Welcome! All nonprofits must file Form 990 annually to the IRS. Except churches. The Freedom from Religion Foundation took issue with this exception and filed a lawsuit against the IRS earlier this year, claiming that the 501(c)(3) tax code gives churches an unfair advantage to obtain and maintain tax-exempt status.

In this issue, I'll take a close look at that case and what it would mean for churches if they had to file Form 990, a nearly 100-page document that requires the disclosure of highly sensitive financial and operational information.

Also, many churches can benefit from a tax credit for health insurance coverage, which is offered in the Affordable Care Act. See pages 3 and 4 to see if your church qualifies.

Finally, be sure to check out our growing library of digital resources on YourChurchResources.com. We've added two new titles—Essential Guide to Church Financial Health and Essential Guide to Church Budgeting, written by Donna Lau and Richard Vargo, respectively. Both serve as editorial advisors for the Church Law & Tax Group, and I'm happy to recommend their work to you.

Blessings as you serve—
Richard R. Hammar

FORCED TO FILE FORM 990?

A federal lawsuit could prove costly to churches if it succeeds.

By Richard R. Hammar

The Freedom from Religion Foundation (FFRF) sued the IRS in a federal district court in Wisconsin, claiming that 501(c)(3) tax code provisions make it easier for churches to obtain and maintain tax-exempt status than other nonprofit organizations. This, they claim, violates the First Amendment's prohibition of an "establishment of religion" and the Fifth Amendment's guaranty of the equal protection of the laws. Freedom from Religion Foundation v. Werfel, 2013 WL 4501057 (W.D. Wis. 2013).

In particular, FFRF alleged that it was required to file a "detailed application" (Form 1023) and pay a fee before obtaining tax-exempt status, and since then has been required to file "detailed, intrusive and expensive annual reports" (Form 990) in order to maintain that status, but churches are not required to do either of these things.

The federal government, which defended the constitutionality of the tax code provisions (since they are federal statutes), asked the court to dismiss the lawsuit on the ground that FFRF lacked "standing" to pursue its claims. Standing is a requirement of any plaintiff in a federal case. It has been described by the United States Supreme Court as follows:

The party who invokes the power [of the federal courts] must be able to show not only that the statute is invalid, but that he has sustained or is immediately in danger of sustaining some direct injury as a result of its enforcement, and not merely that he suffers in some indefinite way in common with people generally. Doremas v. Board of Ed. of Hawthorne, 342 U.S. 429 (1952).

The standing requirement is rooted in a provision in the federal Constitution limiting federal judicial power to "cases and controversies." The court concluded that FFRF was alleging that "the government is relieving an ongoing burden from some taxpayers on the basis of religious affiliation and . . . the alleged injury is the unequal treatment." This, concluded the court, satisfied the standing requirement since the FFRF was asserting a direct injury.

What this could mean for churches

This case is of direct relevance to every church. The tax code for many years has exempted churches from the need to file an exemption application to obtain IRS recognition of tax-exempt status. It also exempts churches from the requirement, which applies to most non-religious charities, that they file the lengthy and intrusive annual information form (Form 990) with the IRS. If the court rules that these two exemptions violate the First Amendment's prohibition of the establishment of religion, and this ruling if affirmed on appeal, then this could lead to the extraordinary requirement that churches obtain IRS recognition of tax-exempt status. This would have little
impact on churches that are included in a denominational “group exemption ruling,” but it would require other churches to file the official exemption application (Form 1023) with the IRS.

But even more troubling is the fact that if the courts conclude that exempting churches from the Form 990 reporting requirement is an unconstitutional preference for religion, then this would require every church in the nation to begin filing the annual information return (Form 990) that most non-religious charities are required to file each year. Form 990, with related schedules, is nearly 100 pages in length, and requires the disclosure of highly confidential financial and operational information, including, but not limited to, the following:

- compensation, including deferred compensation, nontaxable benefits, and bonuses, paid to officers, directors, and the highest compensated employees;
- all current and former employees who received more than $100,000 in compensation from the church;
- all current and former board members who received more than $10,000;
- all first-class travel;
- reimbursement of spouses’ travel;
- the existence of any “discretionary funds”;
- all housing allowances;
- club dues;
- personal services (maid, chauffeur, etc.);
- whether adequate substantiation is required for expense reimbursements;
- existence of a compensation committee or consultant;
- use of compensation surveys;
- whether the board approved all compensation arrangements;
- severance agreements;
- compensation arrangements based on a percentage of revenue;
- number of employees;
- number of board members;
- number of volunteers;
- unrelated business income;
- all charitable contributions received from donors;
- political activities;
- investment income;
- financial statements;
- loans paid to officers or employees;
- itemize noncash contributions of more than $25,000;
- recent, substantial changes to governing documents;
- minutes of membership and board meetings;
- contact information for all board members;
- written conflict of interest policy;
- written whistleblower policy;
- records retention policy.

