

## FEDERAL/STATE TAX INFORMATION

The Internal Revenue Service (IRS) and State Department of Revenue laws and tax codes change from year to year. Suggestions made now may be changed in years to come. This information is designed to give your church some basic guidelines and by no means is an exhaustive or complete discussion of the topics included.

### Important Tax Identification Numbers

#### Employer Identification Number:

This nine-digit number is secured by filing form number SS-4 with the IRS and is used on all federal payroll tax forms.

#### State Identification Number:

In Kansas, this number is secured by filing Form CR-16 and is used on all state payroll tax returns.

In Nebraska, this number is secured by filing *Nebraska Tax Application* Form 20 and is used on all state payroll tax returns.

### State Sales Tax

**Kansas churches are exempt** from state sales and/or use tax as well as any applicable city and county sales tax as of July 1, 1998. A form entitled *Religious Organization Exemption Certificate* (Form ST-280) must be completed for every vendor before purchases are made.

Only **direct** purchases by a church of items to be used exclusively for the church are exempt. A direct purchase is a sale that is billed directly to the church or is paid for by the church's check or credit card. A payment in cash will not qualify as an exempt transaction. Purchases made by employees or church members with their personal funds are **taxable**, even if they are later reimbursed.

Churches are exempt from collecting sales tax in Kansas for "isolated or occasional sales of tangible personal property, services, substance or things."

There is not an exemption from sales tax for the sales of meals by the church. Voluntary donations are acceptable as long as there are no required donations for such meals and people could eat and do eat without a donation. The church may want to pay sales tax on the food and related purchases for the meals and operate the meals as strictly a cost recovery.

**Construction, Remodel, or Repair Projects:** When a church contracts for the repair, remodeling, or construction of a building, or to make other improvements to real property it owns and uses exclusively for religious purposes, it must request and obtain a *Project Exemption Certificate* from the Kansas Department of Revenue so that the contractor, subcontractor, or repairman (carpenter, electrician, etc.) may purchase materials for the project exempt from sales tax. To apply for a project exemption, submit Form PR-76, *Request for Project Exemption*. In the absence of a *Project Exemption Certificate*, only the contractor's labor service is exempt as a direct purchase. The contractor's invoice to the church will include the sales tax paid or accrued on the materials used.

If asked for a sales tax number in Kansas, you can use your *Federal Tax Identification Number*.

If a purchase is made from a vendor in Kansas that refuses to exempt sales tax, keep all documentation of the purchase and send same to the state sales tax office for refund.

**Nebraska churches are exempt** from state sales tax. The church must apply for and receive a *Nebraska Exempt Organization Certificate of Exemption* from the Nebraska Department of Revenue. This certificate assigns the church an exemption number (05-XXXXXXX), which must be used in claiming its exemption. The

church must give its supplier' a *Nebraska Resale or Exempt Sale Certificate* (Form 13) as proof of its exempt status.

The state of Nebraska has very narrowly defined the term "exclusively for religious purposes" and has been adamant in not approving a sales tax exemption number to newly formed associations and to our convention.

## Federal and State Unemployment Tax

Churches in Kansas and Nebraska **are exempt** from Federal and State unemployment taxes.

## Property Tax

Kansas churches must file a request for property tax exemption on a form entitled, ***Application for Tax Exemption***, with the office of the County Appraiser of the county in which the property is located. The County Appraiser' s office must approve the request and send it to the Kansas Board of Tax Appeals, Topeka, KS, for final approval. Each county has the option of automatically accepting the exemption year after year or requesting an annual filing to maintain the property exemption.

Nebraska churches must file a request for property tax exemption on a form entitled, ***Exemption Application***, with the County Assessor of the county in which the property is located. The approved exemption shall continue for a period of four years, beginning with years evenly divisible by four. The first year of each period is known as an application year (e.g., 2000, 2004, 2008 etc.). If application for exemption is made and approved in an intervening year, the exemption shall continue for the remainder of the applicable four-year period.

To continue the exemption for a succeeding four-year period, the church must file an ***Affidavit of Use for Continued Tax Exemption*** form with the assessor on or before December 31 prior to an application year. If this form is not properly and timely filed, **the property will be taxed.**

## Unrelated Business Income

Income the church earns from an **unrelated trade or business regularly carried on** may be subject to income tax reporting. This includes rental income received on property on which the church has debt. The church can receive up to \$1,000 per year in "unrelated business income" before it is subject to income tax reporting. Generally the key question is whether the church has debt on its facilities. If the facilities are free from any indebtedness the rental income is not subject to "unrelated business income." The IRS has ruled that rental income is exempt from unrelated business income tax (UBIT) even though the property is "debt-financed," if the rental arrangement is "**substantially related**" to the charity's exempt purposes.

