Quit Ignoring the ELEPHANT!

Approximately 80% of churches are not 501(c)(3) compliant.

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Step One: Incorporate

As a new church planter, many of are so full of vision and passion to see our dreams come to pass, souls won over to Christ, and a renewed world, that we often forget about the legal side of the ministry. It’s doubtful, too, that the impassioned church planter has thought much about disgruntled church members and lawsuits.

Unfortunately, these types of things do happen. The truth is, we live in one of the most litigious societies on earth. Lawsuits abound from every angle, and the church happens to be the second-most sued organization; second only to the United States government.

Having said that, let’s keep in mind what Benjamin Franklin once said: “An ounce of prevention is better than a pound of cure.”

It’s important that you take into account the need to protect yourself as you move forward with launching your church.

First step to protecting your church - Incorporate!

More than ever, church lawsuits are on the rise. By incorporating your church or ministry, you are providing protection against possible litigation that could be very harmful to the church and its members. Incorporating establishes limited legal liability, otherwise known as "the corporate veil." Simply stated, limited legal liability affords protection for the personal assets of the founders, directors, officers, trustees and others in leadership positions, should anyone ever try to sue the church. This is a must-take step for any church wishing to properly establish itself on solid ground.

You may be wondering, “How do I get the church charter?” First of all, let’s understand what a charter is:

A document issued by a sovereign, legislature, or other authority, creating a public or private corporation, such as a city, (church), college, or bank, and defining its privileges and purposes.

To become chartered you need to incorporate your church. When you incorporate the state grants your church legal status (a charter) and it becomes a
new entity. It’s that simple. However, keep in mind that it’s what’s written in
your charter paperwork that is of extreme importance.

One additional thing to consider when incorporating is to know that there are
annual maintenance requirements for your new church. These annual
requirements differ from state to state, and are often called annual reports. Make
sure that you file your annual report and that the state fees are paid. Also, many
states have adopted the Model Nonprofit Corporation Act, which requires that
corporate records of the church be kept at the registered office of the church.

**The Importance of Incorporating Properly**

Are you ready to incorporate and get your church established the right way? We
are here to help. Whether you want to do the work yourself or you choose to
have us do it for you, we offer the premiere resources to make your vision
possible.

Every state in America has its own set of legislation governing the way
corporations are formed. Do you know what your state requires? We do!

We stress the importance of proper incorporation because so much of the
church’s future depends on whether or not the legal paperwork is set up
correctly. Accurate articles of incorporation will create an entity that can acquire
property and hold assets in its name, license and ordain ministers of the Gospel,
create world-wide missions programs, and do so much more.

Contrary to the beliefs of some, incorporating your church does not mean that
you are subjecting God’s kingdom to the laws of man. You are simply creating
an entity that can act in the name of the church.

Your basic blueprint for success is found within the 10 steps outlined here. If you
have these 10 bases covered, you are surely setting yourself up for success.
Step Two: Write Proper Bylaws

Churches live and die, legally speaking, by their bylaws and board meeting minutes, and yet most church plants are using old, recycled bylaws that they found from some other church. Know that it is critical to the long term legal health of your church to have a set of bylaws created specifically to suit the needs of your organization.

Why Are Bylaws Important?

On any given day, within the 50 states, thousands of churches are in court because of disputes between members and leaders. These disputes usually begin with personality differences, but often end up with both parties having to look at the details of the church's bylaws. Such was the case with a church in Ohio whose pastor chose to change the time of the church's annual business meeting. When some disgruntled members disagreed with his decision and noticed it was inconsistent with their bylaws, they sued the pastor. The court, in keeping with the church's bylaws, invalidated the meeting because the pastor did not follow the procedures stated therein. Do you know what's in YOUR bylaws?

Knowing Your Bylaws

Have you read your bylaws lately? Do you know what they say? You must know what is in those bylaws so that you do not find yourself in trouble for any of the decisions you have made. In the Church Compliance and Ministry Empowerment Conferences that we present across America, one of the most recurring comments we hear is, "We are not doing most of the stuff that’s in our bylaws." This is a serious problem that occurs in thousands of churches. It's no wonder churches, now more than ever, find themselves in court.

Below are the five common ways pastors and leaders violate their bylaws.

Five Ways You May be Violating Your Bylaws

1. Spending Limits

Your bylaws may state that checks for any amount exceeding $1,000.00 require two signatures, but as the pastor you have been signing checks that are for larger amounts without ever realizing the financial limit clause exists. Be sure to check whether or not your bylaws contain such a clause!
2. Annual Audit
Many church bylaws require that an annual audit of the books be conducted every year, but very few churches actually do it. There are different types of audits that can be done with your church books. For churches with more than 1200 members, I recommend the professional approach of hiring this out. However, generally for churches with less than 1200 members, I do not recommend that it be a professional (simply for cost’s sake). Take the approach that a sufficient number of people have looked at the books and can give reasonable assurance that good stewardship and accountability exists, and that the financial records are accurate. It’s recommended that the treasurer do this with a church member who has business/financial training.

3. Removing a Member
When a church member publicly or privately, and without repentance, lives a lifestyle that is contrary to Scripture, the time may come for the church to have that member removed. The procedure used to remove the person must be exactly as described in the bylaws. Did you know that the largest source of church disputes concern matters such as this, as well as which provisions in the bylaws address it? Never assume that a church member living in unrepentant sin will go down quietly. You may not even have a procedure for removal, which means you may not be allowed to remove a member once he/she has been added to membership. If that provision is missing, you need to amend the bylaws.

4. Annual Minutes
The laws of all fifty states require that an incorporated church conduct an annual board meeting with real minutes taken, recording the discussion and decisions of the board meeting. Do your bylaws call for an annual meeting? If not, you need to amend them to have that clause added. If so, have you been conducting one, and do you have adequate minutes to reflect the meeting? If not, then it is time for change.