Why churches shouldn’t have to file Form 990
The FFRF is correct in noting that churches, unlike most non-religious charities, are not required to provide this kind of information each year to the IRS on Form 990. However, there is a compelling reason for this different treatment, and it was ignored by the federal district court in Wisconsin in allowing the FFRF challenge to proceed to trial. In short, churches are treated differently from FFRF and other non-religious tax-exempt organizations because under our

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**Tax Calendar**

**Important Tax Deadlines in December 2013**

In addition to the regular semimonthly and monthly withholding requirements, church treasurers should note the following tax deadlines for next month.

**December 15**

- Complete all year-end transactions to be sure that they are reportable on your income tax return.
- A church must make quarterly estimated tax payments if it expects an unrelated business income tax liability for the year to be $500 or more. Use IRS Form 990-W to figure your estimated taxes. Quarterly estimated tax payments of one-fourth of the total tax liability are due by April 15, June 15, September 15, and December 15, 2013 for churches on a calendar year basis. Deposit quarterly tax payments electronically using the EFTPS system.

**December 31**

- Churches must designate a portion of each minister’s compensation as a housing allowance by December 31 in order for ministers who own or rent their homes to receive the full benefit of a housing allowance exclusion for calendar year 2014. The designation should be adopted during a regular or special meeting of the church board, and should be contained in the written minutes of the meeting. Churches also should designate a parsonage allowance for any minister who lives in a parsonage and who is expected to pay some of the expenses of maintaining the parsonage (e.g., utilities, furnishings, repairs, improvements, yard care).

**Resource.** Need help drafting a housing allowance resolution? Sample housing and parsonage allowance resolutions that your church board or compensation committee can adopt for 2014 are set forth in chapter 6 of Richard Hammar’s 2014 Church and Clergy Tax Guide. To order, call 1-800-222-1840.

- Donors must deliver checks on or by December 31 in order to claim a charitable contribution deduction for 2013. Checks that are placed in the church offering during the first worship service in 2014 will not qualify for a charitable contribution deduction in 2013, even if the check is postmarked in 2013.

- Your marital status on December 31 determines your filing status for the year.
- If you have a minister or lay worker who is treated as self-employed for federal income tax reporting purposes, but who you would like to reclassify as an employee, the ideal time to make the change is on January 1 of the new year.
Constitution, they receive explicit protections not available to secular charities. The First Amendment guaranties of religious freedom and nonestablishment of religion confer special protections upon religious organizations not available to non-religious charities such as FFRF.

In 1971, the United States Supreme Court announced a three-part test to assess alleged violations of the First Amendment’s ban on any establishment of religion:

First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion; finally, the statute must not foster “an excessive governmental entanglement with religion.” *Lemon v. Kurtzman*, 403 U.S. 602 (1971).

The Court observed that “excessive entanglement” between church and state connotes “comprehensive, discriminating, and continuing state surveillance.” The Court has affirmed the result of any attempt to impose the Form 990 reporting requirement on churches. The searching and continuing surveillance of churches by the IRS, which the Form 990 requirement would necessitate, is the very evil that the First Amendment condemns.

Should the federal district court in Wisconsin conclude that the exemption of churches from the exemption application and Form 990 requirements is unconstitutional, and this result is affirmed on appeal, there likely will be many churches that as a matter of conscience will not voluntarily comply, which may lead to a legislative or judicial remedy.

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**HEALTH INSURANCE CREDIT MAY BENEFIT MANY CHURCHES**

*Rules and regulations for the new tax credit.*

By Richard R. Hammar

Many small businesses and tax-exempt organizations that provide health insurance coverage to their employees qualify for a special tax credit authorized by the Affordable Care Act ("Obamacare"). The credit is designed to encourage small employers to offer health insurance coverage for the first time or maintain coverage they already have. In general, the credit is available to small employers that pay at least half the cost of single coverage for their employees.