## Important Internal Revenue Service Forms

### Form W-4 — Employee's Withholding Allowance Certificate:

Employees report withholding allowances on this form. Churches are **required to withhold** from all employees except ordained staff. An ordained staff member can elect **voluntary withholding** by submitting a completed W-4 form to their employing church to withhold a sufficient amount each pay period to cover both income tax and self-employment tax. This withholding is **reported as income tax** and can be used to pay income and self-employment tax. **All non-ordained employees** should complete this form each year.

An ordained minister could request the church (in writing) to withhold a certain amount each pay period and **pay the minister** prior to the dates for filing **self-employment estimates**, namely: April 15th, June 15th, September 15th and January 15th.

### Form I-9 — Employment Eligibility Verification:

The church should have this form on file for each employee, including ministerial staff. It is a result of the Immigration Act of 1986 and is self-explanatory. Failure to have I-9' s for every employee could result in fines for each occurrence. The I-9 is a Department of Labor regulation.

### **Form 941 — Employer's Quarterly Federal Tax Return:**

This form is used by employers (the church) for reporting to the IRS all wages paid to employees, income taxes and FICA taxes withheld each quarter. Churches must file this form quarterly with the IRS if they have at least one employee other than ordained staff. The amounts reported on a church's W-2 forms at year-end must reconcile with the 941 forms filed during the year. Churches with only one employee, and that employee is ordained, are required to file only a W-2 form.

### **Form W-2 — Wage and Tax Statement:**

This form is used by employers (the church) to report annual compensation, withheld income and FICA taxes for each employee. Churches must issue this form to each employee on or before **January 31**. Ordained ministers pay self-employment taxes instead of FICA taxes.

Every church should issue a W-2 form to all employees including ministerial staff. The W-2 for ministerial staff should not include housing in box 1 (Wages, tips, other compensation). In fact, housing does not have to be shown on the W-2, nor should any other tax-free benefits such as annuity or insurance be included in box 1.

### **Form 1099-MISC — Miscellaneous Income Returns:**

Churches use this form to report compensation of \$600 or more paid to non-employees for services during any one year. This includes but is not limited to evangelists, guest speakers and self-employed persons who perform miscellaneous services for the church (plumbers, cleaning, lawn maintenance, etc.) who are not incorporated. 1099's are not required to be issued to corporations. Churches must issue this form on or before **January 31**. It is helpful to obtain Form W-9 (Request for Taxpayer Identification Number and Certification) at the time of payment.

## **Important Tax Information for Ministers**

Ordained ministers are **employees for income tax reporting and fringe benefit purposes** and **self-employed for Social Security purposes**. Ordained ministers are also **employees for the purpose of complying with workers' compensation laws**. In addition, many ministers who are employees of the local church are self-employed for some purposes. For instance, the pastor will be considered self-employed with regard to guest speaking appearances in other churches and services performed directly for individual members.

### **Definition of Minister for Federal Tax Purposes:**

A minister, for federal tax purposes, must satisfy all of the following conditions:

- Be ordained or licensed.
- Administer ordinances and sacraments.
- Conduct worship services.
- Have management responsibility in a local church or denomination.
- Be considered a religious leader by one's church or denomination.

### **Housing Allowance for Ordained Ministers:**

A housing allowance is available to every minister as defined for federal tax purposes. A housing allowance is available even to those who live in church-owned housing with or without utilities paid. The housing allowance should be predetermined by the minister and submitted to the church or appropriate committee for approval prior to the beginning of the tax year. This approval does not imply that the minister must answer to the church or any committee as to the details of spending the housing allowance. The minister answers to the IRS in case of audit. The minister should maintain accurate and complete records of housing expenses. The minister should overestimate housing so as to provide enough monies for unforeseen expenses. At the close of the tax year, the minister must report unspent housing on his tax return as income and must pay appropriate taxes on that unspent portion. All housing allowances and church-furnished housing are subject to self-employment taxes. See Illustrations A and B. **Church-furnished housing is also subject to fair rental value** and should be included with **church-paid utilities** when reporting remuneration for workers' compensation purposes.

