



THEALLIANCE



OFFICE OF THE
CORPORATE SECRETARY

CHURCH RISK

produced by the Office of the Corporate Secretary

Disclaimer

This document is designed to provide accurate information for C&MA churches and official workers in regard to the subject matter covered. The information provided is not intended to be comprehensive but to provide only initial understanding of the issues addressed based on frequently asked questions.

For a more detailed discussion of any of the topics presented, please refer to the recommended resources at the end of each section. *It should be understood that the publisher of this information is not engaged in rendering legal, accounting, or other professional services.* If legal advice or other expert assistance is required, the services of a competent professional should be sought.

If you have a question that is not addressed in these pages, please refer to the additional resources or e-mail the Office of the Corporate Secretary with your question. If the question is general enough in nature, we will attempt to incorporate it in future revisions.

Church & Official Worker Taxes Topics and Questions

Employment Status of the Minister and Staff

Is the minister an employee or self-employed?

Except in rare circumstances, the minister(s) of a church should be considered an employee for income tax purposes. The reasons for this classification are as follows:

- The IRS considers most ministers to be employees of the church.
- Most ministers are employees under the tests applied by the courts.
- The risk of an audit is much lower (IRS focuses on persons for potential audit who receive only one 1099).
- The value of some fringe benefits will be nontaxable, including 1) expense reimbursements under an accountable reimbursement plan and 2) medical insurance premiums paid directly or reimbursed.
- If the IRS reclassifies a minister from self-employed to employee, additional taxes and penalties will be assessed against the minister.

It is important to understand that the minister is considered an employee for income tax purposes but is considered self-employed for Social Security purposes and therefore must file self-employment taxes. This is known as the dual tax status of a minister and creates much confusion for those reporting to the IRS. *See Chapter 6 of the Finance Manual* for more information on the dual tax status of a minister.

Ministers that will, in all likelihood, be treated as self-employed for ministerial services rendered to the church are itinerant evangelists, pulpit supply, C&MA missionaries, and guest speakers.

Are non-ministerial staff considered employees or are they self-employed?

A determination must be made for each person who does work for or provides services to the church. This determination should be made based on the same factors applied to ministers. IRS Form SS-8 contains a checklist of the twenty criteria the IRS applies. The church should review these criteria for each individual working for the church if there is any doubt as to their classification. Many times the classification is easy to determine, but in a few cases it is a little more difficult, such as a part-time custodian or nursery worker. For more information on this issue see *Chapter 7 of the Finance Manual*.

There are some significant differences in reporting taxes to the IRS for the minister versus the non-ministerial staff. The section on Reporting to Tax Authorities will attempt to address these differences.

The Housing Allowance

What is a housing allowance? A housing allowance is a federal tax exclusion from reportable gross income for income tax purposes. A housing allowance is an exclusion from ministerial compensation only and never from secular earnings. The term "housing allowance" is used at times for the three forms of housing exclusions.

- **Parsonage.** A house provided by the church. The annual rental value of the house is not taxable for income tax purposes but must be included as income for self-employment taxes.
- **Parsonage Allowance.** When a parsonage is provided by the church, the church can still designate a portion of the minister's salary as parsonage allowance, which is excluded from reportable gross income for income tax purposes but not from the self-employment tax calculation. This portion of the minister's salary can be used for housing related expenses not paid by the church.
- **Housing Allowance.** This is the portion of the minister's salary that is designated for housing expenses when the minister owns or rents a house. This amount is excluded from reportable gross income for income tax purposes but not for self-employment tax purposes.

The term "housing allowance" will be used throughout the remainder of this section for that portion of the minister's salary designated as either a parsonage allowance or a housing allowance, unless noted otherwise.

Who qualifies for a housing allowance? To qualify for a housing allowance, a person must be a "minister" for federal tax purposes based on the following factors:

- Must be ordained, commissioned, or licensed.
- Administers the sacraments.
- Conducts religious worship.
- Has management responsibility in a local church or religious denomination.
- Is considered a religious leader by the church or denomination.

The IRS and the courts generally require the first factor, but the remaining four need not all be present for the person to be considered a minister for tax purposes.

When and how is a housing allowance determined and designated? A housing allowance must be determined in advance of the housing expenses being incurred. A housing allowance can never be retroactive. Therefore, the governance authority of the church should designate a housing allowance prior to the beginning of the coming tax year (e.g., December meeting) or at the beginning of employment. To avoid the unintended failure to designate an allowance for the next tax year, the governance authority should pass a continuing resolution to be included in the written minutes that designates the amount of the housing allowance. A housing allowance can be amended during the year but only on a prospective basis. The amount of the housing allowance should be based on a reasonable estimate of housing expenses expected to be incurred by the minister for the covered period. It would be wise to include an additional amount in the housing allowance for any unexpected expenses since the minister will declare any excess housing allowance as other income but cannot exclude more than the officially designated housing allowance.

How much of the minister's compensation is excludable as housing allowance? The minister can exclude the lesser of the following three amounts:

- The amount actually spent on housing expenses for the year.
- The church designated housing allowance.
- The fair rental value of a furnished house including utilities.*

**This applies to ministers who are purchasing a house and not to those renting or in a parsonage.*

What kind of housing expenses are excludable? The following kinds of expenses should be considered when calculating the housing exclusion:

- Down payment on a house (remember the fair rental value limitation).
- Mortgage (including principal and interest) or rental payments.
- Real estate taxes.
- Property insurance (real estate and personal).
- Utilities (e.g., electricity, gas, water, sewage, trash pickup, local telephone access charges).
- Furnishings and appliances (purchase and repair).
- Remodeling and physical repairs.
- Yard maintenance and improvements.
- General maintenance items (e.g., exterminations, light bulbs, cleaners).

What can be done to assist a minister who lives in a parsonage but someday may need to buy a house? The church should consider providing the minister with an equity allowance. An equity allowance is designed to partially compensate the minister for the missed opportunity of building equity in a house. The equity allowance is additional compensation, but placing this compensation in a tax-deferred retirement vehicle can reduce the tax impact and help ensure that funds are available at retirement.

How is the housing allowance reported on the W-2? Since the housing allowance is excluded from the minister's compensation for income tax purposes, Box 1 of the W-2 includes the reportable gross income of the minister after reduction for the housing allowance. It is recommended that the housing allowance be placed in Box 14 for informational purposes. If the actual housing expenses are less than the official housing allowance, the minister must report any excess housing allowance as taxable income.

Where can I find more information on the housing allowance? A number of resources are listed on the Resources Web page to assist you in finding more detailed information. One of those resources is the Finance Manual for Alliance Church Treasurers (Finance Manual). The housing allowance is discussed in Chapter 6 (*found in the Finance Manual for Church Treasurers*).

Reporting to Tax Authorities

When and how does the church report to the IRS? Since the church is exempt from paying income taxes on its revenues (except in rare occasions), the main reporting requirement for the church is related to payroll taxes. These reporting requirements are mainly for the IRS and Social Security Administration. There also may be state reporting requirements. The normal federal payroll reporting requirements for churches are as follows:

- Obtain an employer identification number (EIN).
- Determine the employment status of each minister and non-ministerial staff.
- Obtain each person's Social Security number or EIN.
- Obtain a W-4 from each non-ministerial employee and from any minister who volunteers to submit to the withholding of income taxes.
- Based on their salaries and other income, determine how much income tax to withhold from their paycheck (Circular E provides tables and instructions).
- For non-ministerial employees, determine the amount of FICA taxes to withhold.*
- Withheld income taxes and FICA, along with the employer's match for FICA, are sent to the taxing authority quarterly using IRS Form 941 or to a local bank more frequently using IRS Form 8109 if the remittance is greater than \$2,500 in any given month.
- File Form 941 with the IRS quarterly to report the wages that were paid and the taxes withheld.
 - Annually, you must issue W-2's to each employee and file copies of all W-2's with: Social Security Administration using Transmittal Form W-3.
 - State and local tax authorities (if required).

Church & Official Worker Taxes

- Annually, you must issue 1099s to any non-employees for services provided if your total payment to them was \$600 or more for the year and file copies of all 1099s with:
 - IRS using Transmittal Form 1096.
 - State and local tax authorities (if required).

**This assumes the church did not exempt itself from the employer's share of Social Security taxes in 1984.*

The above topic is discussed in detail in Chapter 7 of the Finance Manual.

If the church's only employee is a minister reporting may be minimal depending on factors related to the dual tax status of the minister. Even though the minister is considered a church employee for income tax purposes, the minister's compensation is specifically exempted from mandatory income tax withholding. This does not mean the minister is exempted from paying income taxes but only from mandatory withholding. The minister is required to file and pay a quarterly estimate using Form 1040 ES. The minister may voluntarily agree to be subject to the withholding of income taxes by completing Form W-4. This is helpful to the minister if cash flow is an issue when filing the quarterly estimate.

Since the minister is always considered self-employed for Social Security purposes, the minister must pay self-employment taxes (SECA). The minister is never subjected to FICA taxes. The minister is required to file and pay a quarterly estimate of SECA taxes using Form 1040 ES.

Therefore, if the only employee is the minister and the minister is filing quarterly estimates, then there is no effective purpose in filing a quarterly Form 941 since its purpose is to report and pay both income taxes withheld and FICA payments. The IRS agrees with this position, but this position may also create an apparent discrepancy at the end of the year. The discrepancy will be created because the church is still required to file a W-2 for the minister even though it did not report the minister's wages on Form 941. If the church gets an inquiry from the IRS because of this apparent discrepancy, simply inform the agent that the W-2 was for a minister who filed his own quarterly estimates.

Does the church have to file an IRS Form 990 like other nonprofits? The short answer to this question is no. Form 990 is the Return of Organization Exempt From Income Tax and churches are specifically excluded in the IRS code from filing this form. It is possible that a church could be required to file Form 990T. This form is entitled Exempt Organization Business Income Tax Return. The 990T is used to report and pay income taxes on unrelated business income (UBI). We will discuss UBI in another section due to its complicated nature.

Does the church have to file IRS Form 940? Form 940 is the Employer's Annual Federal Unemployment (FUTA) Tax Return. The church is not subject FUTA taxes and no form needs to be filed.

