

TAXATION SECTION

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Taxation

“...Teacher, we know that you teach the truth about what God wants people to do. And you treat everyone with the same respect, no matter who they are. Tell us, should we pay taxes to the Emperor or not?” Jesus knew they were trying to trick him. So he told them, “Show me a coin.” Then he asked, “Whose picture and name are on it?” “The Emperor’s,” they answered. Then he told them, “Give the Emperor what belongs to him and give God what belongs to God.”

Luke 20:21-25

Introduction to Taxation

The material in this Tax section deals with two different systems of taxation, income tax and self-employment tax (*i.e.*, Social Security). It is vital to remember that these taxes and the rules and regulations under which they are administered are **separate**. Definitions used for income tax purposes are **not** the same as the definitions used for self-employment tax purposes.

At the end of this section is an explanation of various ways to obtain IRS Forms and Publications. In addition, GCFA publishes annual tax information to assist local churches on tax issues for clergy and it is available at GCFA’s web site, www.gcfa.org

Self-Employment Tax

For the self-employment tax (*i.e.*, Social Security or SECA), all clergy are defined by federal statute as self-employed. (Internal Revenue Code §§ 1402(c), 3121(b)(8)). The self-employment tax is a funding mechanism for the Social Security system, analogous in part to employer and employee Social Security (FICA) tax payments. The self-employment rate and the combined employer-employee (FICA) rate are the same — 15.3% of income. (In 2001, self-employed persons will pay 15.3% on income up to \$80,400 and 2.9% of income over \$80,400 for Medicare taxes. The base may change each year thereafter).

Clergy with net earnings from self-employment of \$400 or more are subject to self-employment tax. The definition of “net earnings from self-employment” is the gross income from a clergy person’s trade or business less allowable deductions attributable to the trade of business. In relation to clergy, compensation received for services performed in the exercise of their ministry is considered to be self-employment income for purposes of the self-employment (*i.e.*, Social Security tax). The Internal Revenue Service guidelines state that the following services by a clergy person subject to his/her earnings to self-employment tax:

1. Conduct of religious worship or of sacerdotal functions (Holy Communion, baptism, etc.). This conclusion is reached even where worship is conducted or sacraments performed for a non-religious organization, such as an educational institution.
2. Services performed for a qualifying integral agency of the religious denomination, such as a religious board or agency.
3. When a clergy person is assigned to perform services for an organization that is neither a religious organization nor operated as a religious agency, these services are nonetheless considered to be qualifying services for self-employment tax purposes. Though no sacerdotal functions are performed and no religious worship is conducted, this result is reached because the clergy person is assigned to perform these services by his/her ecclesiastical superiors within the denomination.

Note: Qualifying services do **not** include services performed by clergy who are employees of any governmental agency, such as armed forces or prison chaplains, though they are performing sacerdotal services. Their services are considered performed as government employees rather than self-employed persons within a religious denomination.

Internal Revenue Service Publication 517 — Social Security and Other Information for Members of the Clergy and Religious Workers is useful in addressing general and specific filing questions. See also the text below on “Definition of Minister” for federal tax purposes.

Net earnings of clergy from self-employment to which the self-employment tax rate is applied **include** the fair rental value of any parsonage furnished to a clergy person or the rental allowance (and utility allowance) paid to the clergy person, though these are excluded from gross income for federal income tax purposes under Internal Revenue Code § 107.

Prior to 1968, Social Security coverage for clergy, which is funded by the self-employment tax, was elective. If coverage was not elected, Social Security coverage was not provided. However, for all years since 1967, clergy are **automatically** covered under Social Security unless they receive an exemption from the Internal Revenue Service. Internal Revenue Service Form 4361 must be filed by those seeking the exemption. Form 4361 includes a statement that the applicant is either conscientiously opposed, or opposed because of religious principles, to acceptance of any public insurance, including Social Security benefits, based on his/her services as a clergy. Persons in ministry prior to 1968 and newly ordained clergy since then had until the due date for their second tax return that included more than \$400 of net earnings from self-employment to file Form 4361 seeking the exemption.

Those seeking to be excluded from Social Security must file Form 4361 as soon as possible (within two years) after beginning work as a minister and should never discard the original filing or any Internal Revenue Service responses. The lack of documentation will cause serious problems in the event of an audit. A detailed explanation of the Social Security exemption process is set forth in Internal Revenue Service Publication 517.

In view of the denomination's official stance in support of public insurance such as Social Security, it will be difficult for United Methodist clergy to use the Social Principles to meet these requirements in order to secure the exemption. The GCFA legal department does not recommend seeking the exemption. Loss of access to Social Security disability payments (and other death benefits), the increased cost of Medicare participation if one must buy one's way back into Medicare, and the fact that pension benefits plans within the denomination assume receipt of Social Security benefits as part of one's retirement package, suggest that the long-term financial risks of non-participation in Social Security are significant. Once obtained, this exemption from Social Security coverage is **irrevocable**.

In December 1999, Congress adopted Social Security opt-in legislation that allows clergy to revoke their previously filed exemptions from Social Security and to commence Social Security participation beginning either with tax year 2000 or tax year 2001. This two-year opt-in window took effect on January 1, 2000, and it will expire on April 15, 2002.

For clergy seeking to opt back into social security, visit www.gcfa.org. The topic "Social Security Opt In for Clergy" contains valuable information.

