

TAXATION

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TAXATION ISSUES INVOLVING CHURCH ENTITIES

1. Tax Exemption

Federal: All church entities (schools and churches) are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code, as specified in the group exemption letter obtained by the General Conference.

State: Churches and schools are exempt from taxation by the State under provisions of the State constitution, as specified in exemption ruling obtained by the local Conference Corporation (Association).

2. Property Tax

Section 214 of the California Revenue and Taxation Code exempts from taxation property used exclusively for religious, hospital, scientific, or charitable purposes. (Similar statutory schemes in other states).

Under this law, tax-exempt organizations are required to pay only that portion of the property tax which covers fire and police protection and other services directly applicable to the use of the property (sewage, etc.).

If the property is not used exclusively for tax-exempt purposes, the County Tax Assessor can withdraw the welfare or church exemption and assess the organization full or partial property tax based on the actual use of the property.

Care needs to be taken in the use of the church property and in allowing others to rent or use the premises. Courts have allowed tax-exempt organizations to rent their property to other tax-exempt organizations without the loss of the property tax exemption, provided the property's use is limited to tax-exempt purposes. The property tax can be substantial if the tax-exemption is withdrawn by the tax assessor.

Examples of Taxable Use:

- a. Nursery or Child Care — owned and operated by individual or for-profit entity.
- b. Store — owned and operated by individual or for-profit entity. Church-owned but items sold are substantially "Commercial" and unrelated to religious purposes.
- c. Gym Exercise Club — unless open to general public and related to religious purpose.
- d. Residential — rented to individuals who are not required to reside on the premises.
- e. Vacant Land or Building — subject to property tax if not used for long periods of time.

* Where there is use by another group or individual, there should be a lease or use agreement showing how the property being leased is to be used.

TAXATION ISSUES INVOLVING CHURCH ENTITIES - *Continued*

3. Sales Tax

Under California law, tax-exempt organizations are also subject to sales tax rules whenever they sell tangible personal property to their members or the public. There is a very narrow exemption from sales tax available to a tax-exempt organization whose activities are tax-exempt and the tangible personal property it sells is made, prepared, assembled, or manufactured by the organization itself and the sale is made to a purchaser (at a low price compared to comparable products sold at other establishments) as a matter of assistance to him. Sales made in order to gain profit are not within the exemption intended by the legislature.

There is definitely a responsibility which rests on the church to collect sales tax for items it sells. Arrangements should be made by the church to obtain a permit from the Board of Equalization for collecting sales tax.

4. **The Tax Reform Act of 1969** (Sections 511-513 of the Internal Revenue Code) and Sections 23731-23734 of the California Revenue and Taxation Code require that a tax-exempt organization pay income tax on profits from unrelated trade or business. Unrelated trade or business includes any trade or business which is not substantially related to (aside from the need for income or funds) the exercise or performance of the organization's exempt purpose.

Some of the factors considered in determining whether an activity is unrelated business are as follows:

- a. The primary purpose of the enterprise is to generate income.
- b. The enterprise is regularly carried on in a continuous manner rather than in an occasional manner.
- c. The enterprise holds itself out as doing business with the public (as opposed to being limited to its members.)
- d. The enterprise is operated in competition with comparable commercially-owned businesses.
- e. The enterprise is not substantially related to the exercise of the unique mission of the organization (charitable, educational, or religious).

Various types of income, such as dividends, interest, annuities, rents from real property, gains from the sale of real property, and income from research, are exempt from income tax even though they appear to be "unrelated."

Anytime a tax-exempt organization engages in and earns income from unrelated trade or business, it is required to file Form 990-T with the Internal Revenue Service and Form 109 with the California Franchise Tax Board, and pay any income taxes due.

TAXATION ISSUES INVOLVING CHURCH ENTITIES – *Continued*

Examples:

- a. Thrift Shop — Sale of donated merchandise — income is exempt.
- b. Parking Lot — Church or school charges to customers of adjacent commercial unit is considered unrelated business income.
- c. Renting of Facilities for non-church activities, church charges for services (cleaning and set-up fee) would be considered unrelated business income if done on a regular basis. Rent for use of facilities is exempt income.
- d. Store — Income from sale of non-religious materials is unrelated business income unless all work is done by volunteers.
- e. Sale of Mailing Lists to outside concerns — proceeds are unrelated business income.
- f. Advertising Income — Income from the sale of ads in a regular publication is unrelated business income. Occasional sale of ads in special programs is exempt.
- g. Day Care — Income from services which are essentially “baby-sitting” (no religious training or education) is unrelated business income.
- h. Debt-Financed Rental Income -- Income from property where debt was incurred when the property was acquired is unrelated business income.

