

FREQUENTLY ASKED QUESTIONS

By **NONPROFITS**

ABOUT TAXES

(2016 Revised Edition)



Keller & Owens, LLC

Certified Public Accountants

ANSWERS* TO QUESTIONS FREQUENTLY ASKED ABOUT -

COMPENSATION & BENEFITS

We heard that our pastor is both an employee and an independent contractor for tax purposes. What does this mean?

Most ministers have a “dual tax status”. Most ministers are employees for federal income tax purposes, but are considered self-employed for Social Security purposes. They are not subject to “Social Security” and “Medicare” withholding taxes, but instead pay self-employment tax.

Should we give our pastor/director an allowance for mileage and other expenses they pay personally?

If you give your pastor/director an expense allowance, the amount must be added to his Form W-2. If you reimburse your pastor/director for actual mileage and expenses incurred, and the pastor/director properly accounts for these expenses, the reimbursement should not be added to the Form W-2.

Our church/organization took up a special gift offering for the pastor/leader. How should we treat this?

Generally, these offerings are considered to be a tax deductible charitable contribution to the donor and taxable compensation to the pastor/leader.

How much of the housing allowance can be excluded from income tax?

The amount of housing allowance that can be excluded from taxable income by a minister is the lowest of these factors: (1) reasonable compensation, (2) the amount designated by the employer, (3) actual expenses and (4) the fair rental value of the home including utilities and furnishings.

How is housing allowance designated?

The church/religious organization should designate the payment of a housing allowance to an employee who is a qualified minister who performs qualifying services. The written designation should be included in minutes or resolutions adopted by the governing board prior to the compensation period.

Is the housing allowance subject to any taxes? Does it need to be reported on the W-2 Form?

Housing allowance is generally subject to self-employment tax. Excess designated housing allowance over actual expenses is subject to income tax. Housing allowance is not required to be reported on the Form W-2; however, it may be listed in Box 14.

I've heard that there is a new tax credit for Small Business Health Care Plans. Can my not-for-profit organization or my church qualify for this tax credit?

Your not-for-profit organization (as well as your church) may qualify. The credit can be as high as 35% of the employer provided premiums. Generally, the credit is only available to organizations who pay for at least 50% of the cost of health insurance and who have not more than 25 full time equivalency employees who earn average annual wages of \$51,800 or less. Beginning in 2014, only health insurance purchased through an exchange is eligible for the credit. There are a number of other complex rules and requirements. If your organization qualifies, the credit is claimed by filing IRS form 990T.

Can our organization give employees discounts at our bookstore or coffee shop?

If the discount given is not more than the gross profit percentage, the employee discount is generally not included in the employee's gross income.

Can our organization set up a fund where spending discretion is controlled by the pastor, executive director, or other specified individual?

The amounts transferred to these types of funds can be considered compensation by the IRS. Contact your tax advisor for advice regarding policies for similar types of funds.

CONTRIBUTIONS

We want to give a thank you gift to our large contributors. How should we note this on our contribution receipt?

The contribution receipt should note the value of the gift that the organization is providing to the contributor. It should also state that the deductible charitable contribution is limited to the excess amount of money contributed by the donor over the value of an item provided by the organization in return.

What kind of acknowledgement should be given to donors of non-cash contributions?

Donors of non-cash gifts should be given a receipt that clearly describes the gift, notes the date of the gift and whether any goods or services were provided to the donor in return for the donation. Donations of vehicles, boats or airplanes require additional disclosures. Valuation of the gift is the responsibility of the donor.

What are the substantiation requirements for a contribution of a vehicle, boat or airplane?

If the value of the contribution exceeds \$500, the donee must prepare Form 1098-C and submit it to the IRS and to the donor. Information that must be provided includes: (1) the date of the donation, (2) make, model and year of the item, (3) donor's name, address and ID number, (4) the date and proceeds from the sale of the item, if sold, and (5) if not sold, information about substantial use by the donee, gift of the item to the needy or material improvements to the item. The donors should receive acknowledgement within 30 days of the contribution, or within 30 days of sale, if vehicle is sold.

We received a contribution designated for a struggling family. How should we treat contributions designated for benevolence?

If contributions to the fund are earmarked by the donor for a particular individual, they are treated, in effect, as being gifts to the designated individual and are not deductible. However, a deduction will be allowable where it is established that a gift is intended by a donor for the use of the organization and not as a gift to an individual. The test in each case is whether the organization has full control of the donated funds, and discretion as to their use, so as to ensure that they will be used to carry out its function and purposes.

