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Funding Foreign Activities

Seven legal areas that trip up churches—and how to navigate them.

Frank Sommerville,
Attorney and CPA

The concept sounds well-meaning and innocent enough: Form a charity in the United States that finds sponsors to support poor children living abroad. It's not a unique idea, since many charitable groups, including churches, advocate this type of work to improve living conditions and educational opportunities for the most vulnerable in the world.

But with a nonreligious Oregon charity formed in 1994 to match donors with needy Iranian children, something went wrong. The founder said the work legitimately helped kids, but the US government said the nonprofit sent $11 million to Iran and tried to hide it, with at least a portion of those funds funneled to a suspected terrorist. Both the charity and its founder faced prosecution.

The founder insisted his organization never aided a terrorist. During a March 2012 sentencing hearing, a US District Court judge said it wasn't clear whether or not funds went toward terrorism, but he still assessed fines and penalties for the organization and founder. Why? Primarily because the charity knowingly sent cash to Iran, a country under US embargo since 1995.

The organization received a $50,000 fine and two years of probation. The founder was sentenced to five years of probation, including one year of home detention, and fined $50,000. He also lost his job as an engineer.

While this case didn't involve a religious group, it serves as a powerful example of the complex rules and regulations that churches and nonprofits face for any foreign activity, whether collecting contributions for foreign efforts, sending teams abroad, sending money and resources to missionaries and organizations in other countries, or compensating a foreign pastor who speaks at the church. These activities are highly regulated by the Department of Treasury, by the Internal Revenue Service, and by the US State Department.

Some local churches undertake these foreign activities without paying attention to domestic and foreign rules and regulations governing foreign activities by nonprofit and religious organizations. The consequences are notable, as the Oregon case shows. Ignorance of the law is not an excuse. Churches conducting foreign activities must research the rules and regulations dictating those activities.

Going Solo

In a survey of 1,486 church leaders conducted several years ago by Christianity Today's Church Law & Tax Team (publisher of *Church Law & Tax Report*) and Brotherhood Mutual Insurance Company, 70 percent of leaders said their churches are involved in international outreach efforts. Many provide funds, send teams outside the country, or both.

Among those involved with international ministry efforts, 58 percent partner with denominations or associations, 20 percent partner with other churches, and 18 percent go it alone.

The reasons so many churches go it alone vary. Easy and affordable transportation and communication have made it possible for local churches to expand their reach to a global scale—an opportunity once only possible for the country's largest congregations. Many churches can now plan their own foreign missions activities or connect directly with individuals and international organizations, bypassing well-known missions organizations, including their own denominational agencies, to send teams, money, and resources. They can also sponsor missionaries and charities based outside the country on their own.

The do-it-yourself approach, while possibly efficient, may create unexpected oversights, because the years of experience and knowledge provided by a missions organization or denominational agency are absent.

Like it or not, missions societies and denominational agencies are the best way to ensure compliance with these complex domestic and foreign laws. And, where support is provided to an organization abroad, these societies and agencies can often provide the on-the-ground verifications necessary to maintain compliance (for a cost well below what an individual church would have to spend to do the same).

Nonetheless, some congregations believe they should work directly with partners abroad.

Seven Areas to Watch

This article cannot cover everything a local church must know before undertaking foreign activity, but it introduces church leaders to key issues and provides enough information to ask professionals the right questions. Following are seven areas of foreign activity that merit the full attention of church leaders.

1. Tax Deductible Contributions and Recordkeeping

Funding foreign activities can create challenges for churches. Donors typically want their contributions to qualify for a charitable deduction on their taxes, so churches understandably want to do all they can to make this possible.

But specific rules govern the treatment of a contribution for tax-deductible purposes, and laws mandate how a church can raise funds to support foreign activities. These rules hold true, whether a local church sends a Christmas gift directly to a missionary or it transfers money to a "sister" church in another country.