Exemptions:

- a. Eighty-five percent or more of the property is used for exempt purpose.
- b. Ten-year exemption for property acquired as a gift or bequest.
- c. “Neighborhood Land Rule” — property acquired for future exempt use — ten-year period of exemption of rental income. Property must be in vicinity of other being used for exempt purpose.

5. Employment Tax

Churches with one or more employees are subject to Federal and State withholding rules. Depending on the type of services performed, some individuals may work under contract not as an employee but as an independent contractor. Individuals who perform services under the direct control and supervision of the church, not only as to the result to be accomplished by the work but also as to the details and means by which the result is accomplished are classified as employees. Independent contractors are subject to the control or direction of a customer only as to the result to be accomplished by the work and not as to the means and methods of accomplishing the result.

The church is not required to withhold taxes from the compensation paid to independent contractors.

TAXATION ISSUES INVOLVING CHURCH ENTITIES – *Continued*

Examples:

- a. Janitor — Independent contractor if engaged in providing janitorial services to other customers and may delegate task to other individuals.
- b. Gardener — Same as above.
- c. Secretary — employee
- d. Custodian — employee

* Employees required to reside on the premises:

Section 119 of the Internal Revenue Code provides that “There shall be excluded from the gross income of an employee the value of any meals or lodging furnished to him, his spouse, or any of his dependents by or in behalf of his employer for the convenience of the employer, but only if ... (2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

The Internal Revenue Regulations, Section 1.119-1(b), further explains the requirements as follows: “The value of lodging furnished to an employee by the employer shall be excluded from the employee’s gross income if three tests are met:

- a. The lodging is furnished on the business premises of the employer,
- b. The lodging is furnished for the convenience of the employer, and
- c. The employee is required to accept such lodging as a condition of his employment.”

Under these guidelines, it is possible to exclude from gross income the value of rent for living quarters provided by the church to a custodian or caretaker and his immediate family. In order to stay close to the regulations, the church must make certain that the following are adhered to:

- a. The living quarters are located on the church premises. Houses adjacent to the church facilities will be considered on the premises.
- b. There is an employer-employee relationship between the church and the custodian/caretaker. The custodian cannot be an independent contractor in this case. If there is additional consideration besides the lodging provided, such additional pay is subject to withholding rules. The custodian must also be covered by workers’ compensation insurance carried by the church.
- c. The duties of the custodian/caretaker must require that he live on the premises for the convenience of the church. It is recommended that the church board record the duties of the custodian/caretaker in its minutes. Generally, if the custodian/caretaker is not able to perform his duties unless he lives on the church premises, the requirement that he live on the premises is for the convenience of the employer.

TAXATION ISSUES INVOLVING CHURCH ENTITIES – *Continued*

The following duties have been held by the courts to require the custodian/caretaker to live on the premises of the employer:

- a. Be available at all times to open, close, and secure buildings and grounds as needed for meetings and other activities of various church groups authorized to use church facilities, including provision for heat, ventilation, and lights.
- b. Provide security by his presence on the premises at all times in order to prevent vandalism and unauthorized use of the church facilities.
- c. Maintain and keep in good repair his living quarters provided by the church.
- d. Be available at all times to assist in setting up and putting away equipment and furniture for meetings and other activities of authorized groups.

6. **Noncash Charitable Contributions**

Whenever a noncash gift with a fair market value of \$500 or more is made, both the donor and the charity must execute information forms for filing with the Internal Revenue Service.

- a. Form 8283 — Filed by the donor with his tax return. This form must be acknowledged by the charity-donee and certified by a qualified appraiser, when property value exceeds \$5,000.
- b. Form 8282 — Filed by the charity-donee when any donated property is sold within three (3) years of receipt.

7. **Deductibility of Gift**

To be deductible, a charitable contribution must be a gift, a completed transfer of money or property, without consideration, not compelled by any moral or legal duty.

