

# **PCUSA Mid-Council Financial Conference**

**Charlotte, North Carolina**

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## **Legal Update**

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# Setting the Stage

One way to think about tax law is to view it as a series of general rules qualified by exceptions, and exceptions to those exceptions, and exceptions to those exceptions to those exceptions.

*Continuing Life Communities Thousand Oaks LLC v. Comm'r*, T.C. Memo. 2022-31 (April 6, 2022).

# Setting the Stage

The law helps those who help themselves,  
generally aids the vigilant, but rarely the  
sleeping, and never the acquiescent.

*Hannan v. Dusch*, 154 Va. 356 (Va. 1930)

# TAXES

Let every person be subordinate to the higher authorities, for there is no authority except from God, and those that exist have been established by God. . . . This is why you also pay taxes, for the authorities are ministers of God, devoting themselves to this very thing. Pay to all their dues, taxes to whom taxes are due, toll to whom toll is due, respect to whom respect is due, honor to whom honor is due.

Romans 14:1-7

# U.S. GOVERNMENT'S AUTHORITY TO TAX

The argument that Congress has no constitutional taxing authority over citizens of the states of the United States is a **frivolous one.**

Frivolous positions on tax matters can result in an additional \$25,000 penalty assessment on the taxpayer.

*Harrell v. United States*, 13 F.3d 232, 235 (7th Cir. 1993)

*Gianninis v Commissioner*, T.C. Memo. 2022-65 | June 23, 2022 | Urda, J. | Dkt. No. 20132-19

26 U.S.C. § 6673

# TAX EXEMPTION

Tax exemption is a matter of legislative grace.

## TAX EXEMPTION

- To be exempt as an organization described in section 501(c)(3), an organization must be **both organized and operated** exclusively for one or more of the purposes specified in section 501(c)(3) of the Code.
- If an organization fails to meet either the organizational test or the operational test, the organization is not qualified for tax exemption under section 501(c)(3) of the Code.



## TAX EXEMPTION

In **no case** shall an organization be considered to be organized exclusively for one or more exempt purposes, **if, by the terms of its articles**, the purposes for which such organization is created **are broader** than the purposes specified in section 501(c)(3).

- Purpose Provision
- Dissolution Provision

## TAX EXEMPTION

- “**NO PART** of the net earnings” may inure to the benefit of any control person or insider person.
- **Absolute Prohibition.**
- Any unjust enrichment, whether out of gross or net earnings, may constitute inurement.

## INUREMENT EXPLAINED

The public-benefit requirement highlights the *quid pro quo* nature of tax exemptions: the public is willing to relieve an organization from the burden of taxation in exchange for the public benefit it provides, because for every dollar that a man contributes to these public charities, educational, scientific, or otherwise, the public gets 100%.

Based on the theory that the Government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from other public funds, and by the benefits resulting from the promotion of the general welfare.

*Family Trust of Mass., Inc. v. United States*, 892 F.Supp.2d 149, 155-156 (D.C. Dist. Ct. 2012)

## INUREMENT EXPLAINED

In essence, anything less than “100 percent” would deny the public of at least some tax revenue to which it is entitled, and, therefore, “NO PART OF THE NET EARNINGS . . . which inures to the benefit of any private shareholder or individual” is permitted.

*Family Trust of Mass., Inc. v. United States*, 892 F.Supp.2d 149, 155-156 (D.C. Dist. Ct. 2012)

## **EXAMPLES OF INUREMENT**

- Payment of more than reasonable compensation.
- Payment of excessive rent.
- Receipt of less than FMV in sales or exchanges of property.
- Inadequately secured loans or unfavorable terms.
- Unaccounted for credit card charges and/or expenses paid for or reimbursed by the organization.

**Attempting after the fact to demonstrate that an undocumented transaction is a typical business arrangement is not likely to prevent a finding of inurement.**

## **TAX EXEMPTION – OPERATIONAL TEST**

- An organization will be regarded as operated exclusively for exempt purposes **only if the organization engages primarily** in activities that accomplish exempt purposes of 501(c)(3).
- Organization may meet 501(c)(3) requirements although the organization operates a trade or business as a substantial part of its activities, if
  1. the operation of such trade/business is in furtherance of the organization's exempt purpose or purposes and
  2. the organization is not organized/operated for the primary purpose of carrying on an unrelated trade /business.

