

Legal and Business Issues Pertaining to Church Life

There are various government entities and businesses with whom an established church will transact business on a regular basis and with whom a new church must establish a working relationship. Too often pastors and church leaders become confused as they try to navigate these ever increasingly complex waters. This piece is an effort to clarify and hopefully simplify the process for churches and church planters.

- The first section gives an overview of these various entities. I find that many pastors and church leaders get very confused as it relates to federal vs state issues.
- The second section provides a check-list of things a new church will face in the general order in which they will encounter the items listed in section one.
- The final section relates to “first time pastors” and the first time a new church pays a pastor.

Section I: Various Entities a Church Will Encounter

Government Entities that a Church will encounter are:

COUNTY

Property tax exemption: If the church purchases or owns property, it must file for property tax exemption. Upon the purchase of property the church must immediately file for property tax exemption or property taxes WILL be assessed. In Nebraska, Property Tax Exemption then must be filed annually, usually in October or November, with the County Assessors office. There are specific criteria that must be met to qualify for property tax exemption. Iowa churches do not have to file annually after initial exemption approval.

STATE

Incorporation: Included in this resource is a sample “boiler plate” *Articles of Incorporation*. Once filed, the *Articles of Incorporation* becomes the new church’s constitution, and are the equivalent to an individual’s birth certificate. Bylaws will need to be developed and sample bylaws are also included in this resource. Once a church is incorporated you are required by state law to file a biennial report in even numbered years to update your current registered office, registered agent, and corporate officers. Two points of caution...

- When filing the original *Articles of Incorporation* and subsequent biennial report make sure you use a stable address (for a new church plant, that might be the address of your sponsoring church—never use the planter’s or a pastor’s home address).
- Failure to file the biennial report WILL result in the state dissolving the corporation.

Sales Tax Exemption: This applies to Nebraska churches only (in Iowa churches are not exempt from sales taxes). A religious non-profit organization in Nebraska can receive an exemption by filing a Nebraska Exemption Application for Sales and Use Tax, Form 4. Once it has been approved an exemption number will be received and when purchasing items a business will ask that you complete and have on file with them a Nebraska Form 13. Forms are available on the Nebraska State Revenue Department website:

<http://www.revenue.nebraska.gov>

Employment Identification Number: In Nebraska, a church must file for a state employment identification number on a Nebraska Tax Application Form 20. The form is available on the Nebraska State Revenue Department website. In Iowa, your Federal Employer Identification Number is used and you do not have to file for a separate number. However, in Iowa you do need to complete an Iowa Business Tax Registration form, (78-005), before you pay state withholding taxes for your employees (see next section). That form is located at the state department of revenue website: <http://www.tax.iowa.gov>.

State Withholding Tax: If a church has employees other than ordained ministers,* the church must withhold state income taxes and remit them to the state. In Nebraska this is filed on a Nebraska Employer's Quarterly Withholding Return, Form 941N. In Iowa it is filed on an Iowa Withholding Tax Quarterly Return, Form 44-095. The period is the reporting frequency as assigned by the Department of Revenue. Normally it will be quarterly, but in the case of employers who have small tax liabilities, they may be assigned an annual filing frequency. *Ordained pastors are treated as self-employed and must pay quarterly estimated taxes.

Unemployment Tax: A church in Nebraska or Iowa can choose to be categorized as an employer who pays unemployment on a reimbursable basis. That means a church would not pay unemployment taxes; however, if and when a former employee files for unemployment, the church will be required to reimburse the state for any unemployment compensation paid to that former employee. To be categorized in that manner, a Nebraska churches will need to complete the application for an Unemployment Insurance Account using Nebraska "UI Form 1." Iowa churches "may elect to become a reimbursable employer for a period of not less than two calendar years by filing with the department of revenue a written notice of its election not later than thirty days prior to the beginning of the calendar year for which the election is to be effective" (Iowa Code 96.7 8a1).

New Hire Reporting: Federal and State laws require employers to report newly hired and rehired employees. All Nebraska Employers, both public and private, must report all newly hired, rehired, or returning to work employees to the State of Nebraska within 20 days of hire or rehire date. Information about new hire reporting and online reporting is available at: www.ne-newhire.com. In Iowa churches must report on a centralized employee registry (CER) at <https://secureapp.dhs.state.ia.us/epay>

Worker's Compensation: Any and all salaried employees (including pastor) are to be covered by Worker's Compensation Insurance. The Nebraska Department of Insurance regulates worker's compensation and it is handled through your insurance company. In Iowa the Iowa Workforce Development Department works with the insurance companies.