This is a really important compliance issue. First of all, the states require it. Not doing it can invalidate the members of the board, including the pastor/president. Why? Because the minutes are the official documentation that the board, including the president, secretary, and treasurer, have been elected. In addition, you must document every time the board is re-elected (we recommend no more than a two-year period between re-elections). This may sound like a technicality, but without the directors being re-elected, the law can remove you if you allow
your term to expire without a re-election formally recorded in minutes. Second, in order to keep your tax exempt status, the IRS requires an annual meeting with accurate minutes, regardless of whether you have applied for and received your 501(c)(3) approval. Finally, what does it say of our stewardship when we cannot keep an accurate record of the decisions we make as leaders of the church?

5. Pastor's Authority
Have you been wondering if you have the necessary authority to make church decisions on a day-to-day basis? Is there a clause that authorizes you to do so? One thing that is unique to a church is that it can be an ecclesiastical organization. The document that reflects this more than any other should be the bylaws. The bylaws need to give you authority as the religious leader and visionary to be the chief decision maker because every decision made affects the spiritual wellbeing of the church.

As a pastor you may be leading the church and making the necessary decisions to grow and foster a healthy congregational environment. Without the bylaws giving you ecclesiastical authority, all it takes is one bad apple to bring you grief. Don't be caught off guard and unprotected.

The Bylaws are No Trivial Matter
A dangerous posture to take is the belief that the matters of church bylaws are trivial. Please don't be like one pastor who said, "I don't worry about trivial matters . . . it's God's sheepfold and HE is the One who takes care of me." That is true; He does take care of all of us. He will also take care of us whether we are in church or in court having to defend our ministries. With a little bit of effort today, you can avoid trouble down the road later. Do not walk alone . . . Let us help!

Protecting Your Ministry is of Absolute Importance!
A pastor was once ousted from his own church by the members because they did not like the way he was running the church. After 19 years of ministry experience, I have learned that when church government empowers the members to vote in and vote out their pastors, they usually vote him/her out for seemingly trivial reasons. Moreover, the pastor also has a higher tendency to become a hireling and not a shepherd who lays his life down for the sheep.

Recent history has shown a dangerous trend of hyper-increased lawsuits against churches and pastors. This trend is higher among churches who have poorly
written bylaws, or bylaws that do not give the pastor ecclesiastical authority. The bylaws (also known as the Constitution and Bylaws) create government structure within the church and protect the pastor’s authority to do what he or she feels is the best interest of the church. Are your church bylaws deficient? Do they contain the necessary provisions to properly give the pastor/president the authority to run and manage the church as the Lord directs?

What Exactly is Ecclesiastical Authority?

In short, ecclesiastical authority refers to a set of ideas listed in the constitution and bylaws of a church or religious organization that courts interpret as the religious organizational structure, as well as the decision making process of the church. Lawsuits that challenge properly established ecclesiastical authority always get thrown out because courts cannot decide upon the matter using neutral principal of law. It is important to note, however, that proper ecclesiastical authority in our bylaws is based on Biblical conviction and backed with Scriptures. Many churches try to give the pastor control without properly establishing an ecclesiastical government. Because of deficiencies in the bylaws, the courts can intervene and have their say in church matters. The language of the bylaws must be worded in such a way that the pastor heads the government and relies on the counsel of the board of directors.

In the case of Watson v. Jones, the court ruled, "Whenever the questions of discipline, or of faith, of ecclesiastical rule, custom, or law have been decided by the highest church judicatory to which the matter has been carried, the legal tribunals must accept such decisions as final, and as binding on them . . ." In addition to creating an ecclesiastical government, the bylaws need specific language that declares the pastor as the highest authority of the church. One example that we recommend is as follows:

"Any disputes that arise over the interpretation of these bylaws shall be deferred to the highest authority of this church. In this case it would be the Pastor, with the advice of the Board of Directors. The Pastor shall be responsible for the day-to-day decisions and shall run the affairs of the church."

What Ecclesiastical Authority is Not!

I have read many church bylaws that give the pastor complete and total control of the church with very little regard to doctrine, Scripture or other theocratic government structure. That is not ecclesiastical authority. Because of recent changes to nonprofit, tax-exempt regulations, these types of bylaws do not
qualify to be used in a tax-exempt organization. Moreover, churches that were approved for 501(c)(3) status before the regulations changed DO NOT get grandfather status. They, too, must amend their bylaws.

**How Do We Create an Ecclesiastical Government for Our Church?**

Younger churches have an easier time establishing a scripturally-based ecclesiastical government structure. As the church grows, the culture of the church continues, out of respect and admiration, to operate in a way that honors the pastor’s decisions. Whether you are considering starting a church now, or if you’ve just recently started one, let us take a look at your bylaws. Right now is the best time to ensure that you get off to the right start. We will gladly review them and propose our recommended changes, or we can assist you in starting fresh with a new set to ensure that you get off to the best possible start.

Churches that have been in existence for an extended number of years will have a more difficult time making these changes. It can be hard to change the mindset of a congregation that has operated under a certain government structure. Regardless of the age of your church, it is possible to make the necessary changes, especially if they are to ensure the stability and success of your nonprofit.

