

Before the IRS Calls

Is there a high risk your church will be audited by the IRS? No. The risk of an IRS audit at your church is very low. (There is a higher risk that the Department of Labor will audit your church for Fair Labor Standards Act violations.)

Prudent Steps to Take

Review activities. Does the church have documentation to establish the relationship between the various church programs and its exempt purpose as a church? Today, churches launch a wide variety of ministries. Documenting the relationship of each ministry to the mission of the church is a fundamental principle.

Review your records. Are the basic records of the church (legal, financial, donor, personnel) stored on the church premises and labeled accurately? Many of the church records may be stored electronically on the church network. Does the church have a records retention policy and follow the policy?

Recognize all employees as employees. Does the church have clear policies to determine which workers are employees v. independent contractors? Does the church err on the side of classifying workers as employees? This topic is a hot-button with the IRS. They will tend to classify all workers as employees. If the church has classified workers as independent contractors and the IRS views them as employees, the IRS will assess FICA taxes (both halves—15.3%) and federal income tax withholding, plus penalties and interest—often going back three years.

Stay current on employment tax filings. Are payroll tax returns (Forms 941) timely filed each quarter and payroll tax deposits made when due? If the church is running close on cash, never borrow from the funds that are due to the IRS for payroll tax.

Consider any unrelated business income (UBI) filing responsibilities. Many churches have an obligation to file a UBI return but are unaware of this duty. This is an easy problem for the IRS to find. What triggers UBI filings? Just \$1,000 of gross unrelated business income requires the filing of Form 990-T. There is generally no tax to pay but the filing is still required. What is one of the most common types of UBI? There are many kinds of UBI, rental income from mortgaged property (not currently applicable to Saint Bart's) is a frequent audit item.

Keep your information filings up-to-date. Many other filings may be required with the IRS. Some common examples are: Form 5578 that must be annually filed if the church operates a private school. Form 1099-MISC that must be filed for independent contractors (be sure your files contain justification for independent contractor status). Form 1099-INT must generally be provided to recipients of \$10 or more of interest income. All payments to nonresident aliens, other than expense reimbursements and amounts reported on Form W-2, must be reported on Form 1042 and 1042-S (often overlooked and an important IRS audit item).

Carefully document the status of ministers. If a church treats an individual as a qualified minister, has the church clearly documented ministerial status? Is a copy of the ordination, licensing or commissioning document in each minister's personnel file? Has the church documented the position description of each minister?

Properly document the personal use of church-owned or leased vehicles. Saint Barts will not own or lease any vehicle.

Identify the personal use of cell phones. The personal use of cell phones is another important audit item with the IRS. The IRS Regulations on personal cell phone use are very strict. At a minimum, however, a church must make a reasonable effort to identify the personal use portion of cell phone usage from a compliance and risk management standpoint. It isn't enough to say the church bought so many minutes and didn't go over the limit. While neither option literally complies with Regulations, most churches that pay for church staff cell phone time either gross up the employee's Form W-2 or require a reimbursement for the personal use portion.

Properly handle spousal travel expenses. The spousal travel expenses of church staff members do not qualify for reimbursement by the church unless the spousal travel qualifies as business expense. Even if it appears there is a business purpose for the spousal travel, the key is documentation, e.g., documenting the purpose for spousal travel on a trip-by-trip basis.

Summary. This focused on specific steps to take before the IRS calls. The steps above will help maintain financial integrity and accountability, a worthy goal.

Reference

Enhancing Trust in Ministries, <https://www.ecfa.org/About.aspx>, edited