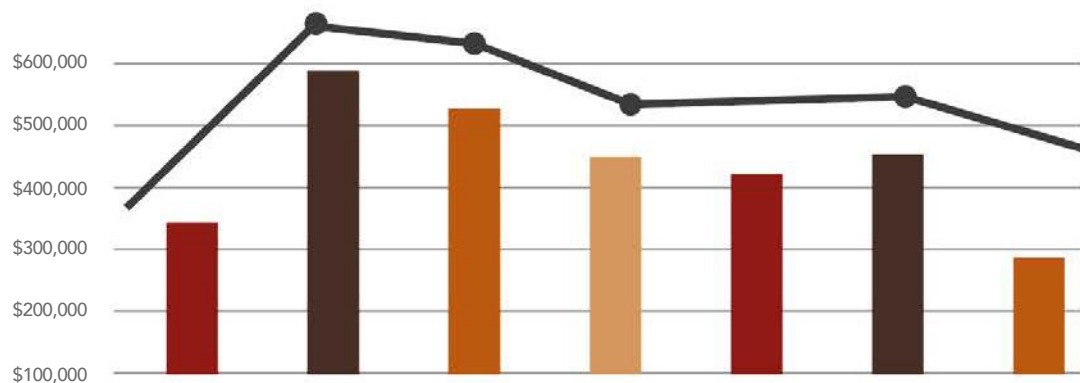


PERSONAL/FISCAL FINANCIAL WHOLENESS IN HOLINESS

PRESENTED BY

**ATTORNEY
AMOS SMITH**

GROSS INCOME



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CHAPTER I - Gross Income

This is the starting point for determining which items of income are taxable for federal income tax purposes in the United States.

Section 61 (of the Internal Revenue Code (IRC)) states that "except as otherwise provided in this subtitle gross income means all income from whatever source derived".

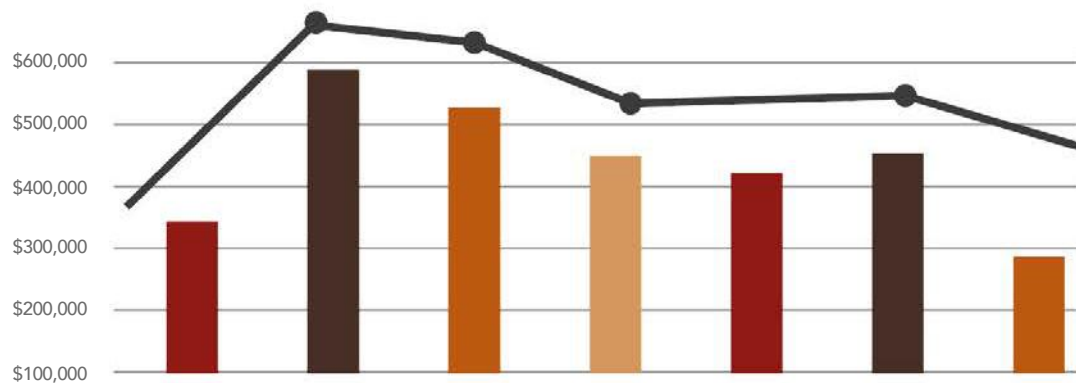
UNITED STATES SUPREME COURT

The United States Supreme Court has interpreted this to mean that Congress intended to express its full power to tax incomes to the extent that such taxation is permitted under Article I, Section 8, Clause 1 (the Taxing and Spending Clause) of the Constitution of the United States and under the Constitution's Sixteenth Amendment.

