



GROW

Your Legal Foundation

10 LEGAL STEPS FOR
CHURCH PLANTS

By Raul Rivera

STEP 1:

INCORPORATION

The benefits of incorporating your church or ministry

Because church lawsuits have increased dramatically, creating a corporation for your church is an absolute must. As a corporation, there are several key benefits that you will experience. The main one is **limited, legal liability**. This benefit is often called the corporate veil. In simple terms, it means that the personal assets of the founders, directors, officers, trustees, and others in leadership positions would be protected if anyone ever tried to sue the church. Many attorneys attempt to drag the pastor and directors into the suit, saying that they were personally responsible for the actions of the church.

RECOMMENDATION

If the church books are in order, then the corporate status shields the pastor and directors from any personal responsibility for the actions of the church. I recommend that you get the Ministry Corporate Records Kit™ we offer because it allows you to keep the necessary records organized and makes them easily accessible. In addition, our Secretary's Suite™ offers resources that teach you preventive measures to take so as not to be held personally responsible for the actions of the church.

How does one incorporate?

In order to form a corporation, you must file articles of incorporation with the state. Some states title them differently, such as certificate of incorporation, articles of formation, and so forth. When these articles have been filed with the Secretary of State, the state officially recognizes your church as having formed a corporation and therefore, the church can begin running its affairs under that incorporated entity. In general, most states require that the articles of incorporation declare the following: the name of the entity, the purpose, the address of the entity, the name of the board of directors, the name of the registered agent, and the name of the incorporator. Optional provisions not inconsistent with state law are also allowed to be included.



Essential components of the articles of incorporation

Not only does each state have essential language one must include in order to get articles of incorporation approved, but the IRS also requires specific language. This language is referred to as the **organizational test requirements**. The IRS requires this because it proves that the church meets the exemption requirements of section 501(c)(3). Our office gets calls on a regular basis from churches that have incorporated on their own using the form provided by their state. All is OK until they apply for 501(c)(3) status. The language is not there. Because the states do not usually require the same language as the IRS, the church has to then file articles of amendment and add the organizational test language. This causes delays and extra money.

The IRS will not allow a church to apply until that language is included. At a minimum, the language should contain:

1. A Purpose Clause

A purpose clause that is consistent with section 501(c)(3),

2. A Dissolution Clause

A dissolution clause stating that the remaining assets will be used exclusively for exempt purposes, such as charitable, religious, educational, and/or scientific, and

3. “no, no, nots”

what we refer to as the “no, no, nots”.

Let us take a further look at what each of these mean.

Purpose clause

The purpose clause states the reason for formation and provides the scope of activities an organization will undergo. This is not to be confused with a list of activities, which is merely how an organization plans to accomplish its purpose.

EXAMPLE OF A PURPOSE CLAUSE

“The specific purpose for which the corporation is initially organized is to establish and oversee places of worship, teach and preach the gospel to all people, conduct evangelistic and humanitarian outreach, license and ordain ministers of the gospel, and to also engage in activities which are necessary, suitable, or convenient for the accomplishment of that purpose, or which are incidental thereto or connected therewith, which are consistent with section 501(c)(3) of the Internal Revenue Code. This corporation is organized and operated exclusively for religious purposes within the meaning of section 501(c)(3), Internal Revenue Code.”



Dissolution clause

The following is an example of a standard dissolution clause:

EXAMPLE OF A DISSOLUTION CLAUSE

“In the event of dissolution of the corporation, no part of the corporation’s earnings or assets shall inure to the benefit of any of its members; the residual assets of the corporation shall be distributed to one or more organizations which themselves are exempt as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986, or corresponding sections of any prior or future law, or to the federal, state, or local government for exclusive public purpose.”

“No, no, nots”

Every nonprofit corporation, churches included, should explicitly state in the articles of incorporation that it will abide by IRS standards as a tax-exempt organization. This is known as nonprofit language, but we commonly refer to it as the “no, no, nots”.

EXAMPLE OF THE “NO, NO, NOTS”

“**No** part of the net earnings of the organization shall ever inure to the benefit of, or be distributable to, its members, trustees, officers, or other private persons, except that the organization shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in the purpose clause hereof.

No substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the organization shall **not** participate in or intervene in (including the publication or distribution of statements) any political campaign on behalf of any candidate for public office.”

Create a Board of Directors

Part of the incorporation process is to select a Board of Directors that will help give legal governance to the church.

What is a board of directors?

You know that God has called you to be a pastor, you have said “yes” in your heart, and you are ready to get started! But who will you look to for support? Your spouse and, perhaps, a few close friends who know your heart and know your calling and are willing to support you in starting a church. You know that you can trust them in the decision-making process for your church, and after praying about it, you are ready to have them on board. You trust these individuals to be a source of support and accountability, but in what other ways can they be a unique part of the church?

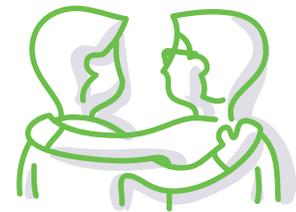
These individuals can be selected to be on your board of directors, often referred to as the “board.” The people you choose to be your board members are there to help you make the governing decisions of the church. Unlike for-profit organizations, all nonprofit organizations must have a board of directors to govern them. This is beneficial and necessary to ensure that the church remains as a benefit to the public, rather than becoming a benefit to any one person. The board of directors must meet the following conditions (we will be looking at each of these shortly):



**A minimum of
three people**



**The majority has to
be uncompensated**



**The majority has
to be unrelated.**

Finding people to serve on your board of directors may seem challenging at first glance, but if you know that God is calling you to this pastoral position, you can trust that He will bring the right people along who will join you in leading your church.

Minimum number and required positions to be filled

According to the IRS, to be classified as a nonprofit organization, as a public charity, your board of directors must be composed of at least three people – assuming no two individuals are related and the majority of the persons serving on your board are uncompensated. There are necessary roles to have for the board members. You cannot overlook these three important positions for your board, which are as follows:

- ▶ President
- ▶ Treasurer
- ▶ Secretary

These positions for your board are the minimal roles that should be filled for the best organizational interests of the church and for compliance with the law.

Who can serve as board members?

According to Treasury Regulation 53.4958-3(b)(1), family members include the following:

- ▶ Spouse
- ▶ Brothers or sisters
(by whole or half blood)
- ▶ Spouses of brothers or sisters
(by whole or half blood)
- ▶ Ancestors
- ▶ Children
- ▶ Grandchildren
- ▶ Great grandchildren
- ▶ Spouses of children, grandchildren,
and great grandchildren



What is a balanced board?

A balanced board consists of a minimum of three people, the majority of whom are unrelated and uncompensated. This complies with IRS standards of being a public charity, allows for accountability between members of the board, and helps to prevent a conflict of interest from taking place. According to IRS Publication 4221-PC,

“An active and engaged board is important to the success of a public charity and compliance with the tax law. A governing board should be composed of persons who are informed and active in overseeing a charity’s operations and finances. To guard against insider transactions that could result in misuses of charitable assets, the governing board should include independent members and should not be dominated by employees or others who are not independent because of business or family relationships.”



How to add a board member

Adding a board member is much easier than removing one. Be sure that the designated person to nominate board members and the proper amount of votes to approve nominations are both specified in your bylaws. Below is a recommended, basic procedure on how to appropriately add someone to your board:

Step 1: Invitation to join

The president, pastor, or designated person identifies and invites the person that he or she wishes to serve on the board. This is done by calling that person and sending an officially approved letter of invitation to serve on the board. That letter should explain, or offer a future meeting time for explaining, the ins and outs of being a board member and the responsibilities involved. *(Call us at 844-277-8229 to get a sample board invitation letter.)*

Step 2: Member accepts position

If the nominated board member wishes to serve, he or she replies to the letter of invitation and expresses a desire to serve.

Step 3: Name added to the agenda

If the nominated board member replies affirmatively, his or her name is added to the agenda of the next, upcoming board meeting.

Step 4: Proper Notice Sent Out

Proper notice is sent out to existing members prior to the meeting. (Proper notice will be discussed later.)

Step 5: Vote and Agreement Signing

During the board meeting, the nominated board members' names are called out, one after another, followed by a vote for each one to either be accepted or rejected. If the board accepts the nominated board member, then the new board member must sign the conflict of interest statement and the board member entry statement. We will take a look at each of these statements below.