Two key points to consider:

> Your church should not accept contributions the donor requires be given to another organization. If the donor controls the ultimate recipient or beneficiary of the donation, then the church is serving as a conduit and has no control over the funds. Since the church must assume control over the funds for a valid charitable contribution, the amounts controlled by the donor are never tax deductible. Under an IRS exam, the IRS will disallow the deduction by the donor. Since the appearance of such a transaction hides the true source of the gift, the church may have aided in unlawful laundering of funds.
>
> If your church wants to designate contributions to support a foreign organization (including churches, schools, and charitable organizations) and give donors tax-deductible receipts, you must review and approve a detailed spending plan provided by the organization, only reimburse appropriately documented and approved expenses, and audit the actual expenditures of the foreign organization.

Several Internal Revenue Service rulings address whether a contribution made to a US charity, but designated to a foreign organization, can be considered tax deductible.

For instance, *Rev. Rul. 63-252,* made by the IRS in 1963, concludes:

> **... it seems clear that the requirements of section 170(c)(2)(A) of the IRC would be nullified if contributions inevitably committed to a foreign organization were held to be deductible solely because, in the course of transmittal to a foreign organization, they came to rest momentarily in a qualifying domestic organization.** In such case the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient. (Emphasis added.)

The Revenue Ruling cited five examples of how funds for international agencies are sometimes funneled through the local church. The church in three instances serves merely as a conduit for foreign aid but it is not the

actual fundraising entity. Therefore, donors cannot claim a tax deduction for this type of charitable contribution.

There are two instances, though, when donated funds to foreign agencies that pass through a church first can be tax deductible. In *Rev. Rul. 66-79, 1966-1 C.B. 48,* a domestic organization's contributions were deductible because the board of directors took specific steps to carefully review a foreign project in advance of any funding and to monitor its continued adherence to the domestic charity's goals.

The organization demonstrated it had full control of the donated funds and discretion as to their use to ensure that the funds were used to carry out the domestic charity's function and purposes. These standards entailed more than deciding whether or not to contribute, or whether or not they could require the foreign recipient to furnish a periodic accounting.

Other cases demonstrate how the level of control and accountability determine the tax deductibility of a donation:

A domestic charity was formed to address problems with plant and wildlife ecology in a foreign country through programs that included grants to foreign private organizations. The domestic charity maintained control and responsibility over the use of any funds granted to the foreign organization by:

> Making an investigation of the purpose to which the funds would be put;
>
> Entering into a written agreement with the recipient organization;
>
> Making field investigations to see that the money was spent in accordance with the agreement.
>
> The charity exercised the power to require expenditure accountability over these programs. Contributions to the organization were deductible. *Rev. Rul. 75-65, 1975-1 C.B. 79*

A domestic organization transmitted funds to a foreign organization without knowing precisely how the money could be spent. Even though the foreign organization promised to use the funds for "humanitarian purposes," and even though both the foreign organization and its distributees were required to account for the use of the funds, there was too little discretion and control by the domestic organization to meet the standards set out in *Rev. Ruls. 63-252 and 66-79.* On the other hand, the required discretion and control could be present even if a domestic organization turned funds over to foreign entities that are not themselves organized and operated exclusively for charitable purposes, provided that the foreign organization can show it follows US rules in *Rev. Rul. 68-489, 1968-2 C.B. 210. G.C.M. 35319 (Apr. 27, 1973)*

G.C.M. 35319 emphasized that the domestic organization did not know, in advance of distributing funds, exactly how those funds would be used. However, *G.C.M. 35319* further stated it may not be necessary for a domestic 501(c)(3) organization to know, in advance, the precise nature of ultimate distributees.

A domestic organization can still ensure the safety of its qualifications under Internal Revenue Code (IRC) Section 170(c)(2)—if it establishes that its methods of operation included the following kinds of procedures:

> At the outset, the domestic organization apprises its agents of the terms of IRC Section 170(c) and makes clear to its agents that they have the same limitations in distributing its funds;
>
> It reviews proposed projects in detail to ensure that the projects are reasonably calculated to accomplish one or more of its charitable objectives before turning over any funds to its agents for expenditure;

It turns over its funds to agents only as needed for specific projects; and,

It (or an independent agent it selected) makes periodic financial audits and requires periodic financial statements to ensure that the funds are not misspent.

Adopting these four guidelines, through the use of a grant agreement with the foreign entity, can help ensure tax deductibility.

