



**Board Governance and
Special Rules for Faith-
Based Nonprofits**

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Introduction

Purpose

- A. Religious organizations have special rules
- B. Awareness of the rules equips leaders to be better stewards of their organization's assets and mission
- C. Organization can better serve its members and the community

Constitutional Background

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof...

U.S. Const. amend I

Constitutional Background

Wash. Const. art. 1, § 11:

- Greater free exercise protection
- Greater establishment protection

Religious Organizations as a Subset of Nonprofits

A. Universe of organizations

1. Nonprofits as a subset (includes (c)(3), (c)(4), (c)(5), etc.)
 - a. 501(c)(3) as a subset (includes religious, charitable, educational, scientific)
 - Religious organizations as a subset (includes churches)
 - » Churches as a subset

Religious Organizations as a Subset of Nonprofits

- A. Important to understand classification of your organization
- B. Different laws apply depending upon whether for-profit, secular non-profit, para-church religious, or church

Definitions

- A. "Religious" and "church" not defined in tax code or IRS regulations
- B. "Religious" defined in other places
 1. Case law – *World Vision*
 2. R-74
- C. "Church" defined by case law

Definitions

A "religious corporation, association, or . . . society . . . is organized for a religious purpose, is engaged primarily in carrying out that religious purpose, holds itself out to the public as an entity for carrying out that religious purpose, and does not engage primarily or substantially in the exchange of goods or services for money beyond nominal amounts.

Spencer v. World Vision (9th Circuit, 2011)

Definitions

"For purposes of this chapter, 'religious organization' includes, but is not limited to, churches, mosques, synagogues, temples, nondenominational ministries, interdenominational and ecumenical organizations, mission organizations, faith-based social agencies, and other entities whose principal purpose is the study, practice, or advancement of religion."

RCW 26.04.007 (Referendum 74)

Definitions

"Religious organization" as defined in this chapter must be interpreted liberally to include faith-based social service organizations involved in social services directed at the larger community.

RCW 26.04.900 (Referendum 74)

Definitions

[I]n order to be considered a church . . . a religious organization must create, as part of its religious activities, the opportunity for members to develop a fellowship by worshipping together.

Foundation of Human Understanding vs. United States (Federal Circuit 2010)

For-profit Religious Organizations?

- A. Not historically recognized at the entity level
- B. Owners have limited First Amendment rights (no right to discriminate on religion)
- C. Supreme Court to hear *Hobby Lobby* case

Introduction - Section Summary

- A. Know the type of organization
- B. Nonprofit > 501(c)(3) > Religious > Church
- C. Pay attention to definitions unique to context

Governance

Sources of Law

- A. State law (federal law does not generally regulate internal affairs of corporation)
- B. Ecclesiastical / canon law
- C. Potential for conflict

State Law - Introduction

- A. Washington Nonprofit Corporation Act
 - 1. Chapter 24.03 RCW
 - 2. Will likely be replaced in 2015
- B. Governs internal affairs of incorporated nonprofits (including churches)

State Law - Introduction

- C. Governing documents
 - 1. Articles of Incorporation – filed with the Secretary of State; public
 - 2. Bylaws – not filed; internal
 - 3. No provision for a “constitution” – legally considered part of bylaws
- D. Tremendous member flexibility

State Law - Introduction

- E. Supplies “defaults” in absence of different standards in governing documents (quorum requirements, some voting)
- F. Some requirements cannot be altered by governing documents (dissolution thresholds; board voting; notice)

State Law - Traps

- A. Ambiguous member voting rights
- B. Meeting notice requirements (minimum 10 days; in writing)
- C. Electronic notice / voting (consent required)
- D. No proxy/email voting/absentee voting for board (must be unanimous or live)

State Law - Traps

- E. Member inspection rights
- F. Quirky dissolution procedure
- G. Loans to officers / directors prohibited

State Law – Board of Directors

- A. Governing body of the corporation
 1. Responsibility for the affairs of the corporation
 2. Relationship to members depends upon bylaws, but members do not have the same fiduciary duties

State Law – Board of Directors

B. Major duties

1. Duty of care
2. Duty of loyalty
3. *Duty of obedience?*

State Law – Board of Directors

C. Duties imposed by state law:

"A director shall perform the duties of a director, including the duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