We strongly believe that creating a proper government for your church is vital to long term success. In all of our Church Compliance and Ministry Empowerment Conferences we teach the importance of certain clauses and articles that need to be included in the bylaws. Some of those articles are as follows:

- Ecclesiastical Authority
- Homosexuality Protection Article
- Scriptural Standard of Living Clause
- Accountability Board Article
- Compensation Committee to Give Pastor Significant Influence
- Numbered Officers Clause
- Member Privacy Article
- Financial Privacy Article
Final Thought On Bylaws

We often assist churches and ministries who have previously hired an attorney or other professional preparation service to set up their legal paperwork, such as the incorporation, bylaws and 501(c)(3) status. The problem is that often preparation services advise to keep the application simple by adopting bylaws that are seriously deficient in ecclesiastical government, but IRS-friendly. This is a disservice to the church because it does not take into consideration the uniqueness of an ecclesiastical organization, where rules and customs must be in place to ensure the church’s special protection and recognition not afforded to other nonprofit organizations. Do not compromise your position and unique status. Take care of it all at once and make sure you properly set up your church government from the start.
Step Three: Complete Organizational Board Meeting Minutes

Does Your Ministry Keep Minutes?

A board meeting without minutes is merely fellowship. When a church has a board meeting, it MUST be documented. Minutes must be taken and properly formatted. The minutes are documented discussions and decisions made by the board of directors. Those minutes must also be read by each board member and approved by a vote of the board. If the board got together and had a board meeting without minutes, the board simply had a time of fellowship.

What if My Board Members Live in Different Cities or States?

The laws of all 50 states clearly require that a minimum of one board meeting take place and that minutes be taken to document the decisions made. Many churches find it difficult to get together for a board meeting because board members live far away. If your church started out with board members living in different states, you understand the difficulties in gathering for a meeting. The answer to this dilemma lies in your bylaws.

Your Bylaws and Minutes

What your bylaws state about board meeting minutes can make or break you. Every church, ministry, and any other type of nonprofit should include language in their bylaws that allows for board meetings to take place through electronic communication. If state laws make provisions for this, why not have articles within your bylaws that allow for electronic means of attendance at a board meeting and unanimous written consent by email? These provisions mean that board members who live in other states can participate as if they were physically at the meetings.
**How to Keep Minutes**

Below is a quick checklist of how to properly schedule a board meeting and to keep meeting minutes. Our resource, titled Corporate Records Kit, will teach you step-by-step how to maintain proper board meeting minutes, along with all of your other corporate records.

1. Create an agenda and properly format it with the call to order, reading of previous minutes, new business, old business, etc.

2. Send out the notice of a board meeting to each board member, giving sufficient time as required by your state's law.

3. Create an attendance list and use it to keep attendance of those present and those absent.

4. Keep detailed notes of the discussions and decisions using a form based on the agenda (StartCHURCH provides that form in the Corporate Records Kit).

5. Use the notes to create the actual minutes using the format we recommend in our Corporate Records Kit. Send a copy to each board member.

6. At the next board meeting, ratify the copy of the minutes you sent to each board member.

**Minutes and Corporate Records**

What good will board meetings be if the minutes do not appear in the corporate records? Section 16.01(a), The Model Corporation Act of 1987, states, "A corporation shall keep as permanent records minutes of all meetings . . ." It also states that the corporation shall keep the following records in the office of the church or ministry:

1. Articles, or restated articles of incorporation and all amendments to them currently in effect;

2. Bylaws, or restated bylaws, and all amendments to them currently in effect;

3. Resolutions adopted by its board of directors relating to the characteristics, qualifications, rights, limitations and obligations of members, or any class or category of members;
4. Minutes of all meetings of members and records of all actions approved by the members for the past three years;

5. All written communications to members, generally within the past three years, including the financial statements furnished for the past three years;

6. A list of the names and business, or home, addresses of its current directors and officers;

7. Its most recent annual report delivered to the secretary of state.

**Final Thoughts**

A federal court in Washington ruled that a church did not have a valid board of directors because minutes were never taken to document the election or appointment of the actual board members. Failure to keep minutes allows for a court to pierce the corporate veil. Additionally, in an audit, the only proof you have to show that your ministry operates in a manner consistent with your purpose, bylaws and section 501(c)(3), is well-documented board meeting minutes. Failure to keep minutes may cause you significant grief.
Step Four: Start a Valid Ordination Program

At StartCHURCH we have always encouraged every church in America to have its own licensing and ordination program. Whether your church has been around for many years or is a brand new start-up, we believe that part of the stewardship of running a ministry is the proper (legal) ordination of those whom the Lord sets apart for the ministry. Because our society has an established set of beneficial laws regarding the ordination of ministers of the Gospel, we ought to take advantage of them, as a matter of operating our ministries with excellence.

For example, legally licensed or ordained ministers of the gospel have the right to perform marriages and funerals and to become chaplains in local correctional facilities and schools. Additionally, special tax breaks such as the Housing Allowance, deferred compensation, and self-employment tax exemption can make a minister’s income become mostly, if not completely, tax free.

However, many churches are nowhere close to being compliant when it comes to the licensing and ordination of ministers. While every church can create its own licensing and ordination program, the state and the IRS have the right to determine whether the ordination of a minister qualifies him or her to perform marriages or to receive special tax benefits. Many ministers have done their tax returns with the assumption that they are ordained and eligible for benefits as a minister, even though they may not necessarily qualify. In order for the IRS to consider the ordination of a minister as valid, the church must make sure that certain requirements are met.

We have identified at least eight requirements that we believe should be met in order to ensure that your church’s ordination of ministers meets all state and federal requirements for tax purposes.

