

TAX ISSUES IN BUILDING

By Frank Sommerville

The anticipation has been building for months. The church is ready to break ground on its new building. In all the excitement, the church executive has not consulted with her friendly tax lawyer (though her conversations with the real estate lawyer have been numerous). This article is to remind the church executive that tax issues can arise, even in building projects. By involving the tax professionals in every step of the building project the church executive can avoid big surprises and lower the overall cost of the building.

PROPERTY TAX ISSUES

Most states exempt church occupied real estate from local property taxes, but tax vacant land until used. To minimize local property taxes, the church should determine when the switch from taxed land to church used land occurs. In many states, the change in status will occur when the first ground work is done. The church should document the first date that the contractor is on site performing ground work. In other states, it may be another date.

Property tax exemptions are rarely given automatically. The church should apply for a property tax exemption as soon as the local law allows.

SALES TAX ISSUES

In a major building project, sales taxes on materials can become a huge financial cost. Some states exempt church purchases from the sales taxes, but they do not exempt the contractor's purchases of materials. To take advantage of the church's sales tax exemption, the contract with the contractor should provide that the church will purchase all the materials. The church would then setup accounts with the major vendors who provide the materials. Other churches set a special checking account where the contractor is the only signature. The contractor pays the materials invoices with church's checks from this special account. The church deposits funds into the special account as needed or as required by the agreement with the contractor.

EMPLOYMENT TAX ISSUES

Many churches act as general contractor for their building projects. This means that the church will contract directly with certain trades to perform services and assume the payroll tax risks associated with contract labor. The IRS believes that the construction industry uses contract labor to avoid payroll taxes. By avoiding withholding and Social Security matching, the contractor may lower his or her labor costs. The checks are cashed and IRS has very few ways to collect the income and self employment taxes. So the IRS will look to the church for its lost revenue.

If the IRS and the courts claim that a worker was an employee, then the church will be liable for unpaid withholding and social security taxes. A discussion of the distinction between a

contract laborer and employee is beyond the scope of this article, but let me give you some signs. The following factors indicate an employee: (1) the church compensates the worker by the hour, (2) the church dictates when the worker works (hours and/or days), (3) the church provides the tools to do the task, (4) the church provides any fringe benefits, such as insurance, (5) the worker may not delegate the task, (6) the absence of a written contract with the worker for a fixed price for the job and (6) the worker does not perform similar services for others at the same time as he works for the church. Factors that indicate a contract worker would include: (1) the worker has his own workers' compensation insurance, (2) the worker has the ability to lose money on the contract, (3) the worker has a substantial investment in tools to perform the service, (4) the church does not reimburse expenses, (5) the church provides no training related to the task, (6) the worker decides the sequence or order in which the services are performed, (7) the church does not require detailed reporting of the worker's activities, and (8) the absence of all the employee factors listed above. If the worker has factors present in both lists, the church should consult with a tax lawyer or knowledgeable CPA. The safest route for the church is to require withholding on all workers controlled and directed by the church.

The church must issue Form 1099-MISC for all qualified contract labor. First, Form 1099-MISC is required for all payments to individuals and partnerships; i.e. not corporations, that exceed \$600.00 in a calendar year. The Form 1099-MISC requires that the church have the worker's Social Security number. The church can secure the worker's Social Security number via Form W-7. If the church does not have the worker's Social Security number, or if the IRS notifies the church that the Social Security number is bad, the church must withhold 30% from each check. The church can also be fined up to \$500.00 per Form 1099 that omits the Social Security number.