> ***Example.*** *A church wants to build a new church in another country. It must review the plans and costs for the new construction. It must make sure that the local laws allow for such a building. And it must monitor the project to make sure the expenses are legitimate and the construction progresses. In one actual case, a church in Liberia took more than a year to provide the necessary documentation to a US church. The US church had to wait until it received the detailed plans. It then disbursed the funds as it received documented expenses. It also sent a representative in Liberia to verify the expenses and the actual construction of the building. Because of the US church's efforts, contributions made to it for the church in Liberia were tax deductible.*

2. Short-Term Mission Trip Rules

If a church sponsors a short-term missions trip, the expenses incurred while ministering to others is tax deductible, even if the donors pay their own expenses. If the trip contains sightseeing or other personal days, then the church will need to allocate expenses between missions expenses and personal expenses. Personal expenses are not deductible.

Individuals may deduct contributions that are (1) **gifts to** or (2) **for the use of a** qualified organization.

Both types of contributions have additional requirements that must be met.

Cash Donations

Since churches are qualified organizations, direct cash payments are tax deductible if the donor receives no goods or services for the payment. This includes instances when the church collects the funds for a short-term missions trip.

Does the donor receive any goods or services when he or she pays to the church to go on a missions trip? It depends on the trip. A direct connection must exist between the expense incurred and the charitable, volunteer services rendered. If the primary purpose is to minister to others in the name of the church, then they aren't receiving any goods or services for the payment. Therefore, the trip qualifies as a church trip and it is mostly deductible.

But if the trip is a retreat where the individual will receive ministry from the church, then the individual is receiving goods and/or services. This trip is personal and nondeductible. Trips where the primary purpose is to educate participants also fall into this category (such as trips to Israel).

The IRC states, "No deduction shall be allowed under [charitable contributions] for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel."

This provision has several requirements:

> **The term "away from home" means the same as it does for business travel.** That is, one must travel overnight, away from the home where one works and lives, while rendering charitable, volunteer services.
>
> **Examination of the detailed itinerary will determine whether the trip contains significant characteristics that make it comparable to a pleasure trip.** In adding this provision to the IRC, the Senate

Committee observed that travel expenses remain deductible, though the individual receives substantial pleasure from serving others through charitable works. In other words, the pleasure one receives from ministry will not preclude a deduction.

However, IRS rules prohibit the deduction of travel expenses that *may appear to be a vacation.* To ensure that volunteers are not deducting vacations as volunteer or business trips, the IRS developed rules that define volunteer trips.

Charitable days must be differentiated from personal days. It is a charitable day if:

- one travels for volunteer business;
- one's presence was required for a charitable meeting;
- one conducted significant charitable work;
- it is a weekend day or local holiday and if charitable work was done both on the day before and the day after these days.

To conduct significant charitable work in a day, most courts require the volunteer to spend the majority of the working hours actively volunteering. Practically speaking, churches should plan at least six hours of volunteer activities per workday.

Work on weekends and holidays count as charitable days if volunteer work is also conducted the day before and the day after the weekend or holiday. For example, one may not count a weekend as charitable days if charitable work was done the Friday before, but not the following Monday. All days that do not count as charitable days are counted as personal days.

For personal days, meals, transportation, or lodging are not considered tax-deductible expenses. To determine the appropriate expense for transportation, one must prorate their transportation costs by the ratio of business days to total traveled days. For example, airfare to a foreign land for a 10-day trip costs $1,000. If eight of the days qualified as charitable days, only $800 of the airfare qualifies as a deductible expense. If six of the days are personal (more that 50 percent of the total days), then none of the airfare qualifies as a deductible expense.

These rules do not mean that all trip days must be charitable work days. It means that the expenses associated with pleasure days are not deductible. The church must disclose that fact to trip participants, preferably upfront, by stating the total cost for the trip and the portion that will be tax deductible.

Travel expenses must be reasonable in amount. The more luxurious the accommodations and meals, the more likely they are unreasonable. The IRS likely will use "luxurious" accommodations to demonstrate that the trip contained substantial elements of personal pleasure.