One very important step is the language that needs to be stated in the church’s articles of incorporation. A tax court rejected the license of a minister because the church that ordained him did not have any language in its articles of incorporation stating that it would license ministers of the Gospel. In its conclusion, the court believed that in the absence of such language in the articles of incorporation, the church was simply engaging in a paperwork procedure just
to get him a tax benefit. Now is a good time to look at your church or ministry's articles of incorporation and check to see if there is language that states that your church will "license and oversee ministers of the gospel." If that language is missing, we strongly recommend that you amend your articles of incorporation to add it to your purpose statement.
Step Five: Create a Proper Housing Allowance Designation

The Housing Allowance is one of the best tax saving benefits that exists for pastors. Every pastor in America, whether or not he or she is on salary at the church, needs to have a housing allowance designation set up at the church. By having an allowance set up at the church, the minister will be able to save thousands of dollars every year in taxes. In 1921, Congress enacted the Revenue Act for all ministers who had a house provided to them by the church. However, in 1954, it amended the act to include ministers who rented or owned their own homes. Then in 1960 the IRS issued new regulations which state that if the housing allowance is properly implemented by the church, any minister of that church can exclude home expenses from his or her income. These home expenses range from rent, principle and interest, taxes, appliances, repairs, furniture and much more, so long as those are expenses that provide the minister a home.

As mentioned earlier, it does not matter whether you own or rent a home. As long as you are a licensed or ordained minister, you can implement a housing allowance program and save big on taxes.

How Has the Housing Allowance Changed?

In 2002, Congress passed the Clergy Housing Allowance Clarification Act. The new act requires ministers to calculate their housing allowance using three different scenarios in order to make sure that it is calculated correctly. Though it has been around for several years, most ministers do not know about the change. Because they are unaware, most ministers have been calculating their housing allowances incorrectly, which can result in severe IRS penalties and interest. It is important to clearly understand how the Clergy Housing Allowance Clarification Act of 2002 requires a minister to calculate the housing allowance.

First, it requires that a minister calculate the estimated expenses of his or her home. Using our housing allowance statement, a minister must estimate the projected cost of every qualifying expense at the beginning of each year. It also requires a minister to calculate the fair rental value of the home, plus furnishings, utilities and garages. The final calculation is the actual cost of the home for the entire year. After these three scenarios have been calculated, the minister is
supposed to claim the lesser of the three figures and report it on line 14 of his or her W-2 form. These three costs have to be calculated by January 1 of each year in order for a minister to properly set the housing allowance in motion.

Sound confusing? It is confusing! The Clarification Act made it much more complicated and cumbersome than before, with more work to be done than ever before.

Although Congress made changes to the Housing Allowance which made it more complicated, it was forced to make these decisions because of a court case that was taking place in the Ninth Circuit Federal Court of Appeals in California. This case was an appeal by the IRS, trying to convince the court that Rick Warren owed over $55,000 in taxes because he over-declared his housing allowance. Though neither Rick nor the IRS asked the court to consider the constitutionality of the housing allowance, the liberal court took it upon itself (this is not usual) to order each party to submit briefs on whether or not the housing allowance was constitutional. The court also asked a law professor from the University of Southern California to become a friend of the court and submit a brief on the constitutionality of the housing allowance. As expected, the professor and the liberal court quickly moved towards making it unconstitutional. However, in an unprecedented move, Congress acted quickly and unanimously passed the Housing Allowance Clarification Act of 2002. Congress specifically passed this law to end the IRS’s need to continue its case before the Ninth Circuit of Appeals. By ending the IRS appeal, the case became moot and was dismissed before the court could decide on the constitutionality of the housing allowance.

Though the changes made to the Housing Allowance may be more complicated than ever before, it is still a worthwhile tax benefit. You are able to write off 100 percent of either your actual expenses or rental value. However, it must be done correctly. In order for the Housing Allowance to be set up, the church must have a board meeting to set up the Housing Allowance Designation. The language of the designation in the minutes has to be precise to reflect the new changes, as well. That is why we offer it as a service. We want every minister in America to get it right.
Step Six: Create Important Policies and Procedures

The Convenience of Debit Cards

"It’s convenient and much easier than writing a check," were the words one pastor said as he swiped his card at a Christian bookstore. He was buying research material for a sermon series he was doing on marriage and family. He purchased several books and one set of DVD teachings from a popular Christian speaker. Later that day he went online and made a small purchase of mp3 messages as he continued to do his research. The pastor took all of the research material home and stayed up until the wee hours of the night studying and preparing. He was now at the tail end of preparation for the new six-week series and would soon preach it at the church. The total bill of his research was approximately $400.00. It was a small price to pay compared to the impact it would have on the church and its families.

What the IRS Has to Say About it.

In 1996, Congress passed section 4958, designed to give the IRS power to penalize board members and others of significant church/ministry influence when they violate certain rules. Under the rules of section 4958, if a board member, such as the pastor, receives a benefit without proper documentation, it is automatically classified as an "excess benefit transaction."

What is an Excess Benefit Transaction?

It is very common for a pastor to pay for sermon research materials using the church debit card, and for those materials to end up in the pastor's personal library. Although this is reasonable and there is normally nothing wrong with it, if the church paid for the materials then it has to be properly documented as part of the church's accountable reimbursement plan. It is usually in the area of documentation that we are sloppy because it feels like unnecessary or unreasonable paperwork. However, IRS agents are instructed to look at each transaction to determine if the written requirements were satisfied, regardless of whether or not the transaction was reasonable, and to issue very heavy fines if they do not meet the documentation requirements.
How to Properly Document Such Transactions

In order to properly document the pastor’s use of the church debit card to pay for the pastor’s study three things have to be done:

1. Adopt an accountable reimbursement policy: In order for the church to reimburse any expenses, it first has to adopt a reimbursement policy that meets the requirements of section 62(a)(2)(A). This policy has to describe an arrangement that either pays for or reimburses expenses that are in connection with the performance of services as an employee.

2. Authorize the pastor: The pastor has to receive written authority in advance by the board of directors to make purchases of this nature. If the pastor is on any type of salary, then this authority has to be part of the salary compensation agreement. If the pastor is not on salary, then it needs to be passed as a resolution of the board of directors. Below is sample text that gives this authority.