## **TAX EXEMPTION – OPERATIONAL TEST**

The presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

# **EMPLOYMENT LAW AND HUMAN RESOURCES CONSIDERATIONS**



# WHAT IS A MINISTER?

## Federal Income Tax

The Code and Regulations provide a series of activities that are considered “**duties of a minister**” for income tax purposes:

1. The performance of sacerdotal functions;
2. The conduct of religious worship;
3. The administration and maintenance of religious organizations and integral agencies; and
4. The performance of teaching and administrative duties at theological seminaries.

# **WHAT IS A MINISTER?**

## **Federal Income Tax**

1. Whether service performed by a minister constitutes the conduct of religious worship or the ministration of sacerdotal functions depends on the tenets and practices of the particular religious body constituting the church or church denomination.
2. Whether services performed by a minister in the control, conduct, and maintenance of a religious organization relate to directing, managing, or promoting its activities.
3. If a minister is performing service in the conduct of religious worship or the ministration of sacerdotal functions, such service is in the exercise of the ministry whether or not it is performed for a religious organization.

# WHAT IS A MINISTER?

## Federal Income Tax

*Wingo v. Commissioner*, 89 T.C. 64 (1987) summarized Treas. Regs. 1.107-1 and 1.402(c)-5 into (basically) five factors:

1. Ministration of sacerdotal functions;
2. Conduct of religious worship;
3. Performing services in the control, conduct and maintenance of organizations within the congregation;
4. Whether the person is “duly ordained, commissioned, or licensed”; and
5. Whether the congregation itself considers the person to be a religious leader or minister (*i.e.*, spiritual official, leader)

# **WHAT IS A MINISTER?**

## **Employment Law**

Factors related to the duties of the employee and the importance of these duties to the church and its religious functions:

1. The level of religious training required for the position.
2. The formal title given by the church to the employee.
3. Whether the employee is required to perform job duties according to the theological beliefs/standards of the church.
4. Whether the employee's job duties reflect a role in conveying the church's message and carrying out its mission.

# WHAT IS A MINISTER?

## Employment Law

Factors continued:

5. Whether the employee selects or creates religious content.
6. Whether the employee is charged with leading others towards maturity in their faith and teaching the Word of God.
7. Whether the church periodically reviews the employee's skills of ministry and ministerial responsibilities.
8. Whether the church provides continuing religious education to the employee, to support their ministry of the gospel.

# EMPLOYMENT-TAX LAW MATTERS

- Generally, employers are subject to “employment taxes” – **FICA** (federal insurance contribution) and **FUTA** (unemployment tax), and **income tax** withholding.
- Employers must make periodic deposits of amounts withheld from employees’ wages and amounts corresponding to the employer’s share of FICA and FUTA tax.
- However, Churches are exempt from FUTA.

# EMPLOYMENT-TAX LAW MATTERS

- Activities usually exempt from state unemployment taxes:
  - Service performed in the employ of a church or related entity principally supported by a church/association of churches.
  - Service performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry.
- Some states require that notice be given to employees re: no unemployment benefits.
- Employment taxes do not apply to independent contractors.
- EE versus Kor status is determined by applying common law concepts, while keeping in mind that doubtful questions should be resolved in favor of a finding of employment.

# EMPLOYEE VS. INDEPENDENT CONTRACTOR

- **High-Level:** Whether the worker so economically depends upon the business to which services are rendered, such that the individual, as a matter of economic reality, is not in business for himself or herself.
- **Behavioral Control:** Does the church control or have the right to control what the worker does and how the worker does his or her job?
- **Financial Control:** Are the business aspects of the worker's job controlled by the church?
- **Relationship:** Are there written contracts or employee type benefits? Will the relationship continue and is the work performed a key aspect of the business?



# EMPLOYEE VS. INDEPENDENT CONTRACTOR

## ➤ State Law Considerations – Common Law Factors Tests or Statute-With-Factors Test (California AB5, for example)

**CA AB5:** Hiring entity must demonstrate all of the following are satisfied:

(A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

(B) The person performs work that is outside the usual course of the hiring entity's business.

