



# **Accounting for Churches**

By

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Notice: The information provided in this book is general in nature. It does not fall within the IRS definition of a covered opinion. As a result, it cannot be relied upon to avoid IRS penalties. If you want or need a covered opinion (one which can be relied upon to avoid IRS penalties), you need contact a qualified tax professional who is willing to provide covered opinions. Due to the burdensome IRS requirements regarding covered opinions, be prepared to pay a substantial fee to the tax professional if you choose to obtain a covered opinion.

## **Worker Classifications**

### **Do ministers receive special tax treatment?**

Yes and no. Ministers only receive special tax treatment for the following three topics:

- 1) Even though most ministers are considered church employees, they are treated as self-employed for Social Security and Medicare tax purposes. As a result, ministers must pay their own self-employment tax.
- 2) Ministers can receive a housing allowance and/or live in a church provided parsonage. The value of both of these is excluded from a minister's calculation of income tax (but still subject to the self-employment tax).
- 3) Churches cannot withhold Social Security and Medicare tax from a minister's paycheck, and they do not compute a minister's income tax withholding based upon the standard withholding charts/rates.

Each of these unique topics is significant. They are one of the primary reasons this book is necessary. Even experienced bookkeepers who are familiar with payroll tax requirements need to understand the issues specific to ministers.

Many churches assume that ministers receive special tax treatment for all areas of taxation. That is not true. With the exception of the three issues outlined above, ministers are normal employees and are subject to the same tax laws and regulations as all other church employees. This is particularly important to remember when dealing with employee expense reimbursements (e.g., auto allowances).

### **Who is considered a minister for tax purposes?**

In order to be treated as a minister for tax purposes, the minister must satisfy all five separate tests:

1. Be licensed or ordained,
2. Administer the sacraments of the church (baptisms, weddings, funerals, and communion, etc.)
3. Be considered a religious leader by the church,
4. Conduct religious worship,
5. Have management responsibilities in the church.

The Pastor will almost always be considered a minister for tax purposes.

### **Is a part-time youth or music minister considered a minister for tax purposes?**

A youth minister may or may not be considered a minister for tax purposes. First, the minister would need to be either licensed or ordained. With respect to the other tests, the minister does not have to fulfill each function on a continual basis. Even though most youth ministers do not perform each of these functions regularly, they are usually qualified to perform these functions and actually do perform them on occasion. As a result, most youth ministers who are licensed or ordained will qualify for treatment as a minister for tax purposes.

For other types of ministers (e.g., music ministers, education ministers, and children's ministers), the minister should consider consulting a qualified tax professional in order to determine the proper classification. Although the licensed/ordained test is black and white: the minister is either licensed/ordained or not, the other tests are much more subjective and require a judgment call.

### **Do non-minister church employees receive special tax treatment?**

Generally, no. In most situations, non-minister church employees are subject to the same payroll tax withholding and tax reporting requirements as the employees of any for-profit business venture. One exception is that church employees are not subject to federal unemployment tax and may not be subject to state unemployment tax. See discussion of unemployment taxes later in the book.

## **Can the church choose to treat an employee as an independent contractor?**

No! The decision to classify a worker as an employee or independent contractor is not determined by the church's choice or preference, but rather by the specific facts of the working relationship. In recent years, the IRS has made a concerted effort to audit many organizations because of the independent contractor vs. employee issue.

## **What determines if someone is an employee or an independent contractor?**

Non-minister employees are defined as all church employees who did not meet the five tests described earlier. Independent contractors are those who are paid by the church to perform services but who do not meet the definition of an employee.

To determine the proper classification between employee and independent contractor the IRS considers a set of factors which are designed to determine how much control the church exercises over the person providing services (See [Appendix A](#)). The more control the church has over the person, the more likely the person will be classified as an employee. The less control the church has over the person, the less likely the person will be classified as an employee.

In most cases, the following will be employees:

- Staff ministers
- Office secretaries/administrative assistants
- Paid church musicians (pianists, organists, etc...)
- Paid nursery workers
- Full-time custodians.

In most cases, the following will be independent contractors:

- Outside maintenance contractors (including lawn maintenance and janitorial service companies)
- Repairpersons (plumber, electrician, heating/air conditioning repair)
- Construction workers (carpenters, brick masons, carpet layers)
- Guest speakers
- Supply preachers
- Revival ministers.

Remember, these two lists are a general guide but are not all inclusive or definitive. If you have any questions at all about how to classify a worker, you should review the IRS 20-part test and possibly consult a tax professional.

Consider the following two examples:

### **Example #1**

The church contracts with Casey Cutter to provide lawn maintenance services. Casey will provide his own equipment and work on his own schedule. He can hire other helpers or subcontract the work if he chooses to do so. As long as he fulfills the requirements of the contract he will receive the stated amount. Casey is definitely an independent contractor under these facts.

### **Example #2**

The church terminated its contract with Casey because he took advantage of the freedoms afforded by his independent contractor status. He frequently mowed the lawn during worship services and often hired unsavory characters to perform the work. Instead, the church hired Agreeable Andy to provide the lawn services. The church will provide Andy with all of the equipment and tools he needs to perform his job. Andy will work from 8:00 until 5:00 Monday through Thursday. Andy will receive two weeks paid vacation and one week of paid sick leave. Andy will be paid \$15 per hour for his services. Because of the amount of control the church exercises over Andy, he is definitely an employee under these facts.

## Housing Allowance

### What is a minister's housing allowance?

A minister's housing allowance is the payments made by the church to the minister for the minister's estimated housing expenses.

The reason that most ministers will want to designate a portion of their compensation package as a housing allowance is that the housing allowance is not subject to federal income taxes. Depending upon the minister's income tax bracket, excluding the housing allowance from the income tax calculation can result in significant tax savings.

In order to qualify for the exclusion of the housing allowance from the income tax calculation, three very important conditions must be satisfied:

- 1) The housing allowance was **approved BEFORE it was paid**,
- 2) The minister actually spent the allowance on **eligible housing expenses** during the year,
- 3) Only an amount up to the fair rental value of the housing plus utilities can be excluded from income.

The church needs to play an active role in satisfying the first condition. The church should make sure the housing allowance amount is determined before it is paid (e.g. at the beginning of the employment period). There is absolutely no provision in the tax code for a retro-active housing allowance designation. It is highly recommended that the housing allowance be properly documented in the church records (e.g. annual budget, minutes, or employment contract). Frequently the housing allowance is reviewed and adjusted at the beginning of each new budget year.

The church does not have any role in satisfying the second or third conditions. The responsibility for tracking actual housing expenses and determining fair rental value of the housing rests solely upon the minister. The fair rental value of the housing can be obtained by examining comparable rent houses in the same geographical area, then adding their utility costs to that amount.

### Example #1:

Pastor Pete is called to a new church on January 1. His total compensation package for the year is \$40,000. Pastor Pete intends on continuing to live in the same house that he has lived in for several years. Pastor Pete's mortgage payment is \$1,000 per month and his other housing expenses (including utilities, insurance, property taxes, and house maintenance) average \$500 per month. Based on an average of \$1,500 per month, Pastor Pete expects to spend \$18,000 this year on housing. Therefore, Pastor Pete could request that \$18,000 of his compensation package be designated as housing allowance. Assuming the designation is made before it is paid and that he spent the entire amount on housing costs, Pastor Pete will be able to exclude the \$18,000 from his calculation of income taxes. Pastor Pete's housing allowance will still be included in his calculation of self-employment tax.

	Taxable Income for Income Tax Calculation	Taxable Income for Self-Employment Tax Calculation
Base salary	\$22,000	\$22,000
Housing allowance	none	\$18,000
Total	\$22,000	\$40,000

### Example #2:

Pastor Pete is called to a new church on January 1. His total compensation package for the year is \$40,000. Pastor Pete intends on continuing to live in the same house that he has lived in for several years. In addition to the normal \$18,000 per year of housing expenses, Pastor Pete is going to spend \$10,000 this year on a new swimming pool for his house. However, Pastor Pete concludes that the fair rental value of his house is only \$24,000 per year (\$500 utilities plus house valued at \$1,500 a month x 12.) So, even though Pastor Pete is going to spend \$28,000 on housing this year, he can only exclude \$24,000 due to the fair rental value limitation.

### **Can non-minister employees receive a housing allowance?**

No. In order to receive the special tax treatment of a ministerial housing allowance, the worker must meet the IRS's 5-test definition of a minister as outlined earlier.

### **What types of expenses are included in the housing allowance?**

The housing allowance is used to pay for the cost of providing housing for the minister. Housing costs include:

- Mortgage payments/rent
- Utilities
- Insurance
- Property taxes
- Repairs & maintenance
- Furnishing and appliances
- Landscaping/lawn maintenance
- Security service
- Decorations (e.g. curtains, blinds)
- Telephone service (base charge)

### **Do ministers receive a “double deduction” for mortgage interest and property taxes?**

If a minister is eligible for the housing allowance, the amount of the allowance is excluded from income as described above. In addition, if a minister incurs mortgage interest and property taxes on this personal residence, the minister can deduct those as itemized deductions on Schedule A. So, in a sense, the minister is receiving a double benefit from the interest and taxes.

### **What are the tax implications of a church provided parsonage?**

If a minister lives in the church provided parsonage, the minister is not subject to income tax on the use of the parsonage. However, the fair rental value of the parsonage is included in the calculation of self-employment taxes.

Unless the church directly pays for all of the housing expenses, every minister should receive a housing allowance. If the minister lives in a church provided parsonage, the housing allowance can be used to pay for the expenses the church does not pay (utilities, contents insurance, furnishings, etc.). If the church provides the parsonage and pays for all associated expenses including utilities, maintenance, telephone and furnishings, there may not be a need for a housing allowance since the minister is not paying for any of these expenses from his own funds.