   *The board agrees to reimburse Reverend John Doe for all authorized expenses incurred in business directly related to the church, which include but shall not be limited to the cost of books, periodicals, and reference materials used in the performance of duties.*

3. Write on the back of receipts: It is very important that you take the receipt and write a detailed description on the back. It is especially important when the pastor uses the church debit card because it proves that the purchase was necessary as a church expense and that it meets the requirements of the church reimbursement policy, as well the agreement or resolution.

The IRS is Ramping Up Its Audits on Churches

The regulation of IRS Code Section 7611 has been updated and the IRS is once again going to ramp up audits of churches. Is it possible that your church may get audited in the next several months? There is no way of knowing! But what I do know is that if your church does get audited, you will filled with gladness that you took the information in this article and put in into practice. Therefore, keep receipts, take the necessary steps mentioned above, and ensure that your records reflect excellence of stewardship.
Step Seven: Ensure Section 4958 Compliance

What About Section 4958 Requirements?

Under Section 4958, the IRS has been given the ability to levy intermediate sanctions on churches who do not have appropriate salary documentation. Many people believe that Section 4958 was created to ensure that salary packages do not become too excessive. This is not the case. This provision was created to ensure that salary packages are properly documented and reported to the IRS for tax purposes. Under this code, even the smallest gap in documentation will result in stiff intermediate sanctions of up to 200% under Treasury Regulation 53.4958-4(c)(1). The severity of these sanctions needs to be respected, as many ministers and churches will go under the IRS microscope in the near future.

Do you ever wonder if the church can legally pay for the pastor's cell phone, car or gas? Do you ever wonder how to properly allot for love offerings? Do you know whether or not a provision can be added to the pastor's compensation contract to take care of his or her spouse? Can you enter into a voluntary withholding agreement or even a retirement plan? Let us help you turn these questions into reality.

Avoid Excess Benefit Transactions

Compensating pastors for previous, un-paid years of service is perfectly legal. This stems from a court case involving a church who paid a pastor and his [missionary] son in lump sums for the years of work they performed for the church without pay. The church decided to sell its building for $834,000.00 and use a portion of the proceeds to pay the pastor and his son a lump sum so they could pay off their home mortgages of approximately $362,000.00. Some church members did not agree with that and filed a lawsuit against the church to prevent the sales and distribution of the proceeds. The church members involved in the lawsuit argued that this was an improper use of church funds. The court disagreed. It stated that a religious corporation may consider past services when putting together compensation packages, but that the church must exercise due diligence to ensure that the compensation is reasonable. The court also made it clear that Section 4958, which was enacted in 1996, provides severe penalties, or
intermediate sanctions, against organizations and board members who pay excessive benefits to their officers or insiders. Let me explain!

**What About Excess Benefit Transactions?**

The church was already paying the pastors (father and son) a regular salary at the time the building was sold. In addition to their salary, they each received approximately $200,000.00 as a special gratitude for the sacrificial work they had done in the past. While the court agreed that the church was able to consider past years, it noted that the IRS still had the right to scrutinize the total compensation and determine if it was reasonable for that year. Additionally, the court ruled that there are two types of compensation that could occur for past years.

- A church considers past years while putting together a compensation plan. The church must determine if the regular pay, combined with the past years compensation, is reasonable for that tax year.
- When a church promises compensation at an "...earlier date to be paid at a later date..." when the church can afford it.

In the descriptions given by the court, we see two types of past years compensation plans that can be used. The first limits the amount paid, in addition to the regular salary, to the strict requirements of Section 4958, as interpreted by the IRS in Private Letter Rulings 200435019, 200435020, 200435021, 200435022. Below are three steps to follow when considering this type of compensation plan for past years.

Compensation for past years must not exceed the total amount of what is reasonable for any given year. For example: In the year 2009, a pastor receives a salary of $55,000.00, plus the church decides to pay him an additional $30,000.00 to cover the last two years. This brings his total compensation up to $85,000.00 for 2009. The question at hand is whether or not the total compensation of $85,000 is reasonable for the whole year.

- Make sure the church gives the pastor a W-2 for the regular salary and the extra compensation.
- Make sure the pastor reports the regular salary and the extra salary on his or her tax return.
The second plan allows a church to pay lump sums for previous years, but only if the following conditions are met:

- The church enters into a contractual agreement with the pastor to pay him a salary for the work that he does. However, not all of the compensation promised in the contract is paid.
- The church then records it into its books as an accounts payable.
- When able, the church pays the pastor in a lump sum or as often as they are able.

Any amount paid to the pastor gets reported on the pastor’s W-2, and the pastor is required to report it on his Federal 1040 tax return and State tax return, if applicable.

As for the church that wanted to pay the father and son the $362,000.00? The court ruled that the church could consider past years, but it also remanded the case back to the district court to determine whether the $362,000.00 was fair compensation. This happened because the church could not prove that there was a contract signed between the church and the ministers during the years that they served with little or no pay.

Under the regulation of Section 4958, the church has to prove that the extra compensation of $362,000.00 was reasonable and that it furthered the purposes of the church. What should have been a $834,000.00 blessing to the church turned into a fight that lasted for years in court. If the church is unable to prove the reasonableness of the extra pay, the IRS can then issue intermediate sanctions of up to 200%. In this church’s case, that is a fine of $724,000.00!

With the increased scrutiny under the IRS Exempt Organizations Executive Compensation Compliance Initiative, we urge churches to know all the facts before approving compensation for past years. We can help you with this task.

