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Threshold Issues

- Constitutional Issues
- What is a Church?
- Congregational v. Hierarchical



Constitutional Issues

- **Two systems of laws: Federal and state**
 - **First Amendment**
 - **Applies to states via the 14th Amendment.**

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What is a Church?

- **Has extra legal benefits.**
- **Is it the body of people? Or the building?**
- **Not just a reference to Christianity.**

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What is a Church?

- **Key point: You decide how your church runs—and whether to apply for exemption.**
- **Churches are automatically exempt**
- **You still need to be aware of what the IRS thinks is a church (14 points).**

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Congregational v. Hierarchical

- **Do you have a higher church structure that exercises authority over the church?**
- **Will the local church be self-governing?**
- **The choice will impact operations AND possibly court jurisdiction.**

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Form of Entity

- **Trusts**
- **Unincorporated associations**
- **Corporations**
 - **Religious? – depends on state law**
 - **Corporation Sole? – not recommended**

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Questions?

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Corporate Formation Documents

- Articles
- Bylaws
- Constitution?
 - The articles prevail over all other documents.
 - There is no need for a separate constitution.

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Articles of Incorporation

Public document typically filed with your state's secretary of state.

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Articles of Incorporation

I recommend limiting the provisions in the articles of incorporation to:

- **Mandatory terms (those required by the state or the IRS).**
- **Those that should not be easily modified.**
- **Those allowed by state law to limit liability.**
- **One that includes the church's statement of faith.**

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Articles of Incorporation

- **Mandatory terms – common state requirements:**
 - **Name of corporation.**
 - **Address of registered office and name of registered agent.**
 - **Name and address of incorporator(s).**

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Articles of Incorporation

- **Mandatory terms (cont'd):**
 - **Whether the corporation will have members.**
 - **Purpose clause must be consistent with category of tax-exemption.**
 - **Irrevocable dedication; dissolution clause, noninurement.**

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Articles of Incorporation

THE MOST IMPORTANT PROVISION: PURPOSE CLAUSE

- **Important for religious organizations to emphasize religious nature: What distinguishes you from everyone else?**
- **If the church is a hierarchical organization, special language may be necessary.**

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Articles of Incorporation

THE SECOND-MOST IMPORTANT PROVISION: DISSOLUTION CLAUSE

- Where do the assets go upon dissolution?
 - May have a generic provision allowing the members or directors to choose.
 - May designate the organization.

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Articles of Incorporation

- Permissive terms
 - Naming of initial directors (required in some states).
 - Limiting the liability of a director for money damages (allowed in some states).
 - Permitting or requiring indemnification (may be in bylaws).

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Bylaws

- **Create only what is necessary.**
- **Define whether there are members and define their rights and responsibilities.**
- **Set forth powers, rights, duties, and limitations for the board of directors.**

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Bylaws

- **Who chooses the directors?**
 - **Members v. nonmembers**
 - **Appointed directors**
 - **Self-perpetuating directors**

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Bylaws

- **Who controls the corporation?**
 - **Members**
 - **Directors**
 - **Officers**
 - **Overriding religious authority**
 - **Advisory boards**
 - **Committees of the board**

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Bylaws

- **Board of directors**
 - **There is only one board!**
 - **Purpose of board**
 - **“Ex Officio” directors**
 - **Number of directors**
 - **Tenure/Terms—limits?**
 - **Qualifications**
 - **Removal**

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Bylaws

- Board of directors (cont'd)
 - *Regular/special meetings; action without meeting*
 - Use of electronic communications
 - No proxies
 - Advisory directors
 - Compensation

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Bylaws

- Committees
 - NOT selected by chair
- Official board committees
 - Standing Committees
- Other committees—advisory

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Bylaws

- **Officers:**
 - **Purpose of officers – implement and report**
 - **Board vs. staff**
 - **Chair**
 - **President, CEO**
 - **Secretary**
 - **Treasurer**
 - **Subordinate officers**

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Bylaws

- **Resolving disputes**
 - **Method of arbitration to settle disputes outside of court.**
 - **To whom are you willing to submit?**
 - **How do you bind the directors/officers/**
 - **Members to require arbitration?**

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Bylaws

- **What if your church gets sued?**
 - **Indemnification:**
 - **Mandatory**
 - **Permissive**
 - **Advancing expenses**
 - **Directors & Officers insurance.**
 - **Any state statutes that limit liability?**

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Bylaws

- **Other matters to consider:**
 - **Ordination of ministers**
 - **Schools**
 - **Statement of nondiscrimination**
 - **Conflicts of interest**

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Bylaws

- **Miscellaneous matters**
- **Amending bylaws**
- **Dissolution**

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Nonprofit Governance

- Traditionally controlled by state law.
- IRS now actively involved.
- Regulation by disclosure.

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Federal Tax Oversight

- 501(c)(3) – exempts all charitable organizations, including churches.
- 508(c)(1)(A) – exempts churches from filing.
- Benefits to establishing exempt status mean that many churches still apply.

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Federal Tax Status

- IRS Form 1023 v. Form 1023 ez
- A church is exempt from filing Form 990.
- To be exempt,
 - Organized for one or more exempt purposes;
 - Operated for these exempt purposes.

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Requirements for Tax-Exempt Status as a 501(c)(3)

- Exempt purpose(s).
- Organized exclusively for exempt purposes.
- Operated exclusively for exempt purposes.
- No private inurement.
- No candidate political activity.
- No substantial legislative lobbying.

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No Private Benefit

- Public rather than a private interest;
- Not operated for the benefit of private interests;
- May confer incidental benefits to individuals as part of furthering the organization's exempt purposes.

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No Private Inurement

- **RULE:** No net earnings may inure to the benefit of any “insider.”
- “Insiders” – founders, directors, and officers, and other persons in a position to influence decisions of the church.
- **Penalty:** Revocation!

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No Excess Benefit Transactions

- **RULE:** No direct or indirect economic benefit on a disqualified person in excess of the value received by the organization in return.
- **“Disqualified Person”:** current or former director, pastor, relatives, 35% entities
- **Penalty:** Intermediate sanctions
 - 25%; 200% on excess benefit (disqualified person)
 - 10% on excess benefit (up to \$20,000) (directors, if knowingly and willingly participated)

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Rebuttable Presumption of Reasonableness

- Approval in advance by disinterested board (or committee).
- Appropriate comparability data.
- Concurrent documentation.

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No Substantial Lobbying

- **Lobbying**
- **Limitations**
 - **501(h) election – NOT AVAILABLE FOR CHURCHES.**

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No Electioneering

- **Directly or indirectly participating in, or intervening in,**
- **Any political campaign on behalf of, or in opposition to,**
- **Any candidate for elective public office.**

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Exempt Purposes

BIG PICTURE – 501(c)(3)s must be organized and operated exclusively for an exempt purpose (including religious).

- Religious may include activities that may also be charitable or educational.

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Is a Church a Private Foundation?

- Charities and private foundations are all exempt under 501(c)(3).
- Churches are automatically NOT Private Foundations.

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State Oversight

- Tax-exempt status.
- Oversight of charitable activities.
- Continued oversight of corporate status.

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Dig Deeper into Church Formation

Using our ready-reference tools, you can get answers to your legal questions and better understand how to conduct legally sound church business.



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