Accounting and Tax Specifics of Selected Ecclesiastical Institution

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Abstract: Conducted article deals with the issue of ecclesiastical institutions. Authors are focused specifically on accounting and tax treatment of such institutions that differ in many areas from corporate practices. The article describes current position of ecclesiastical institutions in the national economy and legislative framework related to providing activities as the religious legal person. Then the accounting and tax aspects of these entities are explained in relation to the article objective. The main objective of conducted article is to identify the weak points in two mentioned areas using the example of selected ecclesiastical institution (parish) and recommend changes leading to more efficiency in activities currently provided by the organization in the accounting and tax area. Authors used methods of literary research, qualitative research (semistructured interviews) and deep analysis of internal financial documents of analyzed organization to be able to identify weak points, assess their treatment and propose final solution that will be further implemented and used by the parish.

Keywords: accounting, ecclesiastical institution, nonprofit organization, NGOs, taxes

JEL Classification: M410, M480

Introduction

Ecclesiastical institutions belonging to the group of nonprofit organizations represent specific subjects of economic sector. The main purpose of such organizations is to fulfill the mission and activities they were set up for. By the term activities are, in this case, ment socially necessary and desirable services. Provision of these services is the essence of existence of a nonprofit organization. The most significant changes in nonprofit organizations development were visible since 1989 when all-society significance of these organizations grew.

Public awareness of nonprofit organizations is still growing and also the amount of people being included to their activities increases. Even if the general perception of nonprofit organizations is positive, the ecclesiastical organizations as a group of nonprofit organizations are still viewed as a specific subject with no importance for the whole society. But these organizations provide irreplaceable services in areas that are not otherwise secured (Charity of the Czech Republic), because other organizations are not interested in providing them.

This article deals with the issue of ecclesiastical institutions and is focused specifically on their accounting and tax treatment, because those two areas differ from generally known principles applicable in the business sector.

Methods of research used by the article authors were literary research, qualitative research (semistructured interviews) and deep analysis of internal financial documents of analyzed organization.
1. THE STATUS OF ECCLESIASTICAL INSTITUTIONS WITHIN NONPROFIT ORGANIZATIONS IN THE CZECH REPUBLIC

At the beginning, it is necessary to define the nonprofit sector, its objectives and organizations that belong to it.

By Ott and Dicke (2012, p. 1) is nonprofit sector „at least partially a product of the democratic-capitalistic government system that have evolved in the United States and other countries.” With respect to Ott and Dick the objective of the organizations belonging to this sector can be defined as provision of specific services as a reaction to marketplace failures and failures of government with the intention to serve citizens needs to fill the gap which resulted from these failures.

Definition of nonprofit organization can be find in books by Drucker (2011), McLeish (2011) or Hopkins (2018, p. 9) who states that: „nonprofit entity is ordinarily understood to differ from a for-profit corporation principally because it is bared from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.”

For each nonprofit organization is very important its objective and mission. Main characteristics of nonprofit organizations explained by Worth (2014) or originally by Salamon and Anheier (1997) can be summarized as:

- Organized entities (organization).
- Private entities (privacy).
- Non-profit distributing entities. (Profit, if any, is reinvested during fulfilling the objectives of organization.)
- Self-governing entities. (They are not controlled by other institutions.)
- Entities with voluntary membership.
- Of public benefit entities.

The following figure (Fig. 1) shows division of organizations within the national economy.

Fig. 1: National economy - division of organizations by purpose of their creation in the Czech Republic

Division to governmental and nongovernmental organizations reflects the relationship between these organizations and state authorities who are, in the case of governmental organizations, their founders. This kind of nonprofit organizations division is used specifically in the Czech Republic. Following table (Tab. 1) summarizes types of nonprofit organizations in the Czech Republic by their legal forms.
Tab. 1: Types of nonprofit organizations in the Czech Republic - legal forms

| Type of nonprofit organization                                      | Regulated by                                                                 |
|------------------------------------------------------------------|----------------------------------------------------------------------------|
| Civic associations and their organizational units                | Civil Code (§ 214 and further)                                             |
| Foundations and endowment funds                                 | Civil Code (§ 306 and further)                                             |
| Religious legal persons or purpose-built facilities of churches  | Act No. 3/2002 Coll., on the Freedom of Religious Expression and the Position of Churches and Religious Societies, as amended |
| Public benefit corporations                                     | Act No. 424/1991 Coll., on Association in Political Parties                |
| Institutes                                                      | Civil Code                                                                  |
| Educational legal persons (Church schools)                       | (Registered by Ministry of Education, Youth and Sports.)                   |