IRS Section 501(c)(3) and the C&MA Group Exemption Letter

What does it mean to be a tax-exempt organization? A tax-exempt organization is one that is exempt from paying federal income taxes on its revenues, including contributions, interest, or investment income. Depending on the state the church is located in, the organization also may be exempt from any state income taxes. It does not mean the church is automatically exempt from all types of federal taxes, nor does it mean that the church is automatically exempt from various state imposed taxes like sales and property taxes.

What is a 501(c)(3)? This refers to Section 501(c)(3) of the Internal Revenue Code wherein the criteria are established for an organization to be considered exempt from federal income taxes. There are six

requirements in Section 501(c)(3) that must be met by the church in order to be considered exempt. The church:

- Must be incorporated or properly organized under a constitution and/or bylaws.
- Must be organized exclusively for exempt purposes.
- Must be operated exclusively for exempt purposes.
- Must not allow any of its net earnings to inure to the benefit of any private individuals.
- Must not engage in any substantial efforts to influence legislation.
- Must not intervene nor participate in political campaigns.

What does a church have to do to be a 501(c)(3) tax-exempt organization? The short answer is nothing, but this is not an adequate answer. Under IRS regulations, churches are not required to file anything with the IRS to be tax-exempt under Section 501(c)(3), but they still must meet all of the requirements mentioned above.

Why then should a church ever file with the IRS or join the C&MA Group Exemption to be officially recognized as a 501(c)(3) organization? There are a number of good reasons for having official documents showing that the IRS recognizes the church as a tax-exempt organization. One of the main reasons is to be able to assure the church's members/donors that their donations will be deductible if they itemize. Otherwise, should they be audited, they would be required to prove that the donations were given to a tax-exempt organization. Another good reason we have seen is in the matter of grants from other organizations. Almost every time an organization considers a church for a grant it will request documentation showing the church is a tax-exempt organization. It also may simplify the process of seeking other federal and state exemptions by being able to show the federal recognition of the church's tax-exempt status.

How do we go about getting the church officially recognized as tax-exempt if we decide it is worthwhile? There are basically two ways to obtain recognition from the IRS.

- The first way is to file Form 1023 with the IRS and pay a \$500 filing fee. Form 1023 is a very lengthy form and may require the assistance of a certified public accountant or an attorney.
- The second way is to be included under the C&MA Group Exemption letter. This is done by obtaining an employer identification number (EIN) if the church hasn't done so already and by completing a one-page application, which is reviewed by the Office of the Corporate Secretary for completeness and certain requirements by the IRS. Once this review is completed, a letter, which documents the church's inclusion in the Group Exemption, is sent to the church for its permanent records. The IRS is notified annually of all additions, deletions, and changes in the members of the Group Exemption. It is important to keep the Office of the Corporate Secretary informed of any changes to the church's purpose, name, or location as we are required to report these to the IRS annually.

How does a church obtain an EIN? This is accomplished by filing Form SS-4 with the IRS. It may be understood that if you are in a hurry, you can obtain one over the phone. **Important note:** Your church should **never** have an occasion to use The Christian and Missionary Alliance's EIN. In the past this has led to significant confusion with the IRS. A church plant may have need to use the district's EIN but please seek the district's permission first.

Can a church add a separately incorporated school or day care to the C&MA Group Exemption? Because of the nature of the Group Exemption, separately incorporated subsidiaries of a church generally are not includable under the Group Exemption letter. This is also true for affiliated churches since certain IRS requirements for inclusion are not met.

Charitable Donations

How do I determine if money given to the church is a charitable contribution and thus tax deductible? This very important question generally can be answered by determining if the gift meets the following six conditions:

- It is in the form of cash or tangible property.
- It is made before the end of the year in which it is claimed.
- It is made without conditions and does not impart a personal benefit to the donor.
- It is made "to or for the use of" a qualified entity.
- Its amount does not exceed legal limits.
- It is properly substantiated.

What if someone like a lawyer or an accountant donates his or her services? The donation of services or time (volunteer) cannot be considered a charitable contribution. Actual unreimbursed expenditures that are a part of the services or time rendered, such as travel costs or mileage, can be deductible as a donation if properly substantiated. Similarly, forgone income, such as free rent for an apartment or a piece of equipment, is also not a charitable donation.

Can the treasurer issue a tax-deductible receipt to someone who conditions his/her donation by designating a program/project or an individual? This is one of the most difficult questions a church treasurer can face because the answer is so fact based, particularly for designations to individuals. One of the key elements in determining the tax deductibility of a donation is that it is to be made "to or for the use of" the church. The IRS understands this to mean that a donation to the church must be for its purposes and uses as established by the church's governance authority, not by the donor.

- **Programs/Projects.** The church's governance authority should establish the program/project prior to any donation being made and assure that it meets the purposes and uses of the church. When this is done, a subsequent donation designating the approved program/project may be treated as a valid charitable donation. A donation that is made to a nonexisting program/project, with the designation that it be established, should not be accepted until the governance authority has had the opportunity to determine its viability and to assure that the program/project is consistent with the purposes and uses of the church.
- **Individuals.** The designation of a donation to an individual generally disallows the deductibility of the gift. As noted above, a donation designated for an individual would not be "to" the tax-exempt entity (i.e., church), but on occasions such a designation could be "for the use of" the church. The best example of a "for the use of" designation that is often considered deductible is for a missionary who is under the control of the church or an exempt organization. Unless designated for a specific charitable purpose, like the "work of," support designations, while often deductible, also will be considered compensation to the missionary.

What about other designations for things like benevolent funds, scholarship programs, or short-term mission trips? Generally, if the designation is for the charitable purpose itself, the gift will be deductible. Problems arise at times when the gift is designated for an individual as discussed below:

- **Benevolent Funds.** The IRS accepts the use of tax-exempt dollars for the benefit of particular individuals when such use is in the area of basic needs, like food, clothing, and shelter and meets the purposes and uses of the church. Any decision related to the use of tax-exempt funds for benevolent purposes should be made by the governance authority or its delegated committee, such as the deacons. A policy should be in place that clearly defines the class of individuals who may be provided with such assistance and should be broad enough to encompass a large population of potential beneficiaries. Designated donations given to the general fund or benevolent fund for the benefit of a specific individual are not tax deductible. Donations should not be solicited for particular individuals but may be solicited for replenishing the benevolent fund. Members may

suggest to the governance authority certain individuals or families that are in need, but the final decision as to recipients and amounts is the decision of the governance authority.

- **Scholarship Funds.** Donations to scholarship funds created by a church can be tax deductible if the fund is properly established, clearly related to the purposes and uses of the church, and controlled by the church through its governance authority. All of the issues discussed above for benevolent funds also apply to scholarship funds. The universe of potential recipients must be large enough so that the scholarship award has little or no opportunity to personally benefit a particular donor. This is extremely difficult when one of the donors to the fund is a parent or relative of the recipient. Richard Hammar, in his Church and Clergy Tax Guide 2003 Edition, suggests a test the church can use in evaluating the probability that a contribution is deductible by the parents of a potential recipient would be equal to the total number of potential recipients. For example, for 2 potential recipients there would be a 2 percent chance that the parent's donation would be deductible but 40 potential recipients would mean that there was a 40 percent chance that a donation would be deductible. **Remember,** this is only a rule of thumb and not a hard-and-fast rule. An IRS decision will be based on all of the facts and circumstances. It is important to realize that contributions to a scholarship fund by a parent should not be treated as tax deductible unless there are a significant number of potential recipients.
- **Short-Term Mission Trips.** First, the governance authority must approve the short-term mission trip so that it meets the purposes and uses of the church. The church then determines if it will fund the costs of the trip from the general fund with no direct contributions from the participants; through the general fund or a special trip fund with contributions from either or both the participants and non-participants; or by participants paying all of their own costs. There also could be a combination of these three options. Travel expenses that are considered deductible as charitable donations are transportation costs, including transportation between the airport/station and the hotel; lodging costs; and the costs of meals. Also, there is some distinction between contributions for adults and for minors.

If the church pays all travel expenses with no contributions from the participants, except for their normal giving to the general fund, then there are no tax consequences, whether the participant is an adult or a minor, since the governance authority has determined the purpose of the trip as furthering the church's exempt purpose.

If the church pays all travel expenses but participants make contributions to the church for some or all of their own travel expenses, these payments will be deductible contributions but only if there is no significant element of personal pleasure, recreation, or vacation involved in the trip. It is my understanding that this generally means that there should be at least eight hours of ministry involved in each weekday spent on the trip, not including travel time. In the case of a minor where the parents are making the contributions for their children's expenses, the analysis is a little more difficult, but it is very likely that this contribution is deductible. It is critical that the church exercise control over the use of the money to pay the above noted travel expenses.

If the church pays all travel expenses but nonparticipants make designated contributions to cover a participant's travel expenses, these payments will be deductible as charitable contributions. Clearly, undesignated donation would be deductible. The critical aspect of the designated donation, which also applies to the paragraph directly above, is that the donation is not returnable if the participant cannot attend. This should be made clear to all donors and participants. Any excess money should be used for the participants who go on the trip. If the trip is oversubscribed, then the donation should be re-designated for projects related to the trip, another mission trip, or the general fund. This handling is valid for both the adults and the minors.

Finally, if the adult participant pays some or all of his travel expenses, the participant can claim any unreimbursed travel expenses as a charitable deduction. However, this puts the travel expenses under more scrutiny by the IRS for reasonableness and necessity, and would be the least advisable option in my

opinion. In this situation, if there are unreimbursed travel expenses greater than \$250, the church must issue an abbreviated written acknowledgement of the trip's purpose, participant's attendance, and trip dates in order for the participant to be able to substantiate the charitable services provided. As for a minor child, the payment by the parents of the travel expenses, directly or through the child, is very likely to be disallowed as a deductible expense since the parents didn't provide the services directly to the church but only through their child. If the child pays expenses through his/her own personal fund-raising efforts, there is usually no actual tax consequence since children usually will not be filing a tax return and thus don't need a charitable deduction.

