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Before You Share Your Space

Let this article help you avoid jeopardizing your tax-exempt status.

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Churches frequently own large meeting facilities but do not utilize them every moment of every day. By allowing others to use the church's facilities, the churches become the center of community activities and para-church ministries. Churches also frequently want to serve the needs of their members and staff, so they allow them to use the church's facilities.

The use of church facilities by non-church entities and individuals creates many federal and state tax issues. In sum, the tax rules will dictate when and how a church's facilities may be used by outside groups and individuals. This article summarizes the rules, but each church is reminded to seek competent advice before actually agreeing to some uses. Every rule has exceptions, and exceptions to those exceptions are common.

Two levels of taxation must be analyzed before allowing an outside group to use church facilities: federal income taxes and state property taxes. Since the state property tax exemptions vary from state to state, the church should check with local property taxing authorities before allowing outside organizations to use its facilities.

Allowable Use Under Federal Tax Law

The church may allow any organization to use its facilities that is recognized by the Internal Revenue Service as exempt from income tax and described in Section 501(c)(3) of the Internal Revenue Code. This normally includes charitable, educational or religious organizations. Before allowing the use, the church should have in its files a copy of the determination letter issued by the Internal Revenue Service to the organization. The organization should confirm that the determination letter has not been revoked or otherwise restricted since its issuance. Once the church confirms the current status of the organization, then the church may allow the use of the facilities for no charge, or the church may charge any amount it chooses that the organization is willing to pay.

Another allowable use would be where the use furthers an exempt purpose. Exempt purposes would be use that furthers its religious, educational or charitable activities. For example, most faiths view a wedding as a religious service. The church may allow an individual to use its facilities to conduct a wedding service without any federal income tax consequences. The key here is that the church is furthering its exempt purposes.

Charging for the Use of Facilities

I need to insert a word of caution here. If the church charges any amount and the church has a debt outstanding related to the facility, then the church will receive taxable income. Further, if the use involves personal property (such as chairs and tables) and the rental value of the personal property is more than 10% of the amount received, then the amount received from the rent of personal property will always be taxable income. Also, if the taxable amount received is more than \$1,000.00 per year, then the church must file Form 990-T even if no profits are realized.

Many churches try to disguise rents by using other terminology or by claiming that the other organization is simply giving a donation to the church. Other times the church calls it a "clean up fee" or tells the tenant to pay the janitor directly for his services. None of these name games work. If any amount is paid by the other organization to the church or the church's workers, then the IRS and state taxing authorities will likely treat it as rent paid to the church.

Allowable Use Under State Laws

State property tax exemptions vary from state to state, so you must check with your local taxing authority regarding any allowable use. Frequently, the state property tax exemption prohibits any use by any other entity, including use by another tax-exempt organization. Some states will allow the use by other charitable, educational or religious organizations without causing the loss of tax exemption if no amounts are charged the other organization. Check with your local property taxing authority before allowing any outside use.

No Inurement or Private Benefit

Under federal tax law, all churches must use their assets exclusively pursuing its exempt purposes. Most states have a similar requirement to qualify for a property tax exemption. Like many laws, "exclusive" as used in federal tax laws does not

always mean exclusive. Under federal tax laws, the courts have interpreted "exclusive" to mean all but an immaterial amount. This means that the church may allow others to use its facilities as long as the use does not otherwise violate federal tax laws and the use is immaterial. This is a time and frequency test. Stated another way, the use one time a year for two hours is likely to be immaterial, but a weekly use for eight hours for fifty-two weeks will likely be material.

Federal tax law prohibits all forms of inurement and substantial amounts of private benefit. The presence of inurement or substantial private benefit allows the Internal Revenue Service to revoke the church's tax-exempt status. Further, the person benefiting from the inurement is subject to intermediate sanctions up to 200% of the amount of inurement.

Inurement and private benefit have technical definitions. Inurement means enriching a church leader, such as a minister or church board member. "Enriching" means the church is providing a benefit, good or service for less than its fair market value to someone or the church is paying more than fair market value for a benefit, good or service that it buys. In the context of this article, it means that inurement occurs when the church allows a church leader to use the church's facilities for personal use and the leader pays less than the fair rental value of the facility, or portion of the facility. For example, the church has an expensive musical instrument (such as an organ) and the music minister wants to give private lessons using the church's instrument. The church must charge the minister the same amount as a commercial enterprise would charge the minister to use its instrument and facilities. If the church charges less than the commercial enterprise, then the minister is enriched by the difference between the commercial fair rental value and the amount actually charged by the church. This may cause the IRS to revoke the church's tax-exempt status. Also, the music minister has taxable income for the difference between the fair rental value and what the church actually charged.

Private benefit is the same as inurement except the person benefiting from the arrangement is not a church leader. Suppose the person wanting to give the music lessons described above is simply a member of the community instead of the minister. The person would receive a private benefit if the church charges that person less than commercial rates for the use of its instrument and facilities. If this difference is substantial, then the Internal Revenue Service may revoke the church's tax-exempt status. In any event, the music teacher has taxable income for the difference between the fair rental value and the amount actually charged. The church should issue Form 1099 to the music teacher to reflect that difference.

Suggestions

Many times a use can easily be structured to fit within the rules described above. For example, since music is central to the church's functions, the church could hire the music minister to give lessons using its instruments. The church could then pay the minister for giving the lessons at the market rate for music teachers (including a percentage of the amounts collected from the students). The same arrangement would work for the community music teacher.

Another common solution is found in celebrations. For example, a family in the church wants to hold a party celebrating the parent's fiftieth wedding anniversary. Since the church also wants to celebrate this milestone, the church can make the celebration a joint event between the family and the church. The church provides the facility; the family provides the rest. By being creative, the church can continue filling its role as the community center.

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