STEP 2:

F.E.I.N.

The purpose of the F.E.I.N.

The F.E.I.N. stands for Federal Employer Identification Number and it involves filling out Form SS-4 and submitting it to the IRS. The F.E.I.N. is simply an identification number for tax, banking, and credit-building purposes. This number can be compared to a person receiving his/her Social Security number, and the church will use this number mostly for the same purpose an individual would.

Three reasons you need an FEIN:



To open a checking
account



To establish credit



To file all pertinent tax
and informational returns

What the F.E.I.N. is not

A common misconception amongst churches regarding the F.E.I.N. is that, once it is obtained, the church is tax-exempt. That, however, is not true. Getting the F.E.I.N. does not mean your church is now tax-exempt. In addition, the F.E.I.N. is not a tax-exempt number. Tax exemption is an idea that means different things to different people and government agencies.

When we are asked the question, “Is our church tax-exempt?”, we answer by asking another question, “What does tax-exempt mean to you?” The answers range from, “Uh, I am not sure,” or, “IRS taxes” to, “Sales tax exemption.” As most churches will have to deal with approximately five to seven different types of taxes, tax exemption with government agencies is not automatic without first applying for the exemption using the F.E.I.N.

Very few states allow automatic exemptions on taxes if you are a church.

The F.E.I.N. is simply an identification number for tax, banking, and credit building purposes. After your church receives it, you must then apply to the respective government agencies in order for the proper exemptions to be extended.





Today's leading Church Management tools available anywhere.



With the StartCHURCH Cloud we put today's leading church management tools right in the palm of your hand. StartCHURCH Cloud makes it incredibly simple to put your software to work for you right away. With the software you can:

- Track and manage donations and attendance
- Create weekly, monthly and yearly giving reports
- Find examples of pastoral letters for every occasion
- Access a step-by-step guide for housing allowance
- Find 20 ceremonies examples for every occasion
- Access sample corporate record keeping documents
- Learn the basics of grant writing
- Access tax forms
- Find bylaw samples with scripture
- Easily create board meeting minutes
- Manage expenses with the income expense worksheet

<https://www.startchurch.com/products>

STEP 3:

BYLAWS

The second most important document

Every government on the earth has to have a document that clearly lays out its structure, ideals, culture, and principles by which it will govern itself. Without it, a government will lack consistency as well as vision for its future because it does not have a standard by which to measure its success and the accomplishment of its purpose.

In the same way, your church will need a governing document that is biblically based.

By definition, the bylaws is a document that contains the supreme law of the corporation and rules based on the Scriptures, by which the church will govern itself. Second to the Word of God, this makes the bylaws the most important document of your church. As previously stated, your bylaws should contain the supreme law of the corporation (your church) and the rules that are used to uphold it. An illustration of this is the United States Constitution, the supreme document of our government. Each year Congress passes laws that must be consistent with the Constitution. In the same way, your church cannot pass or implement any rules, resolutions, policies, or procedures that contradict your church's bylaws.

IMPORTANT

Many existing churches may refer to this document as “the constitution and bylaws”. However, for the purpose of simplicity, we collectively refer to this document as “the bylaws”. The important thing to remember is that, no matter what you refer to this document as, it contains the supreme law of your corporation and the rules by which it will be upheld.

The eight strategic components of the bylaws

At a minimum, we have identified eight strategic components that need to be included in your bylaws to best protect it from the state, and from potential litigators. By adding these eight strategic components to your bylaws, you close as many loopholes as possible that could come back to create issues. Below is a description of each one.

1. Statement of faith (aka tenants of faith)

The statement of faith is a commonly used term to describe a religious organization's collection of fundamental truths. This seems, at first glance, to be a good practice, and, yes, a nice thing to do for an organization, but it is actually much more powerful than it may seem. This is due to the fact that it may provide protection for your organization in the case of litigation against your organization over a moral issue.

WHAT SHOULD BE INCLUDED

The statement of faith itself should be a summary of fundamental truths, or, in other words, the statement of faith should contain statements about the organization's rudimentary beliefs that will never change. What this means is that the items mentioned will remain true throughout the life of the organization. Furthermore, these statements should include at least 2-3 scriptural references. Such statements may include, "The Bible is the inspired Word of God" and "The One True God".

2. Accountability board

The accountability board is a group of at least three individuals who are not related to the pastor, and who serve as counselors, advisors, and an accountability team. The accountability board does not have any legal authority in the church. However, for the purpose of listening to accusations which have been brought against the pastor, this board can be called into action by a unanimous vote of board members who are unrelated to the pastor. The accountability board will listen to the accusations and decide what, if any, disciplinary actions need to be taken. This helps to meet the IRS requirement of having a way in which the pastor/president can be removed from office in the event that he/she acts in a way that is not in keeping with fiduciary responsibility.

3. Ecclesiastical authority of the pastor

The bylaws need to ensure that the pastor keeps ecclesiastical authority over the church. Having ecclesiastical authority over the church allows the pastor to set the spiritual environment of the church and to also make day-to-day decisions. The senior pastor shall be responsible for the spiritual atmosphere of the church and have the final word regarding matters of doctrine, polity, and ecclesiastical hierarchy of the church. He/she is the chief overseer of all ecclesiastical matters and doctrine of the church and may veto a vote of the board of directors on the basis of

ecclesiastical concern. In such cases, the board shall table the matter and discuss it at the next board meeting. This allows the pastor time to prepare in writing his/her concerns as to why the decision may have violated Scripture or may not be a decision in the best interest of the church.

4. Scripture in the bylaws

Having Scriptures all throughout the bylaws makes it all the more a religious document that courts will usually avoid. The courts have consistently ruled that if the case cannot be resolved without going over doctrinal and religious issues of the church, then the courts have no jurisdiction over the matter.

This naturally brings up the question: **“Where should the doctrines of the church be documented?”**

RECOMMENDATION

We recommend that the doctrines of the church not be in the bylaws, but rather in a separate document that is approved by the church’s board of directors, elders, or body. There is a strategy behind this, which we will discuss shortly.

Later on, we will discuss the need for the church to have a separate document titled “the written doctrines”.



5. Member privacy

Most church members are very particular about their privacy. Letting members know that their records are private and will be held in the strictest form of confidentiality will make them feel more at ease. The following are some suggestions of what should be included in the privacy clause:

1. Will keep private all records concerning polity, doctrine, counseling, and information on membership;
2. Will not disclose any records that may compromise information about a member's attendance, membership status, giving, or counseling records;
3. No request shall ever be released to any government authority without due process and a valid subpoena delivered by the proper government agency; and
4. Any church owned computer that has Internet access must install and maintain filtering software to reduce the potential of harmful content being accessed.

6. Prohibited activities clause

A lot has been said about recent legislation, case law, and regulations that come in direct conflict with the sincerely held, religious beliefs and convictions of Bible-believing Christians. Case in point is the cultural and legislative shift towards same-sex marriage and transgender bathrooms. However, the church is treated differently if it has a clearly documented, religious belief that runs contrary to the activity. Having a clause in your bylaws that prohibits your church/ministry from engaging in activities that violate its written doctrines helps to establish a defense should the church end up in court.

The prohibited activities clause does not call out any one sin or action. Rather, it focuses on the church's doctrines and sincerely held beliefs as a basis for defending the church from legislation that forces believers to engage in activities that run contrary to Scripture.

SAMPLE LANGUAGE

“This church is prohibited from engaging in activities which violate its written doctrines. This church is also prohibited from condoning, promoting, or allowing any of its assets to be used for activities that violate its written doctrines.”

Because same-sex marriage is a big issue to many churches, we strongly recommend that the church document doctrines that define marriage. When it comes to marriage, the church should actually define marriage in its doctrines. In order to create the best defense of your church's stance, the following should be clearly stated:

1. Marriage should be described as sacred.
2. The wedding ceremony must be described as a religious ceremony.
3. Marriage ceremonies at the church are limited only to those that align with the church's doctrinal view.

7. Mutual interest clause

The mutual interest clause allows a nonprofit organization to establish a "code of conduct," so to speak. It states that the behavior of individuals who partner themselves with the organization are expected to conduct themselves in a way that perpetuates the cause and beliefs of the organization.