Assume the same facts as in the first example, except that Pastor Pete is going to move into the church parsonage. Even though Pastor Pete will be living in the church parsonage, he will be responsible for utilities and the maintenance of the house. He estimates the utilities and maintenance of the house will be \$4,800 for the year. Therefore, Pastor Pete could request that \$4,800 of his compensation package be designated as housing allowance. Assuming the two housing allowance conditions are met, Pastor Pete will be able to exclude the \$4,800 housing allowance and the fair rental value of the parsonage from his calculation of taxable income.

	Taxable Income for Income Tax Calculation	Taxable Income for Self- Employment Tax Calculation
Base salary	\$35,200	\$35,200
Housing allowance	none	\$4,800
Fair rental value of parsonage	none	\$12,000
<b>Total</b>	<b>\$35,200</b>	<b>\$52,000</b>

### **Who determines the fair rental value of a church provided parsonage?**

If a minister lives in church-provided housing, the minister will be responsible for determining the fair rental value of the parsonage. This value is included in the minister's calculation of self-employment tax. It is not the church's responsibility to determine the fair rental value. The fair rental value can probably be obtained by analyzing other rental property in the neighborhood. Or the minister may choose to obtain an appraisal from a real estate professional or a certified appraiser who is familiar with the neighborhood.

### **What if the minister does not spend all of the allowance on housing?**

In most employer/employee relationships, the employer is responsible for ensuring that actual expenses are documented before excluding an amount from an employee's wages. However, the housing allowance is an exception to this general rule. The church does not have any responsibility for ensuring that the minister spent the entire housing allowance on housing expenses. Instead, it is the minister's responsibility to report any excess housing allowance as taxable income. So if in the first example above, Pastor Pete only spent \$17,000 on actual housing expenses, he should voluntarily include the extra \$1,000 in his calculation of taxable income. The church would never know, and has no right to know, whether or not he reported this extra income appropriately.

### **How does the church report the minister's housing allowance/parsonage to the IRS?**

The church is not required to report the housing allowance for the fair rental value of the parsonage to the employee nor to the IRS. However many churches choose to communicate the amount of the housing allowance as a courtesy to the minister. The church may choose to report the housing allowance in Box 14 of the W-2 (which is labeled "Other"). Or, the church may prefer to simply include the amount of the housing allowance in a separate letter to the minister. This separate letter should not be sent to the IRS and will not be included or attached to the minister's personal tax return. A sample W-2 and a sample housing allowance letter are included on the free stuff page at [http://www.accountingforchurches.com/free\\_stuff.htm](http://www.accountingforchurches.com/free_stuff.htm).

## Clergy Taxes

### What is self-employment tax?

The self-employment tax consists of 12.4%\*\* for Social Security and 2.9% for Medicare (15.3%\*\* combined). Unlike non-minister employees, the church cannot withhold ½ of the Social Security and Medicare tax from a minister employee's paycheck. Instead, a minister employee is responsible for paying his own self-employment tax. As a result, the minister employee actually pays twice as much Social Security and Medicare as a non-minister employee.

In most circumstances, the amount of the minister's income that is subject to the self-employment tax includes the base salary, the housing allowance, and the fair rental value of church provided housing, if any.

In the first example above, Pastor Pete received \$22,000 of base salary and an additional \$18,000 housing allowance. As a result, Pastor Pete's taxable income for self-employment tax purposes is \$40,000. Since the combined Social Security and Medicare tax rate is 15.3%\*\* , Pastor Pete can expect to pay about \$6,120 ( $\$40,000 * 15.3\%$ ) in self-employment tax for the year.

### Can a minister opt out of Social Security?

Yes. The tax code provides ministers with the opportunity to opt out of Social Security for their ministerial income. In order to opt out of Social Security, the minister must file Form 4361 by the due date of his tax return for the second year in which he earned more than \$400 of ministerial income. Furthermore, the minister has to sign the form and state that he is conscientiously opposed, because of religious principles, to any public insurance (e.g. Social Security and Medicare). Ministers should not rush into this election without due thought and prayer. Very few ministers actually have a religious objection to public insurance based upon Biblical principles. Furthermore, Social Security provides disability insurance in addition to retirement benefits.

### Should a minister make quarterly estimated tax payments?

Possibly. Since the church cannot withhold Social Security and Medicare tax from a minister employee's paycheck, the minister is responsible for paying the tax himself. The minister can choose between two payment methods: quarterly estimated tax payments or voluntary extra income tax withholding. The first and most commonly used method is for the minister to make quarterly estimated tax payments using Form 1040 ES. The minister should estimate his combined income and self-employment taxes for the year and divide the total amount by four to obtain the quarterly estimated amount. The calculation and payment are entirely the minister's responsibility. The church is not involved in any way with quarterly estimated tax payments or Form 1040 ES. Because the amount of income tax due to the IRS is a complicated calculation, it is advisable that the minister consult a professional for tax advice.

### Can the church withhold tax for the minister?

Yes. The church can withhold income tax, but not Social Security tax. In order to pay the minister's income and self-employment taxes, the minister may choose to make quarterly estimated tax payments (described above) or he may instruct the church to withhold income tax. For example, if a minister estimates that his combined income and self-employment tax for the year will be \$12,000 he can request that the church withhold \$1,000 of income tax from each month's paycheck. This is true even though the church is not required to automatically calculate income tax withholding from the minister's paycheck. The minister may request voluntary income tax withholding by completing form W-4 and requesting that a specific amount be withheld from each paycheck. For an example of a minister's W-4 with voluntary income tax withholding go to [http://www.accountingforchurches.com/free\\_stuff.htm](http://www.accountingforchurches.com/free_stuff.htm). If a minister employee requests voluntary income tax withholding, the church must honor the request and the withheld tax will be included with the withheld taxes from the church's other non-minister employees.

Even though the minister can only elect withholding of income taxes, he can use these tax payments against both income and self-employment tax since they are added together on his personal income tax return (Form 1040).

**Can the church pay for or reimburse a minister's self-employment tax?**

The church can pay the minister an extra amount to compensate him for the fact that he has to pay all of his own self-employment tax. However, this self-employment tax reimbursement does not receive any special tax treatment. It is considered regular wages/salary and is reportable on the minister's W-2 the same way as his base salary. So, in reality, calling the amount a self-employment tax reimbursement has no effect, and the amount paid is simply part of the minister's base salary. Many churches misunderstand this concept and incorrectly exclude the self-employment reimbursement from taxable salary.

## Employee Business Expenses

### Can the church reimburse employees (including ministers) for their church related expenses?

Yes. But employee expense reimbursements are one of the most misunderstood and misapplied issues for churches. First, **churches need to realize that the rules for employee expense reimbursements are the same for churches as they are for all other businesses. There are not any special rules for churches in relation to employees' business expenses.**

The most significant concept that gives churches the most problems is the fact that employee expense reimbursements are included as taxable income to the employee unless they are paid under an accountable plan. This is true whether the employee is a minister employee or a non-minister employee. An accountable plan means one that the employee provides documentation of the expenses for which they are requesting reimbursement. For example, if the pastor wants to be reimbursed for some office supplies that he purchased on behalf of the church, he would obviously need to turn in the receipt from the office supply store to document the expense. If the pastor turns in the appropriate documentation and the reimbursement does not exceed the documented amount, the reimbursement has been made under an accountable plan and is not considered taxable income to the pastor.

Employee expense reimbursements include, but are not limited to:

- Business convention and travel expenses
- Automobile travel based upon the federal standard mileage rate (\$.575 for 2015)
- Business communication expenses including cell phone, and Internet access to the extent required for business
- Professional dues, subscriptions, and certain books
- Meals and entertainment expenses to the extent they are business related
- Office expenses

The requirements of an accountable plan are onerous. However, the tax savings from being able to receive reimbursements on a tax-free basis are significant and, therefore, employees should be encouraged to be disciplined enough to adhere to the accountable plan requirements.

### Should employees be given an auto allowance?

Probably not. Instead, ministers should be provided with an auto expense budget from which they can be reimbursed for their actual documented mileage. Auto expense reimbursements follow the same rules as all other reimbursed employee business expenses. Unless they are paid under an accountable plan (described above), payments to employees for auto expenses must be treated as taxable income to the employee. If the employee submits a documented mileage log to the church, he may be reimbursed at the federal standard mileage rate (\$.575 per mile for 2015 and \$.54 per mile for 2016) for his business related miles. However, if the church simply pays the employee a set monthly auto allowance and the employee never documents the actual business miles driven, the payments have been made under a non-accountable plan and, therefore, the amount should be included in the employee's wages as taxable income. In this case labeling the amount as an auto allowance provided no benefit since the payments were actually taxed as regular wages. As a result, it is very important that all employees, including the ministers, realize that they must submit documentation in order to be reimbursed for business expenses on a tax-free basis. A sample mileage log is included on the web-site at [http://www.accountingforchurches.com/free\\_stuff.htm](http://www.accountingforchurches.com/free_stuff.htm). If an employee is reimbursed for more miles than are substantiated by the documentation, the excess reimbursement must be included in the employee's taxable wages.

Another issue that surprises many ministers is the fact that commuting is not considered business mileage. Commuting is defined as traveling between home and the employee's regular workplace. If a church pays an employee for travel between the employee's home and the church, the church should include the amount paid as taxable wages.

## What types of employee benefits can the church provide to employees?

Before a church decides which benefits to offer employees, the church must understand whether or not the benefits can be offered on a discriminatory basis. Some benefits must be offered to all employees, while other benefits can be offered to selected employees on a discriminatory basis. Frequently, churches will overlook these rules and offer benefits to a select few employees and not offer the benefit to other employees even though the tax code requires the benefit be offered on a non-discriminatory basis.