Unrelated Business Income

What is unrelated business income and why is it important to my church? Unrelated business income is income from a trade or business that is regularly carried on and not substantially related to the performance by the organization of its exempt purpose or function, except that the organization needs the profits derived from this activity. An example of this might be the establishment of a T-shirt shop by the church in order to raise additional money for the ministry. Unless each T-shirt carries a message specifically related to the church's exempt purpose, any income generated from the sale of the T-shirts would be unrelated business income and subject to the payment of unrelated business income taxes (UBIT). Furthermore, if the income from the sale of the T-shirts was so significant that it became the substantial source of income for the church over its normal donations, the IRS could determine that the church was no longer a tax-exempt entity but had become a T-shirt business. This would result in the revocation of the church's tax-exempt status. It is critical that the church understands that the use of the income for ministry is unimportant to the IRS in the analysis of what is unrelated business income.

Within this initial definition, there are three requirements that must be met for this income to be classified as unrelated business income. An activity will be considered an unrelated business (and potentially subject to UBIT) if it meets the following three requirements: (1) it is a trade or business, (2) it is regularly carried on, and (3) it is not substantially related to the furtherance of the exempt purpose of the organization. However, there are a number of exclusions and modifications to this general rule.

The IRS Code contains a number of modifications, exclusions, and exceptions to unrelated business income. For example, dividends, interest, certain other investment income, royalties, certain rental income, certain income from research activities, and gains or losses from the disposition of property are excluded when computing unrelated business income. In addition, the following activities are specifically excluded from the definition of unrelated trade or business:

- **Volunteer Labor.** Any trade or business is excluded in which substantially all of the work is performed for the organization without compensation. Some fund-raising activities, such as volunteer-operated bake sales, may meet this exception.
- **Convenience of Members.** Any trade or business is excluded that is carried on by an organization described in 501(c)(3) or by a governmental college or university, primarily for the convenience of its members, students, patients, officers, or employees. A typical example of this would be a school cafeteria.
- **Selling Donated Merchandise.** Any trade or business is excluded that consists of selling merchandise, substantially all of which the organization received as gifts or contributions. Many thrift shop operations run by exempt organizations would meet this exception.

Much of the above comes directly from the IRS web site. To read more, visit the following site:
www.irs.gov/charities

If we determine that the church has generated some unrelated business income, when and how do we go about reporting it? An exempt organization that has \$1,000 or more gross income from an unrelated business must file Form 990-T, Exempt Organization Business Income Tax Return.

We rent our facility to others. Is this income considered unrelated business income? This is a tough question to answer in a few words. The simplified answer, which follows, comes from the IRS Tax Guide for Churches and Religious Organizations.

Rental income. Generally, income derived from the rental of real property and incidental personal property is excluded from unrelated business income. However, there are certain situations in which rental income may be unrelated business taxable income.

- If a church rents out property on which there is debt outstanding (for example, a mortgage note), the rental income may constitute unrelated debt-financed income subject to UBIT. (However, if a church or convention or association of churches acquires debt-financed land for use in its exempt purposes within 15 years of the time of acquisition, then income from the rental of the land may not constitute unrelated business income.) Note: The parenthetical is called the neighborhood land rule.
- If personal services are rendered in connection with the rental then the income may be unrelated business taxable income.
- If a church charges for the use of the parking lot, the income may be unrelated business taxable income.

Parking lots. If a church owns a parking lot that is used by church members and visitors while attending church services, any parking fee paid to the church would not be subject to UBIT. However, if a church operates a parking lot that is used by members of the general public, parking fees would be taxable, as this activity would not be substantially related to the church's exempt purpose, and parking fees are not treated as rent from real property. If the church enters into a lease with a third party who operates the church's parking lot and pays rent to the church, such payments would not be subject to tax, as they would constitute rent from real property. Another couple of exceptions for debt-financed property:

- **Property related to exempt purposes.** If substantially all (85 percent or more) of the use of any property is substantially related to an organization's exempt purposes, the property is not treated as debt-financed property. "Related use" does not include a use related solely to the organization's need for income, or its use of the profits. The extent to which property is used for a particular purpose is determined on the basis of all the facts and may include:
 - A comparison of the time the property is used for exempt purposes with the total time the property is used.
 - A comparison of the part of the property that is used for exempt purposes with the part used for all purposes.
 - Both of these comparisons.

If less than 85 percent of the use of any property is devoted to an organization's exempt purposes, only that part of the property that is used to further the organization's exempt purposes is not treated as debt-financed property.

- **Related exempt uses.** Property owned by an exempt organization and used by a related exempt organization, or by an exempt organization related to that related exempt organization, is not treated as debt-financed property when the property is used by either organization to further its exempt purpose.

- **Related organizations.** An exempt organization is related to another exempt organization only if:
 - One organization is an exempt holding company and the other receives profits derived by the exempt holding company,
 - One organization controls the other as discussed under Income From Controlled Organizations earlier in this section,
 - More than 50 percent of the members of one organization are members of the other, or
 - Each organization is a local organization directly affiliated with a common state, national, or international organization that also is exempt.

Note: *The bigger issue in receiving rental income relates to its impact on any state property tax exemption.*

Handling Business Expenses

Our church provides the pastor with an allowance that he can spend on business-related expenditures. Is this the best way to handle these expenditures? This is certainly one legitimate way of handling business-related expenditures. The IRS calls this a “nonaccountable reimbursement plan” for reimbursements since the pastor and other church employees are not required to substantiate their expenditures to the church. The total amount of the allowance is included as compensation when reporting to the IRS. Since most pastors are employees of the church, this reporting is done on the W-2.

This also has a significant impact on the pastor when reporting and paying income taxes. Unlike a self-employed evangelist or an itinerant pastor who can use Schedule C to report the actual business-related expenditures, a pastor who is an employee must use Schedule A and report the expenditures as miscellaneous expenses. These expenditures are subject to the 2% of adjusted gross income (AGI) limitation and may not be deductible at all if the itemized deductions on Schedule A are insufficient.

Because of these detrimental rules, it is more appropriate for the church to establish an “accountable reimbursement plan”. An accountable reimbursement plan places some additional paperwork on the church that currently rests on the pastor, but significantly assists the pastor in reducing the reportable compensation and potential income tax effect. With an accountable reimbursement plan, the church should not include any reimbursement in the pastor’s income in Box 1 of Form W-2.

- To be an accountable plan, the church’s reimbursement arrangement must require the pastor and other employees to meet all three of the following rules:
- Reimbursed expenses must have a business connection, that is, the expenses must have been paid or been deductible while performing services for the church.
- The employee must adequately account for his/her expenses to the church within a reasonable period of time.
- The employee must return any reimbursement or allowance in excess of the expenses accounted for within a reasonable period of time.

Any part of the reimbursement that does not meet all three rules is considered paid under a nonaccountable reimbursement plan. Simply put, the church must require receipts or other forms of valid evidence for the expenditures that substantiate the business-related purpose of the expenditure, including amount, date, place or description, and purpose and/or participants.

Income/Compensation

What should the church include as income on a pastor's W-2? The first thing to understand is that the income tax code takes the position that any money paid to or for an employee is income unless specifically excluded by the tax code. In addition to the pastor's base salary, there are some items a church may provide as fringe benefits to the pastor or other employees that the IRS may include as income. These may include but are not limited to the following:

- Bonuses
- Honoraria, special occasion, and love offerings
- Retirement gifts
- Forgiveness of debt
- Below-market interest loans
- Social Security grant
- Provided auto for personal use
- Provided cell phone for personal use
- Nonaccountable expense reimbursements
- Severance pay
- Spousal travel
- Sick pay
- Moving expenses
- In-kind transfers of property

There are other kinds of income that would generally be considered as income, except for the fact that they have been excluded within the income tax code or regulations. Some examples of these are:

Employer Provided

- Housing allowance, excludable for income tax purposes only (previously discussed).
- Health insurance premiums paid by the employer directly or reimbursed under an accountable reimbursement plan.
- Medical care reimbursements under an employer sponsored plan.
- Deferred compensation such as a 403(b) plan.
- Employer paid life insurance premiums for coverage up to \$50,000 (excess coverage makes a portion of premium taxable income).
- Educational assistance up to \$5,250 per year.
- Free child care if properly established.
- Employer provided housing and meals for employer's convenience, excludable for income tax purposes only.

Non-Employer Provided

- Gifts from individuals.
- Life insurance proceeds.
- Qualified scholarship money.
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How does the church determine the right amount of compensation for the pastor? Besides the fact that the church should properly compensate its pastor, this is an important question for two other reasons, both related to making sure the church is paying its pastor a reasonable compensation. The first reason is that the payment of unreasonably high compensation can result in intermediate sanctions being applied by the IRS. The second reason is even harsher since a church could lose its tax-exempt status if it was determined that compensation being paid to the pastor is unreasonable.

In 1996, Congress gave the IRS authority to assess intermediate sanctions against both individuals in an organization who are designated as "disqualified persons" and who receive excessive compensation, and any "organization manager" who participated in approving such excessive compensation. Intermediate

sanctions are not assessed against the organization itself. The following definitions are derived from the IRS regulations issued in 1998, including comments, which should help in your understanding.

- **Intermediate Sanctions.** An excise tax that is assessed to the disqualified person or organization manager. Intermediate sanctions are threefold. The first sanction is a 25 percent tax on the actual amount of the excess compensation received by the disqualified person. The second sanction is a 200 percent tax on the excess compensation if the disqualified person fails to return the excess compensation within the taxable period. The third possible sanction is a 10 percent tax, up to \$10,000 assessed against the organizational manager, if he participated in approving the excess compensation.
- **Disqualified Person.** Any person who was in a position to exercise substantial influence over the affairs of the tax-exempt organization or any family member of such a person. The IRS regulations specifically state that the board members (directors), president and treasurer are presumed to exercise the necessary level of influence to be deemed disqualified.
- **Organizational Manager.** Any officer, director (member of the governance authority), or trustee.
- **Excess Compensation.** Compensation above the amount that is determined as reasonable. Compensation for the performance of services is reasonable if it is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances.

The IRS regulations establish a safe harbor for boards called the presumption of reasonableness. It is based on an approval by the board or a committee of the board that:

- Was composed entirely of individuals unrelated to and not subject to the control of the disqualified person involved.
- Obtained and relied upon objective comparability information.
- Adequately documented the basis for its decision.

These kind of excess benefit transactions also include: “any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly, to or for the use of, any disqualified person, and the value of the economic benefit provided exceeds the value of the consideration (including services) received by the organization for providing such benefit.”

The intermediate sanction rules clearly cast a shadow over the free-will offering method that some churches in the United States use in compensating their ministers. The impact on this method of compensation may be addressed after further research occurs.