Members need to be held accountable to uphold a scriptural standard of living. Violation of Scriptures in relation to their lifestyles can result in expulsion by the pastor or the board of directors. It was stated by the Supreme Court in *Jones v. Wolf*, 443 U.S. 595 (1979) that to suspend or exclude from the Lord's Supper members found delinquent is an ecclesiastical matter concerning membership and, therefore, outside the purview of neutral principles of law. With that being said, a member may have membership revoked if the pastor and/or church board of directors deem it necessary so long as the church follows its own rules in so doing. This right and power cannot go under review by the IRS or courts.

SAMPLE LANGUAGE

"The behavior of anyone in fellowship with this church is of common interest to the board of directors and membership. (Gal. 6:1) This church requires every board of directors member and congregational member to adhere to a lifestyle that is consistent with the doctrines of this church as taught in the Holy Scriptures. Therefore, this church reserves the right to refuse service to any individual, whether member or not, that is not submitting their lifestyle to this scriptural mode of conduct. This refusal would include services, benefits, and any use of church assets."

8. Licensing and ordination requirements

Licensing and ordination are important to the IRS, because licensed and ordained ministers are afforded certain privileges that other individuals are not, such as multiple types of tax benefits. In the case of *Salkov v. Commissioner*, 46 T.C. 190, it was determined that because the petitioner was a licensed minister, he was eligible for ministerial tax benefits. On the other hand, in *Lawrence v. Commissioner*, 50 T.C. 494 the petitioner was not found to be eligible for ministerial tax benefits because, even though the individual had extensive training as a minister, he was not licensed or ordained by any entity.



Easy.

Affordable.

Trusted.



A Church Planting Program You Can Trust!

Over the past 20 years, our church planting specialists have helped thousands of churches establish a strong legal foundation that has protected their vision. Join the thousands who have trusted StartCHURCH.

Featured Services:



Become Incorporated



Open a Church Bank Account



Obtain 501(c)(3) Tax-Exempt Status



Become Ordained



Create Custom Bylaws



StartCHURCH[®]

HowToStartMyChurch.com | 844.277.8229

STEP 4:

OBTAIN 501(C)(3) STATUS

The benefits of applying for 501(c)(3)

The benefits of applying for 501(c)(3) status are numerous and remove all assumptions that may be made by not applying. When a church applies for exemption, it writes a detailed summary of all of its activities, including its budgets, whether in the past or for the future, its missionary activities, and the way it pays its pastor(s) and employees. The IRS has a chance to review every detail about that church and to make suggestions of changes it may consider necessary in order to ensure that everything the church does qualifies it for exempt status. Once approved, the church knows that there are no assumptions being made. Churches that never apply will make assumptions that all of their activities fall under the general guidelines of section 501(c)(3) without having official review.

The benefits of having 501(c)(3) status are listed below:

1. Exemption from **federal income tax**;
2. Eligibility to receive **tax-deductible, charitable contributions**;
3. Exemption from certain **employment taxes**;
4. **Assurance to foundations and other grant-making institutions** that they are issuing grants or sponsorships to permitted beneficiaries;
5. State officials may grant exemption from **state income and sales tax**;
6. Counties approve property tax exemptions on **property taxes**;
7. The U.S. Postal Service offers **reduced postal rates** to certain organizations;
8. **Increased credibility** within the congregation;
9. IRS Publication 78 will list your church as **a legitimately organized, nonprofit, charitable organization**, thus making it easy for anyone wanting to know your status.

How to apply for 501(c)(3) status

Application for 501(c)(3) status is done by properly submitting Form 1023. This form is 28 pages long, with numerous questions on each page. The average application that we prepare for our clients can reach up to 100 pages for a church and 65 pages if the client is a ministry. The form requires numerous attachments and significant thought. Below are a few tips that will allow you to better prepare an application.

1. Make sure that the activities match with the budget. If you state that you will run a day care and that you are using a 20,000 square foot building for your church and then you state in your budget that you will only bring in \$8,000.00 in gross income per year, the IRS will return your application stating that you should revise your budget or your activities (and rightly so).
2. Make sure that you have recorded minutes of your board meetings from inception to current, as the IRS may ask for them. The minutes must match the answers on your application to ensure consistency.
3. The answers on Schedule A are what the IRS uses to establish whether you qualify as a church. Please remember it is important that the answers are very thorough and clear.
4. If your application to the IRS is less than 50 pages long as an entire package, you should reconsider going over it again to ensure that you have included all of the required information.

The federal determination letter (FDL)

Contrary to popular belief, when the church gets approval of its application for 501(c)(3) status, it is not issued any special tax exemption number. When you submit your application, you will receive a letter of acknowledgement that lets you know the IRS has received the application. Then, after approval, you will receive an exemption letter that contains several pieces of information, including whether your organization is required to file Form 990. The letter will also be accompanied by Publication 4221. You can find documentation on this subject on our website at www.startchurch.com/resources.

STEP 5:

SALES AND FRANCHISE TAX EXEMPTION

Sales tax exemption is a wonderful benefit available in approximately thirty-five states, yet many churches have not taken advantage of this exemption simply because they are not aware that it exists. Day after day, churches purchase things for their ministries and pay between 5% - 8.5% sales tax. The truth is, for most churches, that should not be so. No pastor in America would refuse an 8% increase in his/her church's annual budget. However, too many do refuse such an increase simply by not applying for sales tax exemption. It is one of the wisest decisions you can make in the legal establishment of your church. All of the purchases or lease agreements that your church makes exclusively for its own purposes will qualify to receive this exemption. Here is an example of what this could mean for your church:

EXAMPLE

A church in Indianapolis, Indiana purchases a church van for the price of \$17,500.00; after calculating the sales tax, the total price will be \$18,550.00. However, if the church has sales tax exemption from the State of Indiana, it will not have to pay the sales taxes and can save \$1,050.00! That is a substantial savings that can be used for other ministry purposes.

How to apply for sales tax exemption

Applying for sales tax exemption is not as difficult as applying for 501(c)(3) status; however, many states require that your church achieve 501(c)(3) status before applying. In most states the application for exemption is handled by the Department of Revenue. States like Pennsylvania, New York, and others have long forms that require special attention to certain details. When applying, be sure to remain consistent with all of the other forms you may have filed with other government agencies, since many states have enacted laws to share information with the IRS.

What is franchise tax?

In short, franchise tax is a corporate tax levied upon a corporation for the privilege of doing business in a particular state. Franchise taxes are commonly imposed upon any type of corporation, whether it be a for-profit or nonprofit. This tax is commonly based upon the

corporation's income for the year and subject to a particular percentage defined by that state. Most states automatically exempt charitable organizations from having to pay the franchise tax. There are, however, three states that require charitable organizations (churches included) to either apply for an exemption or pay the annual franchise tax. These three states are:



California



Texas



Utah

But what many churches and ministries do not realize is that failure to either apply for exemption or to pay the annual franchise tax results in a suspension or forfeiture at the state level. This requires a church or ministry to go through a reinstatement process with the state in order to get back into good standing with the state.

Next, we will look at the franchise tax requirements of all three states (California, Texas, and Utah) and how to apply for franchise tax exemption.

How to apply for franchise tax exemption

As previously stated, most states automatically exempt charitable organizations from having to pay the franchise tax, however there are three states in which charitable organizations must apply for an exemption: California, Texas, and Utah. Check your local government website or call StartCHURCH for more information.



STEP 6:

PREPARE MINISTER'S COMPENSATION PACKAGE

Can a minister set his/her own salary?

For the purpose of setting your own salary, it is important to know that IRC section 4958 considers a pastor who sets his/her own salary to have automatically exercised an excess benefit transaction, which imposes an excise tax of 25% of the entire transaction. This means that if you set your own salary at say, \$40,000.00, the IRS says you must file Form 4720 and pay the tax.

DEFINITION OF A DISQUALIFIED PERSON

According to IRC 4958(f)(1), The term “disqualified person” means, with respect to any transaction, any person who was:

1. at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization,
2. a member of the family of an individual described in 1.
3. a 35-percent controlled entity.

