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JUST THINKING: GIVING

By Dr. Jan Harbuck, PCAI Vice-President

I was thinking today how very important it is for us as Christians to continue to be aware of giving. Paul writes "Remember this - a farmer who plants only a few seeds will get a small crop. But the one who plants generously will get a generous crop." I feel it is so important to give from the heart and give as God has spoken in His Word... not because of pressure because God loves a cheerful giver. Unless we practice generosity (not just in money… in many ways) how can we expect or ask God for more money or meet our every need? I like the saying "God doesn't pour His blessing into pots, but into pipes; not into reservoirs, but into rivers that let it flow out." Just Thinking.... Blessings, Jan ♥

Joy and Love Perfected

By Dr. Daniel O.C., Author/Senior Pastor

Do not faint, even though the way seem long, there is joy in each condition. Happiness depends on happenings but joy depends on Christ. A joy that is shared is a joy made double. *"These things I have spoken to you, that My joy may remain in you, and that your joy may be full. This is My commandment, that you love one another as I have loved you"* (John 15:11-12).

The craving of humanity has not changed with the passage of time. We all seek joy. We always have and will continue to seek joy. Sometimes we resort to various means to find joy. Unbelievers seek joy in drinking parties, cigarette smoking, illegal drugs, pornographic materials, wrong relationships, etc. (1 Peter 4:3-4). All these give temporary joy or no joy at all.

But true joy is in Jesus our Lord. The true joy for all of us is so nearby, we can in fact find it and enjoy its companionship always. ♥

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Top 10 Tax Developments for Churches and Clergy in 2024 (These ten tax developments for churches and clergy included inflation adjustments and the IRS definition of a church.) _*Part 2...Continued from April Issue*

By Richard R. Hammar, Attorney, CPA-Church Law & Tax

9. IRS addresses inurement, intermediate sanctions, and the definition of a church (PLR 202317022)

A private letter ruling (PLR) issued by the IRS in 2023 to a tax-exempt entity claiming to be a church while providing behavioral health services addresses three important topics:

1. Inurement
2. Excess benefit transactions
3. What is a church?

The IRS analysis of these three topics is summarized below.

Inurement

Churches must satisfy several conditions to enjoy the benefits of exemption from federal income taxation. One of these conditions is that none of the net earnings of a church can "inure" to the benefit of an officer or director (or a relative of an officer or director) other than reasonable compensation. The IRS explained this "inurement" requirement in the PLR:

Churches and religious organizations, like all tax-exempt organizations, are prohibited from engaging in activities that result in inurement of the church's or organization's income or assets to insiders (i.e., persons having a personal and private interest in the activities of the organization). Insiders could include the minister, church board members, officers, and in certain circumstances, employees.

Examples of prohibited inurement include the payment of dividends, the payment of unreasonable compensation to insiders, and transferring property to insiders for less than fair market value.

The prohibition against inurement to insiders is absolute; therefore, any amount of inurement is, potentially, grounds for loss of tax-exempt status. In addition . . . the insider involved may be subject to excise taxes. Note that prohibited inurement does not include reasonable payments for services rendered, or payments that further tax-exempt purposes, or payments made for the fair market value of real or personal property.

Excess benefit transactions

Excess benefit transactions are common among churches and expose ministers and possibly church officers and board members to significant penalties under section 4958 of the tax code. Note that these penalties are assessed against the recipient of the excess benefit, not the church.

The PLR shows how much church leaders have ignored this issue, needlessly exposing "disqualified persons" (defined below) to significant penalties.

Let's review the basics. Section 4958 of the tax code imposes an excise tax on a "disqualified person" who engages in an "excess benefit transaction" with a tax-exempt charity. Section 4958(c)(1)(A) defines an excess benefit transaction to mean:

Any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

An applicable tax-exempt organization is defined to include an organization described in tax code section 501(c)(3), including churches and other religious organizations.

Section 4958(a)(1) imposes on each excess benefit transaction an excise tax "equal to 25 percent of the excess benefit" and provides that this tax "shall be paid by any disqualified person . . . with respect to such transaction." If the excess benefit transaction is not corrected in a timely fashion, the disqualified person is liable for a second-tier tax equal to 200 percent of the excess benefit.