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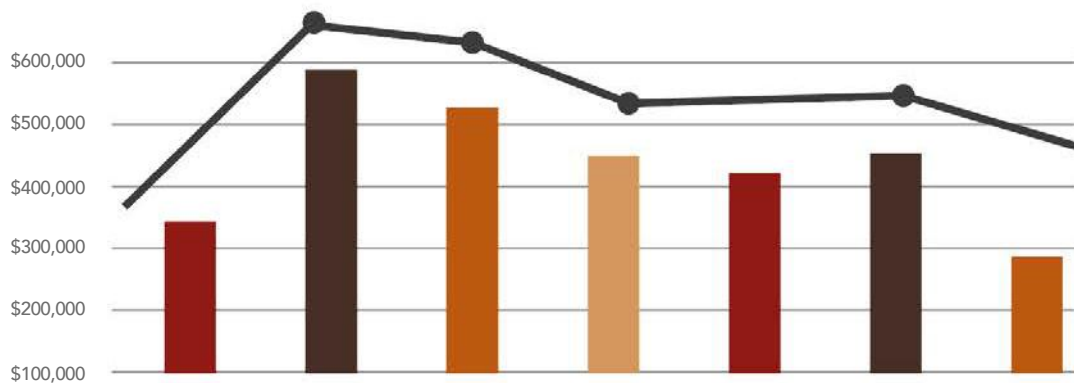


EXAMPLES OF GROSS INCOME



- Offering versus Love Offering versus Pastoral Anniversary
- Good Shepherd Offering
- Christmas and special-occasion offerings
- Honorarium for Speaking Engagement
- Pastor receives some tithes
- Birthday Celebration
- Anniversary – Pastoral, Wedding, Church, etc.

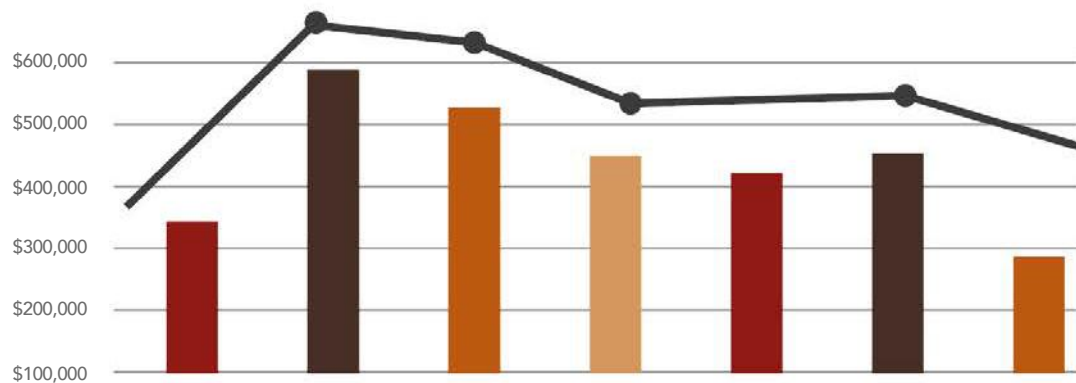
EXAMPLES OF GROSS INCOME



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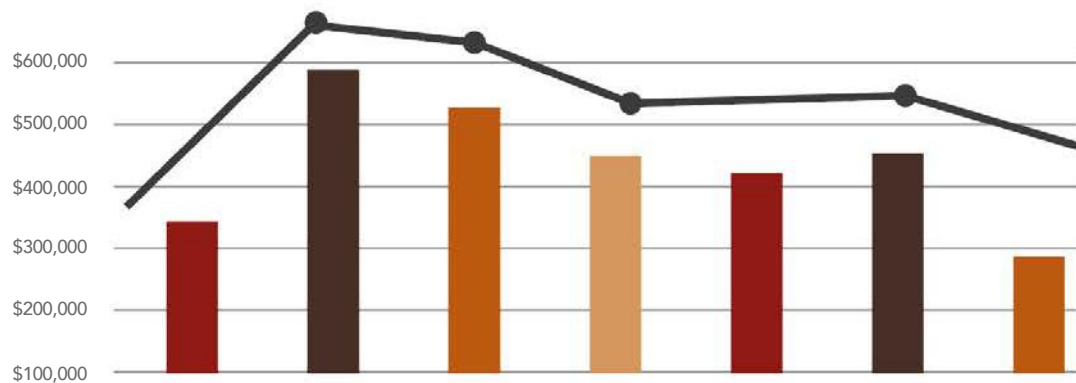
- Salary
- Bonuses
- Christmas and special-occasion offerings
- Retirements gifts
- The portion of a minister's Social Security tax paid by a church
- Personal use of a church-provided car
- Embezzled funds
- Church-paid trips to the Holy Land and
- Non-accountable reimbursements of a minister's business expenses