Many churches, young and old, have pastors that set their own salaries. This is not legal. Current IRS code 4958 allows the pastor to participate in discussions involving salary and to give input, but he/she must be excused from actually voting or setting the salary.

Begin to plan the salary compensation package

Regardless of who plans and puts together the package, when it is finalized it should be presented to the pastor as an offer to enter into an agreement for employment. The board of directors should be comprised of individuals that have the pastor's best interest in mind and create the best package the church is able to afford. We recommend sorting the possibilities by cash and non-cash (see upcoming sample salary compensation package for “Minister Tom”).

Many church boards may not have enough cash to pay the pastor a reasonably good salary and we have found that young start-up churches usually have the most difficulty in determining cash payouts because the weekly income may be inconsistent to meet salary requirements.

Regardless of who plans and puts the package together, when it is finalized it should be presented to the pastor as an offer to enter into an agreement for employment.

When planning the pastor's compensation, it is important to make sure that persons who have researched the matter present all the possibilities that exist for creating the package. Take time to pray over the possibilities and see which ones will be best for the pastor. The discussion at the initial board meeting should have given good insight regarding the desires of the pastor and assist in prioritizing the cash and non-cash payouts.

RECOMMENDATION

When offering the pastor certain non-taxable benefits, we recommend not to give the pastor an option between the benefit or cash, as such option will make it taxable. This type of agreement is best to go under the cafeteria plan under section 125 of the IRC.



Salary Compensation Package Minister Tom		
Categories	Taxable	Amount
Cash Items		
Cash salary	Yes	\$30,000.00
Payment of federal income taxes	Yes	\$5,000.00
Retirement plans; 403(b), 457, SIP, or IRA etc.	No	\$4,000.00
Insurance, life, health, or disability	No	\$7,200.00
Paid vacation	Yes	\$2,000.00
Total cash paid out		\$48,200.00
Benefits		
Reduced tuition plans	No	\$4,000.00
Church owned vehicle (business miles)	No	\$4,800.00
House cleaning allowance	Yes	\$2,500.00
Cafeteria plan Internal Revenue Code section 125	No	\$4,500.00
Child care to allow minister to attend church function	No	\$2,400.00
Travel for church business, miles, sermon research, study, etc	No	\$3,500.00
On site meals	No	\$1,500.00
Working conditions benefits	No	\$1,000.00
De minimus (occasional personal use of church property)	No	??
Legal services and fees such as tax returns, etc.	No	\$600.00
Medical reimbursement (section 105b)	No	\$5,000.00
Totals		\$78,000.00

This compensation package has a total cash value of \$78,000.00, but the church does not necessarily pay that much in cash. Some of the items will not get used up, while others will. **Additionally, the tax impact on the minister of this compensation package may be \$0.00.**

Be careful not to make some benefits optional in terms of cash vs. the benefit. Tax courts have ruled that these are fully taxable.

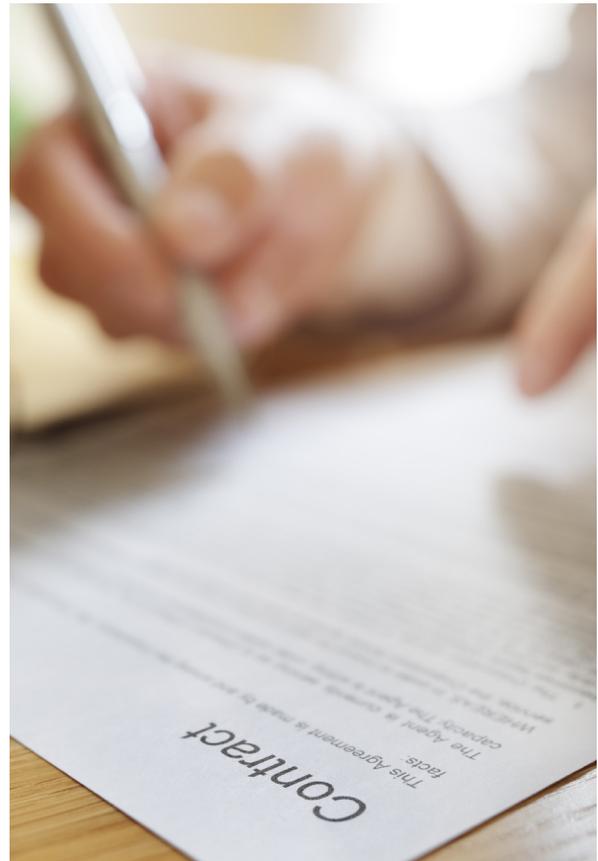
Professional agreement

The professional agreement is one of the most important factors in establishing the compensation package according to Code section 4958. The agreement spells out all of the terms of the compensation package and also places a beginning and ending date in keeping with *Bethany Reformed Church v. Hager, 406 N.E.2d 93, 95 (Ill. 1980)*. In this case, the court ruled that a contract between a church and the minister without beginning and ending dates could be broken at any time and, therefore, is not a real contract at all.

The contract should also mention that the pastor is employed as a minister as defined in IRC section 3401(a)(9), which defines the minister as an employee receiving wages “for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order.”

What terms to be included in a minister’s contract of employment will depend largely on the particulars of each situation. However, clergy and church boards should consider the following elements in structuring a minister’s employment contract:

1. Name of the church and the name of the pastor
2. Treasurer’s signature
3. Describing the pastor as an employee under section 3401(a)(9)
4. A job description of what is expected of the pastor
5. Beginning and ending dates, with the terms of employment and conditions for renewal
6. Dispute clause using an arbitrator rather than the civil courts
7. The compensation package detailing each item,
8. Signature of the pastor



STEP 7:

HOW TO HANDLE A HOUSING ALLOWANCE

What is a housing allowance?

Internal Revenue Code section 107 provides ministers an exclusion from gross income for a housing allowance that is provided as part of his compensation for the services performed as a minister of the gospel. If you have been in the ministry for any time at all, then you know that a minister of the gospel can designate some or all of the salary received from the church as a housing allowance. Although the housing allowance provision has been around for nearly 100 years, it is still largely misunderstood today by both churches and pastors. The misunderstanding stems primarily from the inherent imagery that the words **“HOUSING ALLOWANCE”** create in the minds of church leaders.

HOUSING EXCLUSION

When most ministers hear the words “housing allowance”, they immediately think of a portion of money that is given to them to cover their housing needs. Ministers with this misconception usually do not view themselves as “on salary” when they receive a housing allowance. Perhaps a better term to describe this benefit afforded to ministers is **“HOUSING EXCLUSION”**. This is because the salary that a minister receives (from the church) that is designated as a housing allowance may then be **excluded** from gross income and is thus, excludable from income tax.

What a housing allowance is not

Unfortunately, many ministers have an incomplete understanding of what a housing allowance is. If you were to ask a group of five ministers what housing allowance is, you would most likely receive five different answers. Some ministers might say that a housing allowance is pay they receive in addition to their salary. The fact remains, however, that a housing allowance is not an additional payment made to a minister to offset the cost of maintaining his home. Furthermore, a housing allowance is not a way for ministers to receive income from the church without it having to be approved by the board or reported to the IRS. The housing allowance is a portion

of a minister’s salary that has been approved by the board of directors as housing allowance and is thus excludable from income tax.

Some confusion may also stem from the term “parsonage allowance”. Therefore, it will be beneficial for you to understand the similarities and differences between a parsonage allowance and a housing allowance.

Parsonage allowance vs. housing allowance

Most ministers and church leaders today are familiar with the term housing allowance. You might have even heard it referred to as a parsonage allowance. While the two terms essentially mean the same thing, there is a subtle difference between the two. In general, the term housing allowance refers to a home that a minister rents or owns, and the term parsonage allowance refers to a church-owned home that is provided by the church to the minister.

The notable difference between a parsonage allowance and a housing allowance is who owns the property in which the pastor is living. If the church owns the home in which the pastor and his family live, then it is generally considered a parsonage allowance. If the property is leased, rented, or owned by the pastor, then his exclusion is generally considered a housing allowance.

For the purposes of this manual, we will concentrate on a housing allowance. You can find specific information on calculating and reporting a parsonage allowance in the [Housing Allowance Applet](#) located in the [Compensation Suite™](#).



What qualifies a minister for housing allowance?