One of the most common types of employee benefits is employer provided health insurance. For small employers, employer provided health insurance can currently be provided on a discriminatory basis, meaning that it does not have to be provided for all employees equally. Although the Affordable Care Act prohibits this type of discrimination, this provision of the Act has not yet been implemented. Stay alert for changes on this topic. In order for the health insurance to be paid on a tax-free basis, the church should pay the premium directly to the insurance company. In the past, churches were permitted to pay for or reimburse an employee for their individual (non-group) health insurance premiums. Recent regulations issued by the IRS impose significant penalties if an employer pays for an employee's individual health insurance policy on a pre-tax basis. In light of these recent changes, it appears the church only has two viable options: 1) Provide health insurance for employees using a group (or small group) health insurance plan, or 2) Do not pay for employee's individual health insurance policy. If properly handled, group health insurance premiums may be excluded from the income tax calculation as well as the Social Security and self-employment tax calculations.

Beginning in 2015, if the church has more than 100 full time (equivalent) employees, the church must provide basic health insurance to its employees as a result of changes included in the Affordable Care Act. In 2016, the threshold for the requirement to provide health insurance for employees drops to 50 full time (equivalent) employees.

The most common types of retirement plans established by small churches are 403(b) plans and SIMPLE IRAs plans. Churches can also offer 401(k) and 457 plans. All of these plans can receive pre-tax contributions. Explaining the details of each of these types of plans would fill a small book by itself and is far beyond the scope of this book. Contact a financial advisor or denominationally sponsored 403(b) plan for more details.

Although a church could make contributions to an employee's personal traditional IRA or Roth IRA, the payment must be reported as fully taxable income on the employee's W-2. As an example, if a church paid a minister \$40,000 in wages and contributed \$5,000 to the minister's traditional IRA, the minister's W-2 should reflect \$45,000 of taxable income. Then, depending upon the minister's personal tax situation, he or she may be able to deduct the IRA contribution on his or her personal tax return. If the church desires to provide the minister with pre-tax retirement benefits, the church should consider using a SIMPLE IRA or 403(b).

Another common employee benefit is the educational reimbursement plan. Under this type of plan, payments made directly to the educational institution or accountable plan reimbursements made to the employee may be excluded from the employee's taxable income if the education is required by the church or if the education maintains or improves the employee's skills in his present work. Educational expenses are not excludable if they are needed to meet the minimal educational requirements of the employee's present position or if the education will qualify the employee for a new trade or business.

Some churches provide their ministers with a book or research budget. This means the minister can submit receipts to the church and be reimbursed under an accountable plan for ministry-related books and research material. Technically then, the books belong to the church, and not to the minister. So, when the minister leaves the church, the books would need to stay with the church rather than the minister. However, if a book has no marketable value, the church can give the book to the minister with no tax consequence. Many paperback or time-sensitive books have no substantive marketable value after a short period of time.

In today's mobile society, many ministers are informally expected to remain accessible to the members. Hence, many ministers utilize mobile phones and Internet email. The church can provide these communication services to the minister if they are used exclusively for church business. Even if they are not used exclusively for church business, the minister can reimburse the church for the personal use percentage of the service. For example, if the church pays \$50 per month for the minister's phone and 20% of the airtime is personal, the minister could reimburse the church \$10 ( $\$50 * 20\%$ ). The net \$40 paid by the church is tax free to the minister.

The following types of plans must be in writing and cannot be discriminatory. This means that they cannot be offered to only selected employees and they must be offered to all employees:

- Group term life insurance coverage for their employees up to \$50,000 on a tax-free basis
- Dependent care assistance up to \$5,000 for married taxpayers
- Tax sheltered annuities under Section 403(b)
- Cafeteria plans (flexible spending arrangements)
- Medical expense reimbursement plans

Medical expense reimbursement plans are a popular benefit. Under this type of plan, the church will reimburse the employee for out-of-pocket medical expenses. If this plan is funded from the church's general budget any unused amounts can be carried over to a future year. If, however, the plan is funded by reductions from the employee's salary (under a cafeteria plan) any unused amounts will be forfeited and cannot be carried over.

Each of these final five non-discriminatory benefits has very detailed compliance and reporting requirements. If the church is interested in offering these types of sophisticated benefits, the church should acquire the services of a qualified tax professional and possibly an employee benefits company.

## Clergy Compensation Packages

### How does the church structure the minister's compensation package?

Step #1 Determine the overall package amount. Most churches already have a total package amount in mind when they call a minister. Let's assume \$40,000 in our example.

Step #2 Determine how much of the package will be allocated to "tax free" categories:

1. Business auto reimbursement using the standard mileage rate paid pursuant to an accountable plan (\$3,000),
2. Retirement plan contributions paid directly to a denominationally sponsored qualified pension plan (\$4,000),
3. Health insurance premiums paid directly to the insurance company (\$5,000),
4. Tuition paid directly to the minister's educational institution for courses required by the church or for courses which improve the minister's skill in his present position (\$2,000),
5. Business travel & conference expense reimbursements paid pursuant to an accountable plan (\$1,000),
6. Books & research material reimbursements paid pursuant to an accountable plan (\$300),
7. Communications expenses paid directly by the church to the communication providers (\$900).

Step #3 Determine how much of the package will be allocated to the housing allowance. The minister should estimate a little high rather than estimating a little too low. For example, if the minister expects his actual housing costs to be \$12,000, he should consider setting his housing allowance at \$14,000. Since the housing allowance is not paid under an accountable plan, the minister will receive the full amount of his housing allowance whether or not he actually spends all of it on housing. But, if he doesn't spend all of the allowance on housing, the minister must report the excess amount as if it were additional wages.

Step #4 The balance of the package will be actual salary (wages). Since a minister's wages are subject to income tax and social security tax, the salary component is the least favorable component for tax purposes. As a result, the incentive is to classify the least amount possible in this category.

Sample package calculation for a minister who provides his own housing

Total package	\$40,000
Auto reimbursement	-3,000
Retirement plan	-4,000
Health insurance premiums	-5,000
Seminary tuition	-2,000
Business travel reimbursements	-1,000
Books & research reimbursements	-300
Communications expense	-900
Housing allowance	-14,000
Salary	<u>\$10,800</u>

Sample package calculation for a minister who lives in church provided housing

Total package	\$40,000
Auto reimbursement	-3,000
Retirement plan	-4,000
Health insurance premiums	-5,000
Seminary tuition	-2,000
Business travel reimbursements	-1,000
Books & research reimbursements	-300
Communications expense	-900
Housing allowance	-4,000
Salary	<u>\$20,800</u>

## Payroll Taxes

### Does the church withhold tax from employees' paychecks?

Probably. If a church has any non-minister employees, the church must withhold income tax, Social Security tax, and Medicare tax from the employees' paychecks. Even if the church only has minister employees, the church may still have to withhold income tax if the minister has elected voluntary income tax withholding on his Form W-4. As a result most churches will be required to withhold payroll taxes and remit them to the IRS.

### How is payroll tax withholding computed?

For non-minister employees, the church must withhold the following taxes:

1. Federal income taxes based upon the employee's wages, marital status, and number of exemptions claimed on Form W-4. IRS Publication 15 (also known as Circular E) contains withholding charts that identify how much income tax to withhold from each paycheck.
2. Social Security withholding is 6.2%\*\* of gross wages up to the annual maximum wage limit (\$118,500 for 2015).
3. Medicare withholding is 1.45% of gross wages.

### Example for non-minister employee

Susie is the part-time church secretary. She works 170 hours per month and is paid \$10 per hour. On Susie's W-4, she checked single and indicated 1 exemption. Her monthly paycheck would be calculated as follows:

Gross Pay (170 hours * \$10)	\$1,700.00
Federal income tax withholding from the Circular E chart	-160.00
Social security tax withholding (6.2%)	-105.40
Medicare tax withholding (1.45%)	<u>-24.65</u>
Net paycheck	<u>\$ 1,409.95</u>

### Example for minister employee

Pastor Pete is a minister. He meets the tests to be treated as a minister for tax purposes. Pete's salary is \$10,800 and his housing allowance is \$14,000 (see the allocation of his \$40,000 package in the previous chapter). Although the church cannot withhold Social Security and Medicare from a minister's paycheck and the church is not normally required to withhold income tax from a minister's paycheck, Pastor Pete submitted a signed W-4 to the church indicating that he wanted \$450 withheld from each paycheck. His monthly paycheck would be calculated as follows:

Salary (\$10,800/12)	\$ 900.00
Housing allowance (\$14,000/12)	1,166.66
Federal income tax withholding from W-4	<u>-450.00</u>
Net paycheck	<u>\$ 1,616.66</u>

### Does the church have to match FICA tax?

Yes. The church must match the FICA tax withheld from non-minister employee's paychecks. The amount of the matching is:

Social security	6.2%
Medicare	<u>1.45%</u>
Total matching	7.65%

The following monthly recap is based upon the example in the previous topic. It summarizes the amounts withheld from Susie's and Pastor Pete's paychecks, and computes the amount of matching Social Security and Medicare.

Monthly payroll recap

Employee	Gross Wages	Federal Withholding	Social Security W/H	Medicare W/H
Susie	1,700.00	160.00	105.40	24.65
Pastor Pete	900.00	450.00	0.00	0.00
<b>Total</b>	<b>2,600.00</b>	<b>610.00</b>	<b>105.40</b>	<b>24.65</b>

Federal Withholding	\$610.00
Social Security Withholding	105.40
Medicare Withholding	<u>24.65</u>
Total Withholding	<u>\$740.05</u>

Social Security Matching	105.40
Medicare Matching	<u>24.65</u>
Total Matching	<u>\$ 130.05</u>

Total Payroll Liability for the month \$ 870.10

### How much can an employee make before the church has to withhold taxes?

There is no minimum amount an employee has to make before taxes are withheld. As long as the worker is properly classified as an employee and has not claimed a tax exemption, taxes must be withheld from the employee's check unless they are treated as a minister for tax purposes. For example, if the church employs two college students to work in the nursery for a one-time event and pays them \$100 each, the church should withhold taxes from the students' paychecks unless they can be classified as independent contractors (discussed above).