EXAMPLES OF GROSS INCOME



- Purchases of church property for less than fair market value
- Rental income
- Interest income
- Some forms of pension income

EXAMPLES OF GROSS INCOME



- Some reimbursements of a spouse's travel expenses
- Forgiven debts
- Severance pay
- "Love Gifts"
- Winnings from gambling
- Income from crime or illegal business transactions

CRIMINAL PENALTIES

- A willful attempt to evade taxes. Criminal liability requires an affirmative act such as filing a false return.
- Tax evasion is a felony punishable by a fine of not more than \$100,000 (500,000 for a corporation) or a prison sentence of up to five years or both. *IRC 7201*.

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AL
CAPONE

A woman with dark curly hair is sitting at a desk, looking down at a stack of papers with a weary expression, her hand resting on her forehead. A man with glasses is leaning over her, pointing at the papers. The desk is cluttered with tax forms, a calculator, and sticky notes. The background shows a home interior with a plant and wooden cabinets.

TAX REPORTING

A. Ministers and income taxes.

Ministers are not exempt from paying federal income taxes on their income.

B. Who should file a tax return?

Ministers are required to file a federal income tax return if they have earnings of \$400 or more (if they are not exempt from Social Security), by using Form 1040.

C. Tax Penalties.

Ministers are subject to substantial penalties for not filing a tax return and for reporting inaccurate information on a tax return.

BROWN PAPER BAG OFFERING!!!



TAX PENALTIES

D. Estimated taxes.

Ministers should prepay their income taxes and self-employment taxes by using the estimated tax report procedure.

E. Accuracy-related penalties

Penalties are imposed for various inaccuracies in tax returns.

F. Negligence or disregard

If an underpayment of tax is due to negligence or a disregard of tax law, a negligence penalty is imposed.

This is computed by multiplying 20 percent by the amount of the underpayment of taxes that is due to negligence or disregard. *IRC 6662(b)(1)*.



TAX PENALTIES

G. Substantial understatement

Taxpayers who substantially understate their income tax are subject to a substantial understatement penalty. *IRC 6662(b)(2)*.

This penalty is computed by multiplying 20 percent by the portion of an underpayment of income taxes that is due to a substantial understatement.

H. Substantial valuation misstatement

Taxpayers who understate their income taxes in any year by \$5,000 or more because they misstated the value of property on their tax return are subject to a penalty. *IRC 6662(b)(3)*.

I. Fraud

The fraud penalty, which is imposed at a rate of 75 percent, applied to the portion of any underpayment of income taxes that is due to fraud.

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TAX PENALTIES

Sanctions and costs

Failure-to-file penalty

Frivolous income tax return

Tax payers can be assessed a penalty of \$5,000.00 for filing a "frivolous" return that does not include enough information to figure the correct tax.

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AUDIT RISK

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- The risk of being audited is much higher for self-employed persons and for self-employed persons who receive only one or two Form 1099.
- Many ministers who report their federal income taxes under self-employed status using a Form 1099 are at a greater risk of being audited.
- Minister who file a Form 1040 Schedule C

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DEFINITION OF A MINISTER/CLERGY

For federal tax purposes, a minister is a person who performs the following duties:

- (1) ordained, commissioned, or licensed status
- (2) administration of sacraments
- (3) conduct of religious worship
- (4) management responsibilities in the local church or a parent denomination and
- (5) whether the person is considered a religious leader by the church or parent denomination



IRS BALANCING TEST

In general, the IRS and the courts require that a minister be ordained, commissioned, or licensed, and then they apply a "balancing test" with respect to the other four factors. The more of those factors a person satisfies, the more likely he or she will be deemed a minister for tax reporting.