Planter/Pastor Estimated Tax Payments: An ordained pastor/church planter is viewed as self-employed for income tax purposes. As such he is required to file quarterly estimated income tax payments by April 15, June 15, September 15, and January 15 for each tax year. In Nebraska, if the individual's Nebraska income tax after allowance of personal exemption credits can reasonably be expected to exceed withholding and other credits by \$500 or more payments are to be made on form 1040N-ES. In Iowa taxpayers who estimate they will owe \$200 or more in tax must pay estimated taxes using form IA 1040ES.

FEDERAL

Employer Identification Number (EIN): There is a simple on-line form that can be completed at the IRS website—there is NO FEE. CAUTION—make sure you are on the official IRS government web site. There are third party web sites that will charge you a fee to do what you can do for free. You can also complete an IRS Form SS-4 and submit it via fax or mail. A Federal EIN is required by banks when you open a checking account for your church.

Income Tax Exemption: Most people are familiar with the term a "501(c)3 tax exempt organization." This refers to the section of federal code relating to religious non-profit organizations. A cooperating SBC church falls under the umbrella exemption of the SBC and state convention. There are some government, businesses, and ministry organizations that will request verification that your church is a qualifying 501(c)3 organization before granting discounts or providing services. In Nebraska you can contact the Heartland Church Network office and copies of the necessary forms will be e-mailed to you. In Iowa, you will need to call the state convention office where they will verify your SBC status and send you the necessary letter.

Employment Eligibility Verification: A federal Form I-9 must be completed on every employee, including pastors and church planters, and kept on file by the church—you do not send this to the federal government.

There are requirements to retain the form even after the employee has left—you will want to check current law before disposing of an I-9 on someone who is no longer employed by your church.

Federal Tax Requirements for a church: There are several pieces that fall into this category.

- Generally, tax-exempt organizations must file an annual information return (Form 990 or Form 990-EZ); however “A church, an interchurch organization of local units of a church, a convention or association of churches” is exempt from this requirement.
- Form W-4—The church must complete a W-4 when hiring an employee other than an ordained pastor who is viewed by the IRS as self-employed. Having the employee review this form annually is a good practice. This is retained by the church and is not submitted to IRS.
- Form 941—Law requires an employer to withhold income, social security, and medicare taxes from the employee’s paycheck, match the social security and medicare amounts and send quarterly payments using Form 941 to the IRS. This does NOT apply to ordained pastors who are viewed by IRS as self-employed.
- W-2 or 1099—Annually a W-2 must be given each employee (including pastors) and a summary W-3 must be sent along with copies of the W-2s to both the federal and state governments. A 1099 must be sent to any individual the church pays over \$600 in a given year—i.e. speaking honorariums, contract workers, etc.

Planter/Pastor Estimated Tax Payments: An ordained pastor/church planter is viewed as self-employed for income tax purposes. As such he is required to file quarterly estimated tax payments on an IRS Form 1040ES by April 15, June 15, September 15, and January 15 for each tax year. This is to provide timely payments to the IRS for “self-employment tax” which is the equivalent of an employee’s social security and medicare taxes combined. A pastor’s income tax liability is a completely separate issue.

Planter/Pastor Housing Allowance: The federal government allows an ordained minister to claim a housing allowance for the expenses incurred in owning and maintaining a home. See the Housing Allowance Worksheet included in this appendix section for qualifying expenses. The church MUST approve a planter or pastor’s request prior to it being claimed. This obligation can be met when a church approves its annual budget if salary and housing allowance are clearly differentiated. Or it can be approved by a church’s personnel committee or other authorized board by approval of a motion specifying the dollar amount of the housing allowance.

Reporting Charitable Contributions: A church will want to provide an annual contribution letter to anyone who contributes more than \$250.00 a year. The letter should specify that only religious services were provided—no goods or services were provided.

Businesses that a church will encounter are:

BANK

Before establishing a checking account, a new church will need to have secured a Federal Employer Identification Number (see above). In most cases you will want to have completed your incorporation process to establish your legal identity and to secure your name (see above). Churches will want to establish simple accounting guidelines for receipt, deposit, and disbursement of funds. Included in this appendix are basic financial procedures that will help your church avoid problems down the road, as well as budget worksheets and simple excel budget and finance reporting templates.