Political Activity

What kind of political activities are prohibited for churches? As a condition of their tax-exempt status, churches are prohibited by federal law from participating or intervening, directly or indirectly, in any political campaign on behalf of, or in opposition to, any candidate for public office. This prohibition applies equally to national, state, and local elections. The IRS has issued guidelines outlining prohibitions of involvement in political campaigns for churches and other tax-exempt organizations. They state that a church cannot endorse candidates, make donations to campaigns, engage in fundraising, distribute statements, or become involved in any other activities that may be beneficial or detrimental to a candidate. Churches may sponsor debates or forums to educate voters; but if the forum or debate shows a preference for or against a certain candidate, it becomes a prohibited activity.

A church can have political candidates address the congregation as long as overt campaign activities are avoided, the same opportunity is afforded to all other qualified candidates for the same office, and the congregation is informed before and after the speech that the church does not endorse any candidate for public office. Other activities, such as voter education, are permitted as long as they are neutral in content

and format. Rating candidates or even organizing forums where members of the public rate political candidates can be a problem since it may encourage people to vote for or against a candidate. The church may publicize its position on moral and social issues but must not link that position to specific candidates.

A church should be careful to walk the line between addressing an issue and endorsing or criticizing a particular candidate and his position on an issue. Pastors need to be particularly careful in making statements of this type since they may be viewed as agents of the church. If a pastor wishes to individually make a political endorsement, he must qualify his remarks by stating explicitly that they are being made in a private capacity and not as an agent of the church and that the church has not taken any action to endorse or express its opposition to any candidate. The time spent by the pastor on political activities must be his personal time and not compensated by the church.

If the IRS finds that a church is engaged in a prohibited political campaigning activity, the church could lose its exempt status and also could be subject to an excise tax on the amount of money spent on that activity. Contributions to a church that loses its tax-exempt status because of political activities are not deductible by the donors for federal income tax purposes.

State and Local Taxes

Does my church's status as a 501(c)(3) tax-exempt organization also automatically exempt it from other taxes like property or sales? The quick answer no. Each state has its own laws related to its income taxes (if any), property taxes, sales taxes, and other taxes it may implement. The church's status as a 501(c)(3) may exempt it from paying these taxes, but each tax must be investigated to determine its applicability. Your district office may be a good resource for such information. Generally, churches are exempt from state income taxes and are able to obtain a property tax exemption in most states, but the sales tax exemption for either buying or selling is wide open, with each state having its own rules.

While generally available, property tax exemptions can be very different between states, particularly when it comes to using the property for nonexempt purposes. Some states will take away the entire exemption if any part of the property is used for nonexempt purposes, while other states will prorate between the exempt and nonexempt use. Some states will even allow minimal nonexempt use without jeopardizing the property exemption.

Are churches subject to unemployment taxes? On a federal basis, churches are clearly exempt from the Federal Unemployment Tax Act (FUTA), but on the state level there is some confusion. Overwhelmingly, churches have been exempted from state unemployment tax laws, and pastors have not had access to the various state unemployment systems. A current legal battle in Oregon is addressing this issue related to a pastor's right to access the Oregon unemployment system. See Current Issues and Alerts for more information.

Church & Official Worker Taxes Current Issues and Alerts

Housing Allowance Limitation: Warren v. Commissioner of Internal Revenue

In 2000, the U.S. Tax Court handed down a decision in the *Warren v. Commissioner of Internal Revenue* case that determined the exemption for housing allowance could not be limited to the fair rental value of a pastor's house. This limitation had been implemented by the IRS in its regulations, but the court found it was not supported by the language in the law. As a result, the IRS appealed to the 9th Circuit Federal Court of Appeals. Unexpectedly, one of the justices on this court decided that the constitutionality of the entire exemption should be questioned and ultimately determined.

As a result, Congress made a preemptive strike against the federal appeals court regarding the possible revocation of the housing allowance. On May 2 the Senate passed a bill designed to protect a long-standing tax break for clergy. The House passed the bill 408-0 and the Senate followed suit, passing it by unanimous consent. The measure was subsequently signed by the President. Generally, the new legislation is effective for the 2002 tax year and beyond. It also may be effective for prior tax years depending on how your pastor(s) filed his tax return.

The legislation instituted a limitation in the excludable amount of housing allowance for clergy who own their own house, "not to exceed the fair rental value of the house, including furnishings and appurtenances such as a garage, plus the cost of utilities."

The question has been asked as to how the fair rental value is determined. The IRS has not provided any guidance in computing the fair rental value, but it is likely that any extraordinary expenses (such as a large down payment or major remodeling) would not be excludable in any one particular year. To avoid this, it may be necessary to obtain a mortgage or house-improvement loan that could spread payments over time. One suggestion: To obtain a reasonable estimate of the fair rental value of his house, a pastor may want to seek professional real estate assistance to determine the rental values in his neighborhood for a furnished house, including a garage or shed.

As a result of the legislation, the IRS requested that the case be dismissed and the federal appeals court did just that, preserving for now the housing allowance exemption that has been in place since 1921.

State Unemployment Taxes: Newport Church of the Nazarene v. Hensle

Several years ago, a former pastor of a Nazarene church filed for unemployment insurance benefits in Oregon. The church challenged the award of benefits on several grounds, including the assertion that including ministers in the unemployment insurance program violates the Religion Clause of the First Amendment to the U.S. Constitution. This challenge has been winding through the court system for several years, with the church losing each major decision, most recently before the Oregon Court of Appeals. The Oregon Supreme Court recently upheld the ruling of the Oregon Court of Appeals, and thus ruled against the church and in favor of the Oregon Employment Department. There is currently no word on whether the church will appeal to the U. S. Supreme Court.

This decision means that, at this time, churches and pastors are not exempted from the Oregon unemployment laws.

IRS Publication 78: Where is the C&MA?

On occasion we receive notification that The Christian and Missionary Alliance cannot be found in IRS Publication 78, which is the listing of tax-exempt entities approved by the IRS. This has come up as a part of a donor's tax preparation when the CPA or tax preparer tries to verify the C&MA's tax-exempt status. Please be assured that The Christian and Missionary Alliance is tax-exempt and continues to maintain that exemption. The problem appears to be the way the C&MA is listed on the IRS web site and in Publication 78. It appears that the IRS has abbreviated certain items due to space constraints even though it is not the correct way to display our name or city. For further reference, we have included the listing as it appears in both locations:

Christian & Missionary Alliance
Colorado Spgs CO 1

The "1" at the end indicates that the C&MA has a group exemption letter in place.

Church & Official Worker Taxes Resources

Church & Official Worker Taxes

The Christian and Missionary Alliance

Phone: (719) 599-5999

Web site: www.cmalliance.org

Publications: Finance Manual for Alliance Church Treasurers (and Pastors)

Christian Ministry Resources

Phone: (800) 222-1840

Web site: www.churchlawtoday.com

Publications: Church and Clergy Tax Guide; Church Law and Tax Report; Church Treasurer Alert!

Worth Tax & Financial Service

Phone: (800) 368-0363

Web site: www.worthfinancial.com

Publications: Income Tax Guide for Ministers & Religious Worker's Professional Tax Record Book

Evangelical Council for Financial Accountability

Phone: (800) 323-9473

Web site: www.ecfa.org

Publications: The Zondervan Church and Nonprofit Organization Tax and Financial Guide; The Zondervan Minister's Tax and Financial Guide; Political Campaign Activities

Internal Revenue Service Web Site

Web site: www.irs.ustreas.gov

Publications: All IRS Forms and Publications

Church Insurance & Risk Management Topics and Questions

Risk Management Defined

What is risk management and why should our church care? This is a really good question. The first thing to understand is that risk management includes much more than insurance. Risk management is recognizing that insurance only can do so much and go so far in protecting the church. In reality, insurance is mostly about financial loss, while risk management is about financial, emotional, and physical loss. Risk management for the church is about making sure that children are as safe and secure as reasonably possible. It is about making sure individuals are not injured, harmed or even killed because of a hazard in the church or on the church property that has not been identified and taken care of in a timely manner. It is about making sure that the property is not needlessly destroyed because someone did not take the time to inspect the church for hazards or because the church was unwilling to spend the needed amount of maintenance dollars. It is about making sure your employees know that you care enough about them to protect them, if at all possible, from injury or that the church will address an injury quickly if it does occur.

How does a person manage the church's risk? Basically, there are three ways to manage the everyday risks inherent in the life of every church. The first, and probably most important, is to minimize risks whenever and wherever possible. This would entail a thorough safety audit of the church's property, people, policies, and procedures to identify where corrections should be made to minimize potential risks. Minimizing risks is a process of observing, imagining, and acting. Observe the things around the church or the personnel policies that are in place; imagine what could happen; and then take steps to reduce the potential loss. This may include investing in safety equipment such as alarms, locks, or even surveillance cameras. It may include training employees to know what to do in an emergency or accident. It may mean helping employees understand the need to take appropriate steps to reasonably protect the assets God has provided to the church.

The second way is to transfer those risks to others by placing the responsibility on them. This may include contract provisions with vendors or contractors that make them responsible, but more commonly it takes the form of a waiver of release for activities that the church may be sponsoring.

The final way is by procuring insurance coverage for potential losses and liabilities with the goal of protecting the church from a major financial loss.

Safety Audit

When our staff does a safety audit, what should we look for? The first thing to remember is that you need to do both an internal and an external audit. The internal audit is concerned with hazards that can be found inside the building, and includes items that can assist in avoiding or reducing risks. The following are some of the areas to address:

- Make sure all exits are marked and independently lighted.
- Make sure all hallways and doors are clear of impediments.
- Each room and meeting area should have an emergency evacuation plan openly displayed.
- Make sure fire extinguishers are accessible and serviced.

The external audit of the church property should include the following:

- Survey the church property, including sidewalks and playground to make sure there are no unsafe conditions.
- Maintain adequate security.
- Avoid, post, and/or fence off "attractive nuisances" that kids might be attracted to, such dirt mounds, holes that can retain water, stacked items, etc.