To prove the extent and duration of volunteer services, the church should keep an hour-by-hour itinerary of the entire trip for each volunteer. The itinerary should separate times when the volunteer is on duty for the charitable organization from those times when the volunteer may choose personal activities. The church should retain detailed documentation and photos to support the itinerary. Also, churches that send nonexempt employees on mission trips should check with a labor lawyer to determine whether the minimum wage and overtime laws could apply to that trip.

Out-of-Pocket Cash Trip Expenses

If the payment is for the use of the church, it is tax deductible. For example, if the trip costs collected by the church do not include evening

meals, then participants may deduct the costs of the evening meals. This rule applies to every expense the individual pays. If the entire cost is paid directly to travel vendors by the individual, then it is still deductible if the trip meets the rules discussed above. If the expenses exceed $250, then the donor/volunteer must secure a letter from the church acknowledging the volunteer services and that certain expenses were not paid by the church.

Paying for Others to Go

Many members have the skills needed for a trip, but lack the funds to pay for the trip. Many church groups raise funds to pay for the trip by soliciting donations from friends and relatives. These contributions are deductible if the church controls the selection of the recipient of the funds.

For instance, a gift designated by a donor to send Susie on a youth trip is not tax deductible. Instead, a gift designated by a donor to support a youth trip that Susie is joining is tax deductible. From a tax perspective, the best way to raise money for the youth trip is to raise money for the whole group.

> ***Example.*** *It will cost $20,000 to send the youth on a mission trip to Haiti. The youth must raise the money together to meet that goal.*
>
> ***Example.*** *The church selects participants for the trip and then asks donors to underwrite the cost of sending each person on the trip. In other words, the church may raise funds to send Susie on the trip, but a donor cannot require the church to send Susie on the trip.*

Refunding Payments for Short-Term Trips

If the payment to the church for the mission is tax deductible, then the church may not refund the payment. But if the payment to the church for the mission trip is not tax deductible, then the church may refund the payment. At the time of solicitation, the church must notify the donor whether or not this payment is tax deductible. The church should review all solicitation letters before sending them to potential donors.

3. The Restrictions of 501(c)(3) in Foreign Contexts

Foreign organizations supported by US churches and charities must operate under the same governance restrictions that apply to US churches and charities. This means that they must prohibit personal inurement (excessive personal compensation) and private benefit, prohibit political activity, and prohibit illegal activities and activities that violate US public policy.

This section addresses situations in which a church conducts ministry outside of the United States. This includes instances when a church employee serves as a missionary in a foreign country. It also includes instances when the church provides money to an agent, missionary, or other entity to disburse for ministry in a foreign country. Finally, it addresses issues arising from financial support of a missionary in a foreign country.

Inurement and Private Benefit

The prohibition against inurement and private benefit applies just as fully to foreign activities as they do to domestic operations. Reliance on local law or custom as to what constitutes a charitable operation will not eliminate a US inquiry into whether private benefit or inurement is involved.

For example, if local custom provides that the charity will give money to a person who dispenses money as he or she sees fit, with no separate accounting for money received from the United States for charitable purposes, exemption would be denied under IRC Section 501(c)(3) on the grounds of inurement, serving a private interest, and/or failing to serve any charitable purpose. Even if the recipient used the funds only for charitable purposes, he or she still would have to account fully for

their use, and the organization applying for recognition of exemption under IRC Section 501(c)(3) would have to retain discretion and control over the use of the funds for exemption to be recognized. *Rev. Rul. 68-489,* supra. Furthermore, records of the charity dispensed must be maintained. *Rev. Rul. 56-304, 1956-2 C.B. 306.*

Lobbying and Electioneering

As with inurement and private benefit, the restriction against lobbying and the prohibition against political activity on behalf of, or in opposition to, a candidate for elective public office (electioneering) exists in a foreign context. For example, *Rev. Rul. 73-440, 1973-2 C.B. 177* concludes that the term "legislation" includes foreign and domestic laws for purposes of the IRC Section 501(c)(3) lobbying restriction.