Federal Income Tax — Employee Status for Clergy

The case of Weber vs. Commissioner, (60 F. 3d 1104) decided by 4th Circuit Court of Appeals in 1995, addressed the issue of whether United Methodist clergy at the local church could file as self-employed for federal income tax purposes and use Schedule C. The court ruled that Reverend Weber was **an employee** for purposes of federal income tax and thus could not use a Schedule C.

United Methodist churches, pursuant to the Weber holding, should issue W-2s for all clergy. Clergy will be at great risk if they file as self-employed for federal income tax purposes. To assist local church treasurers, GCFA issues an annual tax packet to conference treasurers to assist local churches. That tax information is available at www.gcfa.org. That information includes accountable reimbursement policies, housing allowances, clergy travel issues and completion of tax forms such as Form 941, W-2, and W-3.

It is important to remember that *the tax system for self-employment (Social Security) taxation of clergy is completely separate and distinct from the tax system for income taxation of clergy.* Different rules, regulations, and definitions of status are used in the two systems. Confusion will result if one mixes self-employment tax definitions with income tax definitions. For purposes of federal income taxation, the determination of one's status as either employee or self-employed person is left to the individual, although clergy serving at a local church or working for the annual conference or a general agency in the church are advised to file as employees in light of the Weber decision. (Remember that for self-employment (*i.e.*, Social Security) tax, clergy are defined as self-employed **by federal statute**. No comparable statute exists for the determination of income tax filing status.)

What Weber Did Not Change

While the Weber case had substantial impact on clergy, many tax issues **have not** changed:

- Clergy continue to be considered self-employed for purposes of Social Security and Medicare taxes, based as noted above, on a federal statute unrelated to income tax issues.
- The Weber decision did not affect the clergy housing allowance; any amounts properly set up in advance and paid for housing and utilities are still **not** taxable income for income tax purposes (but are subject to Social Security tax).
- Clergy should continue to use Schedule C to report income and to deduct expenses directly related to honoraria (*e.g.* weddings, funerals).
- Churches cannot withhold for social security tax for clergy.
- Churches are not required to do any income tax withholding for clergy but they may, pursuant to a W-4 request by clergy, do voluntary income tax withholding for them. Voluntary withholding may enable clergy to avoid quarterly estimated tax payments.
- Accountable expense reimbursement policies may be set-up, which have the advantage of minimizing the economic impact of not being able to use Schedule C.

United Methodist Polity

It is very important to note that *clergy income tax filing status for federal, state or local income does not determine clergy status for church purposes, including the appointment process*. For example, the issuance of a W-2 by the local church and the filing of federal income tax returns as an employee by a pastor do not mean that the pastor is an employee of the local church or the annual conference under United Methodist polity. The IRS' view of United Methodist clergy as "employees" does **not** change *The Book of Discipline*, alter the historic covenants that bind annual conferences, clergy and congregations, or change episcopal appointive powers or procedures. ¶ 141 of the *Discipline* provides:

¶ 141. *Employment Status of Clergy*—Ministry in the Christian church is derived from the ministry of Christ (¶ 301). Jesus makes it clear to us that he is a shepherd and not a hireling (John 10:11-15). Similarly, United Methodist clergy appointed to local churches are not employees of the local church or the annual conference. It is recognized that for certain limited purposes such as taxation, benefits, and insurance, governments and other entities may classify clergy as employees. Such classifications are not to be construed as affecting or defining United Methodist polity, including the historic covenants that bind annual conferences, clergy, and congregations, episcopal appointive powers and procedures or other principles set forth in the Constitution or the *Book of Discipline* (see e.g., ¶¶ 301; 319-320;-324-325; 329; 331). In addition, any such classifications should be accepted, if at all, only for limited purposes, as set forth above, and with the full recognition and acknowledgment that it is the responsibility of the clergy to be God's servants.

Positive Impact of Weber Decision

There are some advantages for clergy filing as employees:

- Most pastors will be able to neutralize the economic impact of the Weber decision by claiming and being reimbursed for legitimate business expenses under an accountable reimbursement policy rather than using an allowance (sample reimbursement policies are at the end of this **section**);
- Most pastors will be in a better position regarding the taxability of benefits (e.g., health insurance premiums, cafeteria plans) paid or established by the salary paying unit, because the Internal Revenue Service takes the position that such benefits are not taxable to employees but are taxable to self-employed persons;
- The Internal Revenue Service and the courts have not attempted to define United Methodist polity.

Accountable Reimbursement Policies

An accountable reimbursement policy is nothing more than a **method** of claiming and reimbursing business expenses rather than providing an expense allowance. It is not a benefit plan; it is not a method of sheltering income from taxes; it is not mandatory. Reimbursement of — and

accountability for — business expenses is a routine part of most businesses. It's as easy as this: a church budgets for legitimate business expenses of its employees, such as travel, subscriptions, continuing education, and the like. When an individual incurs a business expense, s/he submits a claim for the expense, with appropriate documentation, such as vouchers, receipts, etc. Then, the church directly pays the expense or reimburses the individual for the expense (sometimes a business credit card is provided for business expenses). Local churches can set up a method of accounting for business expenses that is this simple.

For Accountable Reimbursement Policy information, including a Q & A on Accountable Reimbursement Policies and sample forms, see www.gcfa.org under the Tax Information topic.

1. Funding the Accountable Reimbursement Policy

Care should be taken in funding the accountable reimbursement policy when preparing the church's budget for the coming year or prior to a pastor starting a new appointment. While it is legal to establish an accountable reimbursement policy after the start of a compensation cycle, the Internal Revenue Service **prohibits** a reduction in the pastor's salary in order to fund the policy. The church may take its old budgeted fund for an allowance (for travel or continuing education) and move that budgeted amount into an accountable reimbursement policy.

