Recent IRS Rulings of Interest to Churches

By Dan Busby

Churches and pastors are not immune from the reach of the Internal Revenue Service (IRS). This principle is demonstrated in a series of four recent IRS rulings and one Tax Court case. While the ruling about "gift cards" did not involve a church, the determination is applicable to churches.

Church Is Lax in Handling Funds

A founder-pastor, his wife and two sons are the directors of the church (corporation). Here are some of the issues that drew the attention of the IRS, as reflected in a series of Technical Advice Memoranda *(TAM 200435019-22)*:

- The pastor and his wife maintained two personal residences, one near the church and one in an adjacent state. The church paid for cable TV expenses at one residence, and landscaping, cable TV and security system costs at the other. The IRS determined the cable TV, landscaping and security system expenses paid by the church were personal.
- The church bought another house to which only the pastor, his wife and their handyman have access. The church paid for the utilities, security system, cable TV and landscaping expenses for this house. The IRS determined the expenses paid for this house were personal, and the use of this church asset was an excess benefit.
- The church had several different credit cards. The pastor and his wife used the cards for meals, gas and other items. They retained the credit card statements and a few receipts. They did not note any business purpose or relationship, with respect to entries on the statements. Neither did they maintain any other records, account books, diaries, etc. to establish the business purpose or relationship of the expenses. The IRS made assessments related to the expenses not properly documented.
- The church paid cellular phone bills in full for the pastor's sons. The IRS found documentation that listed only the telephone numbers called and did not indicate with whom the sons spoke and the business reasons for their conversation. Aside from phone calls made to the church phone numbers, all other calls were considered unsubstantiated.
- The church purchased an automobile, which is driven occasionally and only on church business. However, the car is housed in the garage at the pastor's personal residence. The IRS determined most of the mileage was personal commuting, not subject to reimbursement, because the residence was not a principal place of business.

The IRS imposed a first-tier excess benefit transaction excise tax on the pastor equal to 25 percent of the excess benefit. Additionally, the agency imposed a 200 percent excise tax because the transactions were not corrected within the taxable period.

What could the church have done to avert the assessments made by the IRS in this case? If the directors of the church had formally indicated their intent in a timely manner (e.g., in an employment contract, church board minutes, or other documents) to treat the transactions as compensation, the IRS assessment could have been averted.

Tithing Does Not Qualify as a Necessary Living Expense

A minister received a notice of intent-to-levy from the IRS *(Pixley v. Commissioner, T.C. No. 7093-021)* concerning unpaid tax liabilities for two years. He submitted a request for a collection due-process hearing.

The minister claimed a tithe to the church as part of his necessary living expenses. The appeals officer requested evidence that the tithe was a condition of the minister's employment. Because the minister was unable to provide this evidence, the appeals officer declined to take the alleged tithing expenses into account.

The court concluded that disallowance of the alleged tithing expense did not violate the minister's First Amendment rights to free exercise of religion.

Gift Cards Are Includable in Wages

Churches sometimes provide gift cards to employees that they can use to buy a gift at the local mall. In a recent Technical Advice Memorandum *(TAM 200437030)*, the IRS made it clear that gift certificates, cash cards and checks are cash equivalents and fully taxable when given to employees.

The employer traditionally gave employees a turkey, ham or gift basket at certain times of the year. Then, the employer substituted a gift check for these items. The gift check could not be redeemed for cash; it had to be redeemed for groceries at selected grocery stores.

Even if a church has a long history of giving a turkey or ham or other tangible property, substituting a gift certificate with a specific dollar amount printed on its face will not make the gift certificate excludable from wages, regardless of how low the value of the gift card is.

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