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# 2021 Tax Update for Ministers & Churches

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## Presenters



### **Jerry Walker, CPA**

- Co-founder of FlockBase Software LLC
- 29 years of public accounting
- Church accounting and tax consulting
- Prepared hundreds of ministers' tax returns



### **Kevin Chessher, CPA**

- Partner - FlockBase Software LLC
- 31 years of accounting experience
- 23 years in church administration
- Church & minister consultant



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# Today's Webinars

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Time	Webinar
9:00-11:00 CST	Tax Update for Ministers & Churches
11:30-1:00 CST	How to Get Started Using FlockBase
1:30-3:30 CST	COVID-19 Laws for Churches

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# Schedule

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## 9:00-10:00 Session I

- Tax savings tips for ministers
- Maximizing ministerial housing allowance
- Fine tuning tax-free employee reimbursements
- Car allowance or mileage reimbursement
- Educational expenses
- Health benefits for employees
- Employee retirement plans
- Structuring ministerial compensation packages
- Q&A

## 10:05-11:00 Session II

- Opting out of Social Security
- New 2020 Form W-4
- Forms 1099
- Common payroll reporting errors
- Reporting cash & non-cash contributions
- 501(c)(3) tax-exempt status
- Form 990
- Unrelated Business Taxable Income
- Fund accounting
- Audited financial statements
- On-line giving
- Q&A

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# Housekeeping

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- Who will benefit? Ministers & church treasurers financial secretaries
- Post your questions via FaceBook Live; we will answer as many as possible
- Try to save your questions until after we have covered the topic
- We will not be “driving 5 over”
- We are available for tax consulting and tax preparation; but not for free
- Disclaimer: This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

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# Minister defined

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- According to the Internal Revenue Code a minister must satisfy two separate tests:
  - Be licensed, commissioned or ordained, AND
  - Perform ministerial services in denominational service, as a missionary, an evangelist or within a local church.
    - Administer the sacraments of the church (baptisms, weddings, funerals, and communion, etc.),
    - Be considered a religious leader by the church,
    - Conduct religious worship, and
    - Have management responsibilities in the church.
- The Senior Pastor will almost always qualify as a minister. A music minister, youth minister or children's minister may also qualify as long as they meet both of the separate tests.

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# Special Tax Treatment of Ministers

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## Ministers:

- are employees, but pay Social Security & Medicare tax as if they are self-employed,
- do not have Social Security or Medicare withheld from their paychecks,
- are not required to have income tax withheld from their paychecks,
- are eligible for income tax free housing allowance and/or live in church provided parsonage income tax free, and
- have a limited opportunity to opt-out of Social Security for their ministerial income.

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# Paycheck withholding (wages)

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Wages Paycheck	Minister Employee	Non-minister Employee
Wages	\$1,000.00	\$1,000.00
Federal Income Tax Withholding	\$0.00	\$120.00
Social Security Withholding <b>6.2%</b>	\$0.00	\$62.00
Medicare Withholding <b>1.45%</b>	\$0.00	\$14.50
Net check	\$1,000.00	\$803.50
Income tax still due	\$120.00	\$0.00
Self-employment tax still due <b>15.3%</b>	\$153.00	\$0.00
Total tax paid by church <b>(7.65% matching)</b>	\$0.00	\$76.50
Total tax paid by employee	\$273.00	\$196.50

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## Paycheck withholding (housing)

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Housing Allowance Check	Minister Employee	Non-minister Employee
Housing Allowance	\$1,000.00	n/a
Federal Income Tax Withholding	\$0.00	n/a
Social Security Withholding 6.2%	\$0.00	n/a
Medicare Withholding 1.45%	\$0.00	n/a
Net check	\$1,000.00	n/a
Income tax still due	\$0.00	n/a
Self-employment tax still due 15.3%	\$153.00	n/a
Total tax paid by church (7.65% matching)	\$0.00	n/a
Total tax paid by employee	\$153.00	n/a

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## Tax Savings: Housing allowance

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- Housing allowance – subject to self-employment tax (aka Social Security and Medicare), not subject to income tax!
- Compliance requirement: The housing allowance must be **approved BEFORE** it is paid.
- Any amount of housing allowance not spent on qualified housing expenses must simply be claimed as additional income on the minister's personal tax return

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## Limit on housing allowance



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The amount the minister can exclude from income is limited to the LESSER of:

1. The amount properly designated,
2. The amount actually spent on **eligible housing expenses** during the year, or
3. The fair rental value of the furnished housing, all bills paid.

