Managing The Church’s Financial Resources

How is your church managing its money? Is everything in order? Is the senior pastor unjustly benefiting? What would happen if someone inspected under a microscope what your church is doing?

By [John P. Joseph](http://enrichmentjournal.ag.org/200401/200401_28_financial.cfm#author)

Part 1 was looked at in the previous module. Here is part 2

**Undesignated and designated donations**

An offering envelope will often contain instructions from the contributor on how to use his or her offering. This is called a **designated offering**. As a general rule, undesignated contributions (tithe or cash) are monies available for general expenses of the church (mortgage, payroll, utilities, miscellaneous expenses). However, when a donation is designated by the donor for a specific purpose, it can only be used for its intended purpose. Once accepted and deposited, the church has a fiduciary responsibility to use that money for the stated purpose. Such designated gifts must be for an approved project or program of the church. Furthermore, the church must exercise full administrative and accounting control over the contribution so it is spent in furthering the mission of the church. An example may be a gift to an approved missionary.

It is important for pastors to refrain from checking donation records of their people. It is important to know whether people tithe if they are being considered for leadership. For such occasions, it is appropriate for the pastor to know if this individual tithes. However, to inspect personal giving records on a regular basis for no other reason than personal interest may render the minister biased and frustrated.

**Gifts to church leaders**

It is common for churches to collect an offering for their pastor, especially on minister appreciation day or on the pastors’ anniversary or birthday. But how should such designated money be accounted for in the books? The general rule is this: If the money is collected for the pastor, it must be run through the church’s books as taxable income. It is also included on the pastor’s W-2. Thus, special-occasion gifts to a pastor funded through members’ contributions to the church need to be reported as taxable wages and are subject to self-employment taxes if the pastor has not opted for exemption. The contributor can then receive contribution credit for the gift. If donors are willing to give up their contribution credit, they can write their checks directly to the pastor. These would then be tax-free gifts.

**Noncash gifts**

Contributions of noncash gifts raise issues for the church and the donor. Read Richard Hammar’s Church & Clergy Tax Guide for specifics.

Generally, IRS Form 8283 needs to be filed if the church receives a noncash contribution having a fair market value between $500 and $5,000. However, if the FMV is over $5,000, a qualified appraisal is needed. The donor, not the church, must establish value. Since many church members are not familiar with IRS Form 8283, keep several on hand. When your church receives a substantial gift, write a letter thanking the donor for the gift and enclose IRS Form 8283 for his or her use. Should the church decide to sell a donated asset valued over $5,000 within 2 years of donation, the church must file IRS Form 8282.

**Contribution statements**

All offerings must be physically received or postmarked by midnight December 31. Predating a check to the church will not work, nor will postdating a check. A check can be mailed before December 31 and be received after December 31 and still satisfy IRS guidelines. Simply verify the postmark.

All donations (unrestricted and restricted) must be recorded and a record provided for the donor for income tax purposes. All church donations must be properly substantiated to be tax-deductible. There are two general rules for a church to follow. First, a donor is responsible for obtaining written acknowledgement from the church for any single contribution of $250 or more before the donor can claim it on a tax return. Second, the church is required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.

The church follows these substantiation rules by annually providing a contribution statement. Each person’s contribution statement needs to include all donations by that person.

**MANAGING FINANCES IN THE CHURCH OFFICE**

In smaller churches, taking care of the church financial records is often the responsibility of the church treasurer. But as a church grows—or in a larger church—it becomes necessary to hire a bookkeeper to take care of the church’s financial records. Before hiring a bookkeeper, the pastor and board need to develop a job description that lists qualifications and responsibilities for this position.

Besides keeping track of donations, a church must also manage its payroll. How payroll is managed depends on the classification of your workers (nonministerial employees, ministerial employees, and independent contractors).

**Workplace regulations**

Regardless of whom your church hires, certain Federal, State, and IRS guidelines must be met. Order updated labor law posters, read them carefully, and abide by them. In fact, a church must post these laws in a conspicuous place in the church office. A church can purchase these posters by calling G. Neil at 1-800-999-9111 or visit their Web site at [www.gneil.com](http://www.gneil.com/).

**Employee files**

Once you have hired the right persons, you need to open an employee file. Include the following in each employee’s file:

1. Employment application.

2. Completed criminal background screening form and results.

3. Completed I-9 (verifying the employee is employable).

4. Completed W-4 (employee’s determination of voluntary Federal tax withdrawals).

5. Internal memo listing the starting pay, starting date, and benefits. The employee needs to sign this.

6. Annual evaluations and employer recommendations, including all written and oral employee commendations and warnings.

The employee files should be kept in a locked file cabinet since they contain private information.