### How does the church pay its payroll taxes?

The timing and method of paying payroll taxes will depend upon whether the payroll tax liability is determined to be small, medium, or large.

The payroll tax liability is considered small if, for the entire quarter, the total tax liability is less than \$2,500. Most small churches with only one or two employees will fall into this category. If the payroll tax liability is considered small, the church may simply pay its payroll taxes with the quarterly federal Form 941 report. Simply prepare the Form 941 and indicate the amount of tax owed on the bottom of the form. Include a check made payable to the United States Treasury for the amount of tax due.

The payroll tax liability is considered large if for the previous two years the average payroll tax liability is more than \$50,000 per year. For purposes of this test, the previous years start with the month of July and end with the month of June. So, in order to determine the classification of the payroll tax liability for 2015, examine the payroll tax liability for the period July 1, 2012 to June 30, 2014. If the payroll tax liability is considered large, pay the payroll taxes to the IRS using a semi-weekly schedule. Very few small-medium sized churches fall into this category.

If the payroll tax liability is more than \$2,500 per quarter and less than \$50,000 for year, the church falls into the medium category. In this category the church must remit its payroll tax liability to the IRS on a monthly basis. The taxes are due on the 15th day of the following month. For example, payroll taxes withheld in January will be due on February 15.

If the church is in the medium or large category, pay payroll taxes by making a payment via the Electronic Federal Tax Payment System (EFTPS). Payments through EFTPS can be made over an automated telephone system, or via the web site at [www.eftps.gov](http://www.eftps.gov).

**Do churches have to pay state or federal unemployment taxes?**

Churches are exempt from federal unemployment taxes. Many states also grant exemption to churches from state unemployment taxes. Consult the state unemployment tax agency for your particular state to ensure your state grants an exemption to churches.

## Payroll Tax Forms

### What is Form 941?

Form 941 is used to report to the IRS amount of wages, withholding and tax paid during the quarter.

### When does the church file Form 941?

All churches that withhold payroll taxes must submit a Form 941 Employer's Quarterly Report to the IRS according to the following schedule:

<u>Quarter Ended</u>	<u>Report is Due</u>
March 31	April 30
June 30	July 31
September 30	October 31
December 31	January 31

### How is Form 941 prepared?

The first step in preparing an accurate Form 941 is to summarize your payroll information for the entire quarter.

The following quarterly recap is based upon the example in the previous two topics. It summarizes the amounts withheld from Susie's and Pastor Pete's paychecks, and computes the amount of matching Social Security and Medicare.

Quarterly payroll recap

<b>Employee</b>	<b>Gross Wages</b>	<b>Federal Withholding</b>	<b>Social Security W/H</b>	<b>Medicare W/H</b>
Susie	5,100.00	480.00	316.20	73.95
Pastor Pete	2,700.00	1,350.00	0.00	0.00
<b>Total</b>	<b>7,800.00</b>	<b>1,830.00</b>	<b>316.20</b>	<b>73.95</b>

Tax Deposits for the Quarter

Deposit made on 2/15/15 for the month ended 1/31/15	\$ 870.10
Deposit made on 3/15/15 for the month ended 2/28/15	\$ 870.10
Deposit made on 4/15/15 for the month ended 3/31/15	<u>\$ 870.10</u>
Total deposits for the quarter	<u>\$2,610.30</u>

## Line by line instructions for Form 941

Line #1: Enter the number of employees you had that received wages for that quarter.

Line #2: Enter the taxable wages paid to non-minister employees and the true salary paid to minister employees. This does not include the minister's housing allowance or any of the other employee expense reimbursements paid under an accountable plan. However, if employee receives an auto allowance or other amount not paid under an accountable plan, it should be included as taxable wages. (\$7,800)

Line #3: Enter the amount of federal income tax withheld from employee's checks for the quarter. (\$1,830)

Line #4: Check this box only if no wages or compensations were subject to Social Security and Medicare.

Line #5a: Enter the amount of taxable wages paid to non-minister employees. Do not include any amounts paid to minister-employees. (\$5,100)

Line #5a: Column 2: Multiply line 5a by 12.4 %.(  $\$5,100 * 12.4\% = \$632.40$ )

Line #5b: Not applicable to churches.

Line #5c: Enter the amount of taxable wages paid to non-minister employees. Do not include any amounts paid to minister-employees. (\$5,100)

Line #5c: Column 2: Multiply line 5c by 2.9 %.(  $\$5,100 * 2.9\% = \$147.90$ )

Line #5d: Usually, you will not need to use this line.

Line #5e: Total social security and Medicare taxes due. ( $\$632.40 + \$147.90 = \$780.30$ )

Line #5f: Usually, you will not need to use this line.

Line #6: Add lines 3+5e. (\$2610.30)

Line #7: Usually you will not need to use this line. However, if the tax deposits you made for the quarter are just a few cents different than the total liability per the 941, it is probably because of rounding. If it is rounding, you use the "Fraction of Cents" adjustment field (7a) to account for the rounding differences.

Line #8: Usually, you will not need to use this line.

Line #9: Usually, you will not need to use this line.

Line #10: Add lines 6-9. (\$2610.30)

Line #11: Total deposits for the quarter. (\$2,610.30)

Line #12: Balance due, if any not already paid in a prior month.

Line #13: Enter the overpayment, if any. (\$0)

Line #14: Enter whether you are a quarterly, monthly (Enter the amount of payroll tax liability for each month during the quarter. Although this should be the same amount that you paid each month, it may not necessarily be the same if you accidentally paid the wrong amount during a month. This line is asking for what you owed each month, not what you paid each month. (\$870.10, \$870.10, \$870.10) or semimonthly depositor.

Line #15: Mark if your business has closed or you stopped paying wages.

Line #16: Mark if you are a seasonal employer.

Sign the Form 941 and make a copy of it before you mail it to the IRS.

### **What are Forms W-2 & W-3?**

Form W-2 communicates to the IRS, to the Social Security Administration and to the employee the amount of wages and withholding for the year.

Form W-3 is the cover page for all of the W-2's that will be submitted to the Social Security Administration. The W-3 summarizes the total wages and withholding included on all of the W-2's.

All churches that have paid employees must prepare forms W-2 and W-3 each year. The W-2 form consists of at least three copies. Copy A has preprinted red boxes and must be submitted to the Social Security Administration along with the W-3. Copies B and C both have preprinted black boxes and are to be given to the employee. The employee will use Copy B to attach to his personal federal income tax return and Copy C is for his records. The church should also keep a copy of Form W-2 for its records.

**It is imperative that the totals included on the W-3 match the sum of totals on the four quarterly Form 941's.** If they do not match, you will surely hear from the IRS within a few months. Then you will be forced to either correct the 941's or the W-2's so that they do match. It is far better to make sure they match before you submit them than to have to correct them later.

Box #1 on Form W-2 should agree to the sum of Line #2 on all four quarterly Form 941's.

Box #2 on Form W-2 should agree to the sum of Line #3 on all four quarterly Form 941's.

Box #3 on Form W-2 should agree to the sum of Line #5a on all four quarterly Form 941's.

Box #4 on Form W-2 should agree to ½ of the sum of Line #5a-column 2 on all four quarterly Form 941's.

Box #5 on Form W-2 should agree to the sum of Line #5c on all four quarterly Form 941's.

Box #6 on Form W-2 should agree to ½ of the sum of Line #5c-column 2 on all four quarterly Form 941's.

Box #12 on Form W-2 is used to report employee's elective deferrals to a 403(b) retirement plan.

Although you can use "Box 14 Other" on the Form W-2 to record a minister's housing allowance, you are not required to do so.

### **When are Forms W-2 & W-3 due?**

Copy B and Copy C of each employee's W-2 must be postmarked by the end of January.

Copy A of the W-3 and Copy A of all W-2's must be postmarked to the Social Security Administration by the end of February.

Note that the church does not send a copy of the W-2/W-3 directly to the IRS. Instead, the Social Security Administration shares the W-2/W-3 information with the IRS so that the church does not have to send copies to both agencies.

### **What are Forms 1099 & 1096?**

Form 1099 communicates to the IRS and the recipient the amount of money paid to the recipient during the year.

The church must provide a 1099-MISC Form to every independent contractor that you paid more than \$600 in rents, services (including parts and materials), prizes and awards and other income payments. **DO NOT PROVIDE 1099-MISC'S TO CORPORATIONS.** Services include independent contractors who provide a service. Common examples of service oriented independent contractors include: janitorial services, repair persons (air conditioning, plumbing, electrical, etc...), accountants, lawn maintenance services, non-employee sales representatives, and delivery services. For example, you would provide a 1099-MISC to an air conditioning repair person that performed more than \$600 of services per year. You would not provide a 1099-MISC to the business you bought a \$600 piece of equipment from. Services do

not include payments solely for products, materials, or parts. As a result, you would not send a material supplier a 1099 form, unless they also provided services to your business.

Churches need to provide a 1099-MISC form to landlords, revival ministers, supply preachers, guest speakers, repair persons, construction workers, and any other independent contractor who was paid more than \$600 during the year. **Any payments** made to an attorney must be reported on a 1099-Misc.

