

# Top 5 Legal and Tax Issues for Churches, from *an Attorney's Perspective*

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Without these items we are not properly able to credit you for this course.

## SESSION OBJECTIVES

**At the end of this session you will be able to:**

- Identify Important Legal and Tax Issues Facing Churches
- Consider Important Actions that may Lead Church Through Difficult Issues and Legal Challenges
- Create Plans and Policies to Champion Legal, Tax and Liability Issues

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## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

Issue #1:

# Tax Exemption Issues

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## Issue #1: Tax Exemption Issues

### Tax Exempt and Government Entities FY 2020 Program Letter (Priorities) (Oct. 2019)

#### Exempt Organizations

- Private benefit and inurement
- Organizations show indicators of potential private benefit or inurement to individuals or private entities by way of private foundation loans to disqualified persons.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #1: Tax Exemption Issues

Section 501(c)(3) grants exemption to orgs organized and operated exclusively for exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities consists of attempting to influence legislation, and which does not participate in any political campaign on behalf of (or in opposition to) any candidate



# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #1: Tax Exemption Issues

“Exclusively” for Exempt Purposes:

The presence of a single, substantial nonexempt purpose or activity, can destroy the exemption regardless of the number of exempt purposes.

*Better Bus. Bureau v. U.S.*, 326 U.S. 279 (1945) (examining 501(c)(3) org)



# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #1: Tax Exemption Issues

Private Inurement - “... no part of the net earnings of which inures to the benefit of any private shareholder or individual ...”

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #1: Tax Exemption Issues

- “The term ‘net earnings’ in the inurement-of-benefit clause . . . has been construed to permit an organization to incur **ordinary and necessary expenditures** in the course of its operations without losing its tax-exempt status.
- However, ‘an examination [of the Internal Revenue Code] reveals unmistakable evidence that, underlying all relevant parts of the Code, is the intent that **entitlement to tax exemption** depends on meeting certain common law standards of charity—namely, that an institution seeking tax-exempt status must serve a public purpose.’ . . .
- “[F]or every dollar that a man contributes to these public charities, educational, scientific, or otherwise, the public gets 100 percent.”

*Family Trust of Mass., Inc. v. U.S.*, (U.S. Dist. Ct. D.C. Sept. 24, 2012).

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #1: Tax Exemption Issues

PLR 201922036 –

- Salary paid in excess of approved amount = inurement
- Unpaid payroll taxes = inurement
- Mileage reimbursements not verified = inurement.
- Payments to the CFO = inurement (no verification as to whether the payments were loan repayments, reimbursements or compensation).

PLR 201921014 – Church denied exempt status due to inurement where congregational size small and primarily one family and most funds given were distributed back to the donor since they were operating the church. Church failed to designate compensation packages and other

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #1: Tax Exemption Issues

PLR 201906012 – Exemption revoked:

- Organization paid president for living expenses, and reimbursed expenses through non-accountable plan; no records or reporting.
- Loans to president reported on Form 990 but the amounts were deemed to not be bona fide loans.
- Expenditures classified as excess benefit transactions.
- Exempt purposes accomplished, but the size and scope of the transactions were significant, the transactions happened repeatedly, no safeguards were ever instituted to stop the activity, and no corrections were made.

PLR 201902032 Failure to follow an accountable expense reimbursement plan = revocation of tax exemption

## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

Issue #2:

# Child Abuse Issues

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

### Report of the Special Investigative Counsel Regarding the Actions of The Pennsylvania State University Related to the Child Sex Abuse Committed by Gerald A. Sandusky

- Four of the most powerful people at the University failed to protect against a child sexual predator harming children for over a decade.
- These men concealed Sandusky's activities from the Board, the University and authorities.
- “These individuals, *unchecked by the Board of Trustees that did not perform its oversight duties*, empowered Sandusky to attract potential victims[.]”

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

“Institutions and teams must take a fresh look at their policies and procedures relating to oversight, training, and screening of coaches, administrators, and volunteers – especially those with access to children.”

*Post-Penn State: Protection Against Sexual Harassment and Misconduct in Athletics*, Christian Dennie,

TEXAS BAR JOURNAL, Dec. 2012



# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

Who are we protecting?

The Lamb

&

The Flock

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

“A person having cause to believe that a child’s physical or mental health or welfare has been adversely affected by abuse or neglect by any person shall immediately make a report”.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

**Abuse:** Categories of “abuse” consist of acts or omissions by a person:

- Mental injury to a child that results in an observable and material impairment in the child’s growth or psychological functioning;
- Permitting the child to be in a situation in which the child sustains a mental injury that results in an observable and material impairment;
- Physical injury that results in substantial harm to the child, or the genuine threat of substantial harm from physical injury to the child;
- Failure to make a reasonable effort to prevent an action by another person that results in substantial harm to the child;
- Sexual conduct harmful to a child’s welfare, including conduct that constitutes a sex offense under the Penal Code

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

**Neglect:** Includes placing a child in or failing to remove the child from a situation in which the child would be exposed to a substantial risk of sexual conduct harmful to the child, or placing a child in or failing to remove the child from a situation in which the child would be exposed to acts or omissions that constitute sexual conduct.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

### What to Report:

The report should reflect the reporter's belief that a child has been or may be abused/neglected, and should identify, if known:

- The name and address of the child
- The name and address of the person responsible for the care, custody, or welfare of the child; and
- Any other pertinent information concerning the alleged or suspected abuse or neglect.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #2: Child Abuse

### No Clergy Privilege in Texas:

The requirement to report applies without exception to an individual whose personal communications may otherwise be privileged, including a member of the clergy.

## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

Issue #3:

# Sexual Harassment Issues



## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

### Issue #3: Sexual Harassment

“One by one the stories tumbled out, and every single woman at that table of church members had a story to tell.”

*Washington Post, Acts of Faith, Dec. 1, 2017, What Churches Must Do Right Now to Stop Being Part of the Sexual Harassment Problem*

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #3: Sexual Harassment

Fort Worth Star-Telegram, Oct. 8, 2019: “Baylor erred in dealing with sexual assault claims”

“The biggest mistake Baylor administrators made in dealing with the sexual assault claims at the school is that it failed to put the needs of the student ahead of the perception and PR of the school.”

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #3: Sexual Harassment

Sexual Harassment, Sexual Exploitation and Unlawful Discrimination → All Are Accountable

“Issues of sexual abuse and exploitation and gender discrimination are not just for one political party or type of theology.”

Kelly Rosati, vice president for child advocacy at Focus on the Family

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #3: Sexual Harassment

### Take Action:

- Have, consistently enforce *and use* policies and Employee Handbook – applies to all.
- Important: VOLUNTEER POLICY as well.
- Annual training for employees, including clergy, and volunteers.
- Teach employees to report even observed suspicious behavior
- Take actions reasonably designed to prevent future occurrences of harassment
- Document Investigation and Actions Taken
- Personnel File Reports

## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

Issue #4:

# Property Use and Tax Exemption Issues

## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

### Issue #4: Property Use and Tax Exemption Issues

- To obtain an exemption from state property taxes, the taxpayer must apply for it
- To maintain an exemption, the taxpayer must use its property in a manner consistent with the application and exemption rules
- The State may require re-application

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #4: Property Use and Tax Exemption Issues

### Tex. Tax Code: Exemption for Religious Orgs:

- Real property owned by the religious organization, is used primarily as a place of regular religious worship, and is reasonably necessary for engaging in religious worship.
- Tangible personal property owned by the religious organization and is reasonably necessary for engaging in worship at the place of **religious worship**. TEX. TAX CODE § 11.20(a)(1)-(2).
- Religious Worship: Individual or group ceremony or meditation, education, and fellowship, the purpose of which is to manifest or develop reverence, homage, and commitment in behalf of a religious belief.



## TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

### Issue #4: Property Use and Tax Exemption Issues

#### Tex. Tax Code: Exemption for Religious Orgs:

Occasional secular uses will not result in loss of the exemption if the primary use is for religious worship and all income from the other use is devoted exclusively to the maintenance and development of the property as a place of religious worship.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #4: Property Use and Tax Exemption Issues

- “[A] a place of religious worship includes not only the sanctuary, but also those grounds and structures surrounding the sanctuary which are necessary for the use and enjoyment of the church.” *City of Austin v. Univ. Christian Church*, 768 S.W.2d 718, 719 (Tex. 1988); see *City of Houston v. Cohen*, 204 S.W.2d 671, 673 (Tex. Civ. App.—Galveston 1947, writ ref'd n.r.e.); *Trinity Methodist Episcopal Church v. City of San Antonio*, 201 S.W. 669, 670 (Tex. Civ. App.—San Antonio 1918, writ ref'd).
  
- A parking lot, for example, may be a place of religious worship. Depends on:
  - whether the religious org owns the property,
  - whether property’s use is primarily religious, and
  - whether the property's use is reasonably necessary to the religious worship.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #4: Property Use and Tax Exemption Issues

### The Church should thoroughly analyze:

- Who wants to use facilities?
  - Other tax-exempt Orgs?
  - Disqualified Persons?
  - For-profit “entity”?
- What activities are proposed?
  - Providing any non-landlord-type services will likely create UBI.
- When do they want to use it?
- What portion to they want to use?
- How will the Church be compensated and protected?

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #4: Property Use and Tax Exemption Issues

### Facilities Use Policy

- Policy gives staff guidance
- Policy allows for consistent decisions
- Policy protects organization
- Policy helps compliance with laws
- Policy manages risk

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

Issue #5:

## Embezzlement

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## Issue #5: Embezzlement

Fort Worth Star-Telegram, March 27, 2019:  
“Woman who took \$1 million from charity gets 3 years in prison”

- Controller
- Passing checks (325) payable to herself using forged signatures from officials. Also used a stamp.
- Ordered to pay \$992,000+
- Jan. 2013 – April 2018.
- “New procedures were implemented to make sure this never happens again.”

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #5: Embezzlement

“Woman Who Stole \$300,000 From Mansfield Little League Program Gets 8 Years in Prison”.

Jan. 22, 2020.

- Volunteer
- Treasurer
- \$22,000 Amazon purchases
- \$50,000 restaurants
- Charges upgraded to 1<sup>st</sup> Degree Felony because victim was a nonprofit org.

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #5: Embezzlement

### Concepts / Harbingers of Embezzlement

- There is no such thing as “small fraud”.
- “I want to be rich, and I want it now!”
- “I’m underpaid, so....”
- “Just this once; I’ll pay it back....”
- “I’ll show them....”
- Love
- Easy pickin’s



# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #5: Embezzlement

### Harbingers of Embezzlement

- Living beyond means
- Financial difficulties
- Relationships with service providers and others with financial stake / business
- Excessive control issues
- Personal / Family challenges (divorce, health-related, higher education costs/expectations, other)

# TOP 5 LEGAL AND TAX ISSUES FOR CHURCHES

## Issue #5: Embezzlement

### Harbingers of Embezzlement

- Expense reimbursements
- Purchases
- Phony service providers
- Give to missions org and ask for cash in return
- Forgery
- Misuse of credit cards

**THANK YOU!**

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