2. Amount of Funding

The pastor and church should carefully determine the amount to be budgeted for the business expenses because, in some instances, a pastor may not spend the full amount during the year. In such a case, the church should **not** write a check for the difference and give it to the pastor. If it does so, the Internal Revenue Service may take the position that the church is really giving an expense allowance and thus treat **all** of the reimbursable funds as taxable income to the pastor. However, the church may choose to carry over any unspent amounts to the next year's accountable reimbursement policy or use the unspent amounts for other general budgetary purposes.

3. Scope of Reimbursement

Some local churches have requested assistance in determining what are appropriate business expenses for purposes of reimbursement under an Accountable Reimbursement Policy. It is important for the church and the clergy to have a clear understanding and agreement from the beginning of how funds are to be spent and what, if any, limitations are to be put on the use of the reimbursable funds.

See www.gcfa.org for a list of examples proper and improper reimbursements under the Tax Information topic at the end of the Q&A on Accountable Reimbursement Policies.

4. Spending of Funds

Concerns have also been raised about a fact situation in which for example, the pastor spends 80% of the funds in the account by May 30, receives another appointment in June, and then the new pastor has only the remaining 20% of the budgeted funds available for the final six months of the year. The best precaution is for the church and the pastor to be good stewards together to watch the funds that are spent (and reimbursed) and try not to overspend in the first half of the year.

Income Taxation — Housing Allowance/Parsonage Allowance

§ 107 of the Internal Revenue Code states:

In the case of a “Minister of the Gospel,” gross income does not include: (1) the rental value of a home furnished to him/her as part of his/her compensation; or (2) the rental allowance paid to him/her to rent or provide a home.

Two requirements must be met by clergy persons in order to qualify for the income exclusion as defined above. Those requirements are that the person must be a “minister” and performing ministerial duties (by IRS interpretation of the term) and a properly established housing or parsonage allowance must be set up in advance.

1. Definition of “Minister”

The clergy person first must satisfy the Internal Revenue Service definition of a “Minister” and s/he must receive either the rent-free use of a home or a properly completed housing allowance as compensation for performing the ordinary duties of a clergy person. Internal Revenue Service Publication 517 provides the following definition of the term “Minister” that is applicable for this issue:

“Ministers” are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given authority to conduct religious worship, to perform sacerdotal functions, and to administer ordinances or sacraments according to the prescribed tenets or principles of that church or denomination.

Elders and Licensed Local Pastors.

Fully ordained elders in The United Methodist Church serving at the local church clearly qualify under this definition. Formerly, the Internal Revenue Service required that licensed or commissioned clergy persons had to establish a status that was fully equivalent to ordination. A series of revenue rulings changed the Internal Revenue Service position such that those licensed or commissioned must be able to perform substantially all of the religious functions of an ordained clergy person for the denomination and must do so on a regular basis. Elders and local pastors ministering to

congregations on a easily satisfy the requirement of performing the duties of a “Minister of the Gospel.”

Deacons in the Church

In 1998, IRS issued a private letter ruling concluding that three ordained United Methodist deacons qualified as ministers of the gospel eligible to have a portion of their salaries designated as a parsonage allowance and excluded from gross income under the provisions of IRS code § 107. Private Letter Ruling 199910055 (Issued December 10, 1998 – Released March 12, 1999).

A copy of the entire decision and a detailed Q&A on deacon tax issues can be found at the GCFA web site (www.gcfa.org) under Deacon Tax Status Memo.

The 1996 General Conference established the Order of Ordained Deacon in *The Book of Discipline*. To qualify for ordination as a deacon, an individual had to meet requirements set forth in the *Discipline*: to be recommended by the Annual Conference and to receive the affirmative vote of the ministerial members of the Conference. The General Conference also promulgated transitional rules that would permit certain diaconal ministers to become ordained deacons. Once ordained, deacons would have authority to carry out most of the duties of the elders.

Under the *Discipline*, an ordained deacon is permitted to teach and proclaim the gospel form and nurture disciples, perform marriages and funerals, and assist ordained elders in administering the sacraments. An ordained deacon has full vote in the Annual Conference, may hold offices reserved to clergy, and may participate in the clergy retirement plan. Ordained deacons are not guaranteed an appointment by the Church.

The above private letter ruling was brought by a local church that employed over fifty employees, including three ordained deacons, who had qualified for ordination under the transitional rules established by the General Conference. These deacons served as the Minister of Education, Minister of Music, and Minister of Stewardship, respectively, in the local church. They were integral members of the local church’s pastoral team, met with the senior pastor to plan worship services, assisted with sacraments, and officiated at weddings and funerals. Each was required to preach at Sunday worship services.

The IRS concluded that all three deacons were ministers of the gospel performing services in the exercise of their ministries, within the meaning of the regulations. As ordained United Methodist clergy, they conducted worship, assisted in the sacraments, and performed services in the control, conduct and maintenance of church. Further, they were considered by the church to be religious

leaders authorized to perform substantially all religious functions within the scope of the United Methodist tenets and practices. Accordingly, they were eligible for the § 107 housing allowance exclusion.

The IRS specifically declined to rule that all United Methodist deacons qualified as ministers of the gospel, preferring instead to examine the facts relating to each individual deacon. The IRS also warned that mere designation of an individual as a minister is not sufficient to qualify that individual as a minister of the gospel for purposes of the Code. In addition, the IRS emphasized that this ruling did not represent a departure from Rev. Rul. 59-270, 1959-2 C.B. 44, in which the IRS ruled that non-ordained ministers of music and education were ineligible for the § 107 exclusion, even though they were performing services that could be considered ministerial.