Our organization supports several missionaries. Can we accept contributions designated for a particular missionary?

To be considered a tax deductible charitable contribution, the church/charitable organization must maintain full control over the donation and ensure that the contribution is being spent to further the mission of the church/charitable organization.

A donor wants to contribute ownership in their partnership or S Corporation and to real estate to our organization. Should we accept the contribution?

Accepting these types of gifts should be done only after careful consideration of all factors. These types of gifts may have unexpected tax or environmental liability consequences. The organization should have a thoroughly considered policy in place to handle the offer of such gifts when they occur.

We are seeking sponsors for an event. What are the tax consequences, if any?

Qualified sponsorship payments are contributions that do not have tax consequences. Contact your advisor to see if your sponsorship payment is eligible to be classified this way.

An individual wants to make a contribution to the school for the tuition of a relative. Is it deductible?

Any "donation" to a school to pay for tuition is not deductible for tax purposes by the donor.

If our organization receives a credit card authorization in the mail postmarked prior to year end, how to we date the receipt?

There is no mailbox rule connected with credit card donations. Generally, the effective date of the contribution is the date of the credit card charge.

A donor designated their contribution for the building fund. The project was abandoned. Should we return the contribution?

In most cases the donor should be sent a letter asking if he would like his contribution returned to him or retained by the church/organization to be used for some other purpose. If the donor requests a refund, the donor should be advised to consult his tax advisor to address the tax consequences of the refund.

We want to organize a fundraising event like a golf tournament. Is this okay and what records should we keep?

There is generally no problem with a charitable organization holding fundraising events. The organization should account for all event receipts and expenses as well as keep track of the fair market value of goods and/or services received by the event participants. Generally, the excess of the participant's donation over the fair market value of goods and services provided is a deductible charitable contribution for the participant. The fair value portion of the proceeds is event revenue to be measured against the costs of conducting the event. The revised Form 990 requires that the following specific event expenses be tracked for each event: cash prizes, noncash prizes, rent/facility costs, food and beverages, entertainment costs and other expenses.

What are the rules that govern the contribution of cash to a nonprofit?

The Pension Protection Act prescribes some tough new rules for the deduction of cash (currency) to a nonprofit. Beginning in 2007 a taxpayer may not deduct charitable contributions of cash unless it is supported by a bank record or a donee statement that provides evidence of the contribution. Other records will not suffice. For example, a log of the dates and amounts of contributions will not meet the requirements of the Act. Donors will want to avoid contributions of currency in favor of contributions evidenced by a cancelled check or debit memo on a bank statement.

UNRELATED BUSINESS INCOME (UBI)

If we rent out a portion of our building, is the income subject to unrelated business income tax (UBIT)?

If there is no mortgage on your building, the rental income is generally not subject to UBIT. If there is a mortgage associated with the property rented, the rental income is subject to UBIT with some exceptions.

If we receive compensation for a communications tower set up on our property, will we have to pay tax?

If you do not own the communications tower, you will generally not have to pay tax on the income.

Can our nonprofit organization operate a business as long as the profits are used for our exempt purpose?

If your organization operates a business separate from performing its exempt purpose, the income is subject to UBIT regardless of how the organization uses the proceeds.

Should we sell advertisements to help finance our monthly magazine/newsletter?

Advertising income is generally subject to unrelated business income tax. Among other exceptions to the rule, if the solicitation of advertisements is done by volunteers, unrelated business income tax can usually be avoided.

Should we solicit contributions to help finance our annual directory?

Contributions designated for the annual directory would not present a problem, unless the contributor wanted advertisement in the directory. Advertisement income related to an annual directory may not be unrelated business income, depending on the time spent on gathering advertisements.

A donor wants to contribute ownership in their partnership or S corporation to our organization. Are there any UBIT considerations?

The income generated from ownership in one of these entities is generally subject to UBIT. If you own only a minority interest, it is possible to have income allocated to your organization and yet receive no cash distribution to pay the tax.

We are considering entering into affinity agreements with some for-profit vendors including links on our website. Is this a problem?

The tax consequences of these types of agreements are determined by the facts of each situation. But beware! Contact your tax advisor before proceeding.

If we have unrelated business income, will we lose our exempt status?