**What if Something Happens to the Pastor?**

Say perhaps that a pastor on salary at a church has recently been thinking about his wife, who has been serving faithfully at the church with him for over 20 years, but without any salary. What began as a passing thought grew into a real concern: If something ever happened to him what would become of his spouse? From the day they married till now she had never needed to seek employment. Though he knew they were both dearly loved and respected by the church board of directors, he wondered how the board would continue to love his wife once he
passed away. This was a real dilemma in his heart, and he felt that the Lord had awakened him to deal with a potential problem.

Once an individual has passed on, people have a way of moving on quickly with their own lives and forgetting the promises they made to that individual. Such was the case in Tennessee when a pastor passed away who had shepherded a church for over 14 years. Before his death, he asked the board of directors (trustees) to please take good care of his wife. Promising to do so, they ensured him that she would be well cared for and lack nothing. When the pastor did pass away, the church kept its promise to take care of his wife. The church signed an agreement that they would give her $785.00 twice a month until the year 2010. All was well for a number of months until, for no apparent reason, less than a year later, the church felt it was in its best interest to discontinue taking care of her.

Unfortunately, she sued the church and LOST the case. The court ruled that it was the church’s right to no longer take care of her because the church was not currently receiving, and never had received, any real value (consideration) in return for its agreement to take care of her.

In basic contract law, a contract is not valid unless the party responsible for making payments receives something of value in return (consideration). Therefore, the church won because the consideration they received was from her husband, not her. The wording to protect her should have been in the compensation agreement between the pastor and the church, stating that in consideration for his services, if he passed away, the church would continue to pay his spouse (x) amount per week/month for (x) period of time. Pastor, please do not think that your church board would never do this. It is my experience that many retired pastors have often had church boards not pay them their retirement pensions and other deferred compensation agreements. Without clearly written contracts you run a high risk of losing out.

**Resolve This Dilemma by Having a Salary Compensation Package!**

There are two legal conditions that need to be met in order to ensure that your spouse is taken care of in the event of your death. The first one is usually enough. However, if you meet the first as well as the second, you create a court-proof agreement that will ensure the care of your spouse as dictated in your compensation package. The conditions are as follows:
1. Consideration
As stated earlier, the language in your compensation package must contain a statement indicating that in consideration for the services the pastor renders the church as a minister (as provided for in his job description), the church is paying the pastor and also making payments to his wife in the event of his death. If the salary compensation package clearly states that in consideration for the pastor's services the church, will, in the event of his death, make payments to her in a certain amount and for a certain period of time, then it becomes enforceable by law.

2. Promissory Estoppel
This is a doctrine that is interpreted by the courts to mean that the church's promise to pay the pastor and to take care of his wife is enforceable by law even without consideration of whether the promises induced the pastor and his wife to rely on those promises to their detriment.

The Bylaws are Not Enough!
Some churches believe that having language in the bylaws which states that the pastor's spouse shall be taken care of in the event of his/her death will ensure it happens. That is not true. Additionally, the IRS does not allow such language because, by regulation which is the full force and effect of law, it is considered private inurement. Taking care of the pastor's spouse in the event of early death must always be an item negotiated in the contract in order for it to be valid.

Many churches allow the pastor to use the church debit card for necessary church expenses such as a car allowance, travel costs, lunches and many other things. Under the law, most of these allowances are illegal and can result in fines and back taxes for the minister.

Improper use of the church debit card is of high priority on the IRS watch list, as many ministers have used it to pay for church expenses for which it is difficult to account. Additionally, if the church does not have a legally ratified Section 62 reimbursement plan, the use of the church debit card to pay for gas, travel and other expenses deemed necessary can be classified by the IRS as embezzlement and can result in fines and possibly criminal charges.

If there is one area where churches are vulnerable it is in the use of the church credit or debit card. That is because these expenses are easy to disguise as "necessary." Please be diligent in educating yourself on how to properly use a
church credit or debit card. Do not think that paying for certain expenses that you feel are necessary is OK with the IRS. There is a right way and a wrong way to do it.

Income tax regulations require that any and all money given to the pastor be reported as income unless certain requirements are met. Most churches are not aware that these regulations exist, much less that failure to follow these regulations may result in heavy fines to the church, the board members, and the pastor. Here is an example.

Church ABC pays Pastor Tom’s car payments. At the end of the year the total payments are $6,500.00. Since the pastor is wholly dedicated to the ministry, he uses his car for both ministry and personal use. The church board of directors recognizes his dedication to the call of God in his life and knows that he is unselfish in using his car for church purposes. Out of love and admiration, they approve for the church to make all his car payments. The problem with this scenario is very big and the consequences are, too!

Since 2005, treasury regulations have focused on these types of transactions. These regulations have been tightened each year. Section 4958 empowers the IRS to issue intermediate sanctions against the pastor and the board of directors for violations. If the church makes Pastor Tom’s car payments, the church is required to report those payments as income on Pastor Tom’s W-2. This means that a tax-free car stipend or allowance really does not exist. It is now labeled by the IRS as an excess benefit transaction. Under the code, the IRS will fine the pastor 200% of the car allowance plus penalties and interests on back taxes. Additionally, each board member that approved the transaction can be fined up to $10,000.00.

This is not written to scare you; rather, it is a trumpet call to the church. We need to know that the times have changed, the laws are real and so are the consequences.
Step Eight: Apply for Sales Tax Exemption

Obtaining Sales Tax Exemption is Great Stewardship!

Did you know that more than 25 states allow churches and ministries to apply for Sales and Use Tax exemption?

Obtaining the sales tax exemption is like getting an increase in your church’s budget. When you are exempt, the percentage of tax that you normally pay (without exemption) now stays in your church’s checkbook. When you compare our small fee for completing the application to the amount of money your church will save year after year, you will be pleased with the value of our services. You will wonder why you did not do this sooner!