Deacons and their salary paying unit should carefully review the entire deacon private ruling letter and the Q&A materials on the GCFA web site.

Appointments to Extension Ministries

Clergy who do not minister to congregations, however, can still qualify for the parsonage exclusion even though they do not conduct religious worship or perform sacerdotal functions, if they perform other duties “in the exercise of their ministry” which are considered qualifying. Teaching and administrative duties at United Methodist theological seminaries, or the control, conduct, and maintenance of religious organizations under the authority of the denomination, also would be considered qualifying duties.

In any case of uncertainty, it is always advisable to seek the advice of competent tax counsel on whether a clergy person’s duties are qualifying for purposes of the housing exclusion.

2. Properly Established Housing Allowance

The second requirement is a properly established housing or parsonage allowance, to be set up in advance through a formal resolution for expenses used to rent or to provide a home for the clergy person. The allowance giving the use of the parsonage or setting a specific amount **must** be designated in advance: retroactive designation of a housing allowance is prohibited and in such cases the exclusion will be disallowed. Expenditures for such things as rent, down payment, mortgage installment payments, closing costs mortgage interest, real estate taxes, special assessments for such purposes as streets and sewers, garbage removal, utilities, repairs and maintenance, fire, theft and accident liability, insurance and home furnishings may be qualifying “costs of providing a home.” If any of these expenses are larger than the amount designated, the excess amount may **not** be excluded.

Any part of the housing allowance spent in connection with business or income property owned by the clergy person, in addition to his/her home, does not qualify for the exclusion and must be included in the gross income. Any part of the allowance spent on items not directly related to renting or providing a home, such as the purchase of food or clothing and maid service, is **not** excludable from gross income. In addition, unless the amount designated as housing allowance is actually **used** for the intended purpose, it is **not** excludable from gross income.

See www.gcfa.org for a Q&A on Housing Allowances under the Tax Information topic.

The allowance amount to be excluded from gross income also **may not exceed the fair rental value of the property**. (But see box below) The fair rental value is defined in Revenue Ruling 71-280 as the amount of rent that an unrelated party would pay for the home, including furnishings and related structures, such as garages, plus utilities costs. Internal Revenue Service Publication 517 states:

In other words, if you own your home and you receive as part of your pay a housing or rental allowance, you may exclude from gross income the smallest of the following:

- The amount actually used to provide a home,
- The amount officially designated as a rental allowance, or
- The fair rental value of the home, including furnishings, utilities, garage, etc. (but see below)

For example, if the housing allowance is \$500 per month and the fair rental value of the home plus utilities expense is \$400 per month, only \$400 a month may be excluded from gross income pursuant to § 107. The excess \$100 a month must be included in gross income, even though it had been designated as housing allowance and was spent on items directly related to providing a home.

In 2000, the U.S. Tax Court issued a surprise ruling that allowed a clergy taxpayer to claim a housing allowance that exceeded the fair rental value of his home, ruling in effect that the IRS had no authority to impose the fair rental limitation value rule on clergy taxpayers. (Warren v. Commissioner, 114 T.C. No. 23, Docket No. 14924-98) The tax court in essence rejected the IRS' position that the housing allowance may not exceed the fair rental value of the home, fully furnished. The IRS filed an appeal, which will be decided by the 9th Circuit Court of Appeals, probably in 2001 or 2002. We are expecting that the IRS also will ask Congress to pass legislation that would nullify the effect of the tax court's decision. Until the 9th Circuit Court of Appeals rules on the case, clergy should think very carefully and consult with their tax advisor before making any decisions to increase their annual housing allowance beyond the fair rental value in reliance on the tax court decision.

The church can document the required advance designation of a pastor's housing allowance in a contract, in minutes, a budget resolution, or any other appropriate written instrument evidencing an **official** action designating a specified amount for the housing allowance in advance (for example, a charge conference resolution adopted in October, November or December 2001, is sufficient for advance designation for the year 2002)

Suggested housing allowance and notification forms are included at the end of this section.

If a church has more than one clergy person, the qualification of each for the exclusion is determined on an **individual** basis. A specific designation is required for each clergy person rather than a general designation for all the clergy. This requirement has been affirmed in the Tax Court case of Boyer v. Commissioner, 69 T.C. 521 (1977).

Other specific points of interest relating to housing allowances are:

1. It is immaterial whether the housing allowance is paid separately or as part of the overall compensation for the clergy person, providing the allowance is properly designated in advance. In other words, one check may be used to pay the clergy person's salary and his/her housing allowance and the allowance will be excludable from his/her gross income if the allowance was properly designated in advance.
2. Designation of a clergy person's entire salary as a housing allowance will not necessarily permit exclusion of his/her compensation from income tax. Only the amount the clergy person **actually spent** for providing a home may be excluded from gross income for federal income tax purposes.
3. Persons not specifically ordained, licensed or commissioned by the denomination do **not** qualify for the housing allowance exclusion. Religious workers such as a "minister of music" or "minister of education" who are not ordained, perform no sacerdotal functions, and who are not commissioned to conduct worship in a congregation do not qualify for the exclusion.
4. The overall amount that is designated for the housing allowance exclusion must be reasonable. Remember that "fair rental value" includes furnishings and utilities. **NOTE TO FILE DISCUSS RECENT 2002 LEGISLATIVE AMENDMENT** Where a furnished parsonage with paid utilities is provided, there still may be some "costs of providing a home" (such as furniture provided by the clergy person) that are out of pocket expenses, but items that could be designated as **personal**, (e.g. a video game machine, toiletries, etc.) rather than related to the home, are unlikely to withstand audit scrutiny.

