and religious organizations are required to maintain books and records that are necessary to accurately file any federal tax and information returns that may be required.
- c. Records for revenue and expenses including payroll records should be retained for at least four (4) years after filing the return(s) for the year in which dispositions occurs.
- d. Records relating to acquisition and disposition of property (real and personal, including investments) should be retained for at least four (4) years after the filing of their return for the year in which disposition occurs.

**6. Filing requirements** (for details see tax guide for Churches and Religious Organizations)

- a. Form W-2 for each employee by 1/31/yyyy
- b. Form W-3 Transmittal of Wage and Tax Statement by 2/28/yyyy
- c. Form 941 Employer's Quarterly Federal Tax Return (or Form 944 annually for small organizations if so informed by IRS)
- d. Form 945 Annual Return of Withheld Federal Income Tax by 1/31/yyyy

- e. NOT REQUIRED FOR CHURCHES. Form 990 Return of Organization Exempt From Income tax; must be filed before the 15<sup>th</sup> day of the 5<sup>th</sup> month following the end of the organization's tax year.
- f. Form 990-T. If a church has Unrelated Business Income of \$1,000 or more.
- g. Form 990-W must be filed quarterly if Unrelated Business Income is expected to be greater than \$500.
- h. Form 1096 Annual Summary and Transmittal of US Information Returns by 2/28/yyyy
- i. Form 1099-Misc Miscellaneous Income, prizes and award for any unincorporated individual or entity (volunteers, freelancers, contractors, gross rents, commissions, fees if \$600 or more during any calendar year by 1/31/yyyy
- j. Form 8282 Donee Donation Information Return if a church sells, exchanges, transfers, or otherwise disposes of certain non-cash donated property within three years of the date it originally received the donation. This applies to non-cash property that had an appraised value of more than \$5,000 at time of donation.

For details refer to the IRS tax guide for Churches and Religious Organizations

<http://www.irs.gov/pub/irs-pdf/p1828.pdf>

#### **CALIFORNIA**

- 1. File form SI-100 Statement of Information every February and August. See form and instructions for details

#### **COUNTY TAX ASSESSOR (if other than Orange County use the Internet to find requirements for your state)**

- 1. 2/15/yyyy Final date for filing a Church, Religious or Welfare Tax Exemption application
- 2. 2/15/yyyy Final date for filing Change in Eligibility or Termination Notice (CARD)
- 3. File property taxes if and when due.
- 4. **Religious Tax Exemption Requirements** (for CA details see Publication 48-LDA, BOE-267-S, BOE-267-SNT, BOE-267-SNT (S2)
  - a. Basically the property must be owned by the church and used exclusively by the church for religious worship or religious worship and a school owned and operated by the church. The property can be leased to another church that meets the same requirements. Other uses that may be eligible are incidental purposed by non-profit charitable local civic groups on an occasional basis, or example meetings of Boy or Girl Scouts or 4-H. The incidental use may not interfere with the use of the property for religious worship or owned religious school. In addition the church may not charge the organizations for the use, except for the ordinary and necessary amounts the church pays to make the facility available for the use, such as janitorial and utility costs.
  - b. The above documents further state that the Religious Exemption cannot be used for the following:
    - i. No activity on the property (no tax exemption is available)
    - ii. Parsonage, living quarters (may be eligible for a welfare tax exemption)

- iii. Thrift store (may be eligible for a welfare tax exemption)
  - iv. Bingo (may be eligible for a welfare tax exemption)
  - v. Other (non-church or non-school) religious or charitable activities of another organization on church-owned property (may be eligible for a welfare exemption, however both the owner and the operator must file for the exemption)
- c. The CA Welfare Tax Exemption publication 149 specifically states that churches that lease property to schools that are operated on their properties must file for the Welfare exemption for those portions of the properties used by the school. In addition the school must also file for the Welfare Exemption as the operator of the property.
5. **Welfare Tax Exemption Requirements.** In general, the Welfare Exemption from local property taxes in CA is available for property of organizations that meet the following requirements:
- a. Formed and operated exclusively for qualifying purposes (religious, scientific, hospital or charitable,
  - b. That use their property exclusively for those qualifying purposes, and
  - c. That have a current tax exempt letter from the IRS or the Franchise Tax Board.

The above requirements, along with others, must be met for the exemption to be granted. The non-profit organization must be a community chest, fund, foundation, corporation, or eligible limited liability company.

Prior to or concurrent with the Welfare Tax Exemption application the organization must file for an Organizational Clearance Certificate with the State Board of Equalization.

For specific details (for CA) for religious and welfare tax exemptions see applications forms and Publications 48-LDA, Publication 149 and Revenue and Taxation code section 214. For other states perform a Google Search of specific state and county tax requirements.

#### **INDIVIDUAL**

1. Form W-9 Request for Taxpayer Identification Number and Certification. Ask any person or company the Church anticipates paying \$600 in any given year to fill out and return to the Church Form W-9. See instructions for details.
2. Form W-4 Employee verifications of Federal tax withholdings. See instructions for details.

#### **RECOMMENDATIONS**

1. Place all reporting requirements on the Church Calendar
2. Refer to Federal, State and County instructions for each Form to be filed.
3. Conduct an audit to see if your church is in compliance with each requirement.

*These samples are provided as input to assist you in developing procedures, but are not a substitute for considering the risks at your church and establishing your own policies and procedures to reduce those risks to acceptable levels. Transformation Ministries provides these as a convenience for its churches but directly states to you, the user that Transformation Ministries is not providing these to you as legal advice or even a substitute for legal advice. Use of these samples is at your own risk. Laws change and best practices change, sometimes rapidly. It is your church's responsibility to stay abreast of changes in laws and best practices. It is recommended you always consult with your attorney and/or CPA as part of the process of developing your policies and procedures.*