

IRS Approval of Exemption Application

If the application for tax-exempt status is approved, the IRS will notify the organization of its status, any requirement to file an annual information return and its eligibility to receive deductible contributions. The IRS does not assign a special number or other identification as evidence of an organization's tax-exempt status.

Public Listing of Tax-Exempt Organizations

[Exempt Organizations Select Check](#) is an online search tool that allows users to search for organizations that are eligible to receive tax-deductible charitable contributions. Note that not every organization that is eligible to receive tax-deductible contributions is listed on *Select Check*. For example, churches that have not applied for recognition of tax-exempt status are not included in the publication. Only the parent organization in a group ruling is included by name on *Select Check*.

Select Check also allows users to search for organizations whose tax-exempt status has been automatically revoked because they have not met their annual filing requirement for three consecutive years. In addition, users may search *Select Check* for organizations that have filed a [Form 990-N](#) (*e-Postcard*) annual electronic notice.

If you have questions about listing an organization, correcting an erroneous entry or deleting a listing on *Select Check*, contact EO Customer Account Services toll-free at 877-829-5500.

Jeopardizing Tax-Exempt Status

All IRC Section 501(c)(3) organizations, including churches and religious organizations, must abide by certain rules:

- their net earnings may not inure to any private shareholder or individual;
- they must not provide a substantial benefit to private interests;
- they must not devote a substantial part of their activities to attempting to influence legislation;
- they must not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office; and
- the organization's purposes and activities may not be illegal or violate fundamental public policy.

Inurement and Private Benefit

Inurement to Insiders

Churches and religious organizations, like all exempt organizations under IRC Section 501(c)(3), are prohibited from engaging in activities that result in inurement of the church's or organization's income or assets to insiders (such as persons having a personal and private interest in the activities of the organization). Insiders could include the minister, church board members, officers, and in certain circumstances, employees. Examples of prohibited inurement include the payment of dividends, the payment of unreasonable compensation to insiders and transferring property to insiders for less than fair market value. The prohibition against inurement to insiders is absolute; therefore, any amount of inurement is, potentially, grounds for loss of tax-exempt status. In addition, the insider involved may be subject to excise tax. See the following section on **Excess benefit transactions**. Note that prohibited inurement doesn't include reasonable payments for services rendered, payments that further tax-exempt purposes or payments made for the fair market value of real or personal property.

Excess benefit transactions. In cases where an IRC Section 501(c)(3) organization provides an excess economic benefit to an insider, both the organization and the insider have engaged in an excess benefit transaction. The IRS may impose an excise tax on any insider who improperly benefits from an excess benefit transaction, as well as on organization managers who participate in the transaction knowing that it's improper. An insider who benefits from an excess benefit transaction must return the excess benefits to the organization. Detailed rules on excess benefit transactions are contained in the Code of Federal Regulations, Title 26, sections 53.4958-0 through 53.4958-8.

Private Benefit

An IRC Section 501(c)(3) organization's activities must be directed exclusively toward charitable, educational, religious or other exempt purposes. The organization's activities may not serve the private interests of any individual or organization. Rather, beneficiaries of an organization's activities must be recognized objects of charity (such as the poor or the distressed) or the community at large (for example, through the conduct of religious services or the promotion of religion). Private benefit is different from inurement to insiders. Private benefit may occur even if the persons benefited are not insiders. Also, private benefit must be substantial to jeopardize tax-exempt status.



Intermediate sanctions - excess benefit transactions

An excess benefit transaction is a transaction in which an economic benefit is provided by an **applicable tax-exempt organization**, directly or indirectly, to or for the use of a disqualified person, and the value of the economic benefit provided by the organization exceeds the value of the consideration received by the organization.

To determine if an excess benefit transaction occurred, include all consideration and benefits exchanged between or among the disqualified person and the applicable tax-exempt organization and all entities it controls.

In addition, if a **supporting organization** makes a grant, loan, payment of compensation, or similar payment to a substantial contributor of the organization, the arrangement is an excess benefit transaction. The entire amount of the payment is taxable as an excess benefit.

In an excess benefit transaction, the general rule for the valuation of property, including the right to use property, is fair market value. Fair market value is the price at which property, or the right to use property, would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy, sell, or transfer property or the right to use property, and both having reasonable knowledge of all relevant facts.

An excess benefit can occur in an exchange of **compensation** and other compensatory benefits in return for the services of a disqualified person, or in an exchange of property between a disqualified person and the applicable tax-exempt organization.

Certain transactions to which **donor-advised funds** or **supporting organizations** are parties are excess benefit transactions.

Date an Excess Benefit Transaction Occurs

An excess benefit transaction occurs on the date the disqualified person received the economic benefit from the applicable tax-exempt organization for federal income tax purposes. However, when a single contractual arrangement provides for a series of compensation payments or other payments to a disqualified person during the disqualified person's taxable year, any excess benefit with respect to these payments occurs on the last day of the disqualified person's taxable year.

Section 4958 applies to all excess benefit transactions occurring on or after September 14, 1995. However, Section 4958 does not apply to excess benefit transactions that occurred under a written contract, if the contract was binding on September 13, 1995 and at all times thereafter before the excess benefit transaction occurred.

Correcting the Excess Benefit

A disqualified person corrects an excess benefit transaction by undoing the excess benefit to the extent possible, and by taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards. The organization is not required to rescind the underlying agreement; however, the parties may need to modify an ongoing contract with respect to future payments.