Great care should be taken in applying this principle, however. The regulations under IRC Section 501(c)(3) carefully limit the definition of legislation to actions by legislatures or by the public through referendum, initiative, constitutional amendment, and so on. *Reg. Section 1.501(c)(3)-1(c)(3)(ii).* The regulations under IRC Section 4911 develop this definition by providing that legislation does not include action by executive, judicial, or administrative bodies. *Reg. Section 56.4911-2(d).* Keep in mind: It may be improper to characterize various types of resolutions, edicts, and so on of a wide assortment of state bureaucracies as "legislation." This is particularly true in dealing with an authoritarian or theocratic regime where the legislative process as it is known in the United States is unknown in that country.

Illegal Activities and Activities Contrary to Public Policy

Conducting illegal activities or activities that are contrary to US public policy may jeopardize a church's exempt status, regardless of the focus of the activity. However, what isn't clear is whether conducting an activity illegal in another country will jeopardize a church's exempt status in the United States.

One example of how this challenge arises is with foreign schools and racial discrimination. US public policy against racially discriminatory schools is so pervasive that foreign schools must furnish the information required by *Rev. Proc. 75-50, 1975-2 C.B. 587*. However, if a foreign school can demonstrate that the information is impossible to collect because collecting it would be illegal under foreign law or impractical under the circumstances, and can make an uncontested case of these facts, such as a copy of the law or regulation (and an English-language translation thereof), the IRS will waive so much of the information required by *Rev. Proc. 75-50,* as is based upon such statistics. *G.C.M. 37867 (Feb. 27, 1979).*

Another illegal activity for churches to note is bribery or payments for influence. The Foreign Corrupt Practices Act (FCPA) applies to churches conducting activities outside the United States. Since bribery or payments for influence constitute a felony under the FCPA, a church cannot (directly or indirectly) pay local officials to avoid harassment or imprisonment. These requirements significantly delayed responses to the Haitian disasters in the early 2010s. The Haitian culture made bribes a common way of life, so US charities could not commence aid until the authorities authorized their services without payment of a bribe. Many organizations operate under a "the end justifies the means" premise, but such operations are short-sighted. With Haiti, US charities that conducted their activities within US law avoided jail time for their employees and volunteers and still accomplished their goals.

One final activity to note: proselytizing or evangelism. It is illegal in certain countries. Churches typically send volunteers for humanitarian reasons to these countries, but undertake covert or relational evangelism. So far, the IRS has been tolerant of evangelism as

furthering exempt religious purposes because such evangelism does not violate US laws.

4. Foreign Grantmaking Rules

More domestic charities are making international grants to foreign charities to conduct charitable activities. This section addresses US churches providing funds to a non-US charity or religious organization (also see Section 1 above).

Making grants to a foreign grantee that does not have a ruling or determination letter classifying it as an IRC Section 509(a)(1), (2), (3) public charity, or as an "exempt operating foundation," creates considerable difficulties. The first problem is outlined in *Reg. Section 53.4945-(6)(c)(1),* which provides that, since a public charity cannot make an expenditure for a purpose other than for one described in IRC Section 170(c)(2)(B), it may not make a grant to a non-IRC Section 501(c)(3) organization unless (1) the making of the grant itself constitutes a direct charitable act, or (2) the grantor is reasonably assured that the grant will be used exclusively for purposes described in IRC Section 170(c)(2)(B). *Reg. Section 53.4945-6(c)(2)(ii)* makes a general statement as to how a grantor church can be "reasonably assured" that a foreign organization with no IRC Section 501(c)(3) ruling or determination letter will be treated as an organization described in that subparagraph—it requires that a foundation manager make a "reasonable judgment" that the foreign grantee organization matches what is described in IRC Section 501(c)(3).

In theory, a local church, intent on making a grant to a foreign organization, after reasonably assuring itself that the grantee is the equivalent of an IRC Section 501(c)(3) organization, would make the grant and exercise expenditure responsibility (see Section 1 for details about expenditure responsibility). However, as discussed above, exercising expenditure responsibility is a complicated and arduous process. Consequently, most local churches will avoid it.