Gift is not deductible if:

- a. Personal attendance fees paid through the church for church-sponsored outings to Pine Springs Ranch.
- b. Specific student scholarship contributions initiated by donor.
- c. Non-board (church or school) solicited “gifts” or pay to pastor or church employee. *Only the church/school boards can solicit and direct recipient specific gifts or grants/scholarships.*
- d. Valid transfer to charity is not completed.
- e. Transfer is made because of moral or legal obligation (not voluntary).
- f. Donor receives or expects to receive financial or economic benefit (See examples below). Receipting responsibility of donee organization in “mixed” donation: The charity must indicate on receipt how much is for payment for goods and services and how much is the gift.

TAXATION ISSUES INVOLVING CHURCH ENTITIES – *Continued*

Examples:

- i. Benefit concerts (tickets vs. donation)
- ii. Dinners
- iii. Rummage or bake sales
- iv. “Tuition-type” payments
- v. Use of church (weddings, etc.)
- vi. Advertising (business expense)
- vii. Field trips or tours.

All transactions/donations of this type need to be recorded by the church or school treasurer or business administrator using a non-charitable contribution code.

Organizations That Qualify To Receive Deductible Contributions

You can deduct your contributions only if you make them to a qualified organization. Most organizations, other than churches and governments, must apply to the IRS to become a qualified organization.

How to check whether an organization can receive deductible charitable contributions. You can ask any organization whether it is a qualified organization, and most will be able to tell you. Or go to [IRS.gov](https://www.irs.gov). Click on “Tools” and then on “Exempt Organizations Select Check” (www.irs.gov/charities). This online tool will enable you to search for qualified organizations. You can also call the IRS to find out if an organization is qualified. Call **1-877-829-5500**. People who are deaf, hard of hearing, or have a speech disability and who have access to TTY/TDD equipment can call **1-800-829-4059**. Deaf or hard of hearing individuals can also contact the IRS through relay services such as the Federal Relay Service at www.gsa.gov/fedrelay.

Types of Qualified Organizations

Generally, only the following types of organizations can be qualified organizations.

1. A community chest, corporation, trust, fund, or foundation organized or created in or under the laws of the United States, any state, the District of Columbia, or any possession of the United States (including Puerto Rico). It must, however, be organized and operated only for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. Certain organizations that foster national or international amateur sports competition also qualify.
2. War veterans' organizations, including posts, auxiliaries, trusts, or foundations, organized in the United States or any of its possessions (including Puerto Rico).
3. Domestic fraternal societies, orders, and associations operating under the lodge system. (Your contribution to this type of organization is deductible only if it is to be used solely for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.)
4. Certain nonprofit cemetery companies or corporations. (Your contribution to this type of organization is not deductible if it can be used for the care of a specific lot or mausoleum crypt.)
5. The United States or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions. (Your contribution to this type of organization is deductible only if it is to be

Table 1. **Examples of Charitable Contributions—A Quick Check**

Use the following lists for a quick check of whether you can deduct a contribution. See the rest of this publication for more information and additional rules and limits that may apply.

Deductible As Charitable Contributions	Not Deductible As Charitable Contributions
<p>Money or property you give to:</p> <ul style="list-style-type: none"> • Churches, synagogues, temples, mosques, and other religious organizations • Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt or maintain a public park) • Nonprofit schools and hospitals • The Salvation Army, American Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts of America, Girl Scouts of America, Boys and Girls Clubs of America, etc. • War veterans' groups <p>Expenses paid for a student living with you, sponsored by a qualified organization</p> <p>Out-of-pocket expenses when you serve a qualified organization as a volunteer</p>	<p>Money or property you give to:</p> <ul style="list-style-type: none"> • Civic leagues, social and sports clubs, labor unions, and chambers of commerce • Foreign organizations (except certain Canadian, Israeli, and Mexican charities) • Groups that are run for personal profit • Groups whose purpose is to lobby for law changes • Homeowners' associations • Individuals • Political groups or candidates for public office <p>Cost of raffle, bingo, or lottery tickets</p> <p>Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups</p> <p>Tuition</p> <p>Value of your time or services</p> <p>Value of blood given to a blood bank</p>

used solely for public purposes.)

Example 1. You contribute cash to your city's police department to be used as a reward for information about a crime. The city police department is a qualified organization, and your contribution is for a public purpose. You can deduct your contribution.