One court has noted that Congress enacted section 4958 not to collect revenue, but rather, to "deter insiders of an organization from using their positions of influence to receive unreasonable compensation." Before the enactment of section 4958, "if an organization . . . did not comply with the rules regarding tax exemption, the [government's] only recourse was to revoke the organization's exemption."

Because revocation falls on the organization, rather than the benefited individuals, Congress recognized the need for intermediate sanctions including the 25-percent and 200-percent penalties described above. Intermediate sanctions are intended to "deter malfeasance and incentivize insiders to restore the charity to the status quo" prior to an excess benefit transaction.

Intermediate sanctions only apply to "disqualified persons," which include:

1. Voting members of the governing body, presidents, chief executive officers, chief operating officers, treasurers, and chief financial officers. The category of "treasurers and chief financial officers" includes "any person who, regardless of title, has ultimate responsibility for managing the finances of the organization." A person who serves as treasurer "has this ultimate responsibility unless the person demonstrates otherwise."
2. Family members of disqualified persons, down to the level of great-grandchildren, with respect to a charity.

In the PLR, the IRS concluded that the petitioner was a disqualified person based on both categories. She served as a director and executive officer of the charity and was the spouse of a disqualified person (the president).

The "contemporaneous substantiation" requirement can be satisfied in two ways—by timely reporting or by "other written contemporaneous evidence." Timely reporting occurs if the organization reports a payment to the disqualified person as compensation on a Form W-2 or a Form 990 filed before the IRS commences its examination. Timely reporting also occurs if the disqualified person reports the payment as income on an original or amended Form 1040 filed before the earlier of the date on which the IRS commences its examination or supplies written documentation of a potential excess benefit transaction.

The "contemporaneous substantiation" requirement can also be satisfied by "other written contemporaneous evidence" showing that "the appropriate decision-making body or an officer authorized to approve compensation approved a transfer as compensation for services in accordance with established procedures."

Such evidence includes "an approved written employment contract executed on or before the date of the transfer," other documentation showing that "an authorized body contemporaneously approved the transfer as compensation for services," and contemporaneous written evidence establishing "a reasonable belief by the . . . organization that a benefit was a nontaxable benefit."

In reviewing the case about the tax-exempt entity claiming to be a church while providing behavioral health services, the IRS noted in the PLR:

The organization has been involved in multiple excess benefit transactions with major officers. There have been several incidents where organization funds have been used to purchase property for officers of the organization. The organization has failed to establish that cash and expenses were not used for the benefit of the organization's officers. There are additional incidences of benefits that also flow to the officers' family members.

Penalties (intermediate sanctions). Tax code section 4958(a) imposes a first-tier tax equal to 25 percent of the excess benefit, payable by the disqualified person. Section 4958(b) provides that, if a first-tier tax is imposed "and the excess

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benefit involved in such transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the excess benefit involved." This second-tier tax, like the first-tier tax, is imposed on the disqualified person. The second-tier tax is not discretionary with the IRS but is statutorily mandated.

Such cases are important because they demonstrate the continuing relevance of intermediate sanctions and excess benefit transactions in the life of virtually every church, and the need to take them seriously. They also underscore the need for careful compensation planning and practices.

Further, note that the IRS deems any taxable fringe benefit provided to an officer or director of a tax-exempt charity (including a church), or a relative of such a person, to be an automatic excess benefit that may trigger intermediate sanctions, regardless of the amount of the benefit, unless the benefit was timely reported as taxable income by either the recipient or the employer. This makes it essential for churches to correctly report taxable income paid to staff, since a failure to report taxable benefits as taxable income can lead to the assessment of "automatic" intermediate sanctions against the recipient.

What is a "church"?

In the PLR, the IRS concluded that the charity was not a church. The tax code uses the term church in many contexts, including the following:

- charitable giving limitations,
- various retirement plan rules,
- unrelated business income tax,
- exemption from applying for exemption from federal income taxation,
- unemployment tax exemption,
- exemption from filing annual information returns (Form 990), and
- restrictions on IRS examinations.

Despite numerous references to the term "church," the tax code provides no definition. This is understandable; a definition that is too narrow may interfere with the constitutional guaranty of religious freedom. Meanwhile a definition that is too broad may encourage abuses in the name of religion.