Reg. Section 53.4945-5(a)(5) provides that a grantor may avoid the expenditure responsibility requirement if it makes a good faith determination that the grantee is an organization described in IRC Section 509(a)(1), (2), or (3). (The regulations do not mention "exempt operating foundations" because IRC Section 4940(d)(2) was enacted after the regulations went into effect. However, a "good faith determination" that the grantee is described in IRC Section 4940(d)(2) would also avoid the expenditure responsibility requirement.) *Reg. 53.4945-5(a)(5)* further provides that a "good faith determination" may be based on an affidavit of the grantee or on an opinion. *Reg. 53.4945-6(c)(2)(ii)* does not prescribe any particular manner for the exercise of "reasonable judgment." It merely states: "The term 'reasonable judgment' shall be given its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts."

Each grantor is now required to make its own "good faith determination" about a particular grantee. In other words, each grantor must prepare its own affidavit or opinion.

Grants to foreign governments and international organizations also may be exempted from the expenditure responsibility rules. *Reg. Section 53.4945-5(a)(4)(iii)* provides that a foreign government, any instrumentality or agency thereof, or an international organization designated by Executive Order under *22 USC. Section 288* will be considered an IRC Section 509(a)(1) organization provided that the grant is made for exclusively charitable purposes as described in IRC Sections 170(c)(2)(B). Effectively, this means that grants to foreign governments, to their instrumentalities, or to international organizations are treated in the same manner as grants to their United States counterparts—the grant must be for exclusively charitable purposes and not for governmental ones.

If the foreign grantee does not fall within any of the above exceptions, then the expenditure

responsibility rules apply. As discussed above, these rules require the church to exert all reasonable efforts and establish adequate procedures to (1) see that the grant is spent solely for the purpose for which it is made, (2) obtain full and complete reports from the grantee regarding how the funds were spent, and (3) make full and complete reports to the IRS.

> ***Example.*** *A church wants to support a school operating in a Middle Eastern country. Since some schools also train young terrorists, the church must carefully document that all funds were spent within the church's exempt purposes.*

> ***Example.*** *A church wanted to regularly support an orphanage in Jamaica. The orphanage sent copies of its governing documents and financial data to the church, along with an affidavit authenticating documents and making certain assurances that it would not fail any US requirements to be tax exempt. The church turned these over to a nonprofit tax attorney who rendered a written legal opinion that the orphanage was substantially the equivalent of a Section 501(c)(3) organization if it were located in the United States. Based on the written legal opinion, the church may send offerings to the orphanage and not require detailed accounting for the expenditures.*

Your church has two choices when it comes to giving church funds to foreign organizations. It can enter into a grant agreement with the foreign organization that satisfies the expenditure test. This means that the church must control the funds as its funds until the organization properly documents expenses and seeks reimbursement for those funds. The second choice is for the church to secure a written legal opinion based on an affidavit from the foreign organization that the foreign organization is the substantial equivalent to a US-based tax-exempt organization.

5. Payments to Foreign Nationals

Some churches choose to directly support foreign ministers. The tax rules vary for this. Payments to nonresident aliens are first classified according to where the services are rendered. If the payment is for services in the United States, then United States tax implications ensue. If the local church is paying a foreign national (other than those with a permanent US work visa) for services rendered outside the United States, then the foreign grant rules discussed above in Section 4 apply.

In the United States

One common activity is for a foreign pastor to visit the United States and speak at a church during his or her visit. If the pastor visits the US using a tourist visa, he or she cannot be compensated for speaking at the churches.

If the pastor visits the US using a visa that allows him or her to work during their visit, they are considered a nonresident alien, and the following rules apply:

> If the pastor is in the United States for less than 30 days within a calendar year ("personal presence test") and a local church's payment is less than $3,000 for the entire calendar year ("income test"), then no United States tax rules are implicated.

> If the pastor is from Mexico or Canada, then he or she must be in the United States less than 183 days during the calendar year for no tax rules to be implicated.

If either the personal presence test or the income test is not complied with, then the local church must comply with the following tax rules:

> The local church must withhold 30-percent of the payment for taxes, unless a treaty changes the rate. Some nonresident aliens qualify for exemption from mandatory withholding. To receive the exemption,

the nonresident alien must give the local church an IRS Form 8233. The church then must send the IRS the Form 8233 at least 10 days before any payments are made. Since Form 8233 requires a taxpayer identification number, the nonresident alien may submit Form W-7, Application for Taxpayer Identification Number, with Form 8233. Without Form 8233, the 30 percent withholding is mandatory unless the rules in the next paragraph apply.

