



Five Tips for Serving Your Synagogue, Church or Temple Clients

by Monica Stern, CPA, and Robert Erven Brown, Esq.

Faith-based nonprofits must be approached differently than your run-of-the-mill 501(c)(3) charities. There are special IRS and legal privileges and challenges involved in serving religious nonprofit organizations. In this article we examine some common pitfalls for the CPAs and attorneys whose practice area may be expanding to include faith-based charitable organizations, such as churches and other religious organizations:

- Taxing the Strip Mall Church
- Pitfalls of Church Payrolls
- Forms 1023 & 990: When and Why to File
- Nonprofits Wrestling With Cultural Issues
- Abandoning Tax Exempt Status — Really?

“Church” Definition

Because churches are entitled to certain special privileges and face other specific requirements under Internal Revenue Code (IRC), it's important to understand the difference between a “church” and a “religious organization.” It is also important to understand the differences between those two faith-based organizations as contrasted with most other 501(c)(3) organizations due to the special tax treatment of churches. Although the word “church” is not defined in the IRC, *American Guidance Foundation, Inc. vs. United States* recognized the Internal Revenue Service's 14-part test in determining whether a

religious organization was a church. A church has:

1. a distinct legal existence;
2. a recognized creed and form of worship;
3. a definite and distinct ecclesiastical government;
4. a formal code of doctrine and discipline;
5. a distinct religious history;
6. a membership not associated with any other church or denomination;
7. an organization of ordained ministers;
8. ordained ministers selected after completing prescribed studies;
9. a literature of its own;
10. established places of worship;
11. regular congregations;
12. regular religious services;
13. Sunday schools for religious instruction of the young;
14. schools for the preparation of its ministers.

Churches include conventions and associations of churches, as well as integrated auxiliaries of churches. Integrated auxiliaries must have a charitable function, be affiliated with the church and receive financial support primarily from internal church sources. A religious organization is not necessarily a church and the distinction is important.

Tax-Exempt Status

One of these distinctions is that churches are not required to file form 1023 to obtain a Determination Letter since they are automatically exempt under 501(c)(3). A mere "religious

organization" which does not rise to the level of a church, however, generally must obtain a Determination Letter by filing Form 1023 or the new 1023EZ, if eligible.

A church may obtain a "No Record Church Letter" from the IRS by calling the Tax Exempt Division at (877) 829-5500 and providing the church name and EIN. The letter states that churches are exempt under 501(c)(3).

Church Payroll

Churches also have special requirements related to payroll, both for clergy and non-clergy staff. Clergy are considered "dual status employees," meaning that they are employees for income tax purposes, but self-employed for Social Security purposes.

Non-clergy compensation is:

- Subject to Social Security and Medicare taxes at employee/employer level, unless the church has filed Form 8724 to exempt the church from employer taxes. Employees will then pay self-employment tax on their individual tax returns.
- Exempt from FUTA, like other exempt organizations.
- Exempt from SUTA, regardless of number of employees – employees are not eligible to file for unemployment benefits.

Clergy compensation is:

- Exempt from employer/employee Social Security and Medicare taxes.
- Exempt from federal and state income tax withholding, but clergy may opt to have taxes

withheld on a voluntary basis.

- Reported on a W-2 Form, if an employee. Most clergy are employees under the employee/independent contractor rules.
- Taxed for social security purposes as self-employment tax on the individual's tax return unless he or she has opted out before the due date of his tax return for the end of the second calendar year of receiving at least \$400 in clergy income – must do so for religious (NOT financial) reasons.
- Paid partially or fully as an income tax-free housing allowance from the employer. This allowance is subject to self-employment tax, however.

Thus, you can see that the tax treatment of clergy, for example, requires special care and understanding.

Legal Considerations

If you wind back the clock 30 years, virtually all of the churches in America were located in special areas zoned and designated for churches, mostly in residential neighborhoods. With the rise of the "mega church" and the attempts to become more friendly to the unchurched, churches have evolved into locations that are more akin to commercial retail space than to the traditional church location.

This development is creating some tension between the taxing authorities and the churches as spaces that previously generated commercial property taxes are now being converted into nontaxable houses of worship.

Although churches are not presently required to file form 990, some commentators feel that the 990 or an alternate filing requirement may affect churches in the future. Understanding what the form is, and generally how it works, can be important background for those dealing with churches. For those dealing with a parachurch or other religious organizations, it is a present reality and must be mastered.

Since the United States Supreme Court legalized same-sex marriage in



Not-for-Profit Conference – June 22

Stern and Brown will address the following topics in much more detail in their session at the Not-for-Profit Conference:

- Taxing the Strip Mall Church
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the Obergefell decision, some religious organizations are concerned with hiring practices and services to the public at large where the religious tenets of the faith may clash with current culture. In the oral arguments before the United States Supreme Court in the Obergefell decision, this Solicitor General of the United States (the president's lawyer) indicated that he thought it would "definitely be an issue" in the future if conservative Christian colleges refused to grant equal housing opportunities to same-sex couples, for example.

Finally, some commentators have been predicting that the increasing tendency of the government to regulate tax-exempt organizations will result in some conservative churches deciding to forgo tax-deductible contributions. The thought is that these churches could be not-for-profit, but not qualify as a "charitable organization." This would, in effect, remove the government subsidy that accrues when a donor takes a tax deduction for a contribution made to a church. ■

Monica J. Stern, CPA, PLLC has been a CPA since 1985. Her practice focuses on the specialized needs of nonprofit organizations, with an emphasis on churches and religious organizations. She has extensive nonprofit tax, accounting and property tax experience with a wide variety of nonprofit organizations. She is an ASCPA member who speaks regularly at nonprofit events and actively participates in the ASCPA Connect Community. You can contact her at MonicaS@mjsterncpa.com.

Robert Erven Brown is a shareholder at the law firm of Gallagher & Kennedy. During his 40-year career, Brown's practice focused on real estate, commercial transactions and charitable organizations. Through his nonprofit work, he represents secular and faith-based nonprofit entities, including churches, synagogues, temples, denominations, Christian schools, rescue missions, a seminary, an adoption agency, prison transition ministries, human services organizations, health-related charities and other faith-based entities. He can be reached at bob.brown@gknet.com.



Not-for-Profit Conference June 22

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Keynote Session:

Changes in Not-for-Profit Accounting & Financial Reporting

Jeffrey Mechanick, Assistant Director of Nonpublic Entities for the Financial Accounting Standards Board (FASB) will give a guided tour of GAAP developments of interest to the sector. He'll make three major stops:

- New Revenue Recognition standard (Topic 606) and some key implementation issues for NFPs
- Recently issued final standard on Leases (ASU 2016-02, Topic 842)
- FASB's generational project on NFP Financial Statements (final ASU on Phase I soon to be issued).

The breakout sessions this year have four tracks:
Risk Management, Revenue, Compliance, and Human Resources.

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