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## House allowance scenarios illustrated



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	1. Low Designation	2. Low Cost	3. Low Rental Value
Amount Designated	24,000	24,000	50,000
Amount Spent	25,000	20,000	60,000
Fair Rental Value	30,000	30,000	30,000
Amount Excluded from Income *	24,000	20,000	30,000
Amount Included in Income	0	4,000	20,000

\* Lowest of the three

- Tax Tip: Estimate/designate a housing allowance equal to the Fair Rental Value.
  - You have nothing to lose.
  - Designating in excess of Fair Rental Value is futile.
- Tax Tip: Payoff your mortgage after you have paid off all other debts.

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## Eligible Housing Expenses

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Any cost of maintaining a home for the minister:

- Mortgage payments/rent
- Utilities
- Insurance
- Property taxes
- Repairs & maintenance
- Cleaning supplies
- Furnishing and appliances
- Landscaping/lawn maintenance
- Security service
- Decorations (e.g. curtains, blinds)
- Telephone service (base charge)
- HOA dues

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## Fair rental value limitation

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- Zillow.com
- Comparable rent houses in your neighborhood
- Real estate professional
- Furnished, all bills paid
- Document it!

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## Church provided parsonage

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The value of a church provided parsonage is included in the minister's calculation of self-employment tax (aka Social Security and Medicare)

**Tax Tip:** Ministers who live in a church provided parsonage can still receive a housing allowance to cover housing expenses paid from the minister's own funds (utilities, cleaning supplies, furnishings, etc...)

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## Tax Savings: Tax free reimbursements

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All employees can/should be reimbursed tax free for their ordinary and necessary business expenses. Examples include:

1. Business travel,
2. Office supplies,
3. Research materials,
4. Business meals,
5. Business use of cell phone, and
6. Business use of home internet.

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## Accountable Plan

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Compliance Requirement: To be tax-free, reimbursements must be paid under an “accountable plan”.

An accountable plan is where the employee submits documentation (receipts or logs) within 60 days and is then reimbursed.

Best practice: Employees should request reimbursement for their business expenses via an expense report with receipts attached.

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## Car allowance or mileage reimbursement

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**Car allowance:** A fixed amount paid to the employee each month. Because this fixed amount is not being paid under an accountable plan, it is simply additional taxable income to the employee and does not provide any tax benefits.

**Mileage reimbursement:** A reimbursement to an employee based upon the federal standard mileage rate and substantiated by a mileage log submitted by the employee is 100% tax free.

2020 mileage rate = \$.575 per mile, 2021 mileage rate = \$.56 per mile

FYI: commuting is not deductible business travel

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## Educational Expenses

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- Educational assistance benefit plan
  - Written plan
  - Reimburse, tax free, up to \$5,250 of qualified educational expenses (tuition, books, fees (and student loan payments through 2026) etc...)
  - Cannot discriminate between full-time employees, if it is offered to one full-time employee, it must be offered to all full-time employees
  - Includes graduate level courses
  - Does not include spouses or dependents
- Educational reimbursement plans
  - Reimburse educational expenses tax free if:
    - Is required by the church to keep the employee's status or job and serves a business purpose of the church, or
    - Maintains or improves skills required in the minister's current position, and
    - Does not qualify the employee for a new trade or business.
  - Can be discriminatory

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## Health Benefits

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- Employer provided group health insurance is tax free if:
  - Paid for by the church, or
  - Offered under a cafeteria plan:
    - Full IRC Section 125 cafeteria plan, or
    - Premium Only Plan (POP)
- Cafeteria plans must have plan documents
- [www.guidestone.org](http://www.guidestone.org) is a good source of group church health plans