Note: Interest and taxes paid by the clergy person on his/her owned primary residence qualify as itemized deductions from income **in addition to** the rental allowance exclusion. A clergy person may use his/her designated allowance to purchase, rather than rent, a home and then deduct interest and taxes paid on his/her personal residence as itemized deductions on his/her tax return, as well as having the rental allowance excluded under Internal Revenue Code § 107. Internal Revenue Service Ruling 83-3 attempted to eliminate this “double benefit,” but it was restored in the 1986 Tax Reform Act.

Retired clergy may qualify for the parsonage exclusion if they satisfy the same requirements as active clergy. If the employing church, conference, or other qualifying organization provides a retired clergy person with a rent-free home or a housing allowance in recognition of his/her past services, Revenue Ruling 63-156 makes the exclusion available to him/her. The exclusion is available **only** to retired clergy themselves and is **not** transferable to other persons, such as surviving spouses.

The Small Business Job Protection Act of 1996 has confirmed that the portion of a clergy person’s retirement distribution from a church plan, properly designed as a housing allowance, is not subject to self-employment taxes. In addition, this law allows a clergy person who works in certain “non-church” jobs fulfilling his/her ministry, such a chaplain, now to participate in a church retirement plan.

Special Tax Topics

United Methodist Group Federal Income Tax Exemption

As a service to United Methodist organizations, the General Council on Finance and Administration administers The United Methodist Church Group Federal Income Tax Exemption Ruling, which is contained in the ruling letter (“Group Ruling Letter”) issued by the Internal Revenue Service to the Council on October 16, 1974. GCFA applied for the Group Ruling under the authority provided by the *Discipline*. A copy of the IRS letter (1974) is available by contacting the GCFA legal department.

1. What Does The Group Ruling Do?

The Group Ruling recognizes certain United Methodist organizations as exempt from payment of federal income tax under §501(c)(3) of the Internal Revenue Code. However, if such organizations have received unrelated business income during the year, they may have to pay unrelated business income tax and file Internal Revenue Service Form 990T. (Exempt Organization Business Income Return)

A copy of the Group Ruling Letter may be used as proof of the tax-exempt status of covered organizations. Persons or corporations making gifts to United Methodist churches and other covered

organizations under the Group Ruling may request evidence that the recipient of the gift is a tax-exempt organization. A copy of the Group Ruling Letter may be furnished to such persons and a letter certifying inclusion from our office will be furnished upon request in such cases. Requests for such letters of certification should be sent to the attention of the GCFA Legal Department. The Group Ruling Letter also may be used in obtaining bulk mailing permits from the U.S. Postal Service.

2. What United Methodist Organizations Are Covered By The Group Ruling?

Organizations that are covered include local United Methodist churches and local United Methodist church agencies, commissions, committees, and officially affiliated organizations; annual conferences and divisions and departments; annual conference agencies, commissions, committees, their divisions and departments, and other related organizations; the Judicial Council and the General Conference. Covered organizations need take no further action to acquire exemption from federal income tax. Copies of the Group Ruling Letter may be furnished as evidence of the covered organization's status. (Despite the 1974 issuance date, this remains in force and effect.)

Certain documents were filed by GCFA in its original application for the Group Ruling back in the early 1970s. These documents are updated annually and contain the names of the organizations that are automatically included within the Group Ruling. The principal listing documents are:

1. The most recent edition of The United Methodist Directory;
2. A computer printout, based on the information most nearly current as of the filing date, which lists the names and addresses of all charges and churches within the denomination and located in the United States;
3. A roster of organizations not included in the above categories that have been accepted upon application to GCFA for inclusion within the group ruling.

The following types of institutions and organizations are **excluded** from coverage within the Group Ruling:

1. Hospitals, nursing homes, other health-care facilities and children's homes;
2. Universities, colleges and other educational institutions;
3. Non-denominational organizations headquartered in local churches, such as day-care centers, extended care facilities, and senior citizen organizations, where such organizations are not an integral part of the local church in which they are located;
4. Certain recreational facilities and summer camps.
5. Ecumenical groups, such as a community food pantry operated by local churches of different

religious denominations.

3. How Does An Organization Not Already Included Apply For Inclusion Within The Group Ruling?

Please forward any requests for inclusion within the Group Ruling to the General Council on Finance and Administration, PO Box 340029, Nashville, TN 37203-0029, to the attention of the Legal Department. You may access a blank request form on www.gcfa.org under Legal Services. Such questions should not be referred directly to the Internal Revenue Service, which has designated GCFA as the administrator of the Group Ruling. Each inquiry will be considered on its individual facts and circumstances. If it is clear that the organization in question qualifies to be tax-exempt as a religious organization under §501(c)(3) of the Internal Revenue Code, GCFA will then make the determination whether or not the organization also qualifies for inclusion within the Group Ruling. **Again, local United Methodist Churches are automatically covered and do not need to file an application with GCFA.**

Any affiliated United Methodist organization seeking to be added to the roster for inclusion within the Group Exemption Ruling (that is, a United Methodist organization that is not automatically covered) should submit to GCFA the following documents in support of its request.