Church Activities

How can we reduce our church's risk during church activities? There are at least four things the church should consider related to church activities, whether it be an AWANA campout, a youth retreat, or a church picnic. Each of these four things is discussed below:

- **Insurance Coverage.** Make sure the church has adequate insurance coverage for its activities. Check with the church's local insurance agent or carrier to assure yourself of this coverage. Remember to verify that the coverage applies to events on-site and off-site. For conferences and mission trips, the church may need to get either special endorsements to its current policy or to purchase special insurance products.
- **Employee/Volunteer Screening.** For the church's employees/volunteers who work with children and youth, the church should always have a written screening process. This would include a written form or application with relevant questions. Always perform background checks on these individuals to assure that, to the best of the church's ability, children are safe. A couple of excellent resources in this area are the Safe Place manual, available from Christian Publications, Inc. and the Reducing the Risk program, available through Christian Ministry Resources.
- **Ensure Careful Planning and Supervision for Events.** This is very important. Lack of appropriate supervision is one of the most critical areas that can lead to accusations and liability. Always make sure that at least two adults are watching the children.
- **Obtain Waivers of Release When Appropriate.** Courts are not very favorable toward waivers, particularly for minors, but if well drafted, a waiver has a better chance of standing up in court. Do not draft the waiver to release the church from every possible claim, but only for those claims where the church is not negligent as to the cause.

Insurance Coverages

What kind of insurance coverages should a church have? There are a variety of insurance coverages that a church can obtain through a local insurance agent.

- **Property.** This coverage is very common and generally understood. Every church that owns its building and/or furnishings should have coverage for perils that can happen to the church's real property (building) and personal property (furnishings). These perils may include fire, earthquake, hail, wind, lightning, theft, or vandalism. Make sure your agent has all the pertinent information as

to size, structure, material, and value of the building and its contents in order that coverage will not be denied because of bad information. If the church doesn't own a building but rents and has personal property, it should obtain rental insurance that provides similar property coverage.

- **Crime.** Crime covers both internal and external theft of church assets. Internally, this usually takes the form of embezzlement, while externally it applies to robberies on and off the church's premises.
- **General Liability.** True to its name, this is coverage for liabilities of a general nature that can occur to others. We will discuss more specific liability coverages later that result from exclusions to the general liability coverage. General liability coverage provides for defense costs, court awards, or settlements as a result of a claim against the church. Claims normally take the form of bodily injury or property damage to a third party, like a slip and fall on church property. Coverage can be extended to include personal injury and advertising claims, such as libel, slander, defamation of character, invasion of privacy, and similar allegations. It also may include a small medical payment for someone injured on the premise (i.e., \$5,000) in an effort to avoid a lawsuit.
- **Automobile.** If the church owns a vehicle, it should carry automobile insurance that provides liability coverage for bodily injury and property damage to a third party. The church also should consider comprehensive and collision coverage. Comprehensive covers physical perils like broken windows, theft, hail, flood, and similar occurrences. Collision covers physical damage as a result of a wreck with another vehicle, with an object (i.e., tree), or as a result of a rollover. Even if the church does not own a vehicle, there is another important automobile coverage the church should obtain. It is called hired/nonowned coverage. This covers the operation of an employee's vehicle while the employee is on church business or if an employee rents a vehicle for a trip or special event. This coverage is usually secondary to the employee's personal automobile insurance.
- **Umbrella Liability.** This is excess coverage to the church's general liability and automobile liability coverages. This means that coverage limits come into play once the primary liability policies use up their limits. For example, assume the church's primary coverage limit for the general liability policy is \$1 million and the umbrella policy's coverage limit is \$5 million. If a lawsuit occurs that results in \$2 million in legal fees and court awards, the general liability will pay its \$1 million limit first, and then the umbrella policy will pay the next \$1 million. The cost of the umbrella policy, since it is excess coverage and not primary, should be very affordable.

The above insurance coverages are sometimes referred to as the church's property and casualty insurance coverages because they relate to the property and assets of the church. The policies that follow are additional insurance coverages for specific stand-alone or unique purposes.

- **Workers' Compensation/Employee Liability.** Workers' compensation is state-mandated coverage for employees who are injured or become ill as a result of their job. Some states have their own state insurance programs, but most allow independent insurance carriers to provide this coverage. In either case, the state will establish the rate the employer is charged for the coverage. In most states the church, as an employer, is required to participate, but there are a few states that exempt the church directly while a few more states exempt any employer with less than a certain number of employees (this ranges from less than three to less than five). This is no-fault insurance for the employee, and it only requires that an employment relationship exist, that the injury occurred as a result of the employment, and an explanation of the nature and extent of the injuries. Timely reporting of an injury by employees is also an important aspect of most workers' compensation legislation. Employee Liability covers employees who are injured or become ill as a result of their job and choose to make a claim outside of the state workers' compensation program.
- **Directors and Officers Liability.** Directors and Officers Liability (D&O) covers liability claims that arise as a result of various acts that can be committed by board members or officers in the course of their official duties and generally are excluded from general liability coverage. These include reasonable but bad decisions that cause a loss, such as in investments, that result in a lawsuit by a member or a third party. This coverage usually protects both the church, if sued, and the individual director or officer, if sued personally.

- **Employee Practices.** This coverage relates to claims brought against an employer by an employee who feels the employer has violated federal discrimination laws. Even though the courts consistently have held that the pastoral staff effectively is exempt from courts applying the federal discrimination laws to them as a result of the First Amendment, non-pastoral staff does not have such an exemption. As a result, employers with at least 15 employees can be sued for discrimination, such as race, color, national origin, gender, or religion, in hiring and firing practices.

Please note that churches and other religious organizations are exempted from the restriction on religious discrimination. Sexual orientation protection in state laws also crops up once in awhile, but religious organizations normally are exempted from these laws, also. Sexual harassment is another form of sex discrimination and can consist of either a "something for something" type harassment or an environment that is hostile based on sex. Age discrimination in employment is also prohibited if the church employs at least 20 people and is involved in interstate commerce. The courts easily overcome the interstate commerce requirement these days. We now have the American with Disabilities Act (15 employees and interstate commerce) that churches need to be aware of and comply with, if appropriate. There are other discrimination and employee-related laws, which we won't take time to mention except to say that each has the potential to result in an employee practices lawsuit.

- **Professional Misconduct.** This type of policy covers specific acts of misconduct by employees or volunteers who are excluded from the general liability policy. In the church, these acts can take the form of sexual misconduct/abuse with adults or children. This is an unpleasant but real issue for the church and it is important that a church not ignore this kind of coverage. Also, it is important that prevention efforts be implemented to minimize the risk of such acts occurring.

When and to whom should the church report an insurance claim? The simple answer is as soon as you are aware of the claim. This may not always be easy to determine, but it should be as soon as the church has any indication that someone is making a claim or may potentially file a lawsuit. The church should not wait until the suit is actually filed if it has letters in hand or has documentation of conversations with someone who threatens litigation.

The "to whom" is the church's agent and any carrier that the church has insurance with. If you ask the agent to notify the church's carriers, make sure he copies the church on any notices. All notices should be in writing.

Personal Insurance

What kind of coverages should the church have for its pastors and other employees? There are several types of insurance products that the church or the pastors should consider in taking care of the personal needs of the pastors or other employees. The following are examples of insurance products that are available:

- Medical
- Dental
- Vision
- Prescription Drug
- Life
- Disability
- Tenant/Personal Property

Church Insurance & Risk Management

Current Issues and Alerts

15-Passenger Vans

One of the more significant risks to churches these days is the use of 15-passenger vans. According to material published by GuideOne Insurance, there are three primary areas of concern in regard to the equipment and design of 15-passenger vans: rollovers, side impacts, and seatbelt use.

It is very clear that the 15-passenger van is an unstable mode of transportation when fully loaded. This results from the center of gravity shifting rearward and upward, increasing the likelihood of rollovers and the potential for loss of control during panic maneuvers. As far as side impacts are concerned, the 15-passenger van was designed to carry cargo and does not have side bar protection. This results in many accidents being more severe than would be expected. Finally, seatbelts, if not provided or not used, can result in significant injuries, ejections, and deaths. According to the National Highway Traffic Safety Administration, over the past decade, 80 percent of the people killed in van rollover crashes were not wearing their safety belt.

If the church is going to use a 15-passenger van, the church should have trained drivers, seatbelts, and avoid a fully loaded van. The church's insurance rates may be increased as a result of using a 15-passenger van. Other options, such as small school buses, are available. If you have questions, talk to your local insurance agent.

Note: This information is provided in the GuideOne Insurance Road to Safety material.

Identity Theft

In a world of fast-paced technology and the desire of many to have easy access to our finances through the Internet and other electronic means, such as ATMs, the lucrative theft of an individual's personal information has become rampant. This information can be obtained through many of our day-to-day actions. Writing a check, charging a meal, paying bills on-line, using a cell phone, applying for a credit card, any and/or all of these could provide an information predator with the opportunity to steal your identity. This thief uses the personal information he gathers to commit fraud or to steal from your financial institutions.

Identity theft can be one of the most devastating forms of theft, as it not only steals financial assets, but also can irreparably harm a person's good name and credit rating. The cost and effort to clean up the mess left by identity theft compound the loss to the individual. The good news is that some practical steps can be taken to help reduce the chance that someone will steal your personal information.

- **Check your credit rating** at least once a year and more often if possible.
- **Use passwords** to protect credit cards, bank account, etc. Even though it may be more challenging to remember, it is important not to use simple passwords but to mix letters and numbers randomly to increase the difficulty for a thief's discovery efforts.
- Make sure personal information at home is in a **secure location** so that the local service repairman can't find it easily.
- **Don't ever give personal information** to anyone on the phone, through the mail, or on the Internet unless you are sure of its purpose or use. Do your best to make sure the organizations to whom you provide information are legitimate.

- **Buy a shredder** and shred every document that contains personal information before putting it in the trash, including pre-approved credit card applications. This may seem extreme but it is not. It is one of the most effective ways to protect personal information from prying eyes.
- **Handle mail appropriately** by not placing it in an unsecured mailbox. Use a local collection box, post office slot, or even a business office mail system, which are usually more secure. Pick up mail from an unsecured mailbox as soon as possible after delivery or obtain a secured box at the post office. Always place a hold on the mail when going out of town or have a trusted neighbor or friend pick it up.
- **Cut up your expired credit cards** and other cards with personal information and numbers and place the pieces in different trashcans to help thwart discovery. Carry only needed information and credit cards and secure all other cards and information in a safe place.
- **Watch out for promotional scams.** Thieves know that most people can't resist a great deal or the opportunity to get something for nothing. Resist this temptation and avoid giving personal information.
- Finally, **stay alert;** recognize that this is one of the fastest growing crimes; take as many of the above actions as possible; and rest in the Lord.