If the personal presence test or the income test is not met and Form 8233 is not filed timely, then the 30-percent withholding applies unless a treaty sets a different lower rate. To determine whether a lower rate applies, the nonresident alien must fill out Form W-8ECI and give it to the local church. A tax professional can provide further guidance with this.

If any withholding applies, the local church should issue Form 1042-S to the nonresident alien and file the original with the IRS along with the amount withheld.

Outside the United States

If the church supports a foreign minister (a non-US citizen without a US work visa), then no payroll reporting is required in the United States. The church is still required to maintain records demonstrating that the minister is furthering an exempt purpose and that the payment is reasonable in amount under the circumstances. The church must require the minister to report all of his or her sources of income from all sources. The minister also must document any expenses that he or she incurred while conducting the ministry. The church also must access compensation sources relevant to the host country to determine the reasonable amount of compensation for the services rendered.

***Example**. A foreign minister receives $1,000 per month from 20 US churches. Each church must request an accounting for the entire $20,000 per month (expenses and compensation). If the minister fails to provide the required documentation, the church must cease all payments until the documentation is received.*

To review

The church must withhold 30 percent of a payment unless a treaty sets a different rate or the statute allows the payment to be exempt from the mandatory withholding. The church must pay that 30 percent to the IRS. The main exemption to the mandatory withholding applies when the visiting minister is in the United States for less than 30 days and the payment is $3,000 or less per calendar year.

The church must require supported ministers outside the country to account for all funds received from the church.

6. Payments to US Citizens Working Abroad

If a missionary is a US citizen, he or she owes federal income taxes on their worldwide income. Unless a tax treaty alters the default treatment, the missionary is also responsible for Social Security and Medicare taxes on their worldwide income.

A church must first determine whether the missionary is employed by the church while serving in a foreign land.

The IRS looks at several factors grouped into three categories to determine whether a missionary is an employee. For instance, a missionary will be considered a church's employee if:

The church is solely responsible for supporting that missionary;

The church controls the details of how the missionary conducts ministry;

The church provides fringe benefits to the missionary, such as health insurance, vacation, or retirement.

The church should seek professional guidance to determine if a missionary is an employee.

If the missionary is an employee, the church must determine whether the missionary qualifies to be treated as a minister under IRS rules. If the missionary has been licensed, commissioned, or ordained by a church, and if the missionary is performing the duties of a minister, then the missionary will be treated as a minister. Assuming the missionary is treated as an employed minister, the church should issue a Form W-2 to the missionary and not withhold income taxes, Social Security, or Medicare taxes. If the missionary does not qualify for minister treatment but qualifies as an employee, the church should treat the missionary for tax purposes the same as other, non-ministerial staff members.

If the missionary is a US citizen and an employee of the church, the church should register with the host country as an employer. The church will be required to also withhold and pay local taxes to the host country, if the host country has such taxes. In many countries, the church must also file an annual report with the host country. The church will also need to purchase insurance in the host country since nearly all US insurance policies are restricted to claims arising in the United States.

The church should retain attorneys and accountants in the host country to help comply with all employment and registration regulations applicable to the church in the host country.

Many churches find it helpful to set up a nonprofit corporation in the host country so that the church pays the nonprofit corporation, which in turn pays the missionaries and the attorneys and accountants hired to help. This eliminates the US church's responsibility to withhold and file payroll taxes in a foreign country.

If the missionary is a US citizen, but he or she does not qualify as an employee of the church, the church is required to issue Form 1099 for all compensation paid to the missionary, except for any housing allowance that has been designated by the church. Again, the church will need to check with attorneys and accountants in the host country to determine the church's obligations in that country.

If the missionary is a US citizen and receives expense reimbursements, the expense reimbursements are included in taxable compensation unless the church has adopted and follows an accountable expense reimbursement plan applicable to the missionary.

If the church uses deputational fundraising (an individual raises his or her own support), then special rules apply to prevent inurement and private benefit issues from arising. The church must accept the funds and the donor cannot require that the funds go to a particular individual. The personal compensation that the missionary receives must be set by the church and not vary depending on the amount of funds raised.