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## Individual health plans

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- Individual health plan premiums cannot be paid by the church unless:
  - The church only has one employee for whom they are paying health insurance, or
  - The church reimburses the individual health insurance premiums under a
    - Qualified Small Employer Health Reimbursement Arrangement (QSEHRA), or
    - Individual Coverage Health Reimbursement Arrangement (ICHRA)
- ICHRA:
  - New for 2020
  - Can be established year-round
  - Must be funded by employer contributions
  - Require participants to provide proof of minimum health insurance coverage, not HSM
  - Can be tailored for different classes of employees
  - Must have legal plan documents
  - Consider using an HRA administrator

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## Alternative Health Plans

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- Health Sharing Ministries (HSM) have increased in popularity
- Do not meet the definition of health insurance under the tax code
- Satisfied the individual mandate to avoid the (now repealed) penalty for not having health insurance
- Effective 1/1/19, the penalty for not having health insurance (individual mandate) was effectively repealed
- Because HSMs do not meet the definition of health insurance, they are not eligible for any preferential tax treatment and HSM payments should not be made by the church

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# Employee Retirement Plans

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- SIMPLE IRAs
  - 2020 elective deferral limit
    - \$13,500 under age 50
    - \$16,500 age 50 or older
- Eligibility
  - Employer: Must have less than 100 employees who earn \$5,000 or more
  - Employee: Must have earned \$5,000 in any two preceding years, and must be expected to earn \$5,000 this year
- Matching:
  - Employer must match up to 3% of employees' wages
- Withdrawals from SIMPLE IRAs within first two years of participation are subject to 25% penalty, otherwise Traditional IRA withdrawal rules apply

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# Employee Retirement Plans (cont)

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- 403(b) plans
  - 2020 elective deferral limit
    - \$19,500 under age 50
    - \$26,000 age 50 or older
  - 2020 overall limit (employee elective deferrals plus employer contributions) \$57,000
  - Absent a hardship, you probably cannot withdraw from your 403(b) until you terminate employment with the sponsoring employer
  - Distributions from certain 403(b) plans in retirement may be eligible for designation as a tax-free housing allowance

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## Individual Retirement Accounts (IRAs)

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- Traditional IRAs – deducted from your personal tax return in the year of contribution;
- Roth IRAs – not deductible in the year of contribution;
- Neither Traditional or Roth IRA contributions by an employer receive any tax preferred treatment. In other words, if an employer makes Traditional or Roth IRA contributions on behalf of an employee, the payments must be reported as taxable income on the employee's W-2 as if the money had been paid directly to the employee.
- There is no tax advantage for an employer to make IRA contributions for an employee

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## Structuring Ministerial Comp Plans

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- Residual method: Add up the tax preferred items first, and then the remainder is reported on the W-2 as taxable wages
- First, all employees should be reimbursed (tax-free) for their business expenses under an accountable plan
  - Are expense reimbursements deducted from the minister's "compensation package," or are they paid on top?
- Next, allocate to tax-free employee benefits
  - Eligible educational expenses
  - Health benefits
  - Retirement plans
- Next, allocate to housing allowance
- The remaining amount is taxable wages

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## Structuring comp plans (continued)

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- Example, assuming the total compensation package is \$80K and that business expenses are being deducted from the package

	Amount
Business expense reimbursements	\$5,000
Group health insurance premium	\$10,000
403(b) contribution	\$12,000
Housing allowance	\$24,000
Sub-total	\$51,000
Total package	\$80,000
Taxable wages (remaining difference)	\$29,000

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## Q&A

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	Accounting	Membership	Bundle	Basic	Plus	Pro
Price	\$149	\$119	\$229	\$16/month	\$29/month	\$59/month
Number of names	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited
Access from anywhere				✓	✓	✓
Check register & bank recs	✓		✓	✓	✓	✓
Financial reports	✓		✓	✓	✓	✓
Payroll & federal withholding	✓		✓		✓	✓
Print W-2s & 1099s	✓		✓		✓	✓
Membership & Contributions		✓	✓	✓	✓	✓
Attendance		✓	✓	✓	✓	✓
Mailing Lists & Labels		✓	✓	✓	✓	✓
Calendar				✓	✓	✓
Online giving					✓	✓
Group emails					✓	✓
Group texts & Text-to-give						✓
Child check-in (& adults too)						✓
Automated Backup						✓
Number of Simultaneous Users				2	5	10