The United States Supreme Court has noted that "the great diversity in church structure and organization among religious groups in this country . . . makes it impossible, as Congress perceived, to lay down a single rule to govern all church-related organizations." *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772 (1981).

In the absence of any meaningful guidance in the tax code and regulations, the courts have developed various approaches to determine whether an organization qualifies as a church.

Several courts have applied a fourteen-criteria standard introduced in 1977 by Jerome Kurtz, then commissioner of the IRS, to determine whether an organization is a church. The Tax Court has applied the fourteen criteria in several cases. They are:

1. A distinct legal existence
2. A recognized creed and form of worship
3. A definite and distinct ecclesiastical government
4. A formal code of doctrine and discipline
5. A distinct religious history
6. A membership not associated with any church or denomination
7. An organization of ordained ministers
8. Ordained ministers selected after completing prescribed studies
9. A literature of its own
10. Established places of worship
11. Regular congregations
12. Regular religious services
13. Sunday schools for religious instruction of the young
14. Schools for the preparation of its ministers.

One court noted:
Due partly to concerns over a mechanical application of rigid criteria to a diverse set of religious organizations, some courts have deemed a few of the criteria within the fourteen-factor IRS test to be of special, or "central" importance. The leading case is *American Guidance*, in which the United States District Court for the District of Columbia articulated the following standard: "While some of the [fourteen criteria applied by the IRS] are relatively minor, others, e.g., the existence of an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance."

A federal appeals court made the following observation regarding the **fourteen criteria:**

We are mindful of [the plaintiff's] claim that the criteria discriminate unfairly against rural, newly formed churches which lack the monetary resources held by other churches. [The plaintiff] is not alone in this position. In large part it is for this reason we have emphasized what we view as the core requirements of the fourteen criteria." *Spiritual Outreach Society v. Commissioner*, 927 F.2d 335 8th Cir. 1991.

The IRS has acknowledged that "no single factor is controlling, although all [fourteen] may not be relevant to a given determination." These criteria have been recognized by a number of courts.
Because of the ambiguity of several of the fourteen factors, any clarifications provided by the IRS or the courts are helpful. The IRS recently did just that. Note that the IRS addressed all but one of the fourteen criteria:

(1) A distinct legal existence.
The IRS concluded that the organization was incorporated and has a legal existence as noted in its articles of incorporation and bylaws. However, "as illustrated by the undocumented cash withdrawals, real estate transactions for personal use, and other benefits flowing to [the president] and her family members, the organization is operated as a private business of a few individuals. The distinct legal existence of the organization exists in paper only, but not in operation.''

(2) A recognized creed and form of worship.
The IRS noted that the organization did not provide a written creed or formal code of doctrine. Further, "in response to a question regarding its form of worship, the organization provided minimal information, which showed that its worship services are secondary or incidental to its overall operations."

(3) A definite and distinct ecclesiastical government.
The organization provided the following statement to show this attribute:
The Board of Directors with the Chairman as the head; The Pastor is the Spiritual Director; Assistant Pastors in charge of the following ministries: Welfare, Healing, Counseling, and Director for Administration. . . .

The organization also provided its minutes of a recent meeting, noting that the meeting began with prayers. The minutes discuss various activities, staff and volunteers, financials, projects and business reports, and the associated expenses. The IRS concluded: "While the organization appears to be governed by a government a closer look shows the 'government' of the church was merely incidental to its overall secular operations."

As stated above, the organization failed to document the mentioned activities, financials, projects, and financial reports as it claims all documentation perished in a rain.

The IRS continued:
"Furthermore, as proved [sic] the fact that [a substantial percentage] of the organization's income is from [sic] and the substantial expenses on activities and staff, the government is merely or incidental to its overall operations."

The IRS concluded that the factor "a definite and distinct ecclesiastical government" was not satisfied since the "government" of the church was merely incidental to its overall secular operations.

(4) Formal code of doctrine and discipline.
The organization failed to provide a specific code of doctrine and discipline in the

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everyday behavior of the congregants.

(5) A distinct religious history.
The organization claimed that it is an established, interdenominational ministry that provided welfare services. The organization described aspects of the ministry to elaborate upon its religious history. According to information the organization gave to the IRS, the pastor conducted services with the assistance of workers present during the services, including the choir, ushers, and instrumentalists. The organization also indicated that it did not have "permanent attendees" and did not track attendance. "Welfare" was provided between certain designated hours, and the "planning and operations of the welfare committee is supervised" by a church council.