Source: own in accordance with Government of the Czech Republic (2016), 2018

This article is further focused on religious legal persons or purpose-built facilities of churches defined by Act No. 3/2002 Coll., on the Freedom of Religious Expression and the Position of Churches and Religious Societies, as amended.

2. LEGISLATIVE FRAMEWORK GOVERNING THE ECCLESIASTICAL INSTITUTIONS FUNCTIONS IN THE CZECH REPUBLIC

Ecclesiastical institutions belong to nonprofit organizations not founded by the state authorities what means that the profit is not redistributed among its members or management and that these organizations are self managed independently of the state authorities (Ministry of Culture of the Czech Republic, 2018b). Legislative standards most important for setting the ecclesiastical institutions are summarized in the following table (Tab. 2).

Tab. 2: Laws governing the creation and functioning of ecclesiastical institutions in the Czech Republic

| Law                                                                 | Solved area                                                                 |
|-------------------------------------------------------------------|----------------------------------------------------------------------------|
| Charter of Fundamental Rights and Freedoms                        | Mutual independence between the state and religion.                        |
| Act No. 3/2002 Coll., on the Freedom of Religious Expression and the Position of Churches and Religious Societies, as amended | Establishing (creation), activities, registration and termination of activity of ecclesiastical institution. |
| Act No. 117/2001 Coll., on Public Collections                     | Public Collections.                                                        |
| Act No. 561/2004 Coll., on pre-school, primary, secondary, higher professional and other education (Education Act) | Religious education.                                                      |
| Internal standards and regulation                                 | Other activities of ecclesiastical institutions.                          |

Source: own, 2018

2.1 Financing of ecclesiastical institutions in the czech republic

Financing of ecclesiastical institutions includes economic, financial and social elements. Financial sources can be divided to the three groups:

- own sources - acquired by own activities of the institution,
- foreign sources - especially loans,
- potential sources - donations, grants, contributions.

The income of ecclesiastical institutions is described in the Act No. 3/2002 Coll., on the Freedom of Religious Expression and the Position of Churches and Religious Societies, as amended (§ 27).
This income consists mainly of contributions from natural and legal persons, sale or lease of moveable and immoveable property, donations and grants. Income may also arise as the income from profitable activities. This specific income is further used as the source of finance for main nonprofit activities of ecclesiastical institution.

Property settlement is solved by Act No. 428/2012 Coll., on Property Settlement with Churches and Religious Societies (Ministry of Culture of the Czech Republic, 2018a). The same Act solves also the provision of contribution to support activities of such organizations.

### 2.2 Accounting framework for ecclesiastical institutions in the Czech Republic

Legislative framework for the accounting area in ecclesiastical institutions consists of the following documents (Ministry of the Interior of the Czech Republic, 2018):

- Act No. 563/1991 Coll., on Accounting (Accounting Act),
- Implementing Decrees to the Accounting Act (Decree No. 504/2002 Coll., Decree No. 325/2015 Coll., etc.),
- Czech Accounting Standards.

Legislative standards allow the ecclesiastical institution provide accounting outcomes in a simplified form. Conditions for recording and reporting financial information are defined by the Accounting Act. Accounting units using this type of accounting are allowed to simplify records in accounting books, to use simplified accounting in accounting books, to combine accounting in journal with accounting in general ledger and have also the possibility to prepare Financial Statements in simplified form.