Example 2. You make a voluntary contribution to the social security trust fund, not earmarked for a specific account. Because the trust fund is part of the U.S. Government, you contributed to a qualified organization. You can deduct your contribution.

Examples. The following list gives some examples of qualified organizations.

- Churches, a convention or association of churches, temples, synagogues, mosques, and other religious organizations.
- Most nonprofit charitable organizations such as the American Red Cross and the United Way.
- Most nonprofit educational organizations, including the Boy (and Girl) Scouts of America, colleges, and museums. This also includes nonprofit daycare centers that provide childcare to the general public if substantially all the childcare is provided to enable parents and guardians to be gainfully employed. However, if your contribution is a substitute for tuition or other enrollment fee, it is not deductible as a charitable contribution, as explained later under [Contributions You Cannot Deduct](#).
- Nonprofit hospitals and medical research organizations.
- Utility company emergency energy programs, if the utility company is an agent for

a charitable organization that assists individuals with emergency energy needs.

- Nonprofit volunteer fire companies.
- Nonprofit organizations that develop and maintain public parks and recreation facilities.
- Civil defense organizations.

Canadian charities. You may be able to deduct contributions to certain Canadian charitable organizations covered under an income tax treaty with Canada. To deduct your contribution to a Canadian charity, you generally must have income from sources in Canada. See Publication 597, Information on the United States-Canada Income Tax Treaty, for information on how to figure your deduction.

Mexican charities. Under the U.S.-Mexico income tax treaty, a contribution to a Mexican charitable organization may be deductible, but only if and to the extent the contribution would have been treated as a charitable contribution to a public charity created or organized under U.S. law. To deduct your contribution to a Mexican charity, you must have income from sources in Mexico. The limits described in [Limits on Deductions](#), later, apply and are figured using your income from Mexican sources.

Israeli charities. Under the U.S.-Israel income tax treaty, a contribution to an Israeli charitable organization is deductible if and to the extent the contribution would have been treated as a charitable contribution if the organization had been created or organized under U.S. law. To deduct your contribution to an Israeli charity, you must have income from sources in Israel. The limits described in [Limits on Deductions](#), later, apply. The deduction is also limited to 25% of your adjusted gross income from Israeli sources.

Contributions You Can Deduct

Generally, you can deduct contributions of money or property you make to, or for the use of, a qualified organization. A contribution is “for the use of” a qualified organization when it is held in a legally enforceable trust for the qualified organization or in a similar legal arrangement.

The contributions must be made to a qualified organization and not set aside for use by a specific person.

If you give property to a qualified organization, you generally can deduct the fair market value of the property at the time of the contribution. See [Contributions of Property](#), later.

Your deduction for charitable contributions generally cannot be more than 50% of your adjusted gross income (AGI), but in some cases 20% and 30% limits may apply. See [Limits on Deductions](#), later.

Table 1 in this publication gives examples of contributions you can and cannot deduct.

Contributions From Which You Benefit

If you receive a benefit as a result of making a contribution to a qualified organization, you can deduct only the amount of your contribution that is more than the value of the benefit you receive. Also see [Contributions From Which You Benefit](#) under [Contributions You Cannot Deduct](#), later.

If you pay more than fair market value to a qualified organization for goods or services, the excess may be a charitable contribution. For the excess amount to qualify, you must pay it with the intent to make a charitable contribution.

Example 1. You pay \$65 for a ticket to a dinner-dance at a church. Your entire \$65 payment goes to the church. The ticket to the dinner-dance has a fair market value of \$25. When you buy your ticket, you know its value is less than your payment. To figure the amount of your charitable contribution, subtract the value of the benefit you receive (\$25) from your total payment (\$65). You can deduct \$40 as a charitable contribution to the church.

Example 2. At a fundraising auction conducted by a charity, you pay \$600 for a week's stay at a beach house. The amount you pay is no more than the fair rental value. You have not made a deductible charitable contribution.

Athletic events. If you make a payment to, or for the benefit of, a college or university and, as a result, you receive the right to buy tickets to an athletic event in the athletic stadium of the college or university, you can deduct 80% of the payment as a charitable contribution.

If any part of your payment is for tickets (rather than the right to buy tickets), that part is not deductible. Subtract the price of the tickets from your payment. You can deduct 80% of the remaining amount as a charitable contribution.