The credit is specifically targeted to help small businesses and tax-exempt organizations that primarily employ low and moderate income workers. It is generally available to employers that have fewer than 25 full-time equivalent (FTE) employees paying wages averaging less than $50,000 per employee per year. Because the eligibility formula is based in part on the number of FTEs, not the number of employees, many small employers will qualify even if they employ more than 25 individual workers.

The maximum credit goes to smaller employers (those with 10 or fewer FTEs) paying annual average wages of $25,000 or less.

**KEY POINT.** The law does not exclude religious organizations from this credit. It states that the term “tax-exempt eligible small employer” means “an eligible small employer which is any organization described in section 501(c) which is exempt from taxation under section 501(a).” This language applies to all public charities, including religious organizations.

For tax years 2010 through 2013, the maximum credit was 35 percent of premiums paid for small business employers and 25 percent of premiums paid for small tax-exempt employers such as churches.

For tax years beginning in 2014 or later, there will be changes to the credit:

- The maximum credit will increase to 50 percent of premiums paid for small business employers and 35 percent of premiums paid for small tax-exempt employers.
- To be eligible for the credit, a small employer must pay premiums on behalf of employees enrolled in a qualified health plan offered through a Small Business Health Options Program (SHOP) Marketplace (healthcare.gov/marketplace/shop/).
- The credit will be available to eligible employers for two consecutive taxable years.

The credit is refundable, which is good news for churches that have no taxable income. This means that churches are eligible to receive the credit as a refund so long as it does not exceed their income tax withholding and Medicare tax liability.

To be eligible, you must cover at least 50 percent of the cost of single (not family) health care coverage for each of your employees. You must also have fewer than 25 full-time equivalent employees (FTEs). Those employees must average wages of less than $50,000 (as adjusted for inflation beginning in 2014) per year. Remember, you will have to purchase insurance through the SHOP Marketplace to be eligible for the credit for tax years 2014 and beyond.

Two half-time workers count as one FTE. That means 20 half-time employees are equivalent to 10 FTEs, which makes the number of FTEs 10, not 20. To figure average annual wages you divide total wages the church pays its employees by the number of FTEs.

The amount of the credit you receive works on a sliding scale—the smaller the church, the bigger the credit. So if you have more than 10 FTEs or if the average wage is more than $25,000 (as adjusted for inflation beginning in 2014), the amount of the credit you receive will be less.

The credit is claimed on IRS Form 8941 (Credit for Small Employer Health Insurance Premiums). For detailed information on filling out this form, see the instructions for Form 8941.

**KEY POINT.** If you think your church may be eligible for the credit, contact a tax professional for assistance. There are many smaller churches that qualify for the credit but fail to apply for it.
MINISTERS AND THE HEALTH INSURANCE TAX CREDIT

How do we factor our pastor into the health insurance tax credit for our church?

By Richard R. Hammars

Q: Our church would like to apply for the health insurance tax credit that’s available to small employers and tax-exempt organizations. Can we include our pastor in the calculation for this credit?

A: The Affordable Care Act ("Obamacare") provides a credit for small employers (including churches) who offer health insurance coverage for the first time or maintain coverage they already have. Note the following two points regarding the treatment of ministers for purposes of the health insurance tax credit:

1. If a minister is an employee under the so-called "common law employee test," he or she is taken into account in determining an employer’s FTEs for purposes of the health care tax credit. Also, premiums paid by the church for the health insurance coverage of a minister who is an employee can be taken into account in computing the credit, subject to limitations on the credit. If the minister is self-employed for income tax reporting purposes he or she is not taken into account in determining an employer’s FTEs or premiums paid.

2. Compensation paid to ministers who are employees for duties performed in the exercise of their ministry is not subject to FICA taxes and is not wages subject to income tax withholding. As a result, their wages are not taken into account for purposes of computing average annual wages.

The fact that ministers are taken into account in determining a church’s FTE count, but their wages are not considered in computing the average annual wages paid by a church, makes it more likely that some churches will benefit from the credit since the generally higher wages paid to ministers are removed from consideration.

See chapter 2 in Richard Hammars’s 2014 Church & Clergy Tax Guide for a full explanation of the common law employee test. This is one of the tests used by the IRS and the courts in determining a minister’s reporting status for federal income tax reporting purposes. Also, see the Feature Report titled, "A Valuable Tax Credit for Churches," to learn more on how your church may be able to save money on health coverage. Both resources are available on YourChurchResources.com.

To submit a question for consideration in a future Q&A, email: CFEditor@ChristianityToday.com.

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