In response, the IRS noted, "The organization failed to provide any other records or forms of communications showing such worship was recurring outside of the one event that occurred... Based on the facts of this case [religious] services appear to be secondary or incidental to its overall operations."

(6) Membership that is "not associated with any other. . . denomination."
The IRS observed:
The organization's initial response claimed that it had members. The organization's response was later changed. The organization failed to provide records or information to establish [where] to [where] the claimed number of members comes from. The organization failed to provide records or information to establish who its members were, how to contact them, what was their attendance… whether members were unassociated with others, how often they met, or document any other purely religious services.

(7) Organization of ordained ministers.
The organization stated that it has an ordained minister with a license to conduct marriages. Certificates of minister ordination and authority to solemnize marriage were provided to support this statement. However, except for flyers and bulletins, the organization failed to provide any income, expenses, or other records to substantiate that any weddings, baptisms, or other religious ceremonies had ever been conducted by a minister of the organization. On the other hand, the organization's registered records show the minister has… received compensation for his services.

(8) Ordained ministers selected after completing prescribed studies.
The organization stated that it "does not license ministers."

(9) Established places of worship.
The IRS noted:
The organization claimed that it leased an established place of worship. An image shows that the place is a clinic-like building with only one entrance. The place allows only one person to get in or out at a time. Such a place does not appear to allow for large gatherings of people at the same time. The organization's place of worship was at the same location where the organization provided services… The claimed worship, prayer services, and other activities did not appear to take place when an [IRS agent] conducted a drive-by for observation.

(10) Regular congregations.
The IRS noted:
The organization claimed that it had a regular congregation with groups of administrative personnel and volunteers/ workers in the programs. The organization claims that the size of its membership is [the IRS did not disclose this information]. The organization provided no records to substantiate these numbers. No explanation was given on how this group of people share the same place with clients and workers. . . . The organization has not established that its meeting location could accommodate people meeting at the same time. Bank records show only individuals or entities issued checks to the organization as contributions, besides the family. Analysis of available information shows that the organization's workforce, time, and space are used in full or beyond its capacity for operation. The organization failed to establish that its congregation, as claimed by the organization, did not consist of mostly clients receiving behavioral services. Gathering of such congregation did not appear when the [IRS agent] conducted [a] drive-by during its scheduled service.

(11) Regular religious services.
The IRS noted:
The organization claimed [it conducted] "Bible studies and special prayers; and [a] welfare program... open to all." The IRS noted that the organization "has not provided records to establish these activities. As shown by its full range of health services being used for operation, the organization's religious services are incidental. The observation of [an IRS agent] during her drive-by shows that the organization's religious services are not regular."

(12) Sunday schools for the religious instruction of the young.
The IRS noted:
The organization stated that it has no school for the religious instruction of the young. But it... conducted a Day Treatment program for young children that need help in learning and social activities.

(13) Schools for the preparation of its ministers.
The IRS noted:
The organization claimed that it [operated] an educational and religious program. Compared with the organization's expenses for services, the organization's training expenses are secondary or incidental to its overall operations. Based on its determination that the organization was not a church, the IRS revoked its tax-exempt status.

Concerns with the fourteen criteria
As this PLR shows, the fourteen criteria are so restrictive that many, if not most, bona fide churches fail to satisfy several of them.

The problem stems in part from the use of criteria that apply to both local churches and conventions or associations of churches. To illustrate, few local churches would meet criteria #7, #9, and #14, since these ordinarily would pertain only to conventions or associations of churches. In addition, many newer, independent churches fail criteria #1 and #5, and may also fail #2, #3, #4, #6, and #8.
It is therefore possible for a bona fide church to fail as many as ten of the fourteen criteria.

Indeed, the original Christian churches described in the New Testament book of Acts would have failed most of the fourteen criteria. The criteria clearly are vague and inadequate. Some apply exclusively to local churches, while others do not. And the IRS does not indicate how many criteria an organization must meet in order to be classified as a church, or if some criteria are more important than others.

This vagueness means that their application in any particular case will depend on the discretion of a government agent. This is the very kind of conduct that the courts repeatedly have condemned in other contexts as unconstitutional.

TO BE CONTINUED….