Church Insurance & Risk Management Resources

Church Insurance & Risk Management

Alliance Service Center

Phone: (800) 233-4443

Web site: web1.cmalliance.org

Publications: Safe Place Manual

Christian Ministry Resources

Phone: (800) 222-1840

Web site: www.churchlawtoday.com

Publications: Risk Management Handbook for Churches and Schools; Inspection and Safety Checklists for Church Buildings, Grounds and Programs; Reducing the Risk of Child Sexual Abuse in Your Church — Resource Kit; Risk Management for Churches: A Self-Directed Audit Pastor, Church & Law.

Insurance Carriers Specializing in Church Coverage

GuideOne Insurance

Phone: (888) 218-8561

Web site: www.guideone.com

Brotherhood Mutual Insurance Company

Phone: (800) 333-3735

Web site: www.brotherhoodmutual.com

Church Mutual Insurance Company

Phone: (800) 554-2642

Web site: www.churchmutual.com

The Church & The Law Topics and Questions

Incorporation/Operations

How is the Manual of The Christian and Missionary Alliance relevant to our church? The Manual contains eight sections. Some sections are more relevant to the local church on a day-to-day basis than others, but all of the sections are important to understanding how The Christian and Missionary Alliance operates in its various venues. Two of the more used sections for churches are the Uniform Constitution for Accredited Churches (A5) and the Position Statement on Church Government (H1).

Why should a church consider incorporating? Incorporation is a legal structure created by law that provides certain advantages to an entity choosing to operate as a corporation. The most important feature of a corporation is that, legally, it's a separate entity from the individuals who are the members or who operate it (employees, officers, governance authority, etc.). One of the main advantages of incorporating is that, in most circumstances, it limits the members' and the leaders' personal liability for the corporation's actions. Individuals are still responsible for any actions taken outside of their corporate responsibilities that could give rise to personal liability.

Incorporation laws vary from state to state. Two states do not even allow churches to incorporate (Virginia and West Virginia). Generally, a church that is not incorporated is considered an unincorporated association. An unincorporated association, unless addressed by specific state laws, has no legal existence, but is simply a group of people with common interests. As such, it usually cannot 1) own property in the name of the association, 2) enter into contracts or other legal obligations, or 3) sue or be sued. The status as an unincorporated association could also result in individual members having personal liability for the actions of other members. Some states have passed legislation that overcomes the various disabilities of being an unincorporated association, but many states still retain the traditional view of associations.

How do we go about getting the church incorporated? This is usually a simple matter of contacting the secretary of state's office in your state and requesting their form for Articles of Incorporation. *The Manual of The Christian and Missionary Alliance* includes a Form of Charter for Churches (A6), which can be used as a guide when constructing the church's Articles. For those churches wanting to join the C&MA Group Exemption (discussed above in the Tax Section), the two most important provisions in the Articles of Incorporation in relation to

the C&MA are 1) the purposes and use section and 2) the property reversion clause. Many states have a Nonprofit Corporation Act that governs the incorporation of churches and other nonprofit organizations. Some states, like New York, have a Religious Corporation Act that applies distinctly to religious organizations. In some states, you may have the right to choose either of the two Acts mentioned above, if both exists.

Once the Articles of Incorporation are completed, they are filed, along with the appropriate fee, in the office of the secretary of state. If the Articles are satisfactory, the secretary of state will certify them and return an original, appropriately stamped, along with a certificate of incorporation. Each state has its own renewal or reporting requirements. Some are annual, some are biennial, and some may be permanent, but whatever the state requires, it is important to comply, as noncompliance could result in a fine or even cancellation of the certificate of incorporation. A church should take such reporting requirements seriously to avoid the adverse effects of noncompliance.

Does our church need bylaws? Article XVI of the Uniform Constitution for Churches requires that each church adopt appropriate bylaws. The church constitution establishes the primary areas of importance for the organization of the church. Bylaws, while secondary to the constitution, are important in outlining the details of how the organization will operate. They are amendable by the church, as compared to the constitution, which requires amendment by the General Council. Bylaws also provide the church an opportunity to deal with specific state laws not addressed in the constitution.

What should be included as church records? According to Richard Hammar in his book *Pastor, Church & Law*, Third Edition, "each church should maintain the following records: (1) correct and complete books and records of account, (2) minutes of the proceedings of its members, (3) minutes of the proceedings of its board of directors, (4) resolutions of its board of directors, (5) minutes of the proceedings of committees, and (6) a current list of voting members. These documents, in addition to the corporate charter, constitution, bylaws, certificate of incorporation, and business correspondence, constitute the records of a church corporation."

How should the church records be handled? There are at least three key aspects (see below) of church records that help in deciding how the church records should be handled.

- **Ownership of Records.** This may seem like a simple matter but there are times when individuals may believe or act as if they own the records of the church, particularly the pastor or the treasurer. Obviously, the church is the owner of its records and should make sure that originals are maintained at the church in a secure manner, and not at the house of the pastor or treasurer, if at all possible.
- **Retention of Records.** The variety of records and the various agencies requiring different retention periods make it difficult to establish one clear policy for the retention of records. A suggested guideline for the retention of records is included in Appendix E of the Finance Manual, which can be found at the following location: <http://www.cmalliance.org/resources>
- **Confidentiality of Records.** This is the most complicated area of church records. Since the church owns the records, it has a basic right to maintain their confidentiality. This means that members or other individuals have no right to inspect the church records unless such a right is provided within the church's bylaws or within the state's nonprofit corporation laws. A subpoena from a court also would allow inspection.

Two important reasons to keep church records confidential relate to the clergy-penitent privilege, if provided by state law, and the common law invasion of privacy action. As noted, there are times when the inspection of church records is required by state law or by church governing documents. The Model Nonprofit Corporation Act does include a provision that grants members, their agents, and their attorneys the right to inspect and copy certain records with proper written notice. The general public is not given an inspection right under this act. The IRS disclosure regulations require that tax-exempt entities, including

churches, allow inspection of the documents that establish their tax-exempt status. This inspection is available to anyone, including the general public.

What is a conflict of interest policy? This is a policy that establishes guidelines for disclosing and approving financial transactions between the church and its directors, officers, elders, and even family members or related parties. A conflict of interest policy is driven by the recognition that leadership owes a certain duty of conduct to the organization. According to the Model Nonprofit Corporation Act, the standards of conduct for directors and officers in discharging their duties include the following:

- In good faith.
- With the care an ordinary prudent person in a like position would exercise under similar circumstances.
- In a manner the director or officer reasonably believes to be in the best interest of the nonprofit corporation. In common law, this item is termed the duty of loyalty to the organization.

To assure that any conflicts of interest are disclosed and properly handled, the directors and officers should be required to read the conflict of interest policy, which includes the standards of conduct, and to disclose any actual or potential conflicts, as a result of their new position of leadership, by signing the disclosure. This should be done in advance of the individual's first action as an officer or board member.

Should a conflict of interest transaction arise during a meeting, the conflicted director or officer should excuse himself/herself from the discussion and decision process with such being noted in the minutes of the meeting. The disinterested directors or officers may still choose to authorize the conflicting interest transaction based on the benefit and fairness to the organization. It is important that the disinterested directors or officers do the necessary due diligence to assure that the conflicting interest transaction is best for the organization. This would include multiple bids for contracts or outside input by professionals, such as accountants and lawyers. A conflict of interest policy should be monitored on a continuing basis and annual evaluations should be done to assure compliance. The key to this entire area is to be "above reproach" in all our dealings on behalf of the church.

Are loans to the senior pastor okay? The answer to this question depends on the state laws where the church is incorporated. The Model Nonprofit Corporation Act, which some states have effectively adopted, does not allow for loans to directors or officers. These are viewed by the Act as conflicting interest transactions. If there is no state prohibition, then a loan may be possible, but it should be handled in a manner that would be seen as "arm's length." This means that there should be a written promissory note, secured by a mortgage or similar document if property is involved, and a reasonable interest rate charged that is at least equal to the IRS market value rate as established quarterly by the IRS.

Should a church have a personnel manual? If the church has policies that address operational and personnel issues, then they have a personnel manual. The manual assists both the employer and the employees in being able to find, in one easy place, these various policies. The policies should be reviewed with each employee during an orientation, and employees should sign something that notes that they have read and understood the policies. As to the kind of policies that are included in a personnel manual, these are varied and depend on the church's actual operations. If the church has e-mail access, then there should be an e-mail policy related to use, ownership, privacy, content, etc. If the church has Internet access, then there should be an Internet use policy. The church should have a sexual harassment policy, along with other policies that address benefits, operations, etc. A personnel manual should be carefully crafted to avoid any promises of employment. As with any policy, it is only valuable if enforced, and can result in more harm than good if not enforced consistently.

Copyright/Trademark Laws

What is a copyright and how do I know if the church has one? A copyright is legal protection provided within federal law for anyone who creates an original work and produces it in some tangible form, such as a book, picture, sheet music, video, etc. The law gives the author/owner some exclusive rights related to the original work. These are the rights of reproduction, adaptation, publication, performance, and display. Generally, the church owns a copyright in an original work if you are the author of that original work.

The main exception to this general rule is the “work for hire” doctrine, which states that if an employee creates an original work within the scope of employment, then the copyright belongs to the employer and not the employee. There are obvious questions, at times, related to who is an employee and was the work within the scope of employment. If these are raised, then further research should be done through the resources recommended at the end of this section. If the author is clearly an independent contractor who has been contracted to create an original work, then such contractor will retain the copyright unless the contract clearly provides that the contracting party for the work will own the copyright.

Should I register the church’s copyright with the federal government? Under current law, a copyright does not have to be registered to benefit from the protection of the copyright law. However, it is a fairly simple and inexpensive process to file a copyright with the Library of Congress. The filing fee is currently \$30. If you have interest in registering a copyright, access the Library of Congress web site for further details at the U.S. Copyright Office.