1. A statement giving written authorization to GCFA to add the organization to the roster on file with the IRS;
2. A statement that the organization is not, in its opinion, a private foundation as defined in §509(a) of the Code;
3. A copy of the Articles of Incorporation of the organization, if any;
4. A copy of the bylaws of the organization, if any;
5. If there are no articles or bylaws, then similar “structure” documents, such as a mission statement, charter, standing rules, and/or explanation of structure;
6. A statement setting forth the source and nature of the funding of the organization;
7. The Employer Identification Number (EIN) of the organization.

GCFA carefully examines all these documents with a view to determine whether the organization qualifies for inclusion within the Group Exemption Ruling.

Organizations seeking to be added to the roster should be aware that the annual filing is made September 30 of each year, which is 90 days prior to the close of GCFA’s fiscal year, in accordance

with the Internal Revenue Service's requirements under the Group Ruling. All such requests for additions to the roster should be made in enough time for documents to be submitted and reviewed prior to the annual filing.

Organizations not qualifying for inclusion under the Group Ruling may, nevertheless, qualify for exemption on their own, via an individual tax ruling exemption. In such cases, the ruling is sought directly from the Internal Revenue Service.

IMPORTANT: Organizations must have their own Employer Identification Number (EIN). If your church or United Methodist organization does not have an EIN, you **must** obtain one from the Internal Revenue Service by filing Internal Revenue Service Form SS-4 with their Internal Revenue Service District Office. The EIN functions as a taxpayer identification number for organizations just as a social security number functions in a similar manner for individuals. This number is to be used when churches and other organizations pay employee withholding tax and social security taxes. Inclusion in the Group Ruling is **not** the same as, and does **not** take the place of, having an EIN. Every church organization must have its own EIN!

4. To Whom Should Questions And Requests On The Group Ruling Be Directed?

Additional questions and requests for information on the Group Ruling should be directed to the General Council on Finance and Administration, , PO Box 340029, Nashville, TN 37203-0029, to the attention of the Legal Department. You may access a blank request form on www.gcfa.org under Legal Services. Again, please do not refer questions concerning the denominational Group Federal Income Tax Exemption Ruling to any office of the Internal Revenue Service.

GCFA, as part of its connectional responsibilities, is proud to be able to protect the legal interests of the denomination by maintaining the Group Ruling Exemption.

New Public Disclosure Requirements for Exempt Organizations

IRS regulations (Internal Revenue Code § 6104(d), effective June 9, 1999) require local churches and church organizations to make available for public inspection certain records related to their IRS tax exemption. Most United Methodist churches and church organizations have elected to be covered by the Group Ruling exemption that is maintained by the General Council on Finance and Administration for the entire denomination. All churches and church organizations that are tax exempt, regardless of whether the tax exemption is through the group ruling or a separate exemption, must comply with these new regulations, and there are significant monetary penalties for failure to comply.

If you or any member of your staff receives a request for disclosure of tax exemption records under the new regulations, please immediately contact your annual conference treasurer. The regulations basically require that the information requested be supplied within two weeks. Please

inform your staff what to do if they receive a call from any person or entity, church member or not, requesting an inspection of your exemption records. The conference treasurer can assist you in complying with the request. If you are one of the United Methodist organizations covered by the Group Ruling exemption, the conference treasurer may direct you to the General Council on Finance and Administration for further assistance.

Restrictions on Political Activity and Lobbying

Church organizations, as a condition of the Group Ruling Exemption under Internal Revenue code § 501(c)(3), must be engaged in activities that further exclusively charitable purposes. Churches like all 501 (c)(3) charitable organizations, may not participate in political activities, and a substantial part of their activities may not attempt to influence legislation. IRS Publication 1828 states:

All section § 501(c)(3), organizations, including churches, their integrated auxiliaries, conventions or association of churches, are prohibited from participating in, or intervening in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. Violation on this prohibition results in denial or revocation of exempt status and the imposition of certain excise taxes.

It is important to distinguish between political activity and witnessing/lobbying. Political activity typically involves a candidate for office or political party. Witnessing/lobbying involves a public issue or legislation. Political activity is strictly prohibited. Lobbying is merely limited. What constitutes a “political activity” versus “lobbying?”

Political activity includes endorsements and statements of opposition of particular candidates, parties, or political action committees; provisions of financial and other support; provisions of mailing lists; sponsoring of political action committees; and distributions of partisan campaign materials. The political activity prohibition does not prevent candidate forums being held in or sponsored by a church. As long as such activities are even-handed, nonpartisan, and demonstrate no favoritism for a particular candidate (or opposition to a particular candidate), they are allowed. Endorsement of candidates is strictly prohibited. The IRS has taken aggressive action to try to make certain that churches do not support or oppose candidates, a potential party or political action committees; provide specific financial support, or mailing lists; or distribute partisan campaign materials.

Witnessing/Lobbying, on the other hand, includes contacting or urging the public to contact members of the legislature or the executive branch for the purpose of proposing, supporting, or opposing particular legislation. Witnessing/lobbying may be engaged in as long as it does not constitute a substantial part of the church organization’s total activities. While neither the Internal

Revenue Code nor the regulations define what is substantial, a few cases suggest that the line between what is insubstantial and substantial lies somewhere between 5% and 15% of an organization's total activities as measured by time, effort, expenditure, and other relevant factors.

See www.gcfa.org for more information on Political Activity Guidelines.

Unrelated Business Income Tax

When a church engages in income-producing activities that are unrelated to its tax-exempt purpose, the net income from such activities is subject to unrelated business income tax (UBIT), and the church must file a Form 990-T (Exempt Organization Business Income Tax Return). In order for a church's activity to be classified as subject to the tax on unrelated business income, the following three (3) conditions must be met:

1. the activity must be a trade or business,
2. it must be carried on regularly, and
3. it must not be substantially related to the church's exempt purposes.