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FlockBase Feature	Desktop			Cloud		
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Check register & bank recs	✓		✓	✓	✓	✓
Financial reports	✓		✓	✓	✓	✓
Payroll & federal withholding	✓		✓		✓	✓
Print W-2s & 1099s	✓		✓		✓	✓
Membership & Contributions		✓	✓	✓	✓	✓
Attendance		✓	✓	✓	✓	✓
Mailing Lists & Labels		✓	✓	✓	✓	✓
Calendar				✓	✓	✓
Online giving					✓	✓
Group emails					✓	✓
Group texts & Text-to-give						✓
Child check-in (& adults too)						✓
Automated Backup						✓
Number of Simultaneous Users				2	5	10

## Opting out of Social Security

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- Opting out of Social Security
  - Only applies to ministers, and only to ministerial income
  - Filing IRS Form 4361 by the due date of the tax return for the 2<sup>nd</sup> year of earning more than \$400 of ministerial income
  - “I certify that I am conscientiously opposed to, or because of my **religious principles I am opposed to, the acceptance** (for services I perform as a minister, member of a religious order not under a vow of poverty, or Christian Science practitioner) of any public insurance that makes payments in the event of death, disability, old age, or retirement; or that makes payments toward the cost of, or provides services for, medical care. (Public insurance includes insurance systems established by the Social Security Act.)”

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## Opting out of Social Security (continued)

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- Advantage of opting out
  - You will not be paying into Social Security or Medicare therefore you will be paying less tax
- Disadvantages of opting out
  - You will not be paying into Social Security or Medicare
  - Unless you have earned 40 quarters of credits from other employment, you will not be eligible for Social Security benefits (retirement or disability)
  - You must be disciplined enough to save for your own retirement and purchase disability insurance coverage

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## New 2020 Form W-4

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- Minister employees can pay their taxes by:
  - Making quarterly estimated tax payments via Form 1040-ES, or
  - Completing Line 4c on the new 2020 Form W-4
- Non-minister employees should complete the new W-4 because it is more closely aligned with the new tax law.
- The IRS Tax Withholding Estimator is a good tool for non-minister employees: <https://apps.irs.gov/app/tax-withholding-estimator>
- We have a webinar dedicated to the new W-4. [https://www.youtube.com/results?search\\_query=flockbase](https://www.youtube.com/results?search_query=flockbase)

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## Form 1099-NEC & MISC

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- The church must provide a 1099 Form to every independent contractor that you paid more than \$600 in rents, services and other income payments, including:
  - landlords,
  - revival ministers,
  - supply preachers,
  - guest speakers,
  - repair persons, and
  - construction workers.

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## Form 1099-NEC & MISC (cont.)

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- Do not provide 1099s to:
  - Employees,
  - Corporations, or
  - Suppliers that only provide products (e.g. Wal-Mart, Office Max, or Fred's Pizza)
- Form 1099-NEC are now due by January 31
- Issue Form 1099-MISC for rents

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## Worker Classification

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- Employee versus Independent Contractor (hot audit topic)
- Facts & circumstances determine the classification
- Factors to consider:
  - Level of control (lots of control = employee, little control = contractor)
  - Who provides the training & instructions
  - Who provides the financial investment (tools & equipment)
  - Who bears the “risk of profit or loss”
  - Does the worker offer their services to the public
  - A written contract is helpful, but not definitive

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## Common Payroll Reporting Errors

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- Preparing 1099s for ministers rather than W-2s
- Not reporting a car allowance as taxable income
- Not reporting expense allowances paid outside of an accountable plan as taxable income
- Paying a minister’s self-employment tax (Social Security Offset) and not counting it as taxable income
- Treating an employee as both a minister and a non-minister employee; withholding taxes from their paycheck but paying them a housing allowance
- Paying a nursery worker or staff musician as a contractor instead of as an employee

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## Common Payroll Reporting Errors (continued)

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- Paying an employee's individual health insurance policy premiums outside of a QSHERA
- Paying an employee's health sharing ministry premiums
- Funding an employee's personal IRA and excluding it from taxable income
- Failing to give a contractor a 1099-MISC

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## Reporting Cash Contributions