(C) The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

# Federal Income Tax Status of Ministers of the Gospel

- Most ministers are treated as employees of the hiring church.
- Ministers who are employees are given Form W-2.
- Expenses reimbursed under a non-accountable plan must be included in compensation on the Form W-2.
- Always treated as self-employed for FICA / Social Security tax purposes. (Self-Employment Contributions Act – SECA – not Federal Insurance Contributions Act – FICA)
- Never deduct FICA tax for an employee who is a minister of the gospel for federal income tax purposes.

## **REASONABLE COMPENSATION**

- The amount that would ordinarily be paid for like services by like organizations in like circumstances.
- Section 162 (trade or business expenses) standards apply in determining reasonableness of compensation, taking into account the aggregate benefits (other than any benefits specifically disregarded) provided to a person and the rate at which any deferred comp accrues.
- That a compensation arrangement is subject to a cap is a relevant factor in determining reasonableness.

## REASONABLE COMPENSATION

Concept of “**reasonable compensation**” has 2 prongs:

- **Amount Test** – focuses on the reasonableness of the total amount paid; and
- **Purpose Test** – examines the services for which the compensation was paid.

Certain non-taxable fringe benefits are excluded, such as reimbursements for reasonable business expenses pursuant to an **accountable reimbursement policy**.

## REIMBURSEMENTS/ALLOWANCES

- An employee may deduct certain business expenses incurred in connection with the performance of services for an employer under a reimbursement or expense allowance arrangement.
- If expenses are reimbursed per an “accountable plan,” then the reimbursed amount is not reported as wages and is exempt from withholding and payment of employment taxes.

**If the arrangement fails to meet the requirements of an accountable plan, amounts paid are included as gross income in the employee’s Form W-2 and are subject to withholding and payment of employment taxes.**

# ACCOUNTABLE PLAN

- No deductions for personal, living, or family expenses.
- Employee must verify the date/time/place/amount/business purpose of expenses.
- Receipts required unless reimbursement is made using per diem rates (per diem rates are only available for certain expenses).
- Allowance/reimbursement policy is considered an **accountable plan** if:
  1. There is a business connection to the expenditure.
  2. Adequate accounting by the recipient within a reasonable period.
  3. Excess reimbursements/advances returned within a reasonable period.

# REASONABLE COMPENSATION

- **Total comp package must be evaluated.**
  - Cash Salary (including any bonus)
  - Church-owned Parsonage – fair rental value, including utilities and housing/furnishings allowance
  - Other parsonage – cash housing allowance provided
  - Value of Fringe Benefits
- **Taxable excess benefit transactions** include transactions where the economic benefit provided directly/indirectly to or for the use of any disqualified person exceeds the value of the consideration given by the disqualified person, including performance of services by the disqualified person.

# EXCESS BENEFIT TRANSACTION

**Excess Benefit:** The amount by which the value of the economic benefit provided by a tax-exempt organization directly or indirectly to or for the use of a “disqualified person” (i.e., a control person or their family) exceeds the value of the consideration, including the performance of services, received by the organization.



# EXCESS BENEFIT TRANSACTION

## Tax Consequences:

- 25% tax on the amount or value of the excess; assessed against disqualified person.
- 200% tax on the excess; assessed against disqualified person – if the 25% tax is not timely paid and transaction not corrected.
- 10% tax (up to \$20,000) assessed against each manager who knowingly or willfully participates.
- Loss of tax-exemption.

# EXCESS BENEFIT TRANSACTION: CORRECTION

Corrected by undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the applicable tax-exempt organization involved in the excess benefit transaction in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

- **Forms of Correction** – Include cash and return of property.
- **Amount of Correction** – Basically the excess amount received by the disqualified person plus interest in order to make the tax-exempt organization whole.
- **Correction of Contract Partially Performed** – Termination of the contract not required in order to correct. “However, the parties may need to modify the terms of any ongoing contract to avoid future excess benefit transactions.”