In essence, the IRS has set forth guidelines to determine if a minister qualifies to have a housing allowance.

For a minister to qualify for the housing allowance as defined in section 107 of the IRC, he must be an ordained, licensed, or commissioned minister of a church. There are certain activities that the minister will have to perform to be considered a licensed minister who qualifies for the housing allowance. They are as follows:

- ▶ Performing sacerdotal functions;
- ▶ Conducting religious worship;
- ▶ Controlling, conducting, and maintaining religious organizations, boards, societies, and other integral agencies that are under the authority of a religious body (church or denomination);

You are considered a minister if you control, manage, or promote the organization's activities.

- ▶ Performing administrative duties and teaching at a theological seminary, as long as the school is under the direct control of a church (Rev. Ruling 62-171); and
- ▶ Performing the ordinary duties of a minister as an employee of the United States (other than as a chaplain in the Armed Forces), a state, possession, political subdivision, or the District of Columbia.

Additional requirements

- ▶ Be licensed in accordance with the church's requirements.
- ▶ Have a housing allowance plan clearly stated in the church's board-approved minutes.
- ▶ Receive some type of pay for the purpose of compensating the services performed in the exercise of ministry.

Under these guidelines all pastors and associate pastors will qualify for the housing allowance, as will most worship leaders, youth pastors, and other ministers.

TRUE OR FALSE?

A bi-vocational minister gets paid \$5,000.00 a year for his work at the church. He also gets paid \$40,000.00 a year for his work as a financial analyst. He can correctly claim a housing allowance of \$45,000.00.

Answer: False

Maximizing your housing allowance

In order to maximize your housing allowance benefit, there are three key factors that every minister must understand. These three key factors have to do with ministers 1) knowing how to properly set up their housing allowance, 2) understanding how to calculate their housing allowance, and 3) knowing how to report their housing allowance. We will next look at each of these key factors.

Key factor #1

Know how to properly set up your housing allowance

The first and foremost thing to understand about setting up your housing allowance is that it must be approved by your board of directors and recorded in board meeting minutes prior to you utilizing the housing allowance benefit. One of the reasons that this must be done is because the housing allowance is only prospective and not retroactive. This means that if you do not set up your housing allowance until June of one year, then you will not be able to include the previous months of January to May when calculating your housing allowance.

The housing allowance is established through a board meeting in which the board passes a resolution to provide a parsonage or to adopt a housing allowance plan for the minister. If your church has more than one minister, it will have to create an individual housing allowance plan for each minister. The resolution has to have the following key pieces of information:

1. A board meeting must be properly called;
2. The minute taker must document the date of the board meeting;

3. The chair person must declare that a quorum is present;
4. Wording must state that the parsonage or housing allowance is provided as compensation;
5. It must be carefully worded so that it is set to be perpetual unless it is revoked by the board;
6. The minister's name must be clearly documented as the one receiving the parsonage or housing allowance;
7. In the case of a housing allowance, the board must require a housing allowance expense worksheet from the minister every January.

Key factor #2

Understand how to correctly calculate your housing allowance

Another important part of maximizing your housing allowance is understanding how it is to be calculated. The IRS' Minister Audit Technique Guide states that the amount of your housing allowance excludible from gross income is the LEAST of

1. the amount actually used to provide a home,
2. the amount officially designated as a housing allowance, or
3. the fair rental value (FRV) of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities. IRC § 107(2)



It is the minister's responsibility to calculate each of these items. (Our [Compensation Suite™](#) provides you with a [housing allowance worksheet](#) to help you with this process.)

This inevitably leads to the question, “[What expenses can I use when calculating my housing allowance?](#)” In essence, your designated housing allowance may include all costs that are directly related to maintaining your home. Some examples of qualified housing allowance expenses include the following:

Monthly Payments:

mortgage and rent payments

Taxes:

real estate taxes, personal property taxes;

Insurance:

homeowner's, fire, flood, renter's;

Home Improvements:

new roof, home additions (garage, carport), fencing, landscaping, pool, deck, etc.;

Maintenance & Repairs:

drapes, curtains, blinds, throw rugs, wallpaper, paint, molding, shelving, artwork, bedspreads, sheets, linens, towels, knick-knacks, etc.;

Utilities:

gas, electricity, water and sewer, garbage service, cable/satellite, internet, phone line, home security, etc.; and

Miscellaneous:

home cleaning supplies, brooms, mops, vacuums, light bulbs, home supplies, carpet/rug/drapery cleaning, landscaping services, lawn equipment and supplies, garden hoses, garden tools, etc.

DID YOU KNOW

In 1986, section 265 had paragraph (a)(6)(B) added, which states that no deduction shall be denied for interest on a mortgage or property taxes even if a housing allowance exclusion was claimed by the minister pursuant to section 107. You can deduct home mortgage interest even if you claim a housing allowance. This is legal double dipping!

Before moving on to the third key factor, I want to let you in on a little-known secret regarding how much your church can designate as housing allowance.

There is nothing in the tax code, treasury regulations, or other IRS publications that limits the amount or percentage that a church can designate as a housing allowance.

The designation does not determine how much the minister will be able to exclude from gross income. The amount designated simply needs to meet the legal requirement that your housing allowance be designated in advance of payment for the services you provide as minister to the church.

Therefore, **your church can designate up to 100% of your compensation as housing allowance.** By designating your housing allowance up to 100% of your compensation in advance of payment, it allows you to utilize the actual expenses it cost you to provide a home and, therefore, maximize your housing allowance benefit. Keep in mind, however, that the amount you are able to report is limited to the least of the three amounts previously mentioned. Below is some sample language that you may want to consider including in the board meeting minutes approving your housing allowance.

EXAMPLE LANGUAGE:

BE IT RESOLVED that the board of directors of NAME OF CHURCH hereby designates for tax year 20XX, 100% of the total compensation provided to PASTOR'S NAME as housing allowance.

WHEREAS, that the church will limit the amount of this exclusion to the least of the amount used to provide a home, the amount officially designated as a housing allowance, or the fair rental value of a home, including furnishings and appurtenances such as a garage, plus the cost of utilities.

BE IT RESOLVED, each year, PASTOR'S NAME shall be required to substantiate to the church the actual costs and the fair rental value of his home in a form prescribed by the church.

Calculating the Housing Allowance



WHY THE STEPS ARE IMPORTANT

When the board designates up to 100% of the minister's total pay as housing allowance, it allows the minister to use an accurate number for the real amount it cost him to provide a home since he cannot truly estimate his actual home expenses. So, at the end of each tax year, as long as Step 1 was done in advance, a minister will be able to calculate his actual home expenses, thus maximizing his housing allowance. For instance, if a minister "estimates" his actual home expenses at \$27,500.00 but in reality paid \$30,265.00, then he would be missing out on \$2,765.00 of tax-free income.

In most instances, which figure do you think will be the amount that you are able to claim as housing allowance and exclude from federal income tax?

Also, do not forget that the housing allowance is only prospective and not retroactive, and, therefore, must be approved in advance.

Key factor #2

Know how to report your housing allowance

This may come as a surprise to you, but in the year 2000, the IRS issued a written determination clarifying that section 6051(a) of the Internal Revenue Code does not require the housing allowance to be reported on the minister's Form W-2. Although this can be considered a good thing, there are some benefits to reporting the housing allowance on your Form W-2.

- 1. Banking and major buying purposes:** When you apply for a loan to purchase a home or a car, banks want to see if your income is sufficient to make the payments. Many banks today will deny a loan if the income reported on a W-2 is not sufficient. Oftentimes, the housing allowance reported on line 14 is just enough to get the loan approved.
- 2. Self-employment tax reporting:** Remember, although the housing allowance is excludable from income tax, it is still subject to self-employment tax if you have not "opted out". If you have not opted out of the self-employment tax, then reporting the housing allowance on Form W-2 makes it easier for you to report your income on Form SE of your income tax return for self-employment tax purposes.

Should you decide to report your housing allowance, it should be reported on Line 14 of Form W-2. Consider the following example.

EXAMPLE:

Minister Tom lives in a home that he owns. Minister Tom's monthly mortgage payment is \$1,000.00 and he also spends \$1,250.00 per month in qualified expenses to live in his home. These include light, water, natural gas, appliances, and other qualifying expenses. Minister Tom's salary from his church is \$30,000.00. At the end of the year, when the church prepares his Form W-2, it will do so in the following manner.