Example 1. You pay \$300 a year for membership in an athletic scholarship program

one season ticket for a seat in a designated area of the stadium at the university's home football games. You can deduct \$240 (80% of \$300) as a charitable contribution.

Example 2. The facts are the same as in *Example 1* except your \$300 payment includes the purchase of one season ticket for the stated ticket price of \$120. You must subtract the usual price of a ticket (\$120) from your \$300 payment. The result is \$180. Your deductible charitable contribution is \$144 (80% of \$180).

Charity benefit events. If you pay a qualified organization more than fair market value for the right to attend a charity ball, banquet, show, sporting event, or other benefit event, you can deduct only the amount that is more than the value of the privileges or other benefits you receive.

If there is an established charge for the event, that charge is the value of your benefit. If there is no established charge, the reasonable value of the right to attend the event is the value of your benefit. Whether you use the tickets or other privileges has no effect on the amount you can deduct. However, if you return the ticket to the qualified organization for resale, you can deduct the entire amount you paid for the ticket.



Even if the ticket or other evidence of payment indicates that the payment is a “contribution,” this does not mean you can deduct the entire amount. If the ticket shows the price of admission and the amount of the contribution, you can deduct the contribution amount.

Example. You pay \$40 to see a special showing of a movie for the benefit of a qualified organization. Printed on the ticket is “Contribution—\$40.” If the regular price for the movie is \$8, your contribution is \$32 (\$40 payment – \$8 regular price).

Membership fees or dues. You may be able to deduct membership fees or dues you pay to a qualified organization. However, you can deduct only the amount that is more than the value of the benefits you receive.

You cannot deduct dues, fees, or assessments paid to country clubs and other social organizations. They are not qualified organizations.

Certain membership benefits can be disregarded. Both you and the organization can disregard the following membership benefits if you get them in return for an annual payment of \$75 or less.

1. Any rights or privileges, other than those discussed under [Athletic events](#), earlier, that you can use frequently while you are a member, such as:
 - a. Free or discounted admission to the organization's facilities or events,
 - b. Free or discounted parking,
 - c. Preferred access to goods or services, and
 - d. Discounts on the purchase of goods and services.
2. Admission, while you are a member, to events open only to members of the organization if the organization reasonably projects that the cost per person (exclud-

ing any allocated overhead) is not more than \$9.90.

Token items. You do not have to reduce your contribution by the value of any benefit you receive if both of the following are true.

1. You receive only a small item or other benefit of token value.
2. The qualified organization correctly determines that the value of the item or benefit you received is not substantial and informs you that you can deduct your payment in full.

The organization determines whether the value of an item or benefit is substantial by using Revenue Procedures 90-12 and 92-49 and the inflation adjustment in Revenue Procedure 2011-52.

Written statement. A qualified organization must give you a written statement if you make a payment of more than \$75 that is partly a contribution and partly for goods or services. The statement must say you can deduct only the amount of your payment that is more than the value of the goods or services you received. It must also give you a good faith estimate of the value of those goods or services.

The organization can give you the statement either when it solicits or when it receives the payment from you.

Exception. An organization will not have to give you this statement if one of the following is true.

1. The organization is:
 - a. A governmental organization described in (5) under [Types of Qualified Organizations](#), earlier, or
 - b. An organization formed only for religious purposes, and the only benefit you receive is an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in commercial transactions outside the donative context.
2. You receive only items whose value is not substantial as described under [Token items](#), earlier.
3. You receive only membership benefits that can be disregarded, as described under [Membership fees or dues](#), earlier.

TAX ISSUES

Organization structure

1. All churches are organized under IRS code section 501(c)(3)
2. SDA organizations have a group exemption under the General Conference from the IRS
3. If you are setting up bank accounts, you will need a copy of the exemption that can be obtained from the Treasurer's office, if you don't have it already.
4. A few items can jeopardize your tax-exempt status
 - a. Inurement to insiders – payment of dividends, unreasonable compensation, or transfer of property for less than fair market value
 - b. Excess benefit transactions – excess economic benefit to an insider
 - c. Substantial lobbying activity
 - d. Participating or intervening in any political campaign on behalf of any candidate for elective public office.