A disqualified person corrects an excess benefit transaction by making a payment in cash or cash equivalents equal to the correction amount to the applicable tax-exempt organization. The correction amount equals the excess benefit plus the interest on the excess benefit. The interest rate may be no lower than the applicable Federal rate. There is an anti-abuse rule to prevent the disqualified person from effectively transferring property other than cash or cash equivalents.

With the agreement of the applicable tax-exempt organization, a disqualified person may make a payment by returning the specific property previously transferred in the excess benefit transaction. The return of property is considered a payment of cash (or cash equivalent) equal to the lesser of:

- The fair market value of the property on the date the property is returned to the organization, or
- The fair market value of the property on the date the excess benefit transaction occurred.

If the payment resulting from the return of property is less than the correction amount, the disqualified person must make an additional cash payment to the organization equal to the difference.

If the payment resulting from the return of the property exceeds the correction amount, the organization may make a cash payment to the disqualified person equal to the difference.

Interactive Training

Learn more about the benefits, limitations and expectations of tax-exempt organizations by attending 10 courses at the online [Small to Mid-Size Tax Exempt Organization Workshop](#).

Page Last Reviewed or Updated: 08-Jan-2020

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Payment of Employee Business Expenses

A church or religious organization is treated like any other employer as far as the tax rules on employee business expenses. The rules differ depending upon whether the expenses are paid through an accountable or non-accountable plan, and these plans determine whether the payment for these expenses is included in the employee's income.

Accountable Reimbursement Plan

An arrangement that an employer establishes to reimburse or advance employee business expenses will be an accountable plan if it: (1) involves a business connection, (2) requires the employee to substantiate expenses incurred and (3) requires the employee to return any excess amounts.

Employees must provide the organization with sufficient information to identify the specific business nature of each expense and to substantiate each element of an expenditure. It isn't sufficient for an employee to aggregate expenses into broad categories such as travel or to report expenses through the use of non-descriptive terms such as miscellaneous business expenses. Both the substantiation and the return of excess amounts must occur within a reasonable time.

Employee business expenses reimbursed under an accountable plan are: (a) excluded from an employee's gross income, (b) not required to be reported on the employee's IRS Form W-2, *Wage and Tax Statement*, and (c) exempt from the withholding and payment of wages subject to FICA taxes and income tax withholdings.

Non-accountable Reimbursement Plan

If the church or religious organization reimburses or advances the employee for business expenses, but the arrangement does not satisfy the three requirements of an accountable plan, the amounts paid to the employees are considered wages subject to FICA taxes and income tax withholding, if applicable, and are reportable on Form W-2. (Amounts paid to employee ministers are treated as wages reportable on Form W-2, but are not subject to FICA taxes or income tax withholding.)

For example, if a church or religious organization pays its secretary a \$200 per month allowance to reimburse monthly business expenses the secretary incurs while conducting church or religious organization business, and the secretary is not required to substantiate the expenses or return any excess, then the entire \$200 must be reported on Form W-2 as wages subject to FICA taxes and income tax withholding. In the same situation involving an employee-minister, the allowance must be reported on the minister's Form W-2, but no FICA or income tax withholding is required. For further information see IRS [Publication 463, Travel, Entertainment, Gift, and Car Expenses](#).

One common business expense reimbursement is for automobile mileage. If a church or religious organization pays a mileage allowance at a rate that is less than or equal to the federal standard rate, the amount of the expense is deemed substantiated. (Each year, the federal government establishes a standard mileage reimbursement rate.) There are no income or employment tax consequences to the reimbursed individual provided that the employee substantiates the time, place and business purposes of the automobile mileage for which reimbursement is sought. Of course, reimbursement for automobile mileage incurred for personal purposes is includible in the individual's income.

If a church or religious organization reimburses automobile mileage at a rate exceeding the standard mileage rate, the excess is treated as paid under a non-accountable plan. This means that the excess is includible in the individual's income and is subject to the withholding and payment of income and employment taxes, if applicable.

In addition, any mileage reimbursement that is paid without requiring the individual to substantiate the time, place and business purposes of each trip is included in the individual's income, regardless of the rate of reimbursement.

No income is attributed to an employee or a volunteer who uses an automobile owned by the church or religious organization to perform church-related work.

Recordkeeping Requirements

Books of Accounting and Other Types of Records

All tax-exempt organizations, including churches and religious organizations (regardless of whether tax-exempt status has been officially recognized by the IRS), are required to maintain books of accounting and other records necessary to justify their claim for exemption in the event of an audit. See [Special Rules Limiting IRS Authority to Audit a Church](#). Tax-exempt organizations are also required to maintain books and records that are necessary to accurately file any federal tax and information returns that may be required.

There is no specific format for keeping records. However, the types of required records frequently include organizing documents (charter, constitution, articles of incorporation) and bylaws, minute books, property records, general ledgers, receipts and disbursements journals, payroll records, banking records and invoices. The extent of the records necessary generally varies according to the type, size and complexity of the organization's activities.

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Length of Time to Retain Records

The law does not specify a length of time that records must be retained; however, the following guidelines should be applied in the event that the records may be material to the administration of any federal tax law.

| TYPE OF RECORD | LENGTH OF TIME TO RETAIN |
|---|---|
| Records of revenue and expenses, including payroll records. | Retain for at least four years after filing the returns to which they relate. |
| Records relating to acquisition and disposition of property (real and personal, including investments). | Retain for at least four years after the filing of the return for the year in which disposition occurs. |

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