**Employee designation and wages**

Once an employee is hired and the employee’s files have been completed, a church then needs to prepare to pay wages. There are two types of individuals who receive wages: employees and independent contractors. It is important for a church to differentiate the status of these individuals. For an employee, the church must match their 7.65 percent FICA. The church does not for an independent contractor. Herein lies the temptation for pastors to list employees as independent contractors. The IRS has criteria for churches to follow. Most church employees are just that—employees.

**Employee payroll taxes: support staff**

After withholding the appropriate taxes from each employee’s wages, the church must pay the IRS its portion of these withholding taxes. IRS Form 941 must be filed quarterly. This document states the total wages and the amount of Federal and Social Security taxes paid. In January each year, the church issues employees their statement of earnings and taxes on IRS Form W-2. This document must be given to each employee on or before February 1.

**Employee payroll taxes: ministerial employees**

Dual-tax status of ministers

The general rule is this: Ministers are self-employed for purposes of Social Security and are employees for purposes of Federal income tax. Although ministers must pay their taxes quarterly, they may elect to pay their taxes through the church as employees. This is a sound choice since it makes proper payment to the IRS easier*.***Suggestion:** Have ministers draft and sign a memorandum stating their desire to pay the IRS directly through the church. This memo needs to contain the minister’s name, date, and amount he wants taken out of his check every pay period.

The church also needs to know if a minister has properly revoked paying Social Security. If a minister has not filed Form 4361 and elected to stay in the Social Security system, then he is responsible to pay the self-employment tax in full. The church may choose to contribute toward a minister’s self-employment taxes. Any such match must be included as income on the minister’s W-2 since it is additional income. To be specific, the church pays toward the self-employment tax rather than the employee share of FICA taxes.

**Housing allowance designations**

Credentialed ministers can exclude from their income for purposes of Federal income tax a certain amount designated for housing allowance. Unless the minister has exempted out of Social Security, this designation is still subject to self-employment tax. The designated amount is limited to the fair rental value of the minister’s home furnished, plus utilities. Allowed expenses include rent or mortgage payments, utilities, furnishings, repairs, insurance, and property taxes. Expenses associated with building additions and general maintenance may also be included. It is important to consult your accountant on the current legal status of this benefit.

Since the minister is allowed this benefit, the governing board of the church must prospectively approve the amount elected. **Suggestion:** To determine the fair rental value of the home, have a Realtor determine its rental value and sign an affidavit to that amount, plus the estimated utilities. The minister must keep all receipts justifying his expenditures. Also, initiating a pastor’s housing allowance is never retroactive. Diligent planning is critical. Every December a resolution approving the pastor’s housing allowance for the coming year needs to be recorded in the board minutes.

**Accountable reimbursement plan**

Church employees will often have personal expenses for which the church needs to reimburse them. Using a personal vehicle for hospital visits is reimbursable. To reimburse an employee, the church board must approve an accountable reimbursement plan. An employee then submits a request for reimbursement, justifying the ministerial basis for the expense. All of these items make up a compensation plan for the minister.

**Guest speakers and taxes**

Many churches have guest speakers who are paid by love offerings or honorariums. How should church books reflect such expenses? Guest speakers are often traveling evangelists, musicians, or convention speakers and are not considered employees. The procedure to pay them is this: Before they perform any services, issue them a W-9. (Do not confuse this with the I-9 for immigration eligibility of employment.) This IRS form is given to nonemployee workers who receive over $600 in compensation. This completed document provides the church with the guest speaker’s name, address, and Federal tax ID number. This information is critical for the church to know where to send the check. It also provides the information needed to complete Form 1099 for the IRS in January of the following year, should it be necessary.

**Unrelated business income tax**

Churches are normally tax-exempt. However, they may not engage in activities that are in direct competition with for-profit companies. When a church engages in income-producing activities unrelated to their tax-exempt purposes, the IRS considers any revenue from such activity as unrelated business income and subject to Unrelated Business Income Tax.

According to the IRS, income from any unrelated business is subject to UBIT if the following three conditions are met:

1. The activity constitutes a trade or business.
2. The trade or business is regularly carried on.
3. The trade or business is not substantially related to the church’s exempt purpose.

A church is subject to this tax even if it uses the money earned from this business to further its charitable purpose. Examples may include sale of advertising in bulletins, magazines, and rental income.

Even if the activity falls under these criteria, the income may not be subject to UBIT if it meets one of the following exceptions:

1. Substantially all the work in operating the trade or business is performed by church volunteers.
2. The activity is conducted by the organization primarily for the convenience of its members.
3. The trade or business involves selling merchandise, substantially all of which was donated.

Capital gains, interest, dividends, and real estate rentals are generally not subject to UBIT unless financed with borrowed money. Be careful anytime the church is considering a moneymaking venture. Your first question should be, "Is this subject to UBIT?"