In most cases, we can prepare an application for you and have it ready for state approval in 14 days. The state will then go over the application and will either have additional inquiries that need to be answered or they will grant the sales tax exemption. In either case, we work with the application until your church or ministry is granted a certificate of exemption.

Don’t Confuse Sales Tax Exemption With 501(c)(3) Status

We receive calls on a regular basis from ministries that are under the impression that because they have a tax ID number and 501(c)(3) status, that they are also exempt from Sales and Use tax. Unfortunately, that is not the case. In most states you have to formally apply for this exemption using the state's application process, which follows a strict code as set by the legislature. We understand that the process of getting Sales and Use Tax exemption is complicated and that is why we offer it as a service. Our goal is to help you achieve maximum stewardship over the finances that God has placed into your hands.
What About Franchise Tax Exemption?

Did you know that the state of California does not allow churches to apply for Sales and Use Tax exemption? Plus, they require all churches and ministries to pay an annual franchise tax of at least $800.00 per year. The good news is that you can apply to become exempt from the Franchise Tax. To do so, the church or ministry must formally apply to the Franchise Tax Board. Without official approval, the church or ministry will have to pay the annual tax or else they risk being declared administratively dissolved by the state.

If you have not applied, please give us a call and we will prepare the complete application for you, plus we will do all of the follow-up work required to get you approved.

Tax Exempt Church-Owned Property

Beth-El, an African-American church in the Chicago neighborhood of Englewood, purchased some property on 63rd Street in 1976. The church rehabilitated the property and established itself there. During the years that the church quietly enjoyed its existence on the property, the community improved and the church continued to grow. Unfortunately some time later, the county declared that because the church held bake sales, the property was no longer tax exempt because the bake sales were deemed a non-religious purpose. The county assessed over $100,000.00 in property taxes against the property. The church is currently in federal court trying to get its property back.

This case tells us that we are facing increasingly unfriendly local government attitudes toward churches. Local governments are doing this because of tax reintroduction programs for property. In other words, county officials are seeking to turn tax exempt property into taxable property to generate more revenue. Under these programs, local government officials have engaged in fraudulent activities. In this case, it appears that the government demonstrated hostility against the church by penalizing it without any clear reason. The county stated that the church engaged in unspecified "resale activity," which caused it to lose its property exemption. However, the church's only sales activities were occasional bake sales, which are exempted under state law. Additionally, the county proceeded to continue to tax the church without properly notifying it that it had revoked its property tax exemption. It also mailed tax deficiency notices and redemption letters to the wrong address. Later, the county sold the tax deed
to the city of Chicago, which then moved to have the church locked down and vacated. The church appealed in federal court, where the case finds itself today.

While I believe that Cook County and the city of Chicago acted improperly, I also believe that it is our responsibility to practice due diligence every year to ensure that compliance is met at all levels of church business. Had the church done a tax search every year on their property, they would have noticed that the county was taxing it improperly and could have appealed and had it corrected. Finding out that your church property has been sold off and that another party claims to legally own it is painful. Having to fight in court to retake your property is unbelievable, but true in this case!
Step Nine: Develop An Intellectual Property Agreement

Most Pastors Are Unaware That They Do Not Own Their Sermons!

Many pastors have their sermons recorded on Sundays. They are normally saved in church archives and later used to create sermon series that the pastor sells when he travels. However, they are not aware that it is very likely that the pastor does not own these sermons, nor does he have a right to sell them for personal profit. Why? Aren't those his sermons? Did he not preach them? Aren't they his intellectual property? Those are good questions. Under current tax regulation, Treasury Regulation 53, if the sermon was recorded at a church service, using church funds, then it belongs to the church. Any sales of sermons made by the pastor are classified as an excess benefit transaction and will result in penalties of 200% of any sermon sales. Moreover, board members may also be liable for penalties of up to $10,000.00 each.

Can I Get in Trouble for Selling My Own Sermons?

Section 501(c)(3) prohibits any personal private gain from the church (this does not mean that you cannot earn a salary from the church). This applies to all churches without regard to their 501(c)(3) status (Internal Revenue Manual - 4.76.7.11(1)). When the pastor has his sermon recorded during a church service, it is usually done at a church service where he pastors. In most cases, it is recorded with church owned equipment and church money. At this point, if he takes his recorded messages and reproduces them, he is getting personal private inurement. Because of many other abuses that were taking place in the nonprofit and church worlds, Congress passed Section 4958. It defines any personal private inurement as an excess benefit transaction. Excess benefit transactions are defined as any special private benefits, outside of normal compensation, that are received by any person who is a member or exercises substantial influence or control over the church (4958(f)(1) and (2)). Taking the sermons that you preached at the church's expense is personal private inurement and a violation of Section 4958(c)(1)(a).
Is There a Right Way For Me to keep My Own Sermons?

YES! As a matter of fact, getting this right is easier than you might think. Because a minister is described as a self employed individual under Section 3401(a)(9), he or she is allowed to negotiate a creative license agreement with the church. Under this agreement, the pastor retains his right to keep the copyright to his own intellectual property, and if the church records his sermons, he will be allowed to keep a copy. In order to avoid an excess benefit transaction, the written agreement must describe how the church will transfer the recorded sermons to the pastor in a way that establishes that such transfer is in keeping with the purposes of the church. Generally, churches have a clause in the purpose statement of their articles of incorporation which states that the church will spread the good news of the Gospel. That clause is enough to allow for a sufficient agreement to be written which honors that clause. Following are three different ways it can be done.

Pastor That is on a Salary
In order for the pastor to be on salary at the church, he must sign a compensation agreement. As part of that compensation agreement you will want to include an article titled “Creative License”. That article needs to state that the pastor retains his rights to any and all intellectual property he produces while employed by the church, and that he may use it as he sees fit in order to spread the good news of the Gospel. It must also state that the pastor will reimburse the church (x) amount for each of the sermons of which he wishes to receive a copy. As we teach in all of our conferences, the board of directors must hold a board meeting and approve the contract.