How do I know if the church has infringed on someone’s copyright, and are there any exceptions? Since a copyright includes the rights of reproduction, adaptation, publication, performance, and display, the church can infringe another’s copyrighted work if it does any of the previous without the owner’s permission. One of the more susceptible errors is the reproduction of a copyrighted work, which includes both a verbatim copy and a paraphrase that captures the essence of the copyrighted material. Even the use of verbatim portions of copyrighted material may be an infringement, depending on how much is used and the significance of the copyrighted material to the entire work.

There are a few exceptions to these basic infringement rules. Generally, the church can’t infringe if it has received permission from the owner and use the work within the scope of the permission. Another exception, created within the law itself, is known as the “fair use” doctrine. The law contains a list of the various purposes for which the reproduction of a particular work may be considered “fair,” such as criticism, comment, news reporting, teaching, scholarship, and research. The law also sets out four factors to be considered in determining whether or not a particular use is fair:

- The purpose and character of the use, including whether such use is of commercial nature or is for nonprofit educational purposes.
- The nature of the copyrighted work.
- Amount and substantiality of the portion used in relation to the copyrighted work as a whole.
- The effect of the use upon the potential market for or value of the copyrighted work.

Another exception is the “performance of a nondramatic literary or musical work or of a dramatic—musical work of a religious nature, or display of a work, in the course of services at a place of worship or other religious assembly.” In other words, the reading aloud of a work in a nondramatic way in a worship service, such as from a copyrighted translation of the Holy Bible. The law does not give the church the right to make copies, but to read or render.

Another part of the law states that “the owner of a particular copy lawfully made . . . is entitled, without the authority of the copyright owner, to display that copy publicly, either directly or by the projection of no more than one image at a time, to viewers present at the place where the copy is located.” This is

particularly relevant to those churches that use overheads during a church service, keeping in mind that the church is “the owner of a particular copy lawfully made.”

The last exception found in the law relates to the “performance of a non-dramatic literary or musical work otherwise than in a transmission to the public, without any purpose of direct or indirect commercial advantage and without payment of any fee or other compensation for the performance to any of its performers, promoters, or organizers, if—(A) there is no direct or indirect admission charge; or (B) the proceeds, after deducting the reasonable costs of producing the performance, are used exclusively for educational, religious, or charitable purposes and not for private financial gain, except where the copyright owner has served notice of objection to the performance under the following conditions; (i) the notice shall be in writing and signed by the copyright owner or such owner's duly authorized agent; and (ii) the notice shall be served on the person responsible for the performance at least seven days before the date of the performance, and shall state the reasons for the objection; and (iii) the notice shall comply, in form, content, and manner of service, with requirements that the Register of Copyrights shall prescribe by regulation.”

What is a trademark or service mark? According to the United States Patent and Trademark Office (USPTO), “a **trademark** is a word, phrase, symbol, or design, or a combination of words, phrases, symbols or designs, that identifies and distinguishes the source of the goods of one party from those of others. A **service mark** is the same as a trademark, except that it identifies and distinguishes the source of a service rather than a product.” A registered trademark/service mark is one that has been registered with the USPTO, which generally provides national protection to a registered trademark. A USPTO registered trademark is identified by the following symbol: ®. A state-only registered trademark is valid only in the registered state. A non-registered trademark is valid in the geographical area of its use and can be signified by the letters TM or SM.

Do trademarks and copyrights protect the same things? No. Trademarks and copyrights differ. A copyright protects an original artistic or literary work as described above, while a trademark protects those items mentioned in the previous paragraph.

Is the C&MA logo trademarked? Yes. The Christian and Missionary Alliance registered its original logo with the USPTO more than ten years ago. The current logo with the partial world is a derivative of the original logo and is clearly the trademark of the C&MA. The C&MA also has trademarked its full name and its acronym with the USPTO in the past few years.

How can a church use the C&MA logo? Every church that is accredited, developing, or affiliated with the C&MA may use the C&MA logo for the purpose of identification with the denomination. A church may not use the logo on any products being sold to the public, but may use the logo as identification on clothing provided to members within the church. The logo may not be altered or obscured in any manner as part of its use in identification. Any other use of the logo must be approved by the C&MA National Office.

Can the church make copies of music to insert in the bulletin? Unless the church has permission from the author or obtained a Christian Copyright Licensing, Inc. (CCLI) license, generally copies of music cannot be made for use by the church choir or for insertion in the bulletin. Of course, a church can copy music with an expired copyright or that is in the public domain and not copyrighted. A CCLI license does not provide complete protection from infringement in all situations. The license does not apply in all cases to the reproduction of music. The license does not convey any right to reproduce literary work, such as books or articles.

Charitable Solicitation Laws

What are charitable solicitation laws? Charitable solicitation laws have been enacted by many states. These laws require charitable nonprofit organizations to register with the state before they begin conducting fund-raising activities. The stated purpose of these laws is to prohibit fund-raising activities that are fraudulent or misleading. In most states, churches are specifically exempted from registering or reporting after registering. This is done generally by exempting organizations that do not file IRS Form 990. Churches are specifically exempt from filing Form 990 in the Internal Revenue Code and thus also are exempt in these states from the charitable solicitation filings. Each church should investigate its specific state law regarding charitable solicitation requirements.

Labor Laws

Is the church subject to the Fair Labor Standards Act? Based on a reading of the Fair Labor Standards Act (FLSA), which includes provisions related to minimum wage, overtime compensation and equal pay, there is no specific exception for churches based on their status as a church. There are two specific exceptions for certain classifications of employees. The one exception that relates to the church is for "any employee employed in a bona fide executive, administrative, or professional capacity." For the church, this applies to clergy since they are considered professional employees. Therefore, ministers are not subject to the Act.

Other employees of by the church would not normally fit in the above categories, and thus more analysis must be performed to determine the application of the Act to such employees. Churches that are not engaged in commercial or business activities may not be subject to the Act's minimum wage, overtime compensation, and equal pay requirements because of the definition of enterprise in the FLSA. The FLSA defines "enterprise" as follows: "Enterprise engaged in commerce or in the production of goods for commerce" means an enterprise "that — (A) (i) has employees engaged in commerce or in the production of goods for commerce, or that has employees handling, selling, or otherwise working on goods or materials that have been moved in or produced for commerce by any person; and (ii) is an enterprise whose annual gross volume of sales made or business done is not less than \$500,000 (exclusive of excise taxes at the retail level that are separately stated)."

Generally, churches would not have at least two employees in an "enterprise" and would not meet the annual sales volume requirement (currently \$500,000). The argument that the church is not engaged in commerce would probably fail. This is based on the reality that courts have been defining "commerce" very broadly for many years.

According to the FLSA, all employers having employees covered by the Act must maintain records documenting the covered employees' wages, hours, and other conditions and practices of employment. This would include payroll records, any employment contracts, pension plans and other employee benefits, and worktime schedules. Remember that the FLSA applies only to employees. However, the term "employee" is interpreted very broadly to include persons who are permitted or "suffered" to work. Mere knowledge by an employer of work done for it by another is sufficient to create an employment relationship. The Supreme Court has emphasized that "the Act must be liberally construed to apply to the furthest reaches consistent with congregational direction." In my opinion, this means that employees cannot volunteer their time to do the same work they are already being paid to do.

The church must recognize that many states have enacted their own versions of the Fair Labor Standards Act, and these also should be considered for application to the church.

How does the American with Disabilities Act (ADA) effect the church? The ADA does not exempt any particular group of employers, like churches, from this Act, but there are specific provisions for exemption based on the number of employees. The ADA applies to employers who have 15 or more employees and who engage in interstate commerce. This will effectively exempt most C&MA churches from having to comply with the employment requirements of the ADA.

Those employers with 15 or more employees may not discriminate against any "qualified individual with a disability" on the basis of the disability "in regard to job application procedures, the hiring, advancement or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment." The law requires that the employer make "reasonable accommodations to the known physical or mental limitations of an otherwise qualified individual with a disability who is an applicant or employee unless such [employer] can demonstrate that the accommodation would impose an undue hardship on the operation of the business of such [employer]." The definition of what is a "reasonable accommodation" in these circumstances is a big question. Most of the lawsuits related to this Act revolve around this definition.

The other aspect of the ADA is related to access and public accommodation. As far as the portion of the ADA that relates to public accommodation is concerned, churches are specifically exempted.

Does the church have to comply with the Family and Medical Leave Act (FMLA)? Like the ADA, the FMLA applies to employers with a certain number of employees. The FMLA applies to employers who have 50 or more employees who work within a 75-mile radius. All employees on the payroll, including part-time workers and workers out on leave, count toward the total. Because of this, almost all churches will be exempt from complying with the FMLA.

For employees to be eligible for the FMLA, they must have worked for the employer for at least 12 months (does not need to be consecutive); worked for at least 1,250 hours during the year preceding the start of the leave; and be employed at a worksite where the employer employs at least 50 employees within a 75 mile radius.

Once the above two requirements are met, employees can take the FMLA leave only for specified reasons. Not every personal or family emergency qualifies for FMLA leave. The three reasons allowed under the FMLA are: (1) birth, adoption, or foster care; (2) the employee's serious health condition; and (3) a family member's (narrowly defined) serious health condition.

Under the FMLA, employees can take up to 12 weeks of unpaid leave in any 12-month period for the reasons listed above. When their leave ends, the employer must reinstate employees to the same position they held when they went out on leave, subject to these conditions: (1) employees have no greater right to reinstatement than they would have had if they had not taken leave and (2) employers can refuse to reinstate certain highly paid employees.

Are there any filing requirements for newly hired employees? All U.S. employers are responsible for completion and retention of Form I-9 for each individual, citizen and noncitizen, they hire for employment within the United States. On the form, the employer must verify the employment eligibility and identity documents presented by the employee and record the document information on the Form I-9. Acceptable documents are listed on the back of the form.

What postings are required by labor laws? Generally, the church should display the following postings: Minimum Wage, Equal Employment Opportunity, Workers' Compensation, OSHA, and Employee Polygraph Protection Act. Also, the church should post any postings required by state law.