An amendment of the housing allowance may be in order if the minister:

- Plans to purchase a new home;
- Sells a home;
- Has an increase in salary;
- Faces unexpected home repairs;
- Faces major remodeling costs;
- Plans to purchase new furnishings;
- Plans to purchase new appliances;
- Experiences an increase/decrease in adjustable mortgage interest rates;
- Desires to make a large prepayment;
- Desires to make a large "balloon" payment on the mortgage.

The amended housing allowance must be approved in writing by the same body as approved the original housing allowance, and only applies to future expenditures.

### **Professional Expenses and Continuing Education to Improve Job Skills:**

The reporting of professional expenses (including car allowance and all costs incurred as part of the job) is a tremendous tax break for the staff member, but needs to be handled carefully and in a most advantageous manner. If staff members itemize their professional expenses on their tax return (referred to as a non-accountable plan), the taxpayer stands to lose fifty (50) percent of all meals and entertainment and two (2) percent of their adjusted gross income for deduction purposes. In addition, staff members **must be able to itemize** rather than claim the standard deductions in order to deduct professional expenses.

By accounting for reimbursable business expenses to the church, the pastor and staff can lower their tax liabilities. This is referred to as an **accountable reimbursement plan**. The expense documentation is furnished to the church, and the church reimburses the staff person for the business expenses. The practice of offering a "pay package" in reference to the compensation plus expense reimbursement and fringe benefits could result in the entire amount the staff person has effective control over being considered taxable. Churches should avoid the term "package." Care must be made in constructing the church budget so the IRS does not consider business expense reimbursement to be a salary reduction. The business expense reimbursement account should be in a separate section of the budget apart from the line items of salary, housing, annuity and insurance. See Illustration C for a sample reimbursement policy.

### **Self-Employment Taxes:**

Self-employment tax is the result of the Self-Employed Contribution Act (SECA) and refers to the rate that self-employed people pay into Social Security and Medicare. A self-employed person **pays 12.4%** of earnings up to a maximum amount set by the IRS each year for retirement, death and disability income benefits and **2.9%** for Medicare benefits with no maximum. Social Security tax is the result of the Federal Insurance Contributions Act (FICA) and refers to the rate those employees **and employers** contribute into Social Security. The rate is presently **6.2% for both the employee and employer** of earnings up to a maximum amount and **1.45%** for Medicare with no maximum. **Employers and employees pay Social Security (FICA) and only self-employed individuals pay self-employment tax (SECA)**. Contact the IRS or your tax preparer to keep current on any changes in rates or maximum amounts of earnings.

Ministers have to pay self-employment tax on their ministerial income, unless they have properly followed IRS rules to opt out of Social Security. A minister can opt out of Social Security by meeting strict IRS guidelines required when filing Form 4361. This must be done by the due date of the minister's tax return for the second year in which earnings of at least \$400 was incurred, any part of which was from ministerial income.

**NOTE:** When filing Form 4361, the minister must certify **opposition to acceptance of public insurance** on the basis of religious principles, which includes payments for death, disability, retirement or medical care. In addition the minister must certify that the **ordaining body has been informed** of such opposition.

Moreover, even if ministers have opted out of Social Security for their ministerial income, they must pay Social Security taxes on income they earn from secular employment. This is particularly important to bi-vocational ministers.

A church cannot pay FICA tax for a minister. Ministers are, by law, always treated as self-employed for Social Security purposes. Churches that pay FICA tax for their ministers are violating the law and can cause errors in the Social Security Administration's records, which could create serious difficulties.

A church can give its minister(s) an allowance to help offset the expense of SECA tax. However, it is important to note that such an allowance is taxable income, so the allowance will be subject to SECA tax and income tax.

The minister must pay SECA tax on housing allowance (cash housing allowance and/or parsonage allowance); however, such allowance is excluded from income for federal income tax purposes.

Parsonage allowance should be based upon the **fair rental value plus all utilities** and should be "**low reasonable**" not "**low ridiculous**." Investigate other rental properties in the area, seek the assistance of a local realtor and consider the valuation for property tax purposes in establishing the parsonage allowance.

Churches must pay FICA tax for employees (except ministers) unless the church has elected to exempt itself. Churches must file Form 8274 with the IRS to exempt themselves from paying FICA tax on behalf of their employees.

**NOTE:** When filing Form 8274 a church must certify that it is **opposed to the payment of Social Security taxes** for religious reasons.

The filing deadline for such action relates to the date on which the church must file its first Form 941. **Employees of an exempt church must pay SECA tax**, which is 15.3% instead of 7.65%.