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PARSONAGE ALLOWANCE

- Ministers who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a parsonage allowance.
- This is to the extent that the allowance represents compensation for ministerial services and is used to pay parsonage-related expenses such as utilities, repairs, and furnishings.

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HOUSING ALLOWANCE

- Ministers who own their home do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a housing allowance.
- This is to the extent that the allowance represents compensation for ministerial services. Housing-related expenses include mortgage payments, utilities, repairs, furnishings, insurance, property taxes, additions, and maintenance should be included in the housing allowance.

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BENEFITS FOR MINISTERS

A. Ministers are eligible for the following:

- 1) Housing Allowance and Parsonage Exclusion
- 2) Exemption from Social Security coverage (if several conditions are met)
- 3) Self-employed status for Social Security (if not exempt); and
- 4) Exemption from income tax withholding
- 5) Retirement/Social Security/Medicare!

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DESIGNATING AN ALLOWANCE

Parsonage and housing allowance should be:

- 1) adopted by the church board or congregation,
- 2) in writing, and
- 3) in advance of the calendar year.



SELF EMPLOYMENT OR SOCIAL SECURITY TAXES

A housing allowance and the annual rental value of a parsonage are exclusions only for federal income tax reporting.

Ministers cannot exclude a housing allowance (or the annual fair rental value of a parsonage) when computing their self-employment tax unless "You Have Received an Approved IRS Form 4361.



SETTING THE ALLOWANCE

- There is no limit on the amount of a minister's compensation that can be designated by a church as a housing allowance.
- ONE OF MY PASTOR RECEIVES A \$100,000 TAX FREE HOUSING ALLOWANCE!!!



ACCOUNTABLE BUSINESS PLAN (OR EXPENSE ACCOUNT)

1. only business expenses are reimbursed;
2. no reimbursement is allowed without an adequate accounting of expenses within a reasonable period of time (not more than 60 days after an expense incurred);
3. any excess reimbursement or allowance must be returned to the employer within a reasonable period of time (not more than 120 days after an excess reimbursements is paid)

EXPENSE ACCOUNT

A bank checking account and/or debit/credit card:

- (1) Should be in the name of church and add the pastor's name as a signer;
- (2) Can charge expenses with debit or credit card tied to the account;
- (3) Can also use checks and statements should be sent to church for record keeping.

CHARITABLE CONTRIBUTION

A charitable contribution must be:

- (1) a gift of cash or property,
- (2) claimed as a deduction in the year in which the contribution is made,
- (3) unconditional and without personal benefit to the donor,
- (4) made "to or for the use of" a qualified charity,
- (5) within the allowable legal limits, and
- (6) property substantiated.



CHARITABLE CONTRIBUTIONS

Charitable contributions must be properly substantiated.

- 1) all cash contributions,
- 2) individual contributions of cash or property of \$250 or more,
- 3) "quid pro quo" contributions in excess of \$75,
- 4) contributions of cars, boats and planes, and
- 5) contributions of noncash property valued by the donor at \$500 or more.



EMPLOYEES VERSUS INDEPENDENT CONTRACTORS

- How does one determine whether an individual (such as a Musician or Minister of Music) is an employee or independent contractor for Taxation Purposes?
- The issue as to whether an individual is an Employee or an Independent Contractor for Taxation Purposes is determined based on the facts and circumstances but the wrong result can be costly to you personally and the church.
- The general common law rule is that if an employer has the right to control what and how one does his or her job then that is a significant factor in determining that the individual may be an employee .
- Do you offer employee benefits, vacation pay, an office, furnished with materials, equipment and supplies?

EMPLOYEES VERSUS INDEPENDENT CONTRACTORS

- An individual is an independent contractor if he or she is accountable only as to a result and is not controlled by the person who is seeking the services. Independent contractors usually have their own office, supplies, equipment, material and tools. DOORNBOS HEATING & COOLING STORY!!
- Generally, you must withhold Income, Social Security and Medicare taxes and pay unemployment tax on wages paid to an employee.
- You do not generally have to withhold or pay any taxes on payments to independent contractors.