You should not pay an independent contractor until you have received a completed and signed W-9. You should develop a policy and procedure to make sure the proper documentation is obtained. Use Form W-9 Request for Taxpayer Identification Number and Certification to obtain names, address, and taxpayer identification numbers (SSN or FEIN) from people you will be required to provide 1099's. You should require a W-9 from every payee that provides any service, even if you think they are incorporated. If they are incorporated, there is a place on the W-9 for them to indicate as such.

Next, realize that if you fail to furnish an accurate 1099 to the recipient or the IRS by its due date, you could be subject to a \$250 penalty per occurrence (meaning \$250 for each 1099 form). If you have paid numerous contractors, this can result in a very hefty penalty.

Form 1096 is in effect the cover page for the 1099's that will be submitted to the IRS. The 1096 summarizes the total payments included on all of the 1099's.

#### **When are Forms 1099 & 1096 due?**

The church must furnish Form 1099's to the recipients by the end of January. You must mail Form 1099's and Form 1096 "Annual Summary and Transmittal of U.S. Information Returns" to the IRS by the end of February.

## Tax Exempt Status for Churches

### Do churches need to file for tax-exempt status with the IRS?

Generally, no. As long as it is clear that your organization is a church, the church is automatically exempt from federal income tax without filing the usual application for tax-exempt status.

**CAUTION:** However, if your organization is engaged in activities that the IRS might contend are not church activities, you might consider consulting a qualified tax adviser and/or file an application for tax-exempt status with the IRS. Although activities such as operating a day care or a private school may not automatically disqualify your tax-exempt status, there are dozens of issues to consider and the complexity of those issues are well beyond the scope of this book.

### What is IRC Section 501 (c) (3)?

Internal Revenue Code Section 501 (c) (3) is the portion of the tax code that provides certain entities the ability to receive tax deductible contributions. As a result, it is a very important portion of the tax code. It states that contributions to certain charitable, religious, or educational institutions are tax deductible.

Many church contributors deduct their church contributions on their personal income tax returns. These contributions are only allowable if they are made to an entity which meets the qualifications of 501 (c) (3). The good news is that churches automatically qualify for 501 (c) (3) status. As long as the church is comfortable that it can defend its operation as a bona fide church before the IRS, the church should be able to accept tax deductible contributions. However, read the caution statement in the previous topic.

### Do churches have to file annual income tax returns?

Generally, no. Churches are exempt from filing annual income tax returns. Read the disclaimers and caution statements in the previous two topics if your church is involved in any activities the IRS might not agree are church activities.

### What is a Form 990/990-EZ?

Form 990 (or Form 990-EZ) is the annual tax form filed by most entities that are exempt under IRC Section 501 (c) (3). However, as discussed in the previous topic, churches are automatically exempt from this filing requirement.

### What other types of tax may apply to churches?

Churches need to become informed of the other types of tax that may affect them. The information provided in this topic is general in nature and should be helpful to you. However, each of these topics can vary by state, region, county, city and other taxing jurisdictions. So, if you think any of these may apply to you, you should consult with the taxing agencies in your area.

State income tax - Although most states provide exemption from income tax for churches, the church employees are not exempt from state income tax. So, if your church is located in a state that collects state income tax, the church will probably need to withhold state income tax from employees' paychecks. Likewise the church will be required to remit the withheld taxes to the state and prepare quarterly state payroll reports. State withholding information is included on the bottom of Form W-2 and a copy of the W-2 is usually provided to the state income tax agency. Furthermore, some states require incorporated churches to provide documentation of their church status before granting the church an exemption from state income or franchise tax.

Property tax – Most churches are exempt from property tax on the property they are using to conduct church worship services. However, church owned investment property, rental property, or vacant land may not be exempt from property tax. Consult your local property tax authority for more information.

Sales tax – Most churches are exempt from state sales tax. Typically, the states will allow the church to present a tax exemption certificate to the merchant so that the merchant will not charge the church sales tax. Some states require a tax identification number on the certificate, whereas some states do not. Consult your state's sales tax office for more details.

## Accounting for Contributions

### What are the requirements for contribution receipts?

Because contributions to the church are tax-deductible for many taxpayers, most churches provide their members with annual giving statements. The tax code requires that any deduction for a single contribution of more than \$250 be documented by a written receipt from the church. This means that if a church member were to give \$240 per week to the church they would not be required to obtain a written receipt from the church. Instead the taxpayer can use their canceled check as adequate documentation for their deduction. But if any single contribution exceeded \$250 then the member would need a receipt for that specific contribution. As a practical matter, it is usually just simpler to provide an annual giving statement to each member listing each of his contributions during the year.

In recent years, the IRS has begun to crack down on deductible contributions because of the significant amount of abuse that has taken place. Evidently, many taxpayers were fraudulently deducting their children's private school tuition as a charitable contribution. In response, the IRS now requires specific wording on a charitable contribution receipt. The receipt or annual contribution statement should include the following wording:

"You did not receive any goods or services in connection with these contributions other than intangible religious benefits."

Obviously, you should only include the statement if it is true. If the contributor did receive goods or services in connection with the contribution, the fair market value of those goods or services should be indicated on the contribution receipt.

### What are the requirements for contribution receipts?

A contributor can only deduct a donation by cash or check if the contributor has a receipt or bank record of the contribution. This means that cash contributions of \$250 or less will no longer be deductible unless the contributor has proof of the deduction. The receipt should include the church's name, date of the contribution and the amount of the contribution.

An annual contribution letter as described in the previous topic will satisfy this requirement.

### How are non-cash contributions reported and valued?

Churches should issue written receipts for contributions of non-cash items. Generally, the church is not responsible for establishing the value of the non-cash items and should not include any value on the receipt. Here is an example:

Dear Church Member,

Thank you for your contribution of a solid oak executive desk in good condition. You did not receive any goods or services in connection with this contribution other than intangible religious benefits. If you plan on claiming a tax deduction for this contribution you are responsible for establishing the value of the donated item. If the value of the item exceeds \$500 you will be required to file Form 8283. If the value exceeds \$5,000 you may be required to obtain a certified appraisal. Consult your tax preparer for additional details.

Sincerely,

Church Treasurer  
Dated \_\_\_\_\_

However, a new tax law adopted in 2004 requires extra documentation on the part of the church for contributions of qualified vehicles (including automobiles, boats, and airplanes). The charitable deduction for contribution of a vehicle that is resold by the church is limited to the gross proceeds received by the church upon resale. Since churches sometimes sell vehicles at auctions or in bulk sales where the prices are below Blue Book, donor deductions for gifts of vehicles will be greatly reduced.

The new law also imposes new substantiation requirements for contributions of vehicles for which the claimed value exceeds \$500. A deduction is not allowed unless the taxpayer substantiates the contribution by means of a written acknowledgment by the church stating the name and Social Security number of the donor, the vehicle identification number, and a statement that the vehicle was sold by the church in an arm's length transaction between unrelated parties. It must also show the gross proceeds from the sale and state that the donor's deduction cannot exceed that amount. **The church must provide the acknowledgment to the donor within 30 days of sale of the vehicle.** The church should provide all of this information to the donor using IRS Form 1098-C. The church may order these forms from the IRS by calling 800-TAX-FORM. Different rules apply if the church uses the vehicle rather than selling it or materially improves the vehicle before sale. Penalties apply to churches that knowingly furnish a false or fraudulent acknowledgment.

### **How are gifts to specific individuals reported?**

Generally, gifts by church members to specific church employees or to specific needy individuals are not charitable contributions and should not be included on the contributor's annual contribution statement.

#### **Example #1**

Church member Bob is aware that the pastor needs a new car. Bob purchases the new car and immediately gives the car to the pastor and transfers the title into the pastor's name. Subsequently, Bob asks the church Treasurer to issue him contribution receipt for his generous gift to the pastor. The Treasurer should inform Bob that gifts to individuals are not tax deductible and the treasurer cannot issue a contribution receipt from the church for this gift.

#### **Example #2**

Bob could have donated \$10,000 to the church and required that it be used to purchase a car for the church. If the church decided to accept this restricted contribution, the church would be obligated to use the money to buy a car. The church governing body can then decide whether or not they want to maintain ownership of the car or transfer ownership of the car to the pastor. If they decide to transfer ownership of the car to the pastor, the value of the car must be included as additional compensation and reported as taxable wages on the Employee's W-2. Under this scenario Bob would be eligible for a tax deduction, and the church can issue him a contribution receipt. The key difference between these two scenarios is the fact that Bob contributed the car to the church, not to the individual. Furthermore, the church had the authority to decide how the car would be utilized.

Another scenario related to this topic is when the church takes up a love offering for a minister or a needy individual. If a love offering for a minister is processed through the church's contribution records, and the contributors are going to be able to deduct the contributions, the payment to the minister must be considered taxable income. If on the other hand, the love offering is given directly to the minister, is not processed through the church's contribution records, and the contributors are not going to be able to deduct them, then the love offering is a non-taxable personal gift to the minister by the members. If the love offering is for a needy individual (who does not provide services to the church), the contributors should be able to deduct the contributions; the benevolence assistance to the needy individual is not considered taxable income. One key factor to remember in this scenario is that in both cases the love offering was initiated by the church, not the contributor. It is inappropriate for an individual contributor who wants to make a gift to a specific individual to "run" it through the church in order to obtain his tax deduction. Instead, the church governing body (e.g., pastor, elders, deacons, benevolence committee, etc...) should be initiating and controlling the flow of tax-deductible gifts to needy recipients.

### **Can the church issue a receipt for donated labor?**

No. The IRS does not permit a tax-deduction for donated time or labor. However, the contributor may be eligible to receive a contribution receipt for donated materials and other out-of-pocket expense.

#### **Example**

Plumber Paul is a member of the church. He voluntarily repaired the church's kitchen sink without seeking any payment for his time or materials. He spent \$10 of his own money on materials to fix the sink. The church may issue a Plumber Paul a contribution receipt for the \$10 of materials, but cannot issue a receipt for the donated labor.