Chart of accounts is prepared for each accounting period with the possibility to add individual necessary accounts also during the accounting period. In the case when accounting unit prepares accounting in the full extent, it is necessary to use chart of accounts defined by the Annex No. 3 of the Decree No. 504/2002 Coll. to the Accounting Act. This chart of accounts differs from the chart of accounts used by business units. Differences are described in the table number 3 (Tab. 3).

| Class of accounts | Ecclesiastical institutions | Business units |
|-------------------|-----------------------------|----------------|
| 2                 | Financial accounts          | Short-term financial assets and cash and cash equivalents |
| 4                 | Open                        | Capital accounts and long-term liabilities |
| 7                 | Used in accordance with internal standards and regulation | Balancing and off-balance sheet accounts |
| 8                 | Used in accordance with internal standards and regulation | Management (Cost) accounting |
| 9                 | Equity, the economic result, balancing accounts | Management (Cost) accounting |

Source: own in accordance with Ministry of the Interior of the Czech Republic (2018), 2018

Accounting classes number 0, 1, 3, 5 and 6 are the same for both types of organizations. Numbers of synthetic accounts depend on decision of the accounting unit.

Other difference is related to evaluation of non-current assets. Ecclesiastical institutions use the same rules for evaluation of non-current assets with the exception for evaluation of cultural monuments, museum collections and church buildings where 1 Czech crown (CZK) is used. Because of this difference also the rules for recording depreciation. Such types of assets are not depreciated.

Financial Statements are prepared with respect to the three documents mentioned at the beginning of this chapter, Accounting Act, Decree No. 504/2002 Coll. and Czech Accounting Standards. Audited Financial Statements are obliged to prepare all special purpose facilities using the public sources. In relation to ecclesiastical institutions can be as this facility meant the special purpose facility registered by the ecclesiastical institution with the amount of net turnover higher than 10 million CZK.
2.3 Taxation of ecclesiastical institutions in the Czech Republic

All non-profit organizations in the Czech Republic are the subjects to taxation. However, they also meet the requirements to be the publicly beneficial tax payers, therefore they can use specific tax reliefs. How mentioned Nebuželská (2017), tax specifics offered to publicly beneficial tax payers are in particular:

- narrow tax base,
- income from donations exempt from tax,
- reduction of the tax base,
- under specific conditions not to submit tax returns.

Authors' own research has brought the knowledge that among the taxes collected in the Czech Republic concerning the ecclesiastical institutions belong usually:

- corporate income tax (income of such a kind of institution is most often exempt from tax or it is not subject to tax),
- real estate tax (property tax).

Another advantage used by ecclesiastical institution is the reduction of the tax base with respect to Act No. 586/1992 Coll., § 20. This reduction represents the reduction in the tax base by 30% maximally by 1 000 000 CZK. If the reduction by 30% is lower than 300 000 CZK, it is possible to deduct from the tax base 300 000 CZK (Ministry of Finance of the Czech Republic, 2018).

Exemptions for ecclesiastical institutions exist also in the area of property tax. If the organizations meet the conditions set by the Act No. 338/1992 Coll., on property tax (Financial Administration, 2018).

Accounting and tax rules influencing the management of ecclesiastical institution in financial area will be shown on the case of selected West Bohemian parish in the next section of the article.

3. Accounting and taxes in the selected West Bohemian Parish

This part of conducted article analyzes the current situation in the areas of accounting and taxes in the selected West Bohemian parish. Analyzed institution belongs to religious legal persons. Its mission is to „live a life serving life“. Main activities of the parish are:

- worships,
- pastoral activities,
- church ceremonies,
- and help the needy.

The parish provides services of charitable nature, pastoralism and library services. Economic activities are represented by renting part of their own buildings, selling property and land rentals. Financial sources used by the parish are donations and grants, liturgical collections and loan from the bishopric.

3.1 Accounting aspects of analyzed parish

Parish analyzed by the article authors recorded financial information with respect to the Accounting Act and used the system of simple accounting till 2006. Since that year started to be used the double-entry bookkeeping. In reaction to this movement were done activities like inventorying of assets or preparation of guidelines for evaluation of assets.