He's happy because he knows his taxes are in good hands.

MINISTER'S TAX RETURN SERVICE

With the StartCHURCH™ Minister's Tax Return Service you can walk confidently knowing you are taking advantage of every legal benefit allowed to you as a minister. Whether it is properly deducting your housing allowance or social security exemption, or correctly reporting love offerings, the StartCHURCH™ Minister's Tax Return Service will ensure you are not overpaying taxes and enjoying the best tax status in America.



At StartCHURCH, we fully understand ministerial taxes and ensure that you will not overpay.



We strategically use the housing allowance to give you the largest legal tax return possible.



The StartCHURCH tax team offers 100% accuracy, speed, and customer service.

ALL THIS FOR ONLY

\$349

**CALL US TODAY TO GET STARTED!
844-277-8229**

STEP 8:

FILE FOR SELF-EMPLOYMENT TAX EXEMPTION

What is self-employment tax exemption?

The self-employment tax exemption is a benefit extended to ministers for religious reasons, as it allows a minister to exempt himself from the requirements of the Self-Employed Contributions Act (SECA). The Act requires every person who is self-employed to contribute self-employment taxes of 15.3% of his income, and does not provide for deductions. If the income (defined as gross income minus expenses) is \$25,000.00, then the self-employment tax is \$3,825.00.

The truth is that deciding to apply for self-employed tax does not have to be difficult if you are armed with the correct information.

There are provisions that allow ministers to apply for exemption from having to contribute 15.3% of their income into Social Security. For most ministers, the hardest decision they have to make is whether or not to apply for the exemption. The truth is that deciding whether to apply does



not have to be difficult if you are armed with the correct information. There are several factors to consider when making the decision to opt out.

What criteria must I meet to apply?

In order to qualify for this exemption, you must be one of the following:

- ▶ An ordained, commissioned, or licensed minister of a church;
- ▶ A member of a religious order who has not taken a vow of poverty;
- ▶ A Christian Science practitioner; or
- ▶ A commissioned or licensed minister of a church or church denomination that ordains ministers, if you have authority to perform substantially all religious duties of your church or denomination.

Honesty and integrity are the roads to take when considering exemption. If you are licensed and/or ordained by an internet or mail order ministry/church that has no communication with you and does not foster an ongoing relationship with you, then you will most likely not qualify as a minister defined above.



In addition to the above criteria, you must also have a sincere conviction that you are opposed to receiving government care and benefits from the income you make as a minister. See the text that follows for clarification on how the IRS checks to see if you qualify.

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...

The key phrase here is “for services I perform as a minister”.

Let us put together the entire sentence to see it as a whole:

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 a 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.)

In short, it means that **as a minister** you have a conviction concerning receiving government help, public insurance, or Social Security for the work you do as a minister. Conscientiously opposed means that you have a religious conviction in your heart, even if you cannot explain why, against receiving any government benefits for the work you **do as a minister**. This example may help clarify:

EXAMPLE:

Minister Tom began to pastor a church in 1994. After three years, his wife became pregnant, and with only eighty-five church members, most of the church’s income went to pay the mortgage of the building and his salary of \$450.00 per week that he had been receiving for less than a year. Minister Tom knew that with his income and with no health insurance, he could not afford to pay the doctor bills.

(Example Continues)

Some well-intentioned parishioners approached him saying that the Lord had provided for us a wonderful government, which created a program to take care of people's needs in times like this and then mentioned that he should apply for Medicaid. They believed based on Minister Tom's income, that most likely 100% of his costs would be covered. Minister Tom graciously thanked them for the advice, but declined their proposal. He later went to prayer and asked the Lord why his conviction was so opposed to receiving governmental help. After some more time in prayer and meditation, he discovered that in his preaching he always said that it was the Lord who provided for all of his needs and all of the needs of the Body of Christ. He also knew that as a minister, he was solely in God's hands and depended on Him to provide for his family.

Nine months later his wife delivered a baby boy and they named him Josiah, after one of the kings of the Bible; for Minister Tom knew that the King of Kings would always provide, and he was grateful that he had been able to pre-pay the hospital bill in cash!

For Minister Tom, the decision to apply for self-employment tax exemption was easy because he was opposed to receiving government benefits as an insurance program for the work he did as a minister. He felt that it would be difficult for him to preach to the people that the Lord was their provider if he himself was receiving his provision from the government.

There is a window of time to apply

In order to be able to take advantage of the benefits of exemption, you must apply no later than the due date of your tax return, including extensions, for the 2nd tax year that you earn at least \$400.00 of income as a licensed minister. This means that if at the beginning of this year you make ministry income of \$400.00 or more as a licensed minister, the time clock begins. **From that point on, for whichever second tax year you make \$400.00 or more in ministry income, you have until April 15th of the following year to apply, or else your two-year window will expire.**

Honesty and integrity are the roads to take when considering exemption. If you are licensed and/or ordained by an internet or mail order ministry/church that has no communication with you and does not foster an ongoing relationship with you, then you will most likely not qualify as a minister defined above.

How to apply for self-employment tax exemption

The steps for applying can be somewhat complex to follow and only licensed and ordained ministers may apply. We have created a software program that walks you through the steps needed to create all the forms for you to print to send to the IRS; it will also create your housing allowance. Below are the steps for application for exemption.

- ▶ File Form 4361 in a timely manner;
- ▶ Be conscientiously opposed to public insurance because of your individual, religious considerations (not because of your general conscience), or be opposed because of the principles of your religious denomination;
- ▶ File for other than economic reasons;
- ▶ Inform the ordaining, commissioning, or licensing body of your church or order that you are opposed to public insurance, if you are a minister or a member of a religious order (other than a vow-of-poverty member). This requirement does not apply to Christian Science practitioners;
- ▶ Establish that the organization that ordained, commissioned, or licensed you, or your religious order, is a tax-exempt religious organization;
- ▶ Establish that the organization is a church, a convention, or association of churches; and
- ▶ Sign and return the statement the IRS mails to you to certify that you are requesting an exemption based on the grounds listed on the statement.

For a more detailed examination of the self-employment tax exemption, check out the [Opt Out Applet](#) located in our [Compensation Suite™](#).

STEP 9:

ESTABLISHING PAYROLL FOR THE CHURCH

Decide early in the process who handles payroll

Choose early on who will handle your church's payroll. Changing how your payroll is handled in the middle of the year can cause problems in reconciling the financial books. If you decide to keep payroll in house, it is important that the church carefully calculate how much federal income tax to withhold. (See IRS Publication 15 as a reference.) Additionally, take note that unless there is a voluntary withholding agreement between the church and minister(s), you should not withhold taxes from the minister; we will discuss this later on in this section. If you decide to hire a professional payroll company, make sure that the company you choose has experience with the nuances of church payroll.

Choose payroll frequency

Because every pastor is unique and will vary in preferences, it is recommended that the church ask the pastor whether he would rather get paid weekly, bi-weekly, or monthly. We have found



that most pastors prefer a weekly pay schedule. Once you have determined payroll frequency, take note that all employees will need to be on the same pay schedule.

Two types of employees

Payroll for a church can be very different than that of a regular nonprofit, for-profit, or other ministry organization. Churches have to treat non-ministerial employees and ministers differently for tax purposes; additionally, a church can opt out from withholding payroll taxes altogether, which we will look at shortly. This will mean higher taxes for the employees of the church but not necessarily for the ministers.

The church should consider the type of employees it will have when setting up the payroll. For churches, there are two types of employees:

1. Ministerial employees (ordained), and
2. Non-ministerial employees (non-ordained).

Ordained ministers usually do not have taxes withheld from their paychecks, while most non-ordained employees do have taxes withheld from their paychecks. Most young churches have just the pastor on payroll or possibly the pastor and a secretary.

Get this form from each employee

Whether you have a minister or a non-ordained employee, the first step in setting up payroll is receiving a completely filled out Form W-4. This form is used to gather the information necessary to withhold the correct amount of taxes. The IRS requires that the employer keep this form in the employer's records at all times, and it will not be submitted to the IRS.