Pastor That is Not on a Salary
When a pastor is not on salary, an independent Creative License Agreement covering the points in step one above is signed between the pastor and the church.

Pastor That is Coming into an Existing Church
When a minister is becoming the pastor of an existing church, at the time that an agreement is being signed for him to come, he has a little more negotiating power. This is because he is not considered to be someone of substantial influence until he actually becomes the pastor and, therefore, at the time of signing the agreement he is not subject to the requirements of Section 4958. As a result, the Creative License Agreement does not have to state that he will pay (x)
amount for each of the sermons for which he wishes to receive a copy. So long as that original contract is in place, he can continue to get copies at no charge.

**How Much Should the Church Charge?**

In my opinion, the charge for each sermon ought to be one that, when interpreted by an outside individual, seems fair. Keep in mind that the charge is just a reimbursement to the church for wear and tear on church equipment. Therefore, $3.00 to $10.00 for each copy should suffice.

**I Have Never Given Thought to This Before; What Do I Do Now?**

Correcting the problem may not be easy. While the sermon is yours, the actual recording is not. At this point, if you have already been using some of your sermons, a slightly different Creative License Agreement needs to be signed. This agreement needs to mention the date on which the first sermon was preached and should also state that you reserve your right to retain copyrights to all of your sermons. Furthermore, state that a fee of (“x”) will be paid to the church for each copy you receive. This guarantees that your sermons, from that day forward, are fully yours to use as you please. It does not guarantee that the sermons you produced and sold before the date of the agreement will meet Section 4958 requirements.

**We Will Teach You How To Properly Handle This Issue At One of Our Conferences**

This issue should be of great concern to pastors and leaders of ministries. Do not ignore it. IRS audits will increase now that the IRS Executive Compensation Compliance Project has been completed. Under this project, the IRS has developed an effective way to audit public charities and issue severe fines and penalties for violations. No time is better than the present to educate yourself and to gain the knowledge you need to better manage the ministry to which God has called you.
Step Ten: Learn to Run the Legal Side of Your Nonprofit

Attend a StartCHURCH Compliance Conference

It’s one thing to start right; it’s another thing to stay right! At StartCHURCH, we are committed to helping equip and empower a movement of pastors who don’t just work IN the ministry, but also ON the ministry. One of our most rewarding ways of doing this is through our "Church Compliance and Ministry Empowerment Conferences". We offer one-day conferences held in cities all across America. The aim of each conference is simple: To empower you to successfully navigate the tricky legal landscape of nonprofits and to lead your church to legal compliance.

The Truth Is: What You Do Not Know CAN Hurt You!

Contrary to what some are saying, the IRS is not seeking to persecute churches, BUT they are seriously cracking down on the laws governing all nonprofit, tax-exempt organizations; including churches. The IRS Code contains 265 areas that pertain to churches...265! Some are trivial, while others could cost you big if you do not follow the law exactly. Given that the IRS has a goal to examine one out of three churches in America within the next five years, you must know how to protect yourself. At our Church Compliance and Ministry Empowerment Conference you will learn:

- How to avoid the 10 most common IRS pitfalls. These are the areas where you are most likely to be in noncompliance, and they have the most potential to wreck your day.
- How managing your church benevolence program according to Income Tax Regulation 1.170A-4A(b)(2)(ii)(D) and Revenue Ruling 56-304 can save your church’s tax exempt status. Many churches have benevolence programs; most of those programs are in danger of causing the church to lose its tax exempt status because they are not being conducted according to the requirements of the law.
- The potentially devastating consequences for violating code Section 4958, and how it could cost your church corporately, your trustees individually, and even your church members! Sound scary? It is, but you do not have to be at risk. We will make sure you know what to change to be in compliance.
The fact is that most churches violate many sections of the IRS code without knowing it. Odds are, you are one of them. Ignorance of the law is inexcusable to the IRS. God is gracious, but the IRS is not! The good news is, you can learn how to fix it all.

During the conference we will cover many topics that are absolutely critical to operating your church or ministry in a way that simultaneously benefits the church and pastor while protecting all involved from the ever-increasing scrutiny of the government, such as:

- How to maximize the unique financial benefits available to ministers. Very few ministers take full advantage of the benefits their unique tax status affords them. The sad fact is, most ministers pay FAR more in taxes than legally required. That does not have to be you! With the information you will learn at this conference, you can take home more money, pay less taxes, and secure the financial future of your family.
- Why the ministerial housing allowance, when properly applied, is the single greatest tax savings available to anyone—and it’s only available to ministers! We have identified over 30 items that need to be calculated with your housing allowance, and we will teach you how to use them correctly. You might even eliminate your income taxes altogether!
- How you can take advantage of the unique opportunity for clergy to opt out of paying Social Security taxes without jeopardizing Social Security benefits at retirement. Does this sound too good to be true? It’s not! We will show you how to use IRS code, Section 1402(e), specifically to your benefit.
- How you likely qualified for the Earned Income Credit last year but were told by your misinformed CPA that you made too much money. Not to worry; this is one of the least understood issues for tax accountants. Be prepared this year.
- The money you are spending on medical expenses could be a tax-free benefit from your church under Code Section 105b, but only if it is done correctly. You will learn how.
- How churches can legally provide for the long-term care of the pastor’s spouse in the event of the pastor’s death. No, it is not the same as above, but it is just as valuable to your financial security! It is a better retirement vehicle than any 401k, 403b, IRA, etc., and it is tax free! Like many of the topics we will discuss, this one is available only to ministers. Your financial advisor has probably never heard of it, but now you have.