Year-end tax preparation

1. Start now
 - a. Have your own tax employer ID number
 - i. Once you have been given your ID number, please report it to the Treasurer's office so they can keep it on file.
 - b. Review all payments in the year for taxable payments
 - i. Report all taxable payments to Conference employees to SECC Payroll Dept.
 1. Use the honorarium form
 2. Report as soon as possible to allow SECC processing time
 - ii. Track all 1099 eligible payments for year-end reporting (discussed later)
 - iii. Make sure you have a valid W-9 for all 1099 eligible payees
2. Watch all year-end receipt of contributions
 - a. Valid contributions
 - i. Received in office on or before December 31
 - ii. Post marked on or before December 31
 - iii. Adventist giving – posted on or before December 31 11:59 pm LOCAL TIME
 - b. Make sure all receipts get turned into Southeastern California Conference as soon as possible so there is no large backlog at year end.

Types of taxes

1. Employment taxes
2. Income taxes
3. Sales taxes
4. Property taxes

TAX ISSUES - *Continued*

Employment taxes

1099 Reporting

1. Filling out the forms
 - a. Have a valid W-9 for every payee. Use this information to complete the forms
 - b. Identify what type of payment was made and where to report it on the form
 - c. Prepare 1099 forms and summary 1096 form
2. Reporting
 - a. Send 1099 forms to payees on or before January 31
 - b. Send 1096 and all 1099s to Internal Revenue Service on or before February 28 if in paper form. Other deadline exists if filing electronically
 - c. California reporting is not needed if forms are reported in paper form. According to California rules, IRS will report to them if filed in paper form. If filed electronically, you also need to report them to California.

What payments require 1099 reporting

1. If the following conditions are met, you must generally report a payment as nonemployee compensation
 - a. You made the payment to someone who is not your employee
 - b. You made the payment for services in the course of your trade or business
 - c. You made the payment to an individual, partnership, estate, or in some instances, a corporation
 - d. You made payments to the payee totaling at least \$600 during the year
2. Certain other payments also require 1099 reporting, such as rental payments totaling at least \$600 during the year
3. Some examples of payments most frequently made that may qualify for 1099 reporting
 - a. Landscaping
 - b. Repairs
 - c. Carpet cleaning services
 - d. Organists/musicians
 - e. Plumbers
 - f. Rentals from non-corporations
4. If you have made any withholding from any payment, reporting will be required

Employee or Independent Contractor (IC)

1. The key distinction between employees and Independent Contractors
 - a. Employers have the right to direct and control the way their employees do their jobs
 - b. IC's are self-employed and carry on independent trade or businesses; they also bear a genuine possibility of profit or loss
2. Volunteers present no employment tax issues, but be careful about the way you thank them. If you give volunteers cash items, such as gift certificates or any other taxable fringe benefit, you must include these amounts in the volunteers taxable wages.

TAX ISSUES - *Continued*

3. 501(c)(3)s do not withhold or pay Federal income taxes for ICs unless
 - a. They incorrectly classify an employee as an IC
 - b. Have to backup withhold on the IC
4. See Employment section for Independent Contractor vs. Employee test

Backup Withholding

1. Backup withholding can be caused by many issues. Normally it is the receipt of a letter from the IRS or CA Franchise Tax Board mandating the withholding.
2. Follow the IRS and FTB guidance on when, how, and how much to withhold
3. **IF YOU WITHHOLD** it must be remitted to the proper governing agency according to the withholding rules
4. If you receive a withholding notice and fail to withhold, there will be penalties and consequences imposed
5. FTB guidance says when you receive a Federal backup withholding notice, you must also withhold for the state.

Independent Contractor Reporting

1. California reporting of independent contractors has been required since January 2001
2. Any business that is required to file form 1099-MISC for services performed by an independent contractor (individual who is not an employee) must file a report
3. You must report to EDD within 20 days of either making payments totaling \$600 or more OR entering into a contract for \$600 or more with an independent contractor in any calendar year, whichever is earlier
4. Use California EDD form DE 542 to report (Contractor name, address, SS#, start date, amount)

California Nonresident Withholding

1. There is a mandatory withholding rule for non-employee compensation payments to those who are considered non-residents of the State of California.
2. If you have a visiting singing group or an evangelist visiting from another state, etc. who does not live or registered to do business in CA, you may have withholding requirements for any payments made to them.