7. Anti-Terrorist Rules

If the church is sending the funds to any foreign country through a bank account owned by the church in the foreign country, the church must notify the IRS of the presence of foreign bank accounts. The church should use Form TD F 90-22.1 which can be found at irs.gov. This form is due annually on or before June 30 for the prior calevndar year.

The church is responsible for complying with all suspected terrorists regulations issued by the United States Department of the Treasury. Every transfer of funds outside of the United States must be tested against the suspected terrorist list published by Department of the Treasury. If the church's funds fall into the hands of suspected terrorists on the list, those who authorized the transfer may be charged criminally with aiding and abetting terrorists.

These three lists must be checked before

disbursing the funds internationally:

> treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx
>
> state.gov/j/ct/list/index.htm
>
> treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx

Also, a group of financial professionals has prepared a quick search tool for transferors of funds overseas. It is found at apps.finra.org/rulesregulation/OFAC/1/default.aspx.

> ***Example.*** *A local church wants to buy books for a Christian school located in Syria. Since Syria is designated as a terrorist country, the church cannot send the money or books to the school without securing prior approval from the Treasury Department.*
>
> ***Example.*** *A local church wants to build a church in Kenya. While reviewing construction invoices, the church noticed that the lumber company is owned by someone the US suspects is a terrorist. The church cannot send funds to the Kenyan church to pay the lumber company.*

Above Reproach

Technology has made nearly every part of our globe accessible to every local church. Many churches are taking advantage of these technological advances without taking into the account the increased regulation over their activities. A failure to adhere to government regulations can cause tragic, unintended consequences. But such tragic results can be avoided. The church can strive for excellence. All it takes is a little knowledge and effort. This article gives churches a great start in developing policies and procedures to conduct foreign activities above reproach.

Frank Sommerville, CPA, *is a shareholder in the law firm of Weycer, Kaplan, Pulaski & Zuber, P.C. in Houston and Dallas, Texas, and an Editorial Advisor for* Church Law & Tax Report. *Frank received his masters in professional accounting with an emphasis on taxation from the University of Texas at Arlington. His law degree is from the University of Houston Law Center. He holds a license as a Certified Public Accountant. He is also Board Certified in Tax Law by the Texas Board of Legal Specialization. Frank is rated AV (highest possible) by Martindale-Hubbell Legal Directory.*

Resources

ONLINE RESOURCES:

ChurchLawAndTax.com provides comprehensive, searchable, and easily-accessible information on legal, tax, financial, and risk management matters affecting churches and clergy. The full archives of both *Church Law & Tax Report* and *Church Finance Today* reside on the site as does the Richard R. Hammar Legal Library.

ManagingYourChurch.com serves church leaders by providing accurate, authoritative, and timely law, tax, finance, church administration, and risk management articles and resources.

PUBLICATIONS:

Church Law & Tax Report (published bi-monthly) provides practical information to church leaders on important legal and tax developments that have a direct impact on ministry. In each issue, Senior Editor Richard R. Hammar, J.D., LL.M., CPA, provides summaries of the most recent tax laws affecting churches and ministries, plus compelling case studies. This vital publication keeps pastors, board members, attorneys, CPAs, and church business administrators apprised of the ever-changing legal and tax environment, allowing for sound decisions.

Church Finance Today (published monthly) keeps church treasurers and bookkeepers informed with timely and practical information on issues all churches face when managing money: internal controls, compensation, reporting, and budgeting. In addition, subscribers receive *SkillBuilders*, a bi-monthly supplement offering specific steps to improve money management practices.

FOR BOOKS AND OTHER RESOURCES VISIT ChurchLawAndTaxStore.com:

Church & Clergy Tax Guide

Find comprehensive help understanding United States tax laws as they relate to pastors and churches with **Richard Hammar's** annual *Church & Clergy Tax Guide*. Tax law in general is highly complex and ever-changing. Add to that the many unique rules that apply to churches and clergy and you're set up for a challenging task that requires an expert's guidance.

Planning Safe Missions Trips

Properly planned mission trips can be a great experience for all those involved—if safety precautions are taken in advance. Make sure your group is ready for service before you leave.