As long as the unrelated business income portion of your organization is insubstantial in relation to the rest of the organization's activities, the unrelated business income will not cause your organization to lose its exempt status.

It is also possible for a tax exempt organization to own a for-profit enterprise in the form of a taxable subsidiary. In this situation the for-profit enterprise files its own separate tax return in lieu of filing a form 990-T.

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EXEMPT STATUS

We are a church. Don't we need to file for tax-exempt status from the IRS so members' contributions are tax deductible?

Unlike other charities, churches are not required to apply and receive IRS recognition of tax-exempt status – assuming the church satisfies the conditions specified in section 501(c)(3) of the tax code.

We have been reading about some organizations that have lost their tax-exempt status. How can we be sure that we are not at risk?

Generally, if the organization operates within the conditions specified in section 501(c)(3) of the tax code, including rules related to private inurement, lobbying, political activity, etc., there is minimal risk.

What is private inurement, and how can we avoid it?

Private inurement occurs when a person related to the church/organization (i.e., one who has substantial direct or indirect influence) receives financial benefit by being related to the organization. To avoid private inurement, make sure all transactions involving related parties are conducted at arm's length. Related parties should not receive more than fair market value for any goods or services they provide to the church/organization.

The organization has loaned money at an interest rate that is below market to a key employee. Is that a problem?

The key employee is benefiting financially from his or her relationship with the organization. This transaction is considered private inurement and should be avoided.

We oppose some legislation being introduced. Can we urge people to vote against it?

Churches and charitable organizations can attempt to influence legislation as long as it does not make up a substantial portion of the church's/organization's activities. Churches and charitable organizations are prohibited from participation in political campaigns on the behalf of any candidate.

We are confused about what a church can do to support a political candidate who supports its views.

Churches and other tax-exempt organizations are prohibited from participating or intervening, directly or indirectly, in any political campaign on behalf or in opposition to any candidate for political office. Even activities that encourage people to vote for or against a particular candidate on the basis of nonpartisan criteria are prohibited. However, there are ways the organization can impartially participate; many of these activities are described in the [IRS Tax Guide for Churches](http://www.kellerowens.com) found at www.kellerowens.com.

FORM 990 DISCLOSURES

Is there a problem with our organization doing business with one of our directors?

Related party transactions must be disclosed on the Form 990, and should be made at arm's length. No related party should benefit personally from charges above fair market value.

Our executive director has loaned our organization some money. What disclosures are necessary in the Form 990?

The organization must disclose the details of any related party transaction in the Form 990. Proper disclosures for a loan would include the amount of the loan, the date the loan was made and the loan interest rate.

Our organization is receiving a very large donation this year from one contributor. How will this affect our public support percentage?

This can be a problem for organizations that are required to file Form 990. Sometimes large donations can be classified as unusual grants and not impact the public support percentage.

Are we required to provide copies of our Form 990, Form 990-T and Form 1023 (application for exempt status) to anyone who requests a copy, or is this private information?

If anyone requests a copy of your Form 990, Form 990-T or Form 1023, you are required to provide them with a public inspection copy. This copy should not include private information such as individual donor information. Some organizations post their Form 990 and Form 1023 on their web site.

Nonprofit organizations that have annual gross receipts of less than \$50,000 are not normally required to file the annual Form 990 with the IRS. Do they have any other reporting requirements?

Yes. The Pension Protection Act now requires these tax exempt organizations to provide certain information on an annual basis. This information includes the name, address, taxpayer identification number, Website address, name of principal officer, and evidence of the basis of their exemption. These small tax-exempts provide this information over the internet in the form of an “e postcard” which is labeled as IRS Form 990-N. If an exempt organization fails to provide such information for three consecutive years, they will lose their exempt status. This requirement became effective in 2008.

I hear that the Form 990 has been substantially revised. What is the nature of these revisions and are there any exceptions to filing this complex return?

The Form 990 is very complex. The Form contains 12 core pages and 16 schedules. For certain tax exempts, Form 990EZ may be filed. Only organizations with annual gross receipts of less than \$200,000 AND total assets of less than \$500,000 will be permitted to file the Form 990-EZ.

How do we know which portions of the new Form 990 or which schedules we must complete?

Each organization that files the 990 must complete all portions of the core form (Parts I through XI), and provide certain narrative responses on Schedule O. By completing Part IV, Checklist of Required Schedules, the organization will be able to determine which additional schedules, if any, it must file.