Accounting period of the parish is the calendar year, course of the Czech National Bank is used when converting currencies. The amendment to the Accounting Act valid from 2016 allows ecclesiastical institutions use the simple accounting again. Analyzed parish does not use this allowance and records financial information still using the double-entry bookkeeping. Individual groups of accounts used by the parish are summarized in the following table (Tab. 4).
**Tab. 4: Classes of accounts and analytical accounts used by the analyzed parish**

| Group of Accounts | Analytics |
|-------------------|-----------|
| 02. - Tangible fixed assets - depreciable | Division of individual types of buildings. |
| 03. - Tangible fixed assets - non depreciable | Land, culture monuments, artworks. |
| 04. - Intangible and tangible assets under construction |  |
| 08. - Accumulated depreciation - tangible fixed assets |  |
| 21. - Cash and cash equivalents | Division of cash in CZK and EUR. |
| 22. - Bank accounts | CZK, EUR and public collection. |
| 24. - Short-term financial assistance |  |
| 31. - Receivables | Divided by types. |
| 32. - Payables | Divided by types. |
| 33. - Receivables and payables with employees and institutions |  |
| 34. - Taxes and subsidies receivable and payable |  |
| 38. - Temporary accounts of assets and liabilities |  |
| 50. - Consumed purchases | Divided by types of material. |
| 51. - Services | Tax deductible and non-taxable. |
| 52. - Personal expenses | Division of wages. |
| 54. - Other operating expenses | Donations, premiums, fees. |
| 60. - Revenues from own products, services and merchandise | Divided by type of revenue. |
| 64. - Other operating revenues | Divided by type of revenue. |
| 68. - Received contributions | Divided by type of contribution (donation). |
| 69. - Operating grants | Grants by the purpose. |
| 90. - Equity | Divided by the type of source. |
| 91. - Funds |  |
| 93. - The economic result |  |
| 95. - Loan |  |

*Source: own in accordance with conducted research, 2018*

Analysis of the Financial Statements from the years 2014 - 2016 showed that the greatest part of organization’s expenses is represented by the operating expenses and purchased material and services. Income consists of donations (that are used mainly for financing construction activities), contributions, leasing and church collections. There is no set membership fee. Income is also represented by the revenues from services and rental income.

Donations (subsidies) as not the greatest, but very significant financial source, have to be recorded separately as the specific order. Parish uses as the financial source both types of subsidies, operational and investment. The main steady source is represented by the church collections that are exempt from the income tax. As was written above, parish has no set membership fee, therefore its members uses the possibility of one-time or regular contribution to parish financial sources. Other types of income of the parish are revenues from services and rental income.
3.2 Tax aspects of analyzed parish

Analyzed parish provides economic activity that does not reach the amount of 1 000 000 CZK for 12 immediately fore-going consecutive months, therefore this subject is not a value added tax (VAT) payer. There is also no need to pay the road tax, because the parish does not have the car used by the parson in its own property (it is rented from the bishopric). It was found that there are just two types of taxes solved by the parish, the income tax and real estate tax (property tax).

3.3 Problematic areas and recommendations to improve the current situation

During the conducted survey (qualitative research using the semistructured interviews and deep analysis of internal financial documents), were found some weak points in the areas of accounting and tax treatment. They can be summarized as:

- insufficient extent of parish own economic activities,
- not so clear accounting of wages,
- insufficient detail of records of evidence for the calculation of income tax.

These issues may be solved by the following measures.

Insufficient extent of parish own economic activities means in fact wider, but not used possibilities in the area of use of buildings that the parish has in its own property. The first proposed solution is based on the fact that there are still buildings that may be rented. Some of them, especially old church owned by the parish, should be reconstructed. Its expected that the parish will use suitable offered subsidy titles as the financial source for doing so the same way as it currently does, but only if the conditions set for the applicant’s own contribution share will be acceptable. This church should be then used as a historical monument and made available (for a fee) to the public.

Analyzed parish uses very effectively analytical accounts. However, the area of wages is the exemption. It may be useful to use analytics for division of health insurance and social insurance. Some of currently used accounting records may be omitted, because, with respect to the current accounting legislative Framework, they are not necessary to be recorded.

This is specifically the case described in the following table (Tab. 5).