### **Can volunteers deduct their church related volunteer expenses?**

Generally, yes. Volunteers can deduct the un-reimbursed expenses they incur performing their volunteer services as long as they are directly connected with and solely attributable to providing the volunteer services. Examples of deductible items include travel & lodging, meals incurred during travel which required an overnight stay away from home, automobile mileage and supplies. Automobile mileage is deductible at the current federal standard mileage rate for charitable travel. For 2015, the standard mileage deduction for charitable driving is \$.14. If the volunteer's expenses exceed \$250, they should receive a letter from the church indicating the type of services they provided to the church. The letter should not include the value of the volunteer's expenses; the burden is upon the volunteer to prove their expenses. The letter only needs to provide substantiation that the services were rendered. This would be beneficial for most Sunday school and VBS teachers. An example of this letter is included on the web-site at [http://accountingforchurches.com/free\\_stuff.htm](http://accountingforchurches.com/free_stuff.htm) .

#### **Example**

Teacher Terri is the Sunday school teacher for the 1<sup>st</sup> grade class. Every Thursday Terri drives to the church and prepares her room and teaching materials for the following Sunday. Terri frequently spends her own money for miscellaneous craft and teaching supplies. Terri can claim her mileage (to and from the church along with trip to the store) and out of pocket supplies expense as a charitable contribution on her personal tax return (assuming she itemizes her deductions.)

#### **Example**

Deacon Dan frequently visits sick members in the hospital as part of his deacon duties. He also attends the state convention for his denomination as a duly appointed delegate from his church. His automobile mileage and other travel expenses directly attributable to his deacon/delegate duties are deductible as charitable contributions.

#### **Example**

Layman Larry is a kind and considerate person. He recently took food to a family whose house had just burned down. Although Larry is an active member of his local church, he was not acting in any official church capacity when he delivered the food to the family. Although Larry's actions are commendable, his expenses **are not deductible** since he was not performing any official church assigned responsibilities.

## Financial Reporting, Audits and Internal Controls

### What type of financial reports should be prepared?

Treasurer's reports should be designed to communicate the following facts:

1. How much money did the church have at the beginning of the period?
2. How many contributions did the church receive during the period?
3. How much money did the church spend during the period?
4. How much money did the church have at the end of the period?
5. Of the money that the church had at the end of the period, how much is allocated to each fund?
6. How much money was spent on each budgeted category this period?
7. How much money has been spent on each budgeted category this year?
8. What is the budgeted amount for each category this year?
9. How much of the budget is remaining for each category?
10. Did the church recognize the net increase or a net decrease for the period?

If your Treasurer's Report can answer these ten questions for the reader, then you have answered the church members' most common questions. Sample Treasurer's Reports are included at [http://www.accountingforchurches.com/free\\_stuff.htm](http://www.accountingforchurches.com/free_stuff.htm) which answers all of these questions.

It is also important that your Treasurer's Report illustrate that your Fund Balances equal your net asset balances. For example, if the total of all of your checking accounts equal \$10,000 and your Treasurer's Report identifies a General Fund balance of \$9,000 and a Building Fund balance of \$2,000, it is apparent that there is a mistake. You can't have \$11,000 of Fund Balances and only \$10,000 of money. You would need to research and correct the mistake.

Typically, a Treasurer's Report will consist of a Balance Sheet and a Budget Comparison Report. The Budget Comparison Report will answer questions 6-9, and the Balance Sheet can answer the rest of the questions. The Balance Sheet lists the church's bank balances and fund balances. The Budget Comparison Report should summarize the current month's income and expenses by category. The Budget Comparison Report should also compare year to date expenses to the annual budget.

Although some small churches report the details of every check to the congregation, I believe this is unnecessary. Summary information presented in concise and easy to read format is probably more meaningful for most purposes rather than an over abundance of details. Nevertheless, I also believe that if a church member has a question about the transactions that comprise a summary figure, the member ought to have access to the detail information upon request.

### What is fund accounting?

If a church has more than one fund, it is important for the church treasurer and financial secretary to understand fund accounting. By using a true "fund accounting" system, the church can have an accurate accounting of several different funds without any direct relationship to specific bank accounts. For example, a church could have an operating checking account which contains both the general fund and youth fund money. Or, a church could have one checking account and one savings account, the combined total of which was comprised of nine different fund balances. So, as you can see, with a fund accounting system a church can account for any number of funds with a limited number of bank accounts. It is very important however that the total assets minus total liabilities equal the total of all fund balances.

To set up a fund accounting system, there must be at least four different types of accounts (assets, fund balance, income, and expense). Here is a very simple example:

<u>Account #</u>	<u>Account Name</u>	<u>Account Type</u>	<u>Related Fund Bal.</u>
10	Checking Account	Asset	N/A
1-000	General Fund	Fund Balance	N/A
1-100	General Fund Income	Income	General Fund

1-200	Minister's Salary	Expense	General Fund
1-210	Office Supplies	Expense	General Fund
1-220	Utilities	Expense	General Fund
2-000	Building Fund	Fund Balance	N/A
2-100	Building Fund Income	Income	Building Fund
2-200	Building Fund Expenses	Expense	Building Fund
3-000	Youth Fund	Fund Balance	N/A
3-100	Youth Fund Income	Income	Youth Fund
3-200	Youth Fund Expenses	Expense	Youth Fund

Most churches will want to keep a more detailed accounting than this simple example. They may have five different accounts for General Fund Income and fifty different accounts for General Fund Expenses. It doesn't matter how many income and expense accounts they have, as long as each income and expense account is related to a Fund Balance account. The fund accounting system will calculate each fund's balance through the activity in each fund's related income and expense accounts.

Here is a simple example of how fund accounting works:

### #1 Beginning Balances

AnyChurch Balance Sheet 1/1/15		AnyChurch Profit & Loss 1/1/15	
Checking Account	<u>\$2</u>	General Fund Income	\$0
Total Assets	\$2	General Fund Expense	<u>\$0</u>
		Net General Fund Increase	\$0
General Fund	\$1		
Building Fund	<u>\$1</u>	Building Fund Income	\$0
Total Fund Balances	\$2	Building Fund Expense	<u>\$0</u>
		Net Building Fund Increase	\$0

### #2 On 1/2/15, the church received and deposited a \$5 undesignated contribution.

AnyChurch Balance Sheet 1/2/15		AnyChurch Profit & Loss 1/1/15 through 1/2/15	
Checking Account	<u>\$7</u>	General Fund Income	\$5
Total Assets	\$7	General Fund Expense	<u>\$0</u>
		Net General Fund Increase	\$5
General Fund	\$6		
Building Fund	<u>\$1</u>	Building Fund Income	\$0
Total Fund Balances	\$7	Building Fund Expense	<u>\$0</u>
		Net Building Fund Increase	\$0

**#3 On 1/3/15, the church spent \$2 from the general fund budget for postage.**

AnyChurch Balance Sheet 1/3/15		AnyChurch Profit & Loss 1/1/15 through 1/3/15	
Checking Account	<u>\$5</u>	General Fund Income	\$5
Total Assets	\$5	General Fund Expense	<u>\$2</u>
		Net General Fund Increase	\$3
General Fund	\$4	Building Fund Income	\$0
Building Fund	<u>\$1</u>	Building Fund Expense	<u>\$0</u>
Total Fund Balances	\$5	Net Building Fund Increase	\$0

**#4 On 1/4/15, the church received and deposited \$3 designated for the building fund.**

AnyChurch Balance Sheet 1/4/15		AnyChurch Profit & Loss 1/1/15 through 1/4/15	
Checking Account	<u>\$8</u>	General Fund Income	\$5
Total Assets	\$8	General Fund Expense	<u>\$2</u>
		Net General Fund Increase	\$3
General Fund	\$4	Building Fund Income	\$3
Building Fund	<u>\$4</u>	Building Fund Expense	<u>\$0</u>
Total Fund Balances	\$8	Net Building Fund Increase	\$3

Another issue that sometimes arises in church fund accounting is a transfer between two funds. Assume that the church transfers \$200 per month from the General Fund to the Building Fund each month. This means that the Building Fund will possess ownership of the \$200 and does not have to repay it to the General Fund. It should also be noted that this type of transfer does not require a physical bank transaction. Using a fund accounting system, fund balance transfers can be made entirely with bookkeeping entries. This is because the balance of any specific bank account does not necessarily have to equal the balance of a Fund.

To record a fund balance transfer with bookkeeping entries, we would need to add a couple of accounts to our sample chart of accounts:

Account #	Account Name	Account Type	Related Fund Bal.
1-998	Transfers to Building Fd	Other Expense	General Fund
2-999	Transfers from General Fd	Other Income	Building Fund

Then the monthly \$200 transfer would be recorded as follows:

Increase #1-998 Transfers to Building Fd by \$200.

Increase #2-999 Transfers from General Fd by \$200.

**Do churches need to record depreciation expense?**

Generally Accepted Accounting Principles (GAAP) requires that assets be depreciated over their remaining useful life. So, if your readers require financial statements in conformity with GAAP, you need to record depreciation. However, very few small to medium size churches insist upon GAAP financials. Instead, most of them find a Cash-basis Treasurer's Report to be more informative.

In a cash-basis Treasurer's Report, you would not show depreciation. However, you would show the principal portion of a note payment as a cash disbursement. So, if you have a mortgage note payable on the church building, you would show payments on the note as a disbursement, and would not show depreciation on the building. Although these figures would not be exactly the same, they do bear a relationship to each other.