May those organizations that are members of a group that has a group ruling continue to file as part of a group return?

Yes. The present filing eligibility requirements for group returns have not changed. Appendix E (core form instructions), Group Returns - Reporting on Behalf of the Group, explains how group return filers should complete the form and schedules.

Will the new Form 990 satisfy our state reporting requirements?

State reporting requirements are determined by the individual states, many of which require certain tax-exempt organizations to file a Form 990 or Form 990-EZ. Check with your respective states to determine their filing requirements. Appendix I (core form instructions), Use of Form 990 or 990-EZ to Satisfy State Reporting Requirements, addresses various differences between IRS and state filing requirements.

How do you report payments to investment advisors on the Form 990?

Payments to investment advisors are reported as investment management fees on Line 11f of part IX of the return.

Do all members of the Board need to approve the Form 990 or can just a committee of the Board do it?

The entire Board does not need to approve the Form 990. A committee of the Board or an individual can be designated by the Board to perform the review. The review process does need to be disclosed on the Form 990.

Do all Board members need to receive a copy of the Form 990 in order to answer "yes" to the question on the form?

The answer is "yes". All Board members must be furnished a copy of the Form 990 prior to filing it. It can be sent to the Board members electronically.

Should the confidential or public inspection copy of the Form 990 be filed with state required filings?

The public inspection copy should be sent with state filings unless the state specifically requests a list of contributors or requests the confidential copy.

If we have a coffee shop or bookstore in our organization, do we have to collect and remit sales tax?

It depends on the laws of the state in which you operate. For example, sales from a coffee shop or bookstore are all taxable in Kansas – regardless of where the facility is located or who the purchaser may be.

In Missouri, sales by an exempt charitable/religious organization are not subject to sales tax if the activities are within the organization's exempt functions or activities. If the organization engages in competitive commercial business that serves the general public, even if the proceeds are used for exempt purposes, then sales tax must be collected and remitted.

Does our church or our religious organization have to pay sales tax on purchases?

In the state of Kansas all purchases of property and services by a religious organization (as defined by Section 501(c)(3) of the Internal Revenue Code) are exempt from sales tax. The religious organization will need to present to the retailer its Religious Organization Exemption Certificate (St-280) in order to avoid the sales tax.

Exempt charitable/religious organizations in the state of Missouri are not required to pay sales tax on purchases. The organization will need to present its exemption letter to the retailer in order to avoid the sales tax. The exemption letter can be obtained by filing Missouri Form 1746.

Church & Clergy Tax Guide

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Church and Nonprofit Tax & Financial Guide

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IRS Publications:

- No. 15 Circular E, Employer's Tax Guide
- No. 15-A Employer's Supplemental Tax Guide
- No. 54 Tax Guide for U.S. Citizens and Resident Aliens Abroad
- No. 517 Social Security and Other Information for
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- No. 598 Tax on Unrelated Business Income of
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- No. 1771 Charitable Contributions - Substantiation and Disclosure
Requirements
- No. 1828 Tax Guide for Churches and Religious Organizations
- No. 1976 Independent Contractor or Employees
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U.S. Master Sales and Use Tax Guide

CCH Incorporated (<http://tax.cchgroup.com>)

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Multistate Guide to Regulation and Taxation of Nonprofits

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WEB SITES

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Keller & Owens, LLC

Accounting, tax & consulting to nonprofit organizations

www.irs.gov

Downloadable forms and publications and answers to frequently asked questions, especially for nonprofits at

www.irs.ustreas.gov/prod/bus_info/eo

www.dor.state.mo.us/tax

Missouri Department of Revenue: Data re: taxes, motor vehicle registration and licensing, downloadable forms and answers to frequently asked questions

www.ksdor.org

Kansas Department of Revenue: Data re: taxes, motor vehicle registration and licensing, downloadable forms and answers to frequently asked questions

By specializing in non-profit organizations, we are in a position to identify key issues and needs for tax-exempt organizations and clergy. We offer the following services, among others:

- Tax exemption application and Form 990, 990-T and 990-PF preparation
- Clergy tax planning and return preparation
- Unrelated business income consulting
- Charitable giving consultation
- Property, sales and use tax consultation

For more information about the services we offer or the experienced professionals serving churches and other nonprofit organizations ask us or visit our website at www.kellerowens.com.

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