# **EMPLOYMENT LAW MATTERS**

## **FAIR LABOR STANDARDS ACT**

**(for non-ministers)**

### **Enterprise Coverage or Individual Coverage**

#### **Enterprise Coverage:** employers:

- Employ at least 2 employees engaged in interstate commerce and
- Whose annual gross volume of sales made or business done is not less than \$500,000, or (for this conference's purposes)
- Are engaged in the operation a preschool, elementary or secondary school, or an institution of higher education.

# EMPLOYMENT LAW MATTERS

## FAIR LABOR STANDARDS ACT

(for non-ministers)

**Individual Coverage:** An employee may be protected by the FLSA if the employee's individual work regularly involves interstate commerce, regardless of the amount of sales the employer may transact.

# **EMPLOYMENT LAW MATTERS**

## **FAIR LABOR STANDARDS ACT**

**(for non-ministers)**

- Unless an FLSA-exemption applies:
  - minimum hourly wage (current federal, \$7.25 per hour)
  - overtime wages of at least one and one-half times the employee's regular rate of pay.

**Some states have higher minimum wage requirements, and if so, the employee is entitled to the higher.**

# **EMPLOYMENT LAW MATTERS**

## **FAIR LABOR STANDARDS ACT**

**(for non-ministers)**

### **Exemptions: Employment Duties and Compensation**

- Executive
- Professional
- Administrative

“Teachers,” as defined by law in this context, are exempt from FLSA minimum wage requirements.

\*\*Be careful not to classify custodial, daycare-type employees as teachers if such a classification.

## CHARITABLE CONTRIBUTIONS

When you give alms, do not blow a trumpet before you, as the hypocrites do in the synagogues and in the streets to win the praise of others. Amen, I say to you, they have received their reward. But when you give alms, do not let your left hand know what your right is doing, so that your almsgiving may be secret. And your Father who sees in secret will repay you.

Matthew 6:2-4

## CHARITABLE CONTRIBUTIONS

- Deductible, if taxpayer satisfies substantiation requirements.
- For contribution of \$250+, taxpayer must obtain from the donee a “contemporaneous written acknowledgement”:
  1. The amount of cash and a description (but not value) of any property other than cash contributed;
  2. Whether the donee provided any goods or services in consideration, in whole or in part, for any such property; and
  3. A description and good faith estimate of the value of any such goods or services.



# CHARITABLE CONTRIBUTIONS

- Additional information may be required to support a deduction exceeding \$500 for a contribution of property.
- Qualified appraisal required for contribution of \$5,000+.
- For contribution of a boat, motor vehicle, airplane – donee must provide a written acknowledgment that contains specific information; IRS Form 1098-C.

# PROPERTY TAX MATTERS

- Tax exemption is a matter of legislative grace.
- Must apply for exemption.
- Know who is the contact person for official notices.
- Religious Worship/Purposes; School; Parsonage; Ag; Bees; Other
- Exclusive versus Primary Use
- Governing Documents
- Outside Use Considerations
- Expansion/Construction

## Other State Law Matters

- Registered Agent
- Periodic Reports of Existence
- Current Officers
- Current Directors
- Property Tax Contact – Local Appraisal District

# CONTRACT CONSIDERATIONS

**OFFER + ACCEPTANCE + CONSIDERATION = CONTRACT**

- **Positive Position** – Timing, Needs, Wants, Alternatives
- **Who are those guys?** – Know with whom you transact
- **Services / Deliverables** – Measurable quantities/qualities
- **Term** – Defined, Renewals, Auto-Renewals. Who owns it?
- **Termination** – No-cause exit; For-cause exit; timing
- **Assignment** – Unless stated otherwise, most are assignable

# CONTRACT CONSIDERATIONS

- **Indemnification** – Cost/Liability-Shifting Provisions; Complex, and sometimes not necessary (if not ill-advised)
- **Insurance** – What is required?
- **Force Majeure** – Bear out of hibernation
- **Confidentiality / Non-Disclosure** – personnel, donor, other
- **Intellectual Property** – name, marks, promotion
- **Mitigation** – obligation to reduce damages
- **Law** – What law applies?
- **Venue** – Where may the church be haled into court?
- **Dispute Resolution** – mediation, arbitration; get creative



**MINUTES & MEETINGS MATTER**