The primary purpose of presenting depreciation expense in a financial statement is to help the reader understand how much an asset has deteriorated or used up. For example, assume the church bought a \$30,000 van in 2013. Typically, a vehicle is depreciated over 5 years. Let's further assume that the church prepares financial statements at the end of 2015 to give to a banker. Without booking depreciation, the banker may read the financial statements and conclude that the church owns a van worth \$30,000. This would be incorrect, and illustrates the need to give GAAP financial statements to outside parties. However, if the church members are the readers of your financial statements, they probably know that the van is not worth \$30,000. They can look at it in the church parking lot and see that it has deteriorated some since it was first purchased. Furthermore, most people without an accounting background will not understand the relevance or mechanics of depreciation expense without a significant amount of explanation. Instead, most church members simply want to know how much cash the church has and what the cash receipts and cash disbursements were for last month.

You need to examine the needs and sophistication of your financial statement readers to determine which information is most helpful to them.

### **Does the church need a financial statement audit?**

Before answering that question, the church needs to understand what the purpose of a financial statement audit is. The purpose of a financial statement audit is for a Certified Public Accountant to issue an opinion about whether or not the financial statements being presented are in conformity with Generally Accepted Accounting Principles (GAAP) and are free of material misstatement. The auditor must perform the work using Generally Accepted Auditing Standards (GAAS). The financial statements being presented should include all of the disclosures required by and be in the format prescribed by the Financial Accounting Standards Board (FASB). As you can see, the audited financial statements are affected by a large number of very complex rules. Most laymen in smaller churches are not accustomed to reading financial statements presented in this format. For these reasons, many small churches discover that the auditor's fee is higher than the perceived value of the audited financial statements.

Many laymen are also under the false impression that the audit is designed to determine whether or not any of the church's staff have been cheating or stealing. That is not the case at all. As stated above, the purpose of a financial statement audit is not at all designed to discover fraud. If the auditor discovers fraud during the normal course of an audit, the auditor is required to inform the appropriate authorities. However, it is conceivable that small amounts of fraud could go undetected during the normal course of a financial statement audit because the audit procedures are not designed to specifically uncover fraud.

Some churches are required to provide audited financial statements to their creditors in order to qualify for or maintain credit with the lending institution. In other cases, the lending institution will accept reviewed or compiled financial statements which require less work by the CPA and therefore cost less.

In conclusion, it is an honorable idea for a church to pay for a financial statement audit. The church just needs to have realistic expectations and clearly understand the purpose of the audit. Even if the church does not want to pay for an outside audit, it should have a well designed system of internal controls and be performing some internal audit functions.

### **What types of internal controls does the church need?**

The church should design a system of internal controls to prevent fraud and ensure accurate financial reporting.

Because each church is unique and operates with its own set of unique circumstances, the financial leaders of each church must design the system of internal controls to meet their specific needs.

Here are some basic principles of internal control that should be considered:

1. Controls should protect the church's assets from theft or loss.
2. Dual control of liquid assets is recommended.
3. Independent review of selected accounting functions is essential.
4. Controls not only protect the church's interests, but can also protect the staff members from false allegations.

Each church should specifically identify the assets that need protecting (e.g. cash/check contributions, bank accounts, petty cash, equipment). Then, procedures should be designed to prevent these items from being stolen or lost as well as procedures to quickly detect a problem if it were to occur.

For highly liquid assets such as cash/check contributions, dual control is recommended. This means that two independent (non-related) individuals should account for these monies and document their accounting in ink. Then, after the funds have been deposited into the bank account, another independent individual who has not had any access to the funds should compare the bank validated deposit slip to the initial accounting to ensure that all funds accounted for were actually deposited into the church's bank account. If the person responsible for comparing the deposit slip to the initial accounting has had any access to the funds, the entire control procedure has been rendered useless.

Many churches require dual signatures on each check, signed disbursement requests, purchase orders, or some combination of these measures. All of these are fine measures, but it is equally important that someone review the bank statement to ensure that the items actually clearing the bank account were subjected to the church's required procedures. The person reviewing the bank statement should not have access or authority to disburse funds. Remember, if the person reviewing the bank statement has the access or authority to disburse funds, they are checking up on themselves, which is contrary to the intent of internal controls.

Whenever the church's system of internal controls is weak, not only are the church's resources unnecessarily at risk, but the people who have had access to funds are unnecessarily susceptible to allegations of impropriety. Without good controls, it may appear that an individual has misappropriated funds when either nothing happened, or the dishonest acted was committed by someone else.

If the church's financial leaders are uncomfortable designing their own system of internal controls, the church may consider hiring a CPA who is familiar with auditing to assist with the process as a consultant.

### **What is an internal audit?**

An internal audit consists of selected auditing procedures performed by individuals inside the organization rather than by an outside CPA. Internal audits can be a very cost effective means of improving the church's system of internal controls without the expense of a full scope outside audit.

The purpose of many of the internal audit procedures are to ensure that the church's system of internal controls are operating as intended. The internal auditors (which very well could be volunteers from the church's financial leadership team), should develop an audit program and an audit schedule. The program and schedule should identify which internal control procedures should be tested at the specified interval.

Here are a two example audit program steps:

#1 Internal Control: Disbursements are authorized by department heads and checks are signed by two individuals.

- How often should this internal control be tested? Every July.

- Internal audit procedure to test this control: Randomly select two months of bank statements from the previous twelve months. Make sure that each disbursement clearing the bank during these two months was authorized by the department heads and they were signed by two authorized individuals.

#### #2 Internal Control: Weekly Contribution Count Sheets

- How often should this internal control be tested? Every September.
- Internal audit procedure to test this control: Randomly select six weekly contribution count sheets from the previous twelve months. Make sure that each count sheet was signed in ink by two counters. Make sure that the funds on the count sheet agree to the validated bank deposit slip for that week.

The church may want to consider consulting with a CPA who is familiar with auditing to assist the church in designing the internal audit program and training the internal auditors. Once the audit program has been effectively designed and documented, the church should probably be able to utilize the program for several years with only limited involvement of the outside CPA.

# Selecting Church Accounting Software

## Overview of the process

Choosing the right accounting package for your church is somewhat like choosing a new pair of running shoes. There are lots of different options, features, and vendors but the most important factor of any new shoe is that it must fit. The goal is NOT to find the best software package available on the market. Instead, your goal is to find the best match of a product's features with the specific needs of your church. If you choose an accounting package that does not "fit" your church, the results can become quite uncomfortable.

The process can be divided into four steps:

Assemble a software selection team  
Perform a needs assessment  
Review and evaluate the packages  
Select and implement the system

## Assemble a Software Selection Team

The first step in the process is to assemble a team of individuals who will serve as the software selection committee. Unless you have an experienced church accounting software consultant in your church, it is unlikely that any one individual in your church possesses the necessary skills and experience to effectively handle the process from start to finish by him. The synergy provided by a team can be valuable to this process. It is important to select team members from various backgrounds and abilities who can provide input from several different points of view. The team needs at least one member who can fulfill each of the following roles:

- Chairperson: A wise person who can diplomatically guide a team of individuals with various backgrounds and abilities.
- Clergy representative: Someone who understands what the clergy expect from the software.
- Laymen's representative: Someone who understands what the church expects from the accounting function.
- Accountant/Bookkeeper: The person who will be directly responsible for utilizing the accounting software.
- Computer whiz: Someone who understands the technical side of computers and software and can answer the other team members' technical questions.

Some individuals may be able to fulfill more than one of these roles. Depending upon the size of your church and the complexity of your church's needs, a large church may need more than one individual to fulfill each role.

## Perform a Needs Assessment

The next step is to clearly articulate and document the results of a needs assessment. In addition to identifying the church's needs, each need should be given a priority level. Some needs are critical or mandatory. Other needs may be desirable, but not necessary.

The following questions are designed to assist you in defining your needs:

1. Does the church need a package specifically designed for churches, or will a generic business accounting package suffice?
  - a. Many small churches are satisfied with the capabilities of off-the-shelf business accounting packages that are available at the local office supply store. These packages

are often relatively low cost, bug-free, and easy to use. Furthermore, if your accountant/bookkeeper has experience in business accounting, chances are high that they have worked with one of these packages before. However, the team must give serious consideration to the limitations of these business packages. Most notably, these packages were not designed to do fund accounting and probably do not provide for nicely formatted year-end contribution statements. If the church maintains different "funds" (e.g. General fund, building fund, missions fund), the accounting system needs to be able to provide the bookkeeper with the information necessary to track the balances of these funds. Although many churches have developed creative ways to work-around a business software package's fund accounting limitations, these "work-arounds" are often somewhat complicated.