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- To claim a deduction, donors need a contemporaneous receipt for EACH contribution of \$250 or more
  - Contemporaneous includes a year-end contribution letter
  - You cannot lump all contributions for the year together, you must list each contribution of \$250 or more (date, amount, type)
- Every contribution receipt must identify if the contributor received anything of value besides intangible religious benefits
- "Unless otherwise noted, you did not receive any goods or services in connection with these contributions other than intangible religious benefits."
- Contribution letters should include the organization's name, address and contact info
- Payments for daycare or private school tuition should not be reported as charitable contributions

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## Reporting Non-cash contributions

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- Issue a thank you letter/receipt for each non-cash contribution of a tangible item
  - The letter receipt should include a description of the item, but should not include a value (the church is not in the business of appraising items)
- Do not issue a tax receipt for donated services; donated services are not tax deductible
  - Example: A plumber repairs the lavatory in the church's bathroom and does not want to be paid, but instead wants a "tax deductible receipt" for the amount he would have normally charged. Although it is appropriate to write a thank you letter for his kind service, do not imply in any way that his donated services are deductible. However, donated materials are deductible.
    - "Thank you for repairing the lavatory. That was very kind. Thank you for donating the ceramic lavatory and fittings that were used in the repair."

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## Donations of automobiles

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- Donations of a motor vehicle, motorcycle, boat or airplane must be reported on Form 1098-C; additional reporting
  - The vehicle is sold
  - The vehicle will be used by the church
  - The vehicle will be transferred to a needy person in furtherance of the charitable purpose

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## 501(c)(3) tax exempt status

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- 501(c)(3) organizations are:
  - Organized for charitable, religious or education purposes,
  - Eligible to receive tax-deductible contributions,
  - Generally are subject to annual IRS filing requirements (Form 990).
- Generally, an organization must file Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) within 27 months of formation to receive a 501(c)(3) determination letter
- Applications filed more than 27 months after formation, if accepted, will become effective 27 months prior to the application date
- Filing Fee for Form 1023
  - Form 1023-EZ \$275 (gross receipts less than \$50K for 3 years)
  - Form 1023 \$600

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## 501(c)(3) tax exempt status (cont)

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- Churches are automatically considered tax-exempt under 501(c)(3) as long as they are a "real church"
- As a result of this automatic exemption, churches are not required to file Form 1023
- Denominational group exemption letter may be available from your denomination
- Even though not required, churches may choose to file Form 1023 for the following benefits:
  - To give an extra level of comfort to donors that their donations are tax-deductible,
  - Many corporations or large businesses will only make grants to organizations who have received a 501(c)(3) determination letter, and
  - There is just less confusion about tax-exempt status when you have an IRS letter.

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## Form 990

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- Generally, 501(c)(3) organizations must file an annual Form 990 with the IRS
  - The Form 990 is an informational return, and does not result in tax due
  - Stiff penalties for filing Form 990 late
- Churches are automatically exempt from the annual Form 990 filing requirement, unless they have Unrelated Business Income (see next slide)
- The exemption from filing Form 990 does not apply to other IRS forms (payroll forms 941, W-2/W-3, 1099, etc...)

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## Unrelated Business Income Tax

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Kevin Chessher, CPA

- Generally 501(c)(3) organizations do not pay any federal income tax
- However, if they have more than \$1,000 of gross Unrelated Business Income (UBI), they must file a Form 990-T and pay the corporate tax rates on the profit from the unrelated activity
- According to the IRS, an activity is an unrelated business if it:
  - Is a trade or business,
  - Is regularly carried on, and
  - Is not substantially related to furthering the exempt purpose of the organization.

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## Unrelated Business Income (cont)

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### Examples:

- A one-day car wash conducted by students who volunteer to work so that they can raise money for church camp is not UBI.
- The church opening a full-time car wash business which is staffed by paid employees is likely UBI.
- An on-campus daycare where faith-based curriculum is used with the children is not UBI.
- The church starting a daycare franchise business that does not use faith-based curriculum is likely UBI.