PAYROLL REPORTING REQUIREMENT FOR CHURCHES

1. Obtain an employer identification number
2. Determine whether each worker is an employee or self-employed, and obtain each worker's Social Security number.
3. Obtain a completed Form W-4 (withholding allowance certificate) from each employee.
4. Compute employee wages (including any fringe benefits and other taxable items).



PAYROLL REPORTING REQUIREMENT FOR CHURCHES

5. Determine the amount of federal income taxes to withhold from each employee's wages from tables published in IRS Circular E (Publication 15).
6. Withhold FICA taxes from employee wages (unless the church filed a timely exemption from the employer's share of FICA taxes, in which case non-minister employees are treated as self-employed Social Security).



PAYROLL REPORTING REQUIREMENT FOR CHURCHES

7. Deposit withheld taxes
8. File Form 941
9. Issue a Form W-2 to every employee before February 1 of the following year.
10. Issue a Form 1099-MISC to any nonemployee worker.
11. **ARMOR BEARER STORY!!**



INTERMEDIATE SANCTIONS



- The IRS can impose an excise tax against a "disqualified person," and in some cases against church board members individually, if excessive compensation is paid to the disqualified person.
- Most senior pastors will meet the definition of a disqualified person.
- These taxes are substantial (up to 225 percent of the amount of compensation the IRS determines to be in excess of reasonable compensation).

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EXCESS BENEFIT



1. Occurs if a church pays a minister an excessive salary,
2. makes a large retirement or other special occasion "gift" to a minister,
3. gives church property (such as a parsonage) to the minister,
4. loans money to the minister or sells church property to the minister at an unreasonably low price.

SANCTIONS



Sanctions only apply to a

- minister who is a “disqualified person” (meaning an officer, director, or other control party as well as relatives of such persons).
- In some cases, the IRS can assess additional penalties against members of a church board that approved an excess benefit transaction.

SANCTIONS



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Slide

As a result, governing boards or other bodies that determine clergy compensation should be prepared to document any amount that may be viewed by the IRS as excessive.

This includes salary, fringe benefits, and special-occasion gifts. If in doubt, the opinion of a tax attorney should be obtained.

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Grants & Funding Sources

**CONTACT US ABOUT A
COMMUNITY
DEVELOPMENT
PRESENTATION**

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A portrait of a Black man with a short beard and mustache, wearing a dark blue pinstripe suit, a white shirt, and a red tie. He is smiling slightly and looking towards the camera. The background is a blurred image of a stack of papers or a spiral notebook.

MINISTRY FISCAL/FINANCIAL WHOLENESS IN HOLINESS

Presented by

Attorney Amos Smith



Presentation Topics

- Legal Principles to Know
- Fiscal and Budgetary Concerns
- Real Property Concerns
- Liquid Assets and Personal Property Matters
- Election/Appointment of Trustee Board Officers



Presentation Topics (2)

- Trustee Board Member Job Descriptions
- Structure of Trustee Board
- Church Bylaws – Updates & Amendment
- Elections
- Formation of Not for Profit & 501(c)(3) Status



Legal Principles

1. The Board of Trustees (or Board of Directors), hereinafter ("BOT") is the **Governing Body** that represents the interest of the patrons of a church.
2. Members of BOT are usually **appointed or elected** as stated in the Articles of Incorporation and/or Bylaws.



Legal Principles

3. The BOT ensure that the **Articles of Incorporation are kept up-to-date.**
4. The BOT **complies with State Law, the churches' organizational documents** such as Articles of Incorporation, Bylaws and Conflict of Interest Policy.



Legal Principles

5. The BOT files the **annual Federal, State, County and City reporting requirements.**
6. The BOT Church could **incur personal liability** for failing to withhold payroll taxes and/or issuing w-2's and 1099's.