Income taxes

Unrelated Business Income & Unrelated Business Income Tax (UBI & UBIT)

1. UBI is income from a regularly carried on trade or business that is not substantially related to the organization's exempt purpose
 - a. Trade or business = selling goods or services to generate income
 - b. Regularly carried on = activity shows frequency and continuity
 - c. Not substantially related = activity is not important to furthering the exempt purpose

TAX ISSUES - *Continued*

2. Exceptions to UBI
 - a. Conducted by a volunteer workforce
 - b. Conducted for the convenience of organizational members
 - c. Involving the sale of donated merchandise
 - i. Example of this could be a garage sale
3. Exclusions to UBI
 - a. Interest and dividends
 - b. Royalties

Unrelated Business Income & Unrelated Business Income Tax – *Continued*

- c. Rents from real properties not debt financed
 - d. Some gains or losses
4. Organizations with gross income of \$1,000 or more must complete form 990-T annually

Sales/Use taxes

Sales Taxes

1. Tax exempt organizations are still subject to sales tax rules whenever they sell tangible personal property to their members or the public.
 - a. There are some small exemptions to the rule, but they are complex and need to be researched if you are selling anything
2. If you are purchasing anything, you must pay sales tax. The church is not exempt from the payment of sales tax.
3. If you purchase an item and sales tax has not been charged, you must pay use tax.
 - a. Tax is reported using CA form BOE-401-A2 or using California E-Registration at the California State Board of Equalization website.
 - b. Filed for the previous year by April 15. Other requirements exist if you hold a seller's permit or are required to have a use tax account.
4. Completion of a resale certificate in order to avoid paying sales tax is a criminal misdemeanor if you do not hold a seller's permit.

Property taxes

Property taxes

1. Churches receive a property tax exemption for the portion of property used for the church/church related.
2. The portion of the property used for taxable purposes is not eligible for the tax exemption.
3. The exemption begins with the annual completion of the welfare exemption certificate.
4. The welfare exemption is a simplified form that is sent to the church each January/February.

TAX ISSUES - *Continued*

Other items

Required Disclosures

1. A contribution made by a donor in exchange for goods or services is a quid pro quo contribution
 - a. If an exempt organization receives a donation greater than \$75, and the donor receives goods or services in return for the contribution, the exempt organization must disclose the value of those goods or services to the donor.
 - b. The disclosure statement must provide the donor with a good-faith estimate of the fair market value of the goods or services. It must also tell donors that they can only claim the contribution amount that exceeds the fair market value of the goods or services provided.
 - c. Donors can only claim a deduction for the amount they contributed that is above the value of the goods or services they received.

Required Disclosures - *Continued*

- d. Your organization could be penalized if a statement is not provided at the time of solicitation or when the contribution is received. The penalty is \$10 per contribution, up to \$5,000 per fundraising event or mailing.
 - e. Exceptions
 - i. Tokens – insubstantial goods or services; tokens qualify if the donor gave at least \$43, the item bears the name of the organization or organization logo, and the item doesn't cost more than \$8.60.
 - ii. Membership benefits if the membership payment is \$75 or less
 - iii. Intangible religious benefits or benefits for religious purposes only and are not usually sold commercially.
2. Non-Quid Pro Quo Acknowledgments
 - a. When you do not give a donor something in return for his or her contribution, you do not have a disclosure requirement; however, the donor has a requirement to have a written acknowledgement for contributions of \$250 or more in order to deduct the amount.
 - b. Donors will have trouble meeting IRS requirements of deductible contributions without a written acknowledgement
 - c. Donor acknowledgement letters for contributions of \$250 or more must include
 - i. Name of the organization
 - ii. Amount of cash contribution
 - iii. Description (**but not value**) of non-cash contribution
 - iv. Statement that no goods or services were provided by the organization in return for the contribution, if that was the case
 - v. Description and good faith estimate of the value of goods or services, if any, that the organization provided in return for the contribution
 - vi. Statement that goods or services, if any, that your organization provided in return for the contribution were entirely intangible religious benefits, if that was the case
 - d. If a donor makes a single contribution of \$250 or more in the form of unreimbursed expenses, you must send the donor a written acknowledgment letter and the donor should keep good records of the expenses.