Withholding taxes from employees

Under section 409A, all wages, whether in cash or check, are considered income and are subject to withholding. The following taxes must be withheld:

Type of tax	Employee	Employer
FICA	0.062	6.2%
Medicare	1.45%	1.45%
Medicare Hospital Insurance	0.9%*	0.0%

Wage base limit for FICA is \$118,500.00, and Medicare has no limit.

The Medicare Hospital Insurance Tax is a new tax under the Affordable Care Act. Certain employees will be subject to this new tax. Below is a breakdown.

1. Employees married filing jointly, making over \$250,000.00;
2. Employees married filing separately, making over \$125,000.00;
3. Employees filing single, making over \$200,000.00;
4. Head of household (with qualifying person), making over \$200,000.00;
5. Qualifying widow(er) with dependent child, making over \$200,000.00

These taxes must be withheld each pay period and be matched by the church. The church does not have to match the Medicare Hospital Insurance Tax. When the church withholds, it becomes a trust agent for the employee and these taxes must be paid to the IRS in a timely manner.

What section of the law states that all wages are subject to withholdings?

Ministers are exempt from income tax withholding

Ministers often think that they are exempt from having to pay income taxes. However, **that is simply not true**. Rather, a minister's wages are exempt from income tax withholding. In essence, a church should not withhold federal income tax from a minister's pay without first signing a **voluntary withholdings agreement**.

According to IRS Publication 517, a minister "can enter into a voluntary withholding agreement with the church to cover any income and self-employment tax that may be due." However, if the church and minister choose not to enter into a voluntary withholding agreement, then the minister will be responsible to use Form 1040-ES to pay his/her income tax.

A minister who wishes to enter into a voluntary withholding agreement with his or her church needs to file a completed Form W-4 with the church. This form is used so that the church can

withhold the correct federal income tax from the minister's pay. While completing the Form W-4 is generally enough to constitute a voluntary withholding, it is best practice for the minister and the church to have a written agreement between themselves. According to CFR 31.3402(p)-1(b) (a), the written voluntary withholding agreement should contain the following:

1. "The name, address, and social security [sic] number of the employee making the request,
2. The name and address of the employer,
3. A statement that the employee desires withholding of Federal [sic] income tax, and applicable, of qualified State [sic] individual income tax..., and
4. If the employee desires that the agreement terminate on a specific date, the date of termination of the agreement."

Three things about withholding taxes

1. Failure to withhold is a violation of section 3402(a)(1), which requires tax to be collected at the source.
2. When the church withholds taxes, it is responsible for holding and submitting the taxes of its employees.
3. The taxes withheld must be paid in a timely manner or serious penalties will apply.

PENALTY BREAKDOWN

- 2% - For deposits made 1 to 5 days late.
- 5% - For deposits made 6 to 15 days late.
- 10% - For deposits made 16 or more days late, and also applies to amounts paid within 10 days of the date of the first notice the IRS sent asking for the tax due.

How to pay/deposit taxes

Federal tax deposits must be made by electronic funds transfer using www.eftps.gov. If your church uses the services of a payroll company, that company is required to deposit your taxes electronically. The www.eftps.gov service is free to use. It is a good idea to go online and set up an account. EFTPS is a free service provided by the Department of Treasury.

Form 941 requirements for employers

If you have more than one employee then you are required to file a quarterly Form 941. This form needs to reflect the grand total of wages subject to federal income tax withholding, Social Security and Medicare tax, and how much tax was withheld and sent to the IRS. If the minister is the only person receiving compensation and he/she does not have a voluntary withholding agreement in place, the church technically does not have to file a quarterly Form 941. However, it is recommended that your church still file Form 941.

TAKE NOTE

In this instance, you would simply indicate \$0.00 on Form 941 since ministers are responsible to withhold their own taxes. Most likely, once the IRS has received a year's worth of Form 941's indicating \$0.00, the IRS will send you a letter requesting the church to instead file an annual Form 944. Take note that once your church begins paying a non-ministerial employee, you will be responsible to file a quarterly Form 941.

A common occurrence among churches

I have had many, many conversations with pastors and church leaders concerning the way they are paying their ministers. When I say ministers, I mean pastors and any other person in the church that is licensed, ordained, or commissioned by the church and who receives a salary or love offerings from the church for work done as a minister.

Many churches and payroll companies make a common mistake

What I am noticing is that many churches, and even payroll companies, are withholding FICA taxes from the pastor's paycheck and sending them in to the IRS using quarterly Form 941. This is when the church withholds a certain portion of the minister's paycheck and then matches the FICA and Medicare portion and sends it to the IRS. Though it looks right, the church is actually doing it wrong. Under the law, the church is not allowed to withhold FICA from a minister's salary or from love offerings received from the church. Why, you may ask? Why is a minister different from a regular employee? **It is because he/she is defined under section 3401(a)(9) as a self-employed individual for Social Security purposes.**

It is not as complicated as it looks

Seem complicated? It only sounds that way. Once you understand it, it becomes very easy. Let me give it to you in preacher's terms. When a church pays a salary to a minister, the church cannot withhold and send the taxes to the IRS. A minister gets 100% of his/her salary and must then file a quarterly Form 1040ES and send in his/her taxes to the IRS with his/her own Social Security number.

That may sound burdensome, but really it is not that bad. Typically, all you have to do is set aside approximately 15% of your paycheck into a savings account. Then, every quarter withdraw that money and send it to the IRS.



How to make things easier

There are a few things you can do to make this process easier and more beneficial for you and your church. Let me list them for you.

1. Form W-2:

Make sure to have a Form W-4 for each employee, including all ministers.

2. Form I-9:

Make sure you have a Form I-9 for each employee, including all ministers.

3. Housing Allowance:

Designate a housing allowance for each qualifying minister.

4. S.E. Tax Exemption:

Have the minister apply for self-employment tax exemption. (By following steps three and four alone, most ministers will pay little to no taxes.)

5. File Form 941:

If the minister is the only one at the church receiving a salary, then the church does not have to file a quarterly Form 941; although, it is best practice to do so.

If the church has other employees that are not ministers, then a quarterly Form 941 has to be filed where all the income of the employees, including the minister, is reported on line 2. However, on lines 5a, 5b, and 5c, the church reports the taxable income of the regular employees and not the income of the ministers, since they are exempt from income tax withholding.

6. Form W-2:

Issue the pastor a Form W-2 and NOT a 1099-MISC. Why? First of all, the law requires it. **Secondly, if the minister gets a Form W-2 then he/she will most likely get a bigger tax refund.**

End of year reporting and common mistakes

The church is required to tally up all of the salaries paid to every employee and issue a W-2 form to each one. Many churches and payroll companies make a mistake in the way they prepare the minister's Form W-2. They oftentimes report the minister's taxable income on lines 1, 3, and 5. That is a big mistake and can potentially cost the church, if not corrected. The pastor's taxable income is reported only on line 1. Lines 3 and 5 must be left blank. Additionally, lines 2, 4, and 6 must also be left blank.

On line 14, the church reports the qualifying housing allowance expense incurred by the minister. This number comes from the housing allowance statement filled out by the minister. Let us take a look at one minister's Form W-2 to see how it should be prepared.

EXAMPLE

Church ABC decided to set Minister Tom's salary at the church at \$52,000.00. The church also designated a housing allowance of up to 100% of Minister Tom's salary, which is a key principle learned at our conferences because it ensures maximum benefits from the housing allowance.

During the year, Minister Tom received 52 paychecks of \$1,000.00 each. He also received 2 love offerings from the church, totaling \$3,000.00. This means that Minister Tom's total salary from the church for that year ended up being \$55,000.00. When the year ended, Minister Tom filled out his housing allowance statement, and the qualifying housing allowance expenses were \$32,500.00. He then signed his housing allowance statement, made a copy, and gave the original to the treasurer while keeping a copy for himself.

When preparing Minister Tom's W-2, the church treasurer took \$55,000.00 and subtracted \$32,500.00. The result was \$22,500.00. He then reported \$22,500.00 on line 1 of Form W-2 and \$32,500.00 on line 14 and wrote the words "housing allowance." Lines 2, 3, 4, 5, and 6 were left blank. On the next page is a sample image of the W-2.