Tab. 5: Accounting of wages – expendable accounting entry

| Accounting document | Accounting case | Debet | Credit |
|---------------------|----------------|-------|--------|
| Z20160090           | Wages – 2016   | 331   | 331    |

Source: own in accordance with conducted research, 2018

The last recommendation relates to the fact that currently prepared background for income tax calculation seems to be insufficient. What needs to be improved is the immediate apparenicy of tax and non-tax items. With this intention was prepared, with respect to the tax legislation, following chart (Tab. 6) that enables quick calculation of the tax base.
Tab. 6: Division of income and expenses for the tax purposes – case of analyzed parish (in CZK)

| Account | Name of account | Income | Account | Name of account | Income | Expenses | Difference |
|---------|----------------|--------|---------|----------------|--------|----------|------------|
| 682xxx | Contributions | 464 980,95 | 501xxx | Material | 423 670,96 | 501510 | Material - minor | 26 017 |
| 691xxx | MK ČR subsidies | 301 000 | 502xxx | Energies | 230 153 | 501 820 | Material - other taxable | 8 409 |
| 649xxx | Income from activities - non-taxable | 9 990,05 | 511xxx | Repairs and maintenance | 491 829,50 | 502 100 | Energies | 52 100 |

| Account | Name of account | Income | Account | Name of account | Income | Expenses | Difference |
|---------|----------------|--------|---------|----------------|--------|----------|------------|
| 512xxx | Travel expenses | 215 | 511310 | Repairs - other taxable | 4 084 |
| 6491xxx | Church collection | 1 018 457 | 518xxx | Other services | 148 779,88 | 521200 | Wages - illnesses | 96 932 |
| 602400 | Religious activities | 27 890 | 521xxx | Wages | 110 580 | 521300 | Wages - incl. taxes | 45 000 |
| 527xxx | Statutory social security expenses | 482 | 524 | Statutory social security insurance | 32 665 |
| 532xxx | Real estate tax | 904 | 532100 | Real estate tax | 2 217 |
| 538xxx | Other taxes and fees | 340 | 551200 | Deprec. - taxable | 94 275 |
| 544xxx | Interest on loan | 147 909 | 551200 | Deprec. - taxable | 94 275 |
| 545xxx | Foreign exchange | 6 491,34 | |
| 546xxx | Bank fees | 7 374 | 602200 | Rental - buildings | 344 100 |
| 551xxx | Depreciation | 500 895 | 602201 | Buildings - energies (flat rate) | 48 500 |
| 566xxx | Gifts | 241 891 | 602202 | Rental - others | 1 000 |
| 513xxx | Entertainment and promo expenses | 4 566 | 602300 | Rental - land | 37 263 |
| 515xxx | Services, actions | 127 535 | 602301 | Rental - landlord (restit.) | 10 245 |
| 518xxx | Other services | 4 884 | 602330 | Rental - contributions DNV | 2 217 |
| 649600 | Income - actions | 131 393 | 602600 | Fee-low. | 150 045,98 |

Total | 1 821 318 | 593 370,98 | 364 153 | 229 217,98 |

Economic result | -277 039,70 | Tax base | 229 217,98 |

Source: own in accordance with conducted research, 2018

CONCLUSION
This contribution deals with the possibility of enhancing the effectiveness of processes in the accounting and tax area of selected ecclesiastical institution – selected parish. In accordance with the tendency of churches to become independent in relation to the state increases the amount of economic activities ensured by these institutions. This leads to defining the strict requirements on proper and correct setting of activities in financial and economic area in such institutions.

Financial documents (Financial Statements and others) plays the significant role as the document base for control activities of the state authorities. With respect to this situation were proposed improvements to the existing state that should lead to more efficient setting of activities provided by the analyzed
organization. Their real incorporation into the existing organization processes depends on its staff dealing with the economic issues, but it seems, that there is the tendency to implement and use them. Chart for effective calculation of the tax base described in the last section of the article should be also used by other ecclesiastical institutions of the same or similar size (similar scope of activities). Realization of this idea is conditioned by future detailed survey of the accounting and tax processes set up by organizations with prerequisites for implementation of proposed solution.

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