Church Administration Matters

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Conflict of Interest Policy

Being exempt from income, sales and real estate taxes is a privilege not a right! One of the most fundamental principles of tax exemption is that no person can receive from a tax exempt organization, including a church, a personal financial benefit other than reasonable compensation for services rendered. In fact, this is so fundamental that a tax exempt organization, including a church, could lose its tax exemption for violating this principle. I will address my comments to churches.

The technical term is "private inurement". Private inurement happens when an individual with a personal interest in the church (Pastors, Deacons, Elders, employees, members, donors, etc. or their friends, relatives, etc.) receive an economic gain through the use of the church's assets, including cash or property. There are no amounts that are "too small" to be concerned with – even small amounts are considered a violation of the principle. Some examples of this would be:

- Excessive compensation for services rendered
- Obtaining business from the church (particularly at higher than fair market value pricing)
- Receiving property from the church for less than fair market value
- Use of the church's sales tax exemption to purchase something for personal use
- Personal expenses being paid by the church (other than for authentic benevolence purposes)
- Interest-free loans
- Personal use of church assets, including allowing members to use church property free of charge or at less than "the going rate"
- Letting members use church property or assets to engage in a money making business

What is the potential impact on a church that engages in private inurement?

- Worst case scenario is that the church could lose its tax exempt status!
- Additionally, if the private inurement involves a "disqualified person" (Corporate Officer, Deacon, etc.) the IRS can impose "immediate sanctions" which can result in a "tax" on the person receiving the benefit at 225% of the benefit received and a "tax" on the Deacons who authorized the benefit at 10% of the benefit given.

I've shared all of this to introduce the idea of adopting a **Conflict of Interest Policy** that clearly states what constitutes a conflict of interest. Usually private inurement issues arise when the church has entered into a transaction that poses a conflict of interest.

In the July / August 2009 edition of ***Church Law and Tax Report***, Richard Hammar reports that "In 2008 the IRS ruled that a nonprofit corporation did not qualify as a tax-exempt church, in part because its governing document did not have a conflict of interest policy. The IRS noted that to

qualify for exemption, an organization must be operated for public rather than private purposes, and 'the organization has the burden of demonstrating this by showing that it is not operated for the benefit of private individuals'. . .*IRS Letter Ruling 200830028*". He goes on to say, "This ruling is significant because of the importance the IRS assigned to a conflict of interest policy despite the fact that neither the tax code nor regulations specifically require that a church have such a policy. . .While this concern will not directly apply to most churches, it is a point worth considering. . ."

If you are interested in exploring further the idea of adopting a Conflict of Interest Policy, I have adapted an IRS sample policy that I believe would work well for a church. I'd be happy to send you a copy for your reference.