These three conditions must be met for a church's unrelated business income to be subject to the unrelated business income tax. If one of these conditions is not present, the tax is not due.

See www.gcfa.org for a memo on "Rental of Church Steeples to Cellular Phone Companies – Legal and Tax Considerations."

Even where all three of the above conditions are met, there are still circumstances where the tax may not be imposed:

(1) substantially all of the work in operating the trade or business is performed by volunteers; or (2) the trade or business involves the selling of merchandise substantially all of which was donated. If either of these exceptions applies, the income from the activity is not treated as unrelated trade or business income. Further, in general, rents, royalties and interest are not subject to the unrelated business income tax. (IRS Draft Publication 1828).

Reporting and Deductibility of Spousal Travel Expenses

If an employer pays for the travel of a spouse (or dependent), the reimbursement is excludible from the employee's gross income **only** when the presence of the spouse or dependent has a bona fide business purpose **and** the employee appropriately substantiates the travel (*e.g.*, time, place, amount and business purpose, with receipts) under an accountable business expense reimbursement plan.

Here are some practical tips that may help with your understanding of these rules:

- If the spouse attends an official United Methodist meeting because it is customary for spouses to attend, s/he is probably not traveling with a bona fide business purpose, unless s/he has a business role at the meeting;
- Examples of bona fide business purposes for a spouse would include presiding over a meeting, giving a workshop, serving as a delegate, handling registration of attendees, etc.

Moving Expenses for Clergy

In certain circumstances, conferences that pay or reimburse clergy moving expenses (reimbursements must be under an accountable plan) that qualify for the moving expense deduction will be able to treat these payments as **exclusions from the income of the recipient**. In these cases only (payment of **qualified** expenses for moves over 50 miles to a new principal place of work), the payor will **not** be required to include payments as income on a Form W-2 or 1099. **In all other cases** of nonqualified payments for or reimbursements of moving expenses, Form W-2s or 1099s will continue to be required, as § 82 of the Internal Revenue Code requires that moving expense reimbursements be included in gross income. Employers should always issue a W-2. The annual conference is not the employer and as such should not issue a W-2 for non-qualified moving expenses paid for clergy appointed to the local church. One option for annual conferences that pay these moving expenses is to make payments to the local church and ask the church to pay the pastor and make any necessary reporting on the pastor's W-2. Some annual conferences use a 1099 to report these non-qualified moving expenses for pastors serving in the local church. Senior staff at the IRS national office have suggested that 1099's are not really intended for this purpose.

“Qualified” moving expenses include only (1) the reasonable expenses of moving household goods and personal effects from a former residence to a new residence and (2) the reasonable expenses of travel (including lodging) from a former residence to a new place of residence. (3) Certain reasonable storage costs. In summary, the required conditions for the qualified moving expense are that:

1. The move must be made to a new principal place of work.
2. The new job site must be at least 50 miles farther from the home than the previous job site.
3. The “qualified” moving expenses incurred must be within a “reasonable time” of the start of the job, generally construed to be one year later or

less but expandable if circumstances indicate a longer period would be reasonable.

4. The work at the new location must continue for a certain required period.

See IRS Publication 521, Moving Expenses. Also remember that the Internal Revenue Service requires Form 8822, Change Of Address, to be filed within 60 days of any taxpayer's changing addresses. (This requirement applies to **all** moves.)

Substantiating and Reporting Charitable Contributions

Donors who make a contribution of \$250 more must have a “contemporaneous written acknowledgment from the donee organization.” A written document from the church (including the church's name or on church letterhead) should be provided to meet this requirement. A canceled check is not sufficient to substantiate a contribution of this size.

1. Substantiation

The substantiation document must include:

1. The name of the donor.
2. A listing including each individual contribution of \$250 or more (churches are **not** required to aggregate smaller contributions that add up to \$250 or more in order to trigger these requirements).
3. A statement that no goods or services were provided to the donor in exchange for the contribution. We would suggest that all church statements reflecting money contributions, such as quarterly giving reports, state the following:
Pursuant to Internal Revenue Code requirements for substantiation of charitable contributions, _____ United Methodist Church provided no goods or services in return for these contributions. (You may wish to add *except intangible religious benefits*.)
4. A description of non-cash property (if any) contributed.

The written acknowledgment must be in the donor's hands **prior to** the date on which the donor's tax return is filed, or **prior to** the due date for filing, **whichever is earlier**.

For the typical Sunday morning contribution of cash or check of less than \$250, the canceled check or receipt from the donee church showing the church name and the amount and dates of the contribution are still sufficient. However, documentation is still important. The IRS is suspicious of substantial cash contributions and requires objective documentation, regardless of the amount.

Here are two typical examples:

- Mrs. Jones contributes \$100 a week in an envelope in the Sunday morning collection plate; the church is not required to give her written receipt, but she must document the contribution (e.g., cancelled check). It is not legally required but good practice for the church to give a written statement for all contributions.
- Mrs. Smith contributes one check each month of \$400, which she puts in an envelope on one Sunday morning each month; the church is required to give her a written receipt.