Legal Principles

7. The BOT is legally bound by the **duties of obedience, due care and loyalty**.
8. The IRS may issue **sanctions under IRC Section 4958** as to members of the BOT.
9. The IRS may assess **trust fund taxes and penalties** against the BOT.




Legal Principles

10. The BOT should establish a **tithe and offering system** to avoid misappropriations.
11. The BOT should have a **check signing policy**.
12. The BOT should be aware of the **requirements for issuing charitable statements**.



Fiscal & Budgetary Concerns

1. Trustee boards are typically in charge of budgetary matters
2. The board defines a budget and appropriations at the beginning of each year
3. Develop a uniform system to accept offerings and donations, pay bills and make purchases



Fiscal & Budgetary Concerns (2)

4. Revenues and expenditures are documented by the accounting department
5. Year end comparison of Budget vs Actual amounts must be presented to the members



Real Property Concerns

1. Maintain buildings and property
2. Hold and execute deeds, title and leases
3. Maintain insurance policies
4. Mortgages and loans
5. Event and rental insurance
6. Real estate exemption




Real Property Concerns (2)

7. Zoning compliance and regulation
8. Receive donations, gifts, endowments and inheritances
9. Execute contracts, sales and leases
10. Year end balance statement of real assets



Assets & Personal Property Matters

1. Bank accounts
2. Savings accounts
3. Investments
4. Automobiles, buses and vans
5. Office furniture and fixtures



Assets & Personal Property Matters (2)

6. Computers, printers, phones, fax machines
7. Year end balance statement of liquid and personal assets



Election of Trustee Board Officers

1. Most church trustee board officers are stated in Bylaws, but not the individual name.
2. Officers
 - A. President/Chairperson
 - B. Vice President/Vice Chairperson
 - C. Secretary
 - D. Treasurer
 - E. Parliamentarian



Trustee Job Descriptions

1. Stewards of the property God has entrusted to the congregation.
2. Property and asset management experience
3. Ability to listen to and communicate with people of all ages



Trustee Job Descriptions (2)

4. Ability to delegate responsibility and follow
5. Prior effective ministry leadership
6. Financial supporter of the ministry



Structure of Trustee Board

1. Composed of an odd number and no less than three
2. No inherent conflict of interest, but you should deal with conflicts with a Written Conflict of Interest Policy.
3. Staggered voting



By-Laws (Unjust Judge)

- Rules and regulation for the church
- Articles of Incorporation vs By-laws
- By-laws are specific
 - Rules for electing or appointing board members and other officials
 - Procedures for electing or appointing successors



By-Laws (2)

Bylaws should include the following:

- Qualification and selection of members
- Time and place of annual business meeting
- Calling of special business meetings
- Notice for annual and special meetings
- Quorums
- Voting Rights
- Selection, tenure and removal of officers



By-Laws (3)

- Filling of vacancies
- Responsibilities of trustees/directors and officers
- Methods of amending bylaws
- Purchase and conveyance of property
- Staggered voting of directors



IRS and By-Laws

- Acknowledgment of tax laws, safeguarding of charitable assets and serving charitable interests
- Organizational documents for framework of governance and management
- Informed board members who actively oversee operations and finances
- By-laws needed to apply for 501c(3) status and annually with Form 990 informational return



Elections


The articles of incorporation and/or bylaws may provide for voting by the Board and/or Members:

- a. Each person is entitled to 1 vote
- b. Voting may be cast either orally or in writing
- c. Provision for electronic voting




Elections (2)

- d. Actions authorized by a majority of the votes unless required by the articles of incorporation
- e. Trustees/Directors elected by a plurality of the votes



Not for Profit & 501(c)(3) Status

1. Choose a business name (check availability)
2. Recruit and/or appoint directors
3. Incorporate nonprofit organization
 - File articles of incorporation
 - Create bylaws
 - Hold organizational meeting
 - Create a records book
4. Obtain an Employer Identification Number (EIN)