INSURANCE COMPANY

Every church should have a general liability policy in addition to any property insurance it might desire. The overall package will also need to include Worker’s Compensation Insurance for any salaried employees (including pastor). New churches can be added to the sponsoring church’s insurance, but there are specific steps that the sponsoring church will need to take.

Section II: Step-by-Step Check List

The following is the typical order in which the above issues are encountered.

INITIAL ORGANIZATION STEPS

- Establish simple accounting procedures including a simple budget, establish a process for reporting charitable gifts to contributors. Enlisting a competent and trustworthy treasurer—other than the planter or his wife. For new churches, funds might be held in a designated account by the sponsoring church or local association/network. If a bank account is established in the name of the new church, an Employer Identification Number from the sponsoring church or association will need to be used.
- When you begin to pay your pastor/planter, the church needs to approve the “support package” including salary, housing allowance, expense reimbursement accounts, health insurance, and retirement and establish a process for providing a W-2 at the end of the year. See section III of for further information.
- Set up a personnel file for the planter/pastor to include resume, any covenant agreements or commitments made by the church and planter, a completed USCIS Form I-9 (see above), new hire form (see above), and emergency contact information.
- Once a new church plant is viable, it should be incorporated to establish legal identity and secure the church’s name.
- File for Employer Identification Number and update the EIN number on the new church’s bank account.
- Acquire insurance coverage
- When purchasing from some businesses and agencies as a religious non-profit organization, they will request verification of 501(c)3 status. When that happens you can receive verification by contacting either the Heartland Network office or the state convention office.
- Complete Nebraska Sales Tax Exemption Form 4.

WHEN A NON-ORDAINED EMPLOYEE IS HIRED

- Set up a personnel file for the individual to include job description, resume, USCIS Form I-9 (see above), IRS Form W-4 (see above), new hire form (see above), and emergency contact information.
- For Nebraska churches, a Nebraska New Hire Reporting Form must be completed within 20 days of employment. For Iowa churches, new hires must be report on a centralized employee registry (CER). [See above]
- Complete IRS Form 941 and submit withholding taxes as required. Normal process is to deposit funds monthly by the 15th of each month and file quarterly reports by the end of April, July, October, and January.
- Nebraska churches will need to file a Nebraska Tax Application Form 20 to receive a Nebraska Employer Identification Number. Iowa churches will need to file the Iowa Business Tax Registration form, (78-005).

- Request Nebraska Tax Form 941N or Iowa 44-095 and transmit on a quarterly basis state income taxes that are withheld.
- Churches in Nebraska and Iowa can choose to pay unemployment on a reimbursable basis rather than pay unemployment taxes—see Unemployment Taxes section above for important details.

WHEN REAL ESTATE IS PURCHASED

- Request a Tax Exemption Form from the County and file it in a timely manner. In Nebraska, this must be done on an annual basis. The county usually sends out a request form in late fall.

SUMMARY OF ANNUAL REQUIREMENTS

- In January you need to provide all salaried personnel a W-2 or 1099 and file appropriate forms with IRS by January 31st of each year.
- In January you need to provide all contributors with a giving report.
- Complete Federal and State 941 forms as required (see above).
- In even numbered years complete the biennial report and send it to the Secretary of State. In Iowa this can be completed on-line.
- For Nebraska churches who own property, in November or December complete a property tax exemption form and get to county treasurer.
- Your insurance company estimates the Worker’s Compensation portion of the policy based on initial information you provide. Once a year, they will send an audit report requesting information on actual salaries paid. They will then adjust your premium accordingly.
- Approve planter/pastors housing allowance (see next section).

Section III: Pastor Specific Information

First time pastors and new churches have a steep learning curve as it relates to developing an initial support package. The church will want to help its pastor minimize his tax liabilities using current laws while at the same time developing a “stewardship of resources” mindset within the church. Because an ordained pastor is viewed by the IRS as self-employed, a pastor is treated very differently than a normal employee. In the budget of an established church, the following items might be included in the pastor’s support package:

- Salary
- Self-Employment Taxes
- Housing Allowance
- Ministry Expenses
- Healthcare Expenses
- Retirement

- Salary—Pastors must pay both federal and state income taxes on the salary received from the church. In addition, as a self-employed individual, the pastor will pay “self-employment taxes” which are the equivalent of an employer’s AND employee’s social security and medicare taxes combined. Summarizing the information found in section I:

- Federal: Using IRS Form 1040ES, a pastor will pay quarterly estimated tax payments due on April 15, June 15, September 15, and January 15 for each tax year. This is to provide timely payments to the IRS for both “income” and “self-employment taxes.” Few first time pastors will have income tax liabilities at either the state or federal level. However, they will find that the self-employment taxes, which will be 15.3% of their salary and housing allowance combined, is a MAJOR expense. If a church has a parsonage, the fair rental value of the home (which must be approved by the church) is ADDED to their salary and adds to their income tax and self-employment tax liability.
- State: The payment schedule is the same as federal. In Nebraska, if the individual’s Nebraska income tax liability can reasonably be expected to exceed \$500 or more, quarterly payments are to be made on form 1040N-ES, In Iowa taxpayers who estimate they will owe \$200 or more in tax must pay estimated taxes using form IA 1040ES.
- Self-Employment Taxes—For some new pastors, paying quarterly estimated taxes can create a significant financial challenge. Some churches set up a “Self-Employment Taxes” line item in their budget as part of a pastor’s support package and treat it as a withholding account. The church then writes a check from that account to the pastor the first of the month when the quarterly estimates are due.
- Housing Allowance—Pastors currently have a significant income tax benefit in that expenses related to owning and maintaining a home are exempt from income taxes. The church is required to approve the amount of the Housing Allowance on an annual basis. When a pastor pays his Federal Self-Employment Taxes the housing allowance must be added to the salary when completing the Federal Schedule SE Form. Below you will find a Housing Allowance worksheet that will help the pastor and church to formally establish an amount. Use the worksheet to determine the estimated annual expense and then have the church set the housing allowance just a little more than the estimated amount to be able to maximize this benefit. When the pastor files his federal taxes, any “unused housing allowance” must be reported as income. This amount would be the Approved Housing Allowance minus the Actual Expenses for a given year. A pastor is required by law to list any unused housing allowance on form 1040, line “21 Other Income” and would write on the line “unused housing allowance.” Pastors who live in a church owned parsonage can still take advantage of any qualifying expenses they have as it relates to maintaining a home. In the case of a church owned parsonage, the church will annually approve both a “Housing Allowance” and “a fair rental value of the parsonage.”
- Expense reimbursement account(s)—Expenses that a pastor has related to fulfilling his role can be reimbursed by the church using this account. See below for the type of expenses that can be reimbursed. For first time pastors, these can be hard to estimate; however, it is worth the effort as these reimbursements, if handled properly, do not have to be included in either salary for income tax purposes or on Schedule SE for Self-Employment Tax purposes. This account is opposite the Housing Allowance in that you want to set the account just a little lower than the estimated expenses. Any unspent money in this account CANNOT be given to the pastor.
- Healthcare Expenses—This is becoming a huge issue for many churches. The cost of health insurance continues to increase annually in spite of the Affordable Care Act. There are some ACA approved Christian Health Cooperatives that the pastor and his family should seriously consider. For more information on these you can contact the Heartland Church Network Office.
- Retirement—There are a couple of specific reasons why a pastor should consider setting aside money in a GuideStone Retirement account. First, the state convention in partnership with GuideStone will do some matching of the money placed in a pastor’s account by the church. Second, at retirement, funds invested in an approved denominational fund can be withdrawn and all or a portion can be designated as housing allowance.

For small churches with bi-vocational pastors, it will benefit your pastor if you will use the limited support you are able to provide by funding the items just mentioned in the following order of priority:

1. Expense Reimbursement Account
2. Healthcare Expenses
3. Retirement
4. Housing Allowance
5. Salary
6. Self-Employment Taxes

CLERGY HOUSING ALLOWANCE WORKSHEET

NOTE: This worksheet is provided for educational purposes only. You should discuss your specific situation with your professional advisors, including the individual who assists with preparation of your final tax return.