- b. As a result, I would only recommend that churches consider utilizing a business accounting package if BOTH of the following statements are true:
    - i. The church does not need software designed to track specific fund balances. Either the church has only one fund, or the church maintains one bank account for each fund.
    - ii. The church does not need the software to print year end contribution statements. The church already has another method of tracking individual contributions and printing contribution statements or receipts.
2. What is the church's budget for accounting software?
    - a. Although this may not be the most wise criteria for selecting accounting software, for many churches it may be a reality that budget constraints eliminate some of the more expensive packages from consideration. In any event, the team needs to be informed of the church's budget for the item. Or possibly the church will want to communicate to the team that no budget has been set, because the church doesn't want the budget to be a limiting factor in the software selection process.
  3. Does the software need to track individual members' pledges and/or contributions?
    - a. Most software packages designed for churches include these features. However, some packages offer pledge and/or contribution tracking as an extra module at additional cost. Some packages offer contribution tracking but do not offer pledge tracking.
  4. How easy to use does the program need to be?
    - a. Generally, there is an inverse relationship between a package's flexibility and its ease of use. If a package offers lots of options and lets you customize the way it works, these choices require the user to make more decisions about how to setup and use the software. For experienced bookkeepers, this may be the power they are looking for. However, for inexperienced bookkeepers, it may be better to use a simpler package with fewer options.
  5. How many of the payroll tax processes does the package need to address?
    - a. The payroll tax processes include:
      - i. Calculating withholding from employees' paychecks (including state income tax if applicable)
      - ii. Tracking non-taxable payments such as minister's housing allowance and mileage reimbursements
      - iii. Tracking the payroll tax liabilities
      - iv. Printing information required on quarterly payroll tax reports (especially IRS Form 941)
      - v. Printing year end W-2's

- b. If the Church expects the in-house bookkeeper to be responsible for some or all of these payroll tasks, the software needs to provide the necessary information. If the church out-sources all of these responsibilities to a third-party, the software does not need these capabilities.
6. How much do technical support and program updates cost?
- a. The cost and the quality of technical support are very important considerations. You need to understand:
    - i. How much (if any) technical support is included in the purchase price?
    - ii. What is the on-going cost for technical support and program updates?
    - iii. What are the technical support hours?
    - iv. Is technical support a toll-free call?
    - v. Will you be charged for technical support calls that are a result of program errors?
7. What types of financial reports does the church want?
- a. Because readers of financial reports have different backgrounds and expectations, it is important that the accounting package you choose be able to provide the information that meets your users' needs. Frequently, churches will transfer information from their accounting package to a spreadsheet to format the information in a manner the readers are accustomed to seeing. Although this is widely done, it is prone to human error and it is more preferable to present the readers with financial reports directly from the accounting package itself.
8. What type of format of budget versus actual reports does the church want?
- a. Some churches prefer to compare the year-to-date actual figures to the complete annual budget. Others prefer to compare the year-to-date actual figures to the year-to-date budget. You need to make sure the package you choose can accommodate the church's expectations.
9. What type of additional bells and whistles does the church want?
- a. Many packages offer a variety of more advanced features which are not directly related to accounting. Sometimes these advanced features are built into a comprehensive church management package and sometimes they are sold as separate modules. Examples of these features include:
    - i. Facilities/Asset management and scheduling (vans, meeting rooms, etc...)
    - ii. Tracking attendance and prospects
    - iii. Export selected member information to a word processor for form letters
10. Will the new software package require additional hardware?
- a. You need to calculate the cost of any new hardware required to utilize the new software. For example, some programs allow you to maintain a picture of each member in the database. However, the church would probably need its own digital camera and high quality color printer to fully utilize this feature.

### **Review and Evaluate the Packages**

The next step is to review and evaluate several packages. In addition to the promotional material available from the software makers, most vendors will provide a demo or trial version for little or no cost.

To ensure an objective evaluation of the software, the conclusions reached in the needs assessment should be incorporated into a software evaluation form. As each package is reviewed, each team member should complete the software evaluation form from his own perspective. Then, the results of the individual evaluations should be compiled into an evaluation summary form which should be considered by the entire team.

### **Select and Implement the System**

The final step is to select and implement the new accounting system. The importance of following a well designed implementation strategy should not be overlooked. Often times the implementation of new software will require adjustments to the manual accounting procedures. The team should be able to provide guidance as to the best way to incorporate those adjustments into the church's overall operations.

One of the keys to successfully implementing a new accounting system is provide the necessary time and resources to the project. Try not to schedule the conversion to the new system during the bookkeeper's busiest time of the month/year. Try to minimize interruptions and conflicting duties during the conversion process. Try to ensure the computer hardware is operating correctly before implementing the new system. Consider running the old and the new system simultaneously for a few weeks to ensure the new system achieves the desired results.

FlockBase is a software package designed for small churches. It tracks members, households and contributions. It is not a full accounting system since it does not track expenses or bank balances. But, if a church simply needs to track contributions by member and produce annual giving statements, it is a good option at a reasonable price (\$99). See more details at [www.flockbase.com](http://www.flockbase.com).

We also offer a FlockBase Church Accounting software package through the flockbase.com website that we designed to work with the above stated membership software. It will track all of your bank accounts, payroll and income with expenses. This program also sells for \$99. If you purchase the programs together, you'll receive a discounted price of \$179.

## APPENDIX A: EMPLOYEE VERSUS INDEPENDENT CONTRACTOR TEST

To determine whether or not an employee or independent contract relationship exists, the IRS considers factors which are designed to determine how much control you exercise over the worker. The more control you have over the worker, the more likely the worker is your employee. The less control you have over the worker, the less likely the worker is your employee. Yes answers indicate control whereas no answers indicate a lack of control. The questions are weighted differently based upon the facts and circumstances of your situation. So, you must exercise judgment in making this determination and may want to consult a professional if you have doubts about the proper classification.

- 1 Will you instruct the worker about when, where and how he is to work?
- 2 Will you train the worker?
- 3 Is the worker an integral part of your operations?
- 4 Do you require the worker to render the services personally (instead of being able to use a substitute worker)?
- 5 Will you hire, supervise and pay assistants for the worker?
- 6 Will the worker have a continuing relationship with the business?
- 7 Will you set the worker's hours of work?
- 8 Will the worker work full time for your business?
- 9 Will the worker be required to perform the work on your premises?
- 10 Will you determine the order and sequence of the services to be performed?
- 11 Will you require the worker to submit oral or written reports?
- 12 Will you pay the worker by the hour, week or month or will you provide the worker a guaranteed minimum amount?
- 13 Will you pay for the worker's business and travel expenses?
- 14 Will you furnish the employee with tools and/or materials?
- 15 Will the worker fail to significantly invest in the facilities used in the performance of the worker's services?
- 16 Will the worker be free from real economic loss (e.g., on the payroll instead of operating a business which could realize profit or loss)?
- 17 Will the worker work primarily for you and very little for others?
- 18 Will the worker fail to offer his services to the general public on a regular and consistent basis?
- 19 Can you terminate (fire) the worker because he doesn't obey your instructions?
- 20 Can the worker terminate his relationship with you without any liability?

## APPENDIX B: USING QUICKBOOKS FOR FUND ACCOUNTING

The chapter on Financial Reporting provides an explanation of fund accounting and describes some options you have for accounting software.

If you choose to use QuickBooks, here are some options you will want to consider regarding fund accounting with QuickBooks.

### Option #1: CLASS TRACKING

All versions of QuickBooks come with a help feature called “QuickBooks and Your Industry” or “Using QuickBooks for Your Business.” This section of QuickBooks help is designed to give you specific advice about how to use QuickBooks for your particular industry. Each of them contains a topic for non-profit or tax-exempt. In this help topic, QuickBooks explains that you can use its Class Tracking feature to keep up with your income and expenses by fund. Since QuickBooks comes with its own detailed help document on this topic, I will briefly highlight the important factors and you can read the QuickBooks document for more detailed instructions.

First, turn on Class Tracking in the Edit, Preferences menu option.

Then, setup classes for each fund (e.g... Building Fund, Missions Fund).

When you enter transactions (e.g. checks, invoices, deposits, bills) assign a class to each transaction.

Then you can run a Profit and Loss by Class Report which will detail you income and expenses by fund.

One of the main disadvantages of this approach is that you cannot print a Balance Sheet by Class to find out how much remains in each fund. Instead, the QuickBooks help document provides detailed instructions about how to run a Custom Summary Report which can show you how much you have in each fund as long as you have coded every transaction to a class (fund). Then, to make sure the report is accurate, you have to reconcile it to the overall Balance Sheet. This is a pretty complicated process and is the primary reason I do not recommend this approach.

## Option #2: SETUP FUNDS AS EQUITY ACCOUNTS

This is my preferred method of fund tracking with QuickBooks even though it has some small disadvantages.

1. From the Chart of Accounts, Edit the Retained Earnings Account and change its name to General Fund.
2. Create Equity Accounts for each fund (Building Fund, Missions Fund, and Endowment Fund.)
3. Create sub-accounts for each account created in step 2 above. These sub-accounts should be titled: Income and Expenses.

After completing these three steps, the equity section of your Chart of Accounts should look like this:

Account Name	Account Type
General Fund	Equity
Building Fund	Equity
Income (sub of Building Fund)	Equity
Expenses (sub of Building Fund)	Equity
Missions Fund	Equity
Income (sub of Missions Fund)	Equity
Expenses (sub of Missions Fund)	Equity
Endowment Fund	Equity
Income (sub of Endowment Fund)	Equity
Expenses (sub of Endowment Fund)	Equity

When you are entering a transaction for one of these designated funds, code the transaction to either the income or expense account associated with the designated fund. Do not code any transactions directly to the Fund account. All designated fund transactions should be coded to either the Income or Expenses accounts.

For the General Fund, simply setup a normal set of income and expense accounts in the Chart of Accounts just like you would for a for-profit business. These accounts will be Income and Expense types. Only the designated funds use the Equity Type accounts. This will allow you to setup budgets for the detailed General Fund income and expense accounts. You can run Profit and Loss reports for the General Fund as well as Budget versus Actual reports for the General Fund.

When you print a Balance Sheet, you can see how much is in each fund. To get a summary of the income and expenses for each designated fund for a given time period, you will need to run a Transaction Detail Report filtered for those accounts and for the specified date range. You should memorize the filtered report and name it "Designated Fund Transactions." The Profit and Loss Report, Balance Sheet, and Designated Fund Transactions reports will provide everything you need to generate a Treasurer's Report as illustrated at [http://www.accountingforchurches.com/pdf\\_files/churchfinancialreportexample.pdf](http://www.accountingforchurches.com/pdf_files/churchfinancialreportexample.pdf).

The Pro versions of QuickBooks have the ability to generate form letters in Microsoft Word containing the names and addresses of your customers (contributors). However, it cannot include the list of contributions in these letters. Instead, you would need to run Sales by Customer Detail Report and attach it to the form letter so that your contributors would have a receipt for their individual donations.