Not for Profit & 501(c)(3) (2)

5. Register with State offices

- Attorney General's office (Charitable Solicitation License)
- Department of Revenue (see Business Tax e-Registration website for forms/instructions)

6. Apply for tax exemptions

- Federal: apply for 501c(3) tax exemption
- State: automatic exemption with receipt of federal exemption



BREAK TIME

Amos Smith

Attorney at Law

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Presentation of Topics

- Financial Transparency
- Key Focus Areas and IRS Concerns
- Internal Controls and Segregation of Duties
- Legal Audits



Financial Transparency

- Internal Revenue Service (IRS) probes into faith based organizations
- Transparency and accountability to members and donors
- Long term sustainability



Key Focus Areas

Church Financials

- Tax Exempt Status
- Church Budget
- Internal Controls
- Records Retention
- Form W-9
- Form 1099-Misc
- Offerings: Restricted and Unrestricted
- Contribution Statements
- Financial Statements
- Accounting Software



Key Focus Areas (2)

Pastoral Benefits

- Minister's Paycheck
- Housing Allowance
- Retirement & Life Insurance
- Accountable Plan



IRS Concerns

- Church Activities
- Church Records
- Recognition of Church Employees
- Employment Tax Filings
- Unrelated Business Income (UBI)
- Documented Status of Ministers
- Personal Use of Church-Owned / Leased Vehicles
- Personal Use of Cell Phones



Internal Controls

- Internal financial and operational controls in churches can help to mitigate potential exposures associated with affiliation and the possibility of fraud.
- Objectives of internal controls:
 - Effective and efficient operations
 - Reliable financial reporting
 - Compliance with laws and regulations
 - Safeguarding of assets




Segregation of Duties

Segregation of duties is critical to the maintenance of effective internal controls

It reduces the risk of both erroneous and inappropriate actions.

The following functions should be separated:


- Approval function
- Accounting/reconciling function
- Asset custody function



Segregation of Duties (2)

No one person should:

- Initiate transaction
- Approve transaction
- Record transaction
- Reconcile balances
- Handle assets
- Review reports



Segregation of Duties (3)

- The person who approves the purchase of goods or services should **not** be the person who reconciles the monthly financial reports.
- The person who approves the purchase of goods or services should **not** be able to obtain custody of checks.




Segregation of Duties (4)

- The person who maintains and reconciles the accounting records should **not** be able to obtain custody of checks.
- The person who opens the mail and prepares a listing of checks received should **not** be the person who makes the deposit.
- Deacon who stole \$45,000!!!




Legal & Church Audit

- A process that provides reasonable assurance that good stewardship is being used in handling and accounting for the funds and other assets of your organization.
- External (performed by an outside person) and/or internal (by people in your organization who understand legal & financial management and are not related to the person performing the financial tasks in the church).



Legal & Church Audit (2)


- Protect elected officers from unwarranted charges of improper handling of funds
- Build the trust and confidence of the financial supporters of the organization
- Assurance that contributions made to the organization are being used as intended
- Provide checks and balances for funds received and expended



Legal & Church Audit (3)

An audit should:

- Independently verify the reports of the treasurer(s)
- Follow the funds and see if proper steps are being taken in handling them
- Document that donated funds have been used as stipulated by the donors




Legal & Church Audit (4)

- Accounting controls (systems that reduce the possibility of loss or errors)
- Segregation of duties
- Reasonableness of systems and procedures in the light of all factors, including the size of the organization and its budget



Church Audit (5)

- Copies of policies and procedures related to finance and treasury functions
- Copies of minutes approving transactions
- Listing of all bank and investment accounts, including authorized signors
- Monthly financial statements
- Bank and investment account statements
- Bank reconciliations



Legal & Church Audit (6)

- General and subsidiary ledgers
- Paid invoices and supporting documents
- Payroll data and files (including 941's, year-end W-2's, 1099's and transmittal forms)



Question

Are You a DOM?
**"DEFENDER OF
THE MINISTRY"**



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