TAX ISSUES - *Continued*

Reimbursement activities

1. Reimbursements need to be fully supported or they are taxable benefits
2. Be sure all payments have proper support and appropriate amounts are used

Various issues

1. Collection of funds for an SDA organization within the General Conference IRS exemption
 - a. Receipt the funds through the normal receipting process
 - b. After being receipted, send a single amount to the other organization or pass it on through the conference.
 - c. If checks are made payable to another organization's name, those checks need to be passed on to that organization so they can receipt the funds and deposit the checks.
2. Collection of funds for a non-profit organization outside the General Conference IRS exemption
 - a. Do not receipt the funds. The IRS has issued guidance to make sure everyone knows it would be a crime to issue a tax deductible certificate for funds when we are not the beneficiary.
 - b. Pass the funds and information on to the other organization so they are able to issue the receipts. Make sure all checks were issued in the other organization's name, etc.
 - c. Unidentified loose cash collected can be brought into your records as a liability and reissue a check for the amount to the other organization.
 - d. Do not use your envelopes for collection purposes. Suggest having the other organization supply their own donation envelopes.
 - e. Make sure it is clear that this is a donation to the other organization and not the church.
3. Sending funds overseas
 - a. The IRS has said that the organization sending funds overseas must maintain control of the funds.
 - b. If you are sending funds to another church, mission, division overseas, the funds must be sent up to the General Conference so they can "maintain control" as a higher organization when the funds are sent overseas.
 - c. If the church is going on a mission trip and needs to send funds overseas so things can be purchased in advance or the site of a building prepped for construction, etc., it is believed this can be done and still follow the IRS requirements. This belief is because the mission team will be going overseas to the location of the funds, will be in charge of the building project or their portion of it, and will be bringing back receipts for the use of those funds that they ultimately had directed the use of.
4. Gifts benefitting individuals (from an article in *Compliance* by Marc Hoffman 10/27/2005)
 - a. To be deductible, a donation must be "to or for the use of" a charitable organization, not a designated individual -- no matter how deserving the individual may be. A taxpayer cannot avoid this result by earmarking a gift for a particular individual and flowing it through a charitable organization.

TAX ISSUES - *Continued*

- b. The IRS uses two tests to determine if a gift is earmarked and therefore non-deductible:
 - i. Does the donee organization have discretion and control over the contribution notwithstanding the donor's desire to benefit a specific individual? If the charity has the option to apply the donated funds to other purposes, this supports deductibility of the contribution.
 - ii. Does the donor intend to benefit the charitable organization or the designated individual? A written agreement between the donor and donee provides the clearest evidence of how each side understands its rights and responsibilities. In addition to a gift agreement or correspondence between the donor and the donee organization, the donee organization's fundraising literature and the donor's receipt for the gift will be considered by the IRS in determining whether an earmarked gift is made.
- c. There are a number of cases and rulings involving family members who desire to provide funds for a relative's living expenses while doing missionary work. If the gift is earmarked, the charitable deduction is denied. Facts that have supported a deductible gift include statements in the missionary organization's fundraising material that the organization retains full discretion over the donated funds and will assess all of its current needs before distributing any funds.
- d. To ensure deductibility, the IRS suggests the following language in the donor's receipt: "This contribution is made with the understanding that the donee organization has complete control and administration over the use of the donated funds." Donors should consider including such language in their gift transmittal letter and donee organizations' fundraising materials and gift receipts ought to contain similar language.
- e. In a particularly egregious case, Tim Mosley, a San Rafael, California insurance agent, created a donor-advised fund with a national charitable gift fund. Over a five-year period, Mosley sent contributions to his donor-advised fund, advised his tax preparer that these were charitable contributions, and claimed significant tax deductions on his income tax returns. Mosley recommended distributions from his fund to a religious organization and instructed the organization to use the funds to pay his children's tuition at the organization's school which they attended. Not only did the IRS deny Mosley's deduction for his "gifts" to the charitable gift fund, it also charged Mosley with five counts of tax evasion. Mosley was sentenced to five months in prison and forced to pay the Department of Treasury \$275,000, including \$165,000 of penalties and interest.
- f. It is unclear whether the IRS brought any action against the religious organization or its church school, although both must have knowingly participated in the scheme.

Other Areas to obtain more information

www.irs.gov
www.stayexempt.org
www.edd.ca.gov
www.ftb.ca.gov
www.boe.ca.gov