State Law – Board of Directors

D. Duty of care

1. Attend meetings
2. Be informed
3. Exercise good and independent judgment – may rely on experts

State Law – Board of Directors

E. Duty of loyalty

1. Act in best interests of corporation
2. Avoid / manage conflicts of interest
3. Understand corporate opportunities
4. Maintain confidentiality

Canon Law

- A. Independent / non-denominational
 - 1. Articles & bylaws govern
 - 2. Top down – Episcopal (“elder-governed”) with no voting rights
 - 3. Bottom up – congregational – purely democratic
 - 4. Hybrid – member voting on some issues

Canon Law

- B. Denomination / Network
 - 1. Various types of polity
 - 2. Congregational
 - a. Loose network with no central or higher authority
 - b. Example: Baptist
 - c. Articles & bylaws still primarily govern local church
 - d. Network documents govern network and things like credentialing

Canon Law

3. Hierarchical

- a. Higher church courts have authority over lower courts
- b. Local church not self-governing
- c. Example: Episcopal, Roman Catholic
- d. More chance of conflict between state law and canon law

Canon Law

4. Hybrid

- a. Characteristics of each
- b. Example: Presbyterian, Assembly of God

Canon Law

4. Classification matters in property disputes
 - a. Congregational church – court applies “neutral principles of law” (deeds, bylaws, etc.)
 - b. Hierarchical church – court defers to decision of highest church court even if contrary to deed

Bylaw Recommendations

- A. Consistency with denominational requirements
- B. Identify officers / directors
- C. Discipline / removal
 1. Pastors
 2. Other leaders
 3. Members

Bylaw Recommendations

- D. Specific about voting rights
- E. Notice requirements
- F. Indemnification for directors / officers
- G. Ecclesiastical authority for independent churches
- H. Statement of faith for independent churches

Governance - Section Summary

- A. State law
- B. Duties of board members
- C. Canon law – different types of church government
- D. Bylaw recommendations

Federal & State Tax Issues

Overview of 501(c)(3)

- A. Organized and operated for exempt purposes
- B. No private inurement
- C. No political campaigns
- D. No more than insubstantial lobbying

IRS Filing Requirements

- A. Application for exemption / annual 990
 - 1. Churches, associations, integrated auxiliaries - *Exempt*
 - 2. Other religious organizations - *Not Exempt*
 - 3. Churches that operate a private school must still file annual 5578 (annual certification of racial nondiscrimination)
 - 4. Letter of exemption still useful for churches

IRS Filing Requirements

- B. Churches must still file form 990-T for unrelated business income. Debt-financed rental property subject to UBIT unless qualified for neighborhood land rule.

Minister Compensation Rules

A. Who is a "minister"?

1. Administers sacraments,
2. Conducts worship services
3. Performs services in the 'control, conduct, and maintenance of a religious organization'
4. *Is 'ordained, commissioned, or licensed'*
5. Is considered to be a spiritual leader by his religious body.

Minister Compensation Rules

B. Only in the "exercise of ministry"

"Includes the ministration of sacerdotal functions and the conduct of religious worship, and the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination."

Minister Compensation Rules

C. Special Rules

1. Housing allowance is excluded from federal income tax (but not self-employment tax)
2. Limited ability to opt out of social security
3. Ministers are always self-employed for purposes of social security
4. Minister wages are not subject to income tax withholding

Minister Compensation Rules

D. Legality of housing allowance in question

1. Alleged to violate establishment clause
2. District court in Wisconsin ruled unconstitutional
3. Stayed pending appeal (just appealed to 7th Circuit; Supreme Court likely if 7th Circuit upholds district court)

Church Audit Procedures Act

- A. "High level treasury official" must "reasonably believe" that the church is not exempt or is carrying on an unrelated trade or business in order to initiate an audit.
- B. Since 2009, IRS has not designated a high level treasury official
- C. Doesn't apply to everything

Intermediate Sanctions

- A. Background
 - 1. IRS tool to deter and penalize private inurement
 - 2. Private inurement = benefit to insider
 - 3. Previously limited to the death penalty – rarely used.