Form	Description
W-2	This form is used to report the employees' wages to the Social Security Administration. The employee receives a copy for his/her federal, state, and local tax returns.
W-3	This form is used to reconcile the grand total of all of the W-2's reported. It, too, is sent to the Social Security Administration.
1099-MISC	This form is used to report all wages paid to non-employees for services rendered. This form is sent to the IRS.
1096	This is used to reconcile the grand total of all 1099's issued.
941	This form is filed quarterly by the church to report all wages paid in that quarter.
945	This form is used to report taxes withheld from non-employees who failed to supply a W-9 form or are individuals without a taxpayer identification number.
8109	Use this form to pay your payroll taxes every month at your local bank.
W-4	Use this form to gather the necessary information to process employee payroll.
W-9	Use this form to get the necessary information from a non-employee such as a guest speaker. Failure to get this form may result in a 28 or 30 percent tax against the church.
W-8	Use this form to get the necessary information from a non-employee such as a FOREIGN guest speaker. Failure to get this form may result in a 28 or 30 percent tax against the church.
W-11	Use this form to get a statement from the employee that he/she meets the requirements of the HIRE Act to allow your church the right to apply for the payroll tax exemptions and the \$1,000.00 credit.
1042 S	Use this form to report all wages paid to a foreign nonresident alien.
I-9	Use this form for newly hired employees. Use this form to verify that each new employee is legally eligible to work in the United States. Both you and the employee must complete the US Citizenship and Immigration Services (USCIS) Form.

STEP 10:

KEEP GREAT BOARD MEETING MINUTES

How to take board meeting minutes

Perhaps you have a board meeting coming up, and you want the minutes to be perfect, but honestly, you are not even sure that you know how to take proper board meeting minutes. After all, state and federal law require that board meeting minutes be taken to document decisions made by your church's board of directors. So, what does one do to ensure that the board meeting minutes are properly taken? Below are 6 steps to help you take better board meeting minutes. Our [Minutes Applet](#) located in the [Secretary's Suite™](#) will provide you with the following steps plus all of the necessary templates and forms to help make this a smooth process for you.

Step 1 - Prepare an agenda

An agenda is a list of items to be discussed and considered at the board meeting. Make sure that you follow the proper format, which should have an opening, prayer, reading of the minutes from the previous board meeting, old business, new business, officer reports, open floor, and closing.

Step 2 - Send a notice

State law requires your ministry to comply with proper notice requirements. The notice must contain the date, time, and location that a board meeting will take place. We recommend that you make every effort to send the notice at least 10 days in advance of the board meeting to give each board member enough time to prepare and make the necessary plans to attend. The notice should be sent by mail or email, along with an agenda and a copy of the minutes from the previous board meeting. If your bylaws allow, you can also post the notice in a conspicuous location in the church.

Step 3 - Take notes

Note taking is probably the most difficult thing about a board meeting. What should one write? How much should one document? To make it easier, the minute taker should have a note-taking

form that is based upon the agenda. At a minimum, you should document minimal discussions, any motions made to vote on a matter, and who seconds those motions. You also document who votes yes and who votes no. If the majority vote yes on a matter, then the item is passed; if the majority vote no, then the item does not pass. I cannot stress how important it is to take good notes by allowing yourself to be guided by a good note-taking form. If your bylaws allow, I recommend that you record the board meeting in audio format, which will prove helpful if you need to hear a certain portion again.

Step 4 - Convert the notes to minutes

Here is where your note-taking form will shine. If you used it properly during the meeting, then all you have to do afterwards is convert the notes to a formal set of minutes. Each item on the agenda must have a discussion, a motion duly made, followed by who voted yes and who voted no and whether there were enough votes to pass the motion.

Step 5 - Signatures

One confusing aspect about approving minutes is that the minutes you write for today's board meeting are not approved until the next board meeting. **This means that at each board meeting, the board votes to approve the previous minutes.** It is important that once the minutes are approved they be signed by at least two officers. It is best practice that they be signed by the president and secretary of the board.

Step 6 - Corporate seal

Aha! The corporate seal. Why have one? Well, the corporate seal serves to show that the content of a signed document is an act and deed of the ministry, as opposed to one that is merely signed by a director. A signature without a seal can be interpreted to be an act carried out on behalf of the ministry by its officers or directors. The seal makes it clear that you did not sign on your personal behalf, but rather as an act of the corporation (ministry). It can keep you from being held personally liable for the consequences of an act of the ministry. (If you are in need of a corporate seal, you can receive one through our [Ministry Corporate Records Kit™](#).)

How much detail should board meeting minutes have?

Board meeting minutes should not contain any specific details of a discussion or who directly said those details. There may be rare times when that is necessary, but for the most part, the minutes should contain only the final decisions made during the meeting.

Keeping the minutes concise reduces the chances for courts (or the IRS) to come to their own conclusions concerning what may have happened at the meeting.

Board meeting minutes are legal documents

1. When the secretary of your board takes board meeting minutes and prints them, they go through a procedure known as implementation. The procedure should occur in the following manner:
2. The secretary takes notes during the board meeting;
3. After the meeting, the board meeting minutes are prepared and printed;
4. The board meeting minutes are given to the directors before the next board meeting;
5. At the next board meeting, the board meeting minutes are either read aloud or everyone on the board is asked if they have read them prior to the meeting;
6. The chairperson moves to have the board meeting minutes approved as written. If someone has a discrepancy, then the issue is addressed;
7. If no issues, the board meeting minutes are approved by the board.

Minutes should not contain details of the discussion; rather, the minutes should contain only the final decisions made during the meeting.

Board meeting minutes and corporate records

What good will board meetings be if the minutes do not appear in the corporate records? Section 16.01(a) of the Model Nonprofit Corporation Act, states that “a nonprofit corporation must keep as permanent records minutes of all meetings . . .” It also states that the corporation shall keep the following records in the office of the church or ministry:

1. Articles, or restated articles, of incorporation and all amendments to them currently in effect;
2. Bylaws, or restated bylaws, and all amendments to them currently in effect;
3. Minutes of all meetings of members and records of all actions approved by the members for the past three years;
4. All written communications to members, generally within the past three years, including the financial statements furnished for the past three years;
5. A list of the names and business, or home, addresses of its current directors and officers; and
6. Its most recent annual report delivered to the Secretary of State.



SUMMARY

A good foundation is essential for a church to be lasting and impactful within its community. As every pastor knows, starting a church is a marathon, not a sprint.

In this eBook, we took time to discuss the 10 legal steps that you should take to ensure your church is starting on a solid, legal foundation.

Step 1: Incorporation

Step 2: FEIN

Step 3: Bylaws

Step 4: Obtain 501(c)(3) status

Step 5: Sales and Franchise Tax Exemption

Step 6: Prepare Minister's Compensation Package

Step 7: How to prepare a Housing Allowance

Step 8: File for Self-Employment Tax Exemption

Step 9: Establishing payroll for the Church

Step 10: Keep great board meeting minutes

No matter where you are at in the process, be encouraged knowing that we, at StartCHURCH, are on your side and that with God, all things are possible. Protect what God has given you to lead, by growing your church on a strong legal foundation.

Pace yourself to run the race that God has set before you, for He will give you the strength and resources you need to succeed.

Raul Rivera

ABOUT StartCHURCH

StartCHURCH is a company dedicated to meeting the needs of pastors, leaders and church boards that have a vision to make a difference in their communities through establishing new churches and ministries. Knowing that churches face increased scrutiny, StartCHURCH answered the call to be a voice to the Body of Christ by educating and empowering men and women of God not only to start their churches, but also to run and manage them better.

StartCHURCH believes in helping those who feel called to leadership within the Body of Christ. To that end, the authors have designed all products and services to aid ministers in fulfilling the call of God on their lives. Most of the resources have been authored by Reverend Raul Rivera, who has over 18 years of extensive experience researching the compliance issues that surround religious and non-profit organizations. Using simple day-to-day language, Raul has created more than 80 effective and user-friendly manuals and compliance software and document packages, such as the StartRIGHT™ Program, to make church starts and management easier.

Raul and his wife, Genel, have also used their years of ministry experience to help serve the community in which they live. They have witnessed the powerful way that hearts and lives are opened before them for the gospel, simply by using opportunities that the Lord puts before them to make a difference through giving and serving others.