Some individuals who serve as volunteers, committee members, and directors of church organizations may incur out-of-pocket expenditures for those activities that may qualify for charitable deductions if all substantiation requirements are met. (Example: A volunteer travels to do a work project, bringing his/her own supplies. The travel and other out of pocket expenses may qualify for a charitable deduction contribution) The IRS has indicated that the volunteer may satisfy the substantiation requirement, if: 1) adequate records of expenditures are kept; 2) the church organization furnishes a written acknowledgment that services were performed that required the expense (*i.e.* travel away from home); and 3) the acknowledgment states no goods or services were provided to the volunteer or provides a good faith estimate of the value of such services. Volunteers may claim a deduction either for actual costs of using a car for charitable trips or use a set rate of \$.14 per mile.

See [IRS Draft Publication 1828](#) which can be obtained by calling the IRS at 800.829.3676 for more information on substantiation. Also see IRS Publication 526 on Charitable Contributions.

In addition, there are quid pro quo rules that apply to contributions of \$75 or more that are part contribution and part payment for goods or services in exchange for the contribution, such as a purchase of a \$100 ticket to a fundraising event such as a dinner/dance.

2. Quid Pro Quo Rules

Where goods or services (other than “intangible religious benefits,” such as prayers) are provided in return for **contributions exceeding \$75**, the law requires donors to be provided a written statement “in connection with the solicitation or receipt of the contribution.” A church dinner dance or a church youth fundraising charity auction are examples of goods and services. The church's written acknowledgment of such gifts should include a statement like the following:

In accordance with Internal Revenue Code requirements, we are required to inform you that the amount of your contribution that is tax-deductible is limited to the amount of the contribution you made less the value of any goods or services we provided in return. The law requires us to furnish you this statement and a good faith estimate of the value of goods and services provided to you in connection with this gift. The value of the goods or services provided to you is \$_____.

The **only** exceptions are where the goods are token gift items (such as pens, pencils, etc.) bearing the church name and having a cost of \$7.40 or less, OR where the value of the goods or services is **less than the lesser of \$74 or 2%** of the amount of the contribution (these dollar amounts apply to 2000 and may be adjusted in future years).

Some examples illustrate the requirements. At a church fundraising “sale” a person buys a chair for \$300 which has a value of \$40. This contribution must be reported. If a person buys a book for \$120, which has a value of \$2, the church has no reporting requirement.

If the contribution is less than \$75 the donor may only deduct the amount of the donation less the value of the item received but the church does not have a reporting requirement.

Obtaining IRS Forms and Publications

Pick-up or Order by Telephone

IRS forms can be obtained from your local IRS office or by contacting the IRS at **800.829.3676 (800.TAX.FORM)** and asking them to mail you forms. (This is the only way to get the proper IRS Form W-2 and W-3 for filing purposes) In addition, there are now a number of other convenient ways to obtain forms.

Internet

At www.irs.gov (Click on “Forms and Publications” at the bottom of the page)

Fax Forms

The most frequently requested tax forms are available through IRS Fax Forms Service. Callers must phone directly from the handset of a fax machine. For a menu of items, call from a fax machine

(703.368.9694).

If you are having a problem with the fax method, you can call **703.487.4608** for assistance.

Other

Many public libraries and post offices also have forms available.

**Sample Housing or Parsonage Allowance
Insert for Minutes of Meeting**

The chairperson informed the meeting that under the tax law an minister of the gospel is (1) not subject to Federal Income Tax with respect to the parsonage allowance paid to him or her “as part of his or her compensation to the extent used by him or her to rent or provide a home” and (2) not subject to Federal Income Tax on the rental value of a home supplied to him or her rent-free.

The (Church, Charge Conference or Church Council) on the ____ day of _____, 200__, after considering the statement of Rev. _____ setting forth the amount Rev. _____ estimates he or she will be required to spend to rent or provide a home for himself or herself and his or her family during the year 200__, on motion duly made and seconded, adopted the following resolution: (or—The Church, Charge Conference or Church Council on the __ day of _____, 200_, after discussing the amount to be paid to Rev. _____ as a parsonage allowance, on motion duly made and seconded, adopted the following resolution:)

“Resolved that Rev. _____ receive compensation of \$ _____ for the year 200__. Rev. _____ receive a parsonage allowance of \$ _____ for the year 200__ and all future years unless otherwise provided.”

(If the minister is to have rent-free use of the home, also state: “Rev. _____ shall also have the rent-free use of the home located at _____ for the year 200__ and for every year thereafter so long as he/she is minister of the _____ church unless otherwise provided.”) The parsonage allowance (and rent-free use of a home) shall be so designated in the official church records.

Sample Housing or Parsonage Allowance Notification by Church

Date

Dear _____:

This is to advise you that at a meeting held on _____, your parsonage allowance for the year 200__ was officially designated and fixed in the amount of \$ _____. Accordingly, \$ _____ of the total payments to you during the year 200__ will constitute parsonage allowance and the balance will constitute compensation. (You will also have rent-free use of the home located at for the year 200__). This designation shall apply to calendar year 200__ and all future years unless otherwise provided. Under § 107 of the Internal Revenue Code an ordained minister of the gospel is allowed to exclude from gross income the parsonage allowance paid to him or her as part of his or her compensation to the extent used by him or her to rent or provide a home (He or She may also exclude the rent-free use of a home for income tax purposes).

You should keep an accurate record of your expenditures to rent or provide a home in order to be able to substantiate any amounts excluded from gross income in filing your Federal Income Tax return. Remember that the housing allowance (including the fair rental value of a provided parsonage) must be included as part of your income for the self-employment tax. In the event of an audit, clergy receiving a § 107 exclusion will have the responsibility of substantiating the use of such funds.

Sincerely yours,

Title