Intermediate Sanctions

B. What is it?

1. Transaction with disqualified person at other than fair market value
2. Penalty taxes of up to 225% on the disqualified person
3. Penalty taxes of up to 10% (max \$20,000) on nonprofit board members – joint and several

Intermediate Sanctions

C. Disqualified person (5-year look back)

1. Board members
2. Executive officers
3. Financial officers
4. Family members of disqualified person
5. Organization more than 35% owned by disqualified person
6. Facts and circumstances (major donors)

Intermediate Sanctions

D. Excess benefit transaction

1. Value of benefit conferred by organization is greater than the consideration received
2. Reasonable compensation for services OK if properly documented as such in advance (written minutes or contract, W-2, 1099)
3. Automatic excess benefit transaction for taxable but unreported benefits even if overall compensation is reasonable

Intermediate Sanctions

E. Penalty taxes

1. 25% of excess benefit on the disqualified person
2. 200% of excess benefit if the transaction is not unwound
3. 10% on board members / others who approved / participated in the transaction up to max \$20,000. Joint and several liability.
4. Taxes can be abated if transaction unwound

Intermediate Sanctions

- F. Establishing a rebuttable presumption of reasonableness
 - 1. Decision made by directors who have no conflict of interest
 - 2. Disinterested directors relied on appropriate comparability data (salary surveys, appraisals, etc.)
 - 3. Contemporaneous documentation in minutes (including individual yes/no votes)

State Tax Issues

- A. Excise taxes
 - 1. Religious organizations (including churches) subject to same rules – must pay sales tax as a buyer; charge sales tax as a seller
 - 2. B&O exemptions and deductions for common sources of revenue such as tuition or donations

State Tax Issues

B. Property taxes

1. RCW 84.36.020 and WAC 458-16-190
 - a. Churches, cemeteries, convents, parsonages
 - b. 5-acre limit
2. RCW 84.36.030(2) and WAC 458-16-220
 - a. Church camps
 - b. 200-acre limit

State Tax Issues

B. Property taxes (continued)

3. RCW 84.36.050 and WAC 458-16-270
 - a. Exempts schools
 - b. 400-acre limit
4. Traps
 - a. Church coffee shops
 - b. Vagueness of "church purposes"
 - c. Nonprofit but not "eleemosynary" tenants

Federal & State Tax Issues Section Summary

- A. 501(c)(3) overview
- B. Filing requirements
- C. Minister compensation rules
- D. Intermediate sanctions
- E. State excise & property taxes

Employment Discrimination & Public Accommodation

Federal Law (Title VII)

- A. Applies if 15 or more employees
- B. Prohibits discrimination on the basis of race, color, sex, national origin, or religion
- C. Sexual orientation and marital status not protected

Federal Law (Title VII)

- D. Religious employer exemption
 - 1. Religious discrimination only – does not apply to race, sex, color, or national origin
 - 2. Applies to all types of employees – *Amos* case.
 - 3. Applies to “religious corporation, association, educational institution, or society”

Federal Law (Title VII)

D. Religious employer exemption (continued)

4. What is "religious" – *World Vision* case
 - a. Religious purpose stated in founding documents
 - b. Engaged primarily in carrying out the religious purpose
 - c. Holds itself out to public as religious ("comes with a cost")
 - d. Does not engage primarily in exchange of services or goods for money beyond nominal amounts

Federal Law (Title VII)

E. Ministerial Exception

1. Ministers not protected by antidiscrimination laws due to First Amendment
2. Court in *Hosanna Tabor* affirms, but no clear definition of "minister"
 - a. "Commissioned" in LCMS
 - b. Claimed housing allowance
 - c. Only 45 minutes per day of religious duties

State Law

- A. Applies if 8 or more employees
- B. Much more extensive list of protected classes

age, sex, marital status, sexual orientation, race, creed, color, national origin, honorably discharged veteran or military status, or the presence of any sensory, mental, or physical disability or the use of a trained dog guide or service animal by a person with a disability

State Law

- C. Sexual orientation broadly defined

heterosexuality, homosexuality, bisexuality, and gender expression or identity. As used in this definition, "gender expression or identity" means having or being perceived as having a gender identity, self-image, appearance, behavior, or expression, whether or not that gender identity, self-image, appearance, behavior, or expression is different from that traditionally associated with the sex assigned to that person at birth.