Qualifying expenses—list the amount paid last year, or estimated amount you will pay this year:

Down payment on purchase of primary residence		\$ _____
Mortgage principal and interest payments on primary residence		\$ _____
Home equity loan repayments (loan made for housing-related expenses)		\$ _____
Refinancing costs paid up-front		\$ _____
Real estate commission, escrow fees		\$ _____
Real property taxes		\$ _____
Personal property taxes on contents of primary residence		\$ _____
Homeowner's insurance		\$ _____
Special personal property insurance on house contents		\$ _____
Umbrella liability insurance		\$ _____
Furniture		\$ _____
Appliances		\$ _____
Art and decorative items		\$ _____
Decorator services		\$ _____
Lawn care & gardening		\$ _____
Repairs		\$ _____
Pest control		\$ _____
Supplies for cleaning & care of home		\$ _____
Carpet and home cleaning services		\$ _____
Homeowner's association dues/condominium fees		\$ _____
Utilities:		
Cable	\$ _____	
Electricity	\$ _____	
Internet connection	\$ _____	
Natural gas/oil	\$ _____	
Security system	\$ _____	
Telephone (base charge)	\$ _____	
Trash collection/recycling pickup	\$ _____	
Water/sewer	\$ _____	
TOTAL UTILITIES		\$ _____
Other: _____		\$ _____
Other: _____		\$ _____
Other: _____		\$ _____
Total housing expenses		\$ _____

A PASTOR'S EXPENSE REIMBURSEMENT ACCOUNT

With an accountable reimbursement plan, the church can agree to reimburse reasonable church-related business expenses for a pastor such as the following:

- Conventions, conferences, seminars, and other workshop fees or costs. If the continuing education event furthers the minister's learning experience and the educational event does not qualify the minister for a new position, then the church can reimburse him tax-free for associated costs.
- Church-related business travel. The IRS allows the church to reimburse its employees the IRS standard mileage rate plus parking fees and tolls for business miles driven for church-related purposes. The IRS does not allow a church to reimburse its minister for commuting miles from home to the church no matter how many times the minister goes back and forth each day. Also, the church can reimburse meals its staff incurs if the required travel takes the minister away from the church field during meal times.
- Costs associated with church-related business overnight trips. The church can reimburse its minister for lodging, meals, and other costs associated with overnight church-related business travel.
- Subscriptions, books, tapes, CDs, DVDs, internet, equipment, and other similar tools. Sermon resources and other educational material expenses can be reimbursed by the church if the tool has a church-related business connection. Likewise, the church can provide church-related business equipment like PDAs and computers as reimbursable expenses. Under current IRS rulings, cell phones can only be reimbursed if the employee provides a detailed itemized billing of personal and business use of the cell phone. The church can only reimburse the employee for the business portion of the cell phone bill.
- Hospitality expenses required by the church to entertain others. The church can reimburse its minister's expenses associated with providing a business meal for individuals like prospects or church members if the meal had a church-related purpose. The church can reimburse the minister for entire cost of the meal.

The Internal Revenue Service requires a few other simple rules to be followed so that the reimbursement can be given tax-free.

1. The minister must provide the church with a written receipt within sixty days of incurring the expense. Receipts are required for all expenditures over \$75. If the receipt is not provided, the reimbursement becomes taxable income.
2. The receipt should include the date, amount, church-related business purpose, the location, and, if a hospitality expense, the names of the individuals who were hosted.
3. The church must budget funds for the accountable reimbursement plan. The funds for the accountable reimbursement plan should be budgeted just like any other church expense, such as utilities or maintenance expenditures.
4. The accountable reimbursement plan is a "use it or lose it" approach. If the minister does not use the entire budget line item designated for reimbursement, he cannot receive the overage. Remember, an accountable reimbursement plan is a church expense, not personal income to the minister.
5. With an accountable reimbursement plan, expenses like travel, conventions, hospitality, and others can be grouped together as one budget line item. The reimbursement expenses do not have to be budgeted separately.

6. The accountable reimbursement plan must be church-approved, but the plan does not have to be voted on by the church at church conference. If the church's legal documents empower the finance committee or executive staff to make the determination of budgeted funds for the accountable reimbursement plan, then this is acceptable to the IRS.

7. The committee or staff overseeing the accountable reimbursement plan has the right to determine if a receipt presented for reimbursement is an acceptable expense for reimbursement. The reimbursement must have a church-related business connection.

8. The church should not report any expenses reimbursed properly under an accountable reimbursement plan as taxable income on the minister's W-2.

By adopting and funding an accountable reimbursement plan, the church becomes a better steward of the financial blessings God has given to the church. The reimbursement plan also presents a better financial picture of what the true cost of providing the particular ministry position involves. Finally, the accountable reimbursement plan helps honor God's servants who are faithfully serving in the Lord's work.