

TAX PLANNING WITH DIFFERENT ENTITIES

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A current trend among some larger churches is to create a new entity for every new church ministry. Others are creating new entities for government grant purposes or asset protection purposes. This article focuses on the tax issues that dictate creating a new entity.

ENTREPRENEURIAL CHURCHES

Many successful churches are modeled after business entrepreneurs; that is, the leadership sees a ministry opportunity and decides to pursue that opportunity. Today's churches may operate a bookstore, fitness center, restaurant, day care center or school. They may look for government funding for some of the church's benevolent activities, such as feeding the poor or training single moms. Each of these activities has risks and rewards associated with it. With the addition of these activities, the church has more reasons than ever to create new corporations.

ASSET PROTECTION

Since 1988 when the American Bar Association began holding seminars on suing and defending religious organizations (including churches), churches have become acutely aware that they may be sued. A single successful suit due to sexual misconduct can wipe out assets accumulated over many generations. Besides, the entrepreneurial activities of the church also create new opportunities for the church to be sued. If the church places its assets into an entity that has no activities and follows some simple rules about separation, then its assets will likely be protected. This is such a common structure that IRS has created a name for it: a "supporting organization." The new entity owns the real estate and rents it to the church (where all the activities take place) for a nominal amount under a "triple net lease." The supporting organization must use its assets to support the church activities, so there is no loss of control. Before utilizing this tool, churches should check with their local property taxing units because the supporting organization may not qualify for a property tax exemption.

NEW ACTIVITIES EQUALS NEW ENTITIES

I am aware of churches that have created hundreds of entities to house different activities. I am also aware of large churches that have only two or three entities. How do you know the right number of your church? While only you and your advisers can answer that question, there are several key questions that should lead your church to best answer.

First question: Will the activity create unrelated business income or debt financed income? If the answer is yes, then you should consider creating a new entity. Unrelated

business income and debt financed income obligate the church to file Form 990-T annually. This return is subject to examination by the Internal Revenue Service (IRS). If the IRS selects the church's tax return for examination, many times the agent will seek church financial data to confirm that no other unrelated business income exists. Further, the agents have been instructed to open payroll tax examinations if payroll is involved in the unrelated business activity.

Next question: Does this activity can create risk of liability? If yes, then you may want a new entity to own the activity. You may create an nonprofit asset holding company (IRC Sections 501(c)(2), 501(c)(3) or 501(c)(25)) that will attempt to keep the assets away from tort creditors. You may want to create a for profit corporation if te activity also creates unrelated business income. Depending on several factors, this entity may be required to file an annual tax return.

Next question: Will the church seek government or private foundation funding for this activity? If yes, you want a new entity. Many government and private foundation grants contain restrictions that may not be acceptable to the church, but will help fund the activity. Further, since nearly all grants require free access to the books and records of the recipient, the church will be better served if the government or private foundation can only look at the books of the new entity. Some states require the books to be open to the public if one accepts government funds, giving the church another reason to keep those funds away from the church's books. Usually this type of entity is required to file annual tax returns.

Next question: Does the church encourage long term planned giving? Long term planned giving means it encourages gifts that will bless the church after their death or where donors want to create fund where the earnings will be used to support the church. Commonly referred to as an "endowment," the church may create an entity to hold these funds that are to be invested for the future. It also creates an entity to act as trustee should the church want to manage charitable remainder or charitable lead trusts.

Final question: Will this activity create support apart from church members? Some clients have created a separate entity because they wanted all Christian churches involved in the activity. If the activity is too closely associated with a single church, it may discourage volunteers and donors from participating. If the activity is clearly associated with a single church, other pastors may also discourage members at their church because he is afraid that the he may lose members or money to the sponsoring church as well as the activity. For example, a church could plan its high school in a separate entity to encourage other churches support the school. Food banks and homeless shelters fit in this category. Usually this type of entity files an annual tax return.

CAVEAT

Creating new entities creates new headaches. The books must be kept completely separate from the church's books. You church accounting staff must have the ability to handle complicated allocations. In fact, all the staff must be able to discern which entity

is doing the work. Each entity must have board of director meetings, draining time unless you involve many people in these entities. It will cost the church more to administer these activities than if the church kept them together. All these negatives mean that the church should undertake this decision only after receiving professional counsel and much prayer.