State Law

D. Until *Ockletree*, broad religious exemption

1. "Religious or sectarian organization not organized for private profit" excluded from definition of employer
2. Exemption therefore not limited to religion as in federal law

State Law

E. Pre-empts local / municipal law

1. First *Franciscan* case
2. Cities and counties cannot close the religious exemption in state law
3. Only applies to discrimination – local ordinances such as Seattle sick leave or minimum wage not pre-empted

Ockletree decision

- A. Washington State Supreme Court
 - 1. Washington constitution
 - 2. Stricter than U.S. Constitution on both free exercise and establishment
- B. Facts
 - 1. Hospital security guard
 - 2. Sued for race and disability discrimination

Ockletree decision

- C. Court decision
 - 1. 4-4-1 – no majority opinion
 - 2. Exemption “facially” constitutional
 - 3. Four justices hold unconstitutional in case of “employment discrimination based on grounds unrelated to religious beliefs or practice.”

Ockletree decision

C. Court decision (continued)

4. One justice holds unconstitutional where “job qualifications and responsibilities” are “unrelated to religion.”
5. But agrees with other four that exemption is unconstitutional as applied to Ockletree “assuming that there is no relationship between [the employee’s] duties and religion or religious practices.”

Ockletree decision

D. Meaning of the decision

1. Can prefer employees on basis of religion at all levels
2. Ministerial exception still applies because federal law pre-empts state law
3. Employees likely to prevail if alleged discrimination has no relationship to religious belief or practice

Ockletree decision

- D. Meaning of the decision (continued)
 - 4. To be determined (and litigation likely) on protected classes that arguably relate to religious practice – marital status and sexual orientation (Eastside Catholic situation)
- E. Recommendations

Public Accommodation

- A. Federal law
 - 1. Title II of the Civil Rights Act limited in what facilities it covers and only applies to race, color, religion, national origin
 - 2. Religious organizations exempt from ADA (but not as employers)

Public Accommodation

B. State law

1. Broad list of protected classes
2. Vague religious exemption: does not apply to: "educational facility, columbarium, crematory, mausoleum, or cemetery operated or maintained by a bona fide religious or sectarian institution"

Public Accommodation

3. Same-sex marriage
 - a. No new regulation – RCW 49.60 still governs employment, real estate, public accommodation in sexual orientation and marital status

Public Accommodation

3. Same-sex marriage (continued)
 - b. Separate religious exemptions applicable only to same sex marriage
 - c. Religious organizations exempt as to "solemnization" (the ceremony) and "celebration" (the reception)
 - d. Religious leaders exempt from "recognizing" same-sex marriage

Employment Discrimination & Public Accommodation - Section Summary

- A. Title VII
- B. State Human Rights Act & *Ockletree*
- C. Public accommodation and same sex marriage

Other Risk Management Issues

Charitable Solicitations

- A. About 40 states require registration for charitable solicitations
- B. Each has different religious exemptions
- C. www.multistatefiling.org
- D. Charleston Principles
- E. Washington exempts churches and integrated auxiliaries

Liability of Board Members

A. Contract

1. Generally protected by corporate form
2. Sign contracts properly; watch guarantees

B. Tort

1. Liable for gross negligence or intentional misconduct
2. Volunteer protection statutes give qualified immunity for ordinary negligence

Liability of Board Members

C. Statutory liability

1. Unpaid wages (be careful of exempt/non-exempt and "interns" who are paid, but below minimum wage)
2. Unpaid taxes (failure to remit payroll taxes)
3. Intermediate sanctions
4. Securities violations

Liability of Board Members

D. Mitigating risk

1. Limitation of liability (must be in articles of incorporation)
2. Indemnification by corporation
3. D&O insurance
 - a. Side A
 - b. Side B
 - c. Side C

Child Protection

A. Penn State - Freeh Report

1. http://progress.psu.edu/assets/content/REPORT_FINAL_071212.pdf
2. Broad list of generally-applicable recommendations
3. Standard of care?

Child Protection

B. Liability based on “special Relationship”

1. Anonymous phone call about a member
2. Member made a deacon
3. Abuse occurs away from premises and not at a church event
4. Church liable

Child Protection

C. Social media policies

1. Everyone has a cell phone
2. Be very careful of contact between ministry workers and minors

Legal Self-Audit

- A. Governing documents
- B. Employee handbooks and other employment policies
- C. Child protection policies
- D. Insurance coverage

Other Risk Management Issues – Section Summary

- A. Charitable solicitations
- B. Board liability
- C. Child protection
- D. Legal self-audit

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Q&A

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