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## Unrelated Business Income (cont)

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- Generally, rent income is not UBI. However, there are numerous exceptions to this general rule. Here are a few of the exceptions:
  - If substantial personal services (e.g. maid cleaning service) are provided as part of the rental activity, the income could be UBI,
  - If more than 50% of the rental is for the use of personal property (e.g. weddings where more than 50% of the rental fee is for the use of the sound system and tables/chairs/linens),
  - If the property is debt financed. Consider these examples:
    - A classroom building, which is debt-financed, is leased to an unrelated private school,
    - A parking lot, which is debt-financed, is leased to a neighboring business during the week.

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## Fund Accounting

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- Fund Accounting is different from for-profit accounting because the organization's money may be restricted for specific purposes
- Generally, a fund is created by the acceptance of a restricted donation
- Example: Sister Betty wants to donate \$10,000 for a new piano. The church is agreeable to purchasing a new piano and therefore accepts the donation. Therefore, the church must separately account for the \$10,000 until it is actually spent on a new piano. Because the new piano is going to cost \$15,000, other contributions are solicited from other members and added to the "New Piano Fund." When all of the money inside the fund has been spent on the new piano, the fund can be closed.

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## Fund Accounting (continued)

- A Fund is NOT a bank account. Consider this Balance Sheet.

Account	Amount
Checking account at FNB Anytown	<u>\$10,000</u>
Total assets	\$10,000
Payroll taxes Payable	<u>\$100</u>
Total liabilities	\$100
General Fund	\$6,900
New Piano Fund	\$2,000
Building Fund	\$500
Youth Fund	<u>\$500</u>
Total fund balances	\$9,900

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## Fund Accounting (continued)

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- A Fund is not a line item in the General Fund budget
- Example, a church may have a Youth Fund and a Youth Dept Expense line item in the General Fund Budget at the same time
  - The Youth Fund is used to track designated contributions (or fundraisers) into the Youth Fund and disbursements made from those designated contributions
  - The Youth Dept Expense line item in the General Fund Budget is the amount the church is allocating to youth department expenses from its General Fund budget.

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## Audited Financial Statements

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Kevin Chessher, CPA

- Engaging an outside CPA firm to conduct a full audit under Generally Accepted Auditing Standards is costly
- The purpose of the audit is to determine if the financial statements are free from “material” misstatement
- Some bank loan covenants require a full audit
- If not required, consider the costs/benefits of a full audit
- Developing internal audit procedures to be performed by volunteers on a rotating basis is an economical way to keep everyone honest and ensure church policies are followed

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## Online giving

- According to [nonprofitsource.com](http://nonprofitsource.com), churches that accept tithing online increase overall donations by 32%
- Ensure you are dealing with a reputable merchant processor
- Be aware of monthly fees and discount fees
- Forte, the merchant processor for FlockBase, charges a \$15 fee per month, plus \$.15 per transaction for ACH, average 1.5% for debit or 2.5% for credit

## CHURCH GIVING STATISTICS



Only **3-5%** of americans who give to their local church do so through regular tithing



**37%** of regular church attendees don't give money to church



Only **5%** of americans tithe, and **80%** of americans give **2%** or less of their income



Tithers make up only **10-25%** of a normal congregation

Recurring givers annually donate **42%** more than one-time donors



Churches that accept tithing online increase overall donations by **32%**



**60%** are willing to give to their church electronically



**49%** of all church giving transactions are made with a card



## Q&A

FlockBase Feature	Desktop			Cloud		
	Accounting	Membership	Bundle	Basic	Plus	Pro
Price	\$149	\$119	\$229	\$16/month	\$29/month	\$59/month
Number of names	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited
Access from anywhere				✓	✓	✓
Check register & bank recs	✓		✓	✓	✓	✓
Financial reports	✓		✓	✓	✓	✓
Payroll & federal withholding	✓		✓		✓	✓
Print W-2s & 1099s	✓		✓		✓	✓
Membership & Contributions		✓	✓	✓	✓	✓
Attendance		✓	✓	✓	✓	✓
Mailing Lists & Labels		✓	✓	✓	✓	✓
Calendar				✓	✓	✓
Online giving					✓	✓
Group emails					✓	✓
Group texts & Text-to-give						✓
Child check-in (& adults too)						✓
Automated Backup						✓
Number of Simultaneous Users				2	5	10



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## Disclaimer

This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

We hope this has been helpful.

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