What is the clergy exclusion? Generally, the civil courts will not interfere with a church's decision to terminate a minister's services. According to Richard R. Hammar, in his newsletter Church Law and Tax

Report: "The subject of judicial intervention in ecclesiastical matters, including the termination of clergy, is discussed fully in Judicial Resolution of Church Disputes. To summarize, the courts generally have refused to review claims by dismissed clergy that their dismissal violated their legal rights or was not in accordance with stated ecclesiastical procedure. This view is based on a number of Supreme Court rulings that have reached the following conclusions: (1) the civil courts may never intervene in disputes involving questions of ecclesiastical discipline; (2) civil courts may not resolve alleged deprivations of the 'rights of property, or of contracts' of dismissed clergy if the alleged violations 'follow as an incident from decisions of the church . . . on ecclesiastical issues'; (3) the civil courts cannot resolve controversies regarding the qualifications (or lack of qualifications) of clergy, even if 'civil rights' are involved, absent fraud or collusion; and (4) the civil courts may never resolve claims of dismissed clergy that their dismissal improperly violated stated ecclesiastical procedure."

Other Legal Risks

Are there other legal issues a church should be aware of? This is an important question. Churches no longer hold the honored place in American society that they used to. Litigation against churches, from the outside and even the inside, is on the rise. The following paragraphs will address a number of legal issues related to churches that have shown up in litigation.

Selection and Retention of Staff and Volunteers. Litigation based on negligent selection or retention of staff and volunteers is a growing trend. While this can relate to almost any position in the church, much of the litigation has related to those working with children. Negligent selection arises due to the inadequate background screening of potential employees and volunteers, resulting in the sexual abuse of a child. Many churches are unwilling to do such screening because they either want to trust others or do not want to embarrass someone who is willing to volunteer. These reasons clearly are not valid in the face of protecting the innocent children of the church and avoiding the significant liability that can result. Every employee and volunteer should be required to complete a screening application. The church should pursue background checks, and limit new members or attendees from working with children for at least the first year.

Negligent retention lawsuits against the church results from inappropriate action by an employee or volunteer who was retained after the church had information indicating that he/she posed a risk of harm to others, especially women and/or children. The church should take seriously any credible information that would suggest an employee or volunteer could represent a risk to others in the church. The C&MA Uniform Policy on Discipline should be reviewed and utilized if the information is considered credible. If the church ignores such credible information, it risks being exposed to liability resulting from other inappropriate action that may occur after receiving the information.

Another area of liability risk is the negligent supervision of employees or volunteers. This relates to the failure of the church to have in place personnel policies and to provide direct supervision of employees and volunteers, particularly as it relates to children. The means for youth activities, Sunday School, AWANA, nursery, and other activities involving children or young teens. This issue is also discussed in the "Church Insurance and Risk Management" section under Church Activities

Counseling Practices. Churches that allow or provide counseling services to their members or the public are subject to liabilities that can arise as a result of such counseling. Some of the causes of action related to counseling have been negligent counseling, sexual misconduct, maintaining confidences, and the unauthorized practice of psychology or counseling by unlicensed persons who are not serving as pastoral counselors according to Richard Hammar, in an article published in the Spring 2000, Leadership magazine. The same article suggests three common sense ways to reduce these risks: 1) adopt a policy prohibiting a male minister or counselor from privately counseling an unaccompanied female; 2) install a window in the pastor's office, making all counseling sessions clearly visible to office staff, including only office hours

sessions; and 3) pastors and unlicensed lay counselors should have a clear understanding of those cases that should be referred to a professional counselor. If there are no windows installed in the pastor's office, leave the office door open or ajar during each session.

Child Abuse Reporting. Child abuse is a huge issue in the United States with almost every state, if not all, having specific child abuse legislation. Generally, this legislation includes child abuse reporting requirements for various professions that work with children. In some states, ministers are exempt from mandatory reporting, while in other states they are required to report. Every church and district office should know the child abuse reporting laws of the state(s) in which they are operating. The failure to report, if required by law, can lead both to criminal and civil liability. Ministers also should be aware of the clergy-penitent privilege, which relates to information received by a minister in the course of confidential conversations. The use of this privilege is a matter of state law and should be reviewed with a local attorney if a question should arise.

Securities Laws. When the church uses any type of instrument, defined by the Uniform Securities Act as a security, such as bonds, promissory notes, and other investment vehicles, when raising funds, the church risks violating securities laws. Churches are exempt from securities registration under federal law and most but not all states also exempt churches. Without proper legal advice, the church should not consider using a form of security as a means of raising funds.

Undue Influence in Deferred Giving Decisions. Living in a society where the church and other religious organizations have become less respected and trusted, children and the heirs of donors are more likely to challenge wills and trusts that leave money to the church. One of the most popular causes of action in the area of deferred giving and estate planning is the accusation of undue influence. The church should be aware of this type of accusation and should take steps when approached by an elderly member who wishes to leave money to the church. The best course of action is to recommend that the member obtain independent counsel from a financial planner, accountant or lawyer (not from members of the church). The church, as a beneficiary of a deferred gift, should not overreact to the threat of a lawsuit by heirs if it is satisfied that it has not improperly influenced the donor. Such lawsuits or threats of a lawsuit are meant to intimidate the church into quickly settling. The church should consult with an attorney immediately.

Personal Liability of Governance Authority Members. As noted in the section on incorporation, officers and directors of corporations usually are protected from personal liability when performing their duties. Despite this general understanding, there are times when a member of the governing body of a corporation may be subject to personal litigation. According to Richard Hammar in his Leadership article, the causes of action in this area may include: "1) tort liability for such actions as negligent operation of a church vehicle, negligent supervision of church workers and activities, copyright infringement, and wrongful termination of employees; 2) contract liability for executing a contract without authorization; 3) violating on the 'fiduciary duties' that every officer or director owes to a corporation, including the duties of due care and loyalty to the corporation; 4) selling securities without registering as an agent, or engaging in fraudulent activities in the offer or sale of church securities; 5) willfully failing to withhold or pay over federal payroll taxes to the government; 6) approving a loan to an officer or director." Some states provide statutes that limit liability for uncompensated directors, but not for compensated directors or officers, such as the senior pastor. This is the reason for obtaining directors and officers liability insurance as discussed in the Church Insurance and Risk Management section.

Mediation/Arbitration

Our church is dealing with a situation that is causing conflict among our members and may lead to litigation. What should we do? According to Peacemaker Ministries, the Bible provides a simple yet powerful system for resolving conflict. The scriptural basis for addressing conflict can be found in at least three locations. Matthew 5:21-26 says:

“You have heard that it was said to the people long ago, ‘Do not murder, and anyone who murders will be subject to judgment.’ But I tell you that anyone who is angry with his brother will be subject to judgment. Again, anyone who says to his brother, ‘Raca,’ is answerable to the Sanhedrin. But anyone who says, ‘You fool!’ will be in danger of the fire of hell. Therefore, if you are offering your gift at the altar and there remember that your brother has something against you, leave your gift there in front of the altar. First go and be reconciled to your brother; then come and offer your gift. Settle matters quickly with your adversary who is taking you to court. Do it while you are still with him on the way, or he may hand you over to the judge, and the judge may hand you over to the officer, and you may be thrown into prison. I tell you the truth, you will not get out until you have paid the last penny” (NIV).

Another important Scripture is Matthew 18:15-17:

“If your brother sins against you, go and show him his fault, just between the two of you. If he listens to you, you have won your brother over. But if he will not listen, take one or two others along, so that ‘every matter may be established by the testimony of two or three witnesses.’ If he refuses to listen to them, tell it to the church; and if he refuses to listen even to the church, treat him as you would a pagan or a tax collector” (NIV).

Finally, 1 Corinthians 6:1-8 says:

“If any of you has a dispute with another, dare he take it before the ungodly for judgment instead of before the saints? Do you not know that the saints will judge the world? And if you are to judge the world, are you not competent to judge trivial cases? Do you not know that we will judge angels? How much more the things of this life! Therefore, if you have disputes about such matters, appoint as judges even men of little account in the church! I say this to shame you. Is it possible that there is nobody among you wise enough to judge a dispute between believers? But instead, one brother goes to law against another--and this in front of unbelievers! The very fact that you have lawsuits among you means you have been completely defeated already. Why not rather be wronged? Why not rather be cheated? Instead, you yourselves cheat and do wrong, and you do this to your brothers” (NIV).

All of these verses require that believers address conflict biblically and seek restoration and reconciliation through a conflict resolution process. If the actions required by Scripture are taken by believers in the early stages of a conflict and in a manner that expresses true humility, most conflicts can be resolved. But when conflict is allowed to fester or the offense is significant, biblical action sometimes comes too late. When conflict between believers reaches the point where litigation is being threatened, Christian mediation and possibly binding arbitration should be the main solution before choosing litigation.

Is there anything a church can do to avoid litigation? One of the things a church can do is to develop a policy that, as part of church membership, a person must agree to choose mediation/arbitration over litigation if a conflict cannot be resolved by other means. A mediation/arbitration clause also can be placed in employment applications or contracts, in business contracts, and other agreements the church might enter. See an example of a mediation/arbitration clause in Current Issues and Alerts.

The Church & The Law

Current Issues and Alerts

Uniform Constitution for Churches

Each accredited church of The Christian and Missionary Alliance shall adopt and be governed by the following Constitution:

See: The C&MA Manual, Section A5 (church code and password required).

Mediation/Arbitration Clause

Mediation/Arbitration – _____ and _____ agree that any claim or dispute arising out of this _____ shall be settled by biblically based mediation and, if necessary, legally binding arbitration under a Christian mediation or reconciliation process in accordance with the Rules of Procedure promulgated by Peacemakers Ministries, Inc. of Billings, Montana, United States of America, or its successor. The venue for such mediation or conciliation process shall be _____, _____, or such other location as agreed upon by both parties. Judgment upon an arbitration award may be entered in any court otherwise having jurisdiction. The governing law applicable to any dispute shall be _____ law and, as applicable, federal law.

The Church & The Law Resources

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Christian Ministry Resources

Phone: (800) 222-1840

Web site: www.churchlawtoday.com

Publications: Church Law and Tax Report; Church Treasurer Alert!; Pastor, Church & Law

Evangelical Council for Financial Accountability

Phone: (800) 323-9473

Web site: www.ecfa.org

Publications: The Law of Tax-Exempt Religious Organizations

Peacemaker Ministries

Phone: (406) 256-1583

Web site: www.HisPeace.org

Publications: The Peacemaker

Referrals

Christian Legal Society

Phone: (703) 642-1070

Web site: www.christianlegalsociety.org