

Legal Counsel for Churches

Corporate Governance for Churches and Their Leaders



Church Organizations Could Lose Tax Exemptions

Churches are generally exempt from paying taxes on their related income. As such, churches are not normally required to file an income tax return. For some church organizations, the Internal Revenue Service (IRS) requires an information return.

Some church activities may be incorporated as separate corporate charters. Activities such as recreational centers, daycares, housing projects and other community operations may be organized as their own legal entities. Because there is a connection to the Church, these organizations may be nonprofit entities with a religious and charitable mission.

The reason why this subject is particularly important to church organizations is two-fold. First, one might think that because an organization does not pay taxes, there is no reason to report to the IRS. This is not necessarily true. The IRS can impose significant penalties for late filings of information returns. If required returns go reported, the IRS will revoke the tax-exempt status of a church-related organization.

Secondly, complying with IRS laws is an important governance subject for church leaders. Church leaders have a fiduciary duty to properly manage church affairs. Leaders are entrusted with the responsibility to follow the laws and safeguard the assets of the church. This requires acting in a manner that shows due diligence towards IRS regulations.

Most tax-exempt organizations must file an annual information return. There are three kinds of information returns required by the IRS: Form 990, Form 990-EZ or Form 990-N. The

organization's gross income and total assets determines which form should be filed.

Form 990 is the long version of the information returns. It is more detailed and requires considerably more time to complete.

For smaller nonprofits, a short-version of Form 990 is available. This is called Form 990-EZ. This form is for organizations with gross receipts less than \$200,000 and total assets less than \$500,000.

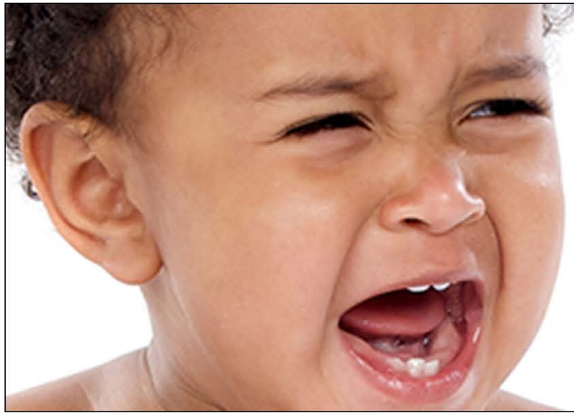
The meaning of gross receipts is the total amount the organization received from all sources during the annual accounting period without subtracting expenses. Total assets are the amounts reported by the organization on its statement of financial condition, or commonly called the balance sheet.

Prior to 2007, nonprofits with annual gross receipts less than \$25,000 did not have to report an annual information return to the IRS. This became a problem for the IRS because it could not keep up with the activities of smaller nonprofit organizations. In 2008, Congress passed a law that made it mandatory for most nonprofits to file an information return.

There is an even shorter form for the smallest nonprofits. For organizations with gross receipts less than \$50,000, Form 990-N is generally required. This form is filed electronically and involves considerably less detail than the other two forms.

Church leaders should double check with their accountants and/or legal counsel to ensure all IRS forms are duly reported. The failure to do so could lead to financial consequences. ■





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Churches Should Be Wary of Easy Money

One might find it unimaginable that someone would cheat a church. After all, churches stand for doing the right thing. The reality is churches are as vulnerable to scam artists as other organizations.

I have written on this subject before. I bring it up again because recently I've been asked to evaluate a number of potentially bogus offers. In every case, the offers were indeed fraudulent. I have found common elements to most of these claims. Here are a few tipoffs to watch for.

Unsolicited Message

Most swindles begin with the bad guys seeking out victims. In some cases, the scam begins with an unsolicited email or letter in the mail. The communication may recite some information about the church and its officials to pretend familiarity. Don't be fooled that the sender knows names, positions and the church address. Some of this information can be easily obtained on-line from the church's web site.

Some of the emails I have seen come from overseas senders. The spelling is often careless and the wording awkward. One can be forgiven of the occasional typo. However, when persons who hold themselves out to be professionals don't communicate that way, there may be a reason for pause.

Sense of Urgency

For rip-offs to work, the swindler must catch the victim off guard. This includes completing the transaction before the victim realized something is amiss. So, most offers will come with an urgency to act fast. There may be a deadline to make a quick decision. The details that come with the story may state that the opportunity is limited or the person in need is in a big hurry. A real warning is a request from the other party to wire money to them before the check that was received has had an opportunity to clear the banking system.

When church leaders make decisions with the church's funds, they have a duty to be vigilant. Transactions with strangers

should only go forward when the church has absolute comfort with all the parties and underlying details. If the church is being hurried to make a fast decision, this is a red flag.

Unbelievable Benefit

There is an old saying. When something sounds too good to be true... well we all know the rest. When I've been asked to review a sting that has fleeced someone, I noticed that the promised benefit was outrageous. There was an unreasonably high profit, large windfall, or lucrative gain to be had. Con artists know that such promises appeal to one's longing to be suddenly blessed. These claims are meant to exploit its victims in an emotional way. With emotions in the way, normally prudent people forget to ask questions.

Church officials should have an idea of what ought to be expected in such a transaction. Any gains above the reasonable level should be looked to with heightened scrutiny. This does not mean that windfalls never happen. Undeniably they do. It's just when the other party is anxious to convey a benefit without a logical reason for doing so, some suspicions should arise.

Verification is Difficult

When a check arrives unexpectedly or a deal is proposed from a stranger, check out the other party. A background check may reveal if the parties are legitimate. Look for instances where a party has been involved in litigation with other clients or counterparties. This history may help one understand the party's previous course of dealings.

If someone is a trickster, the party may avoid divulging information about their background or giving a list of references. Remember the point about the sense of urgency? If the church starts asking questions about the source of funds and insisting on guarantees before making an exchange, the dishonest person will likely abandon the deal before the truth comes to light.

In conclusion, churches run the risk of being misled as much as any business, association or organization. It is important to examine each transaction carefully before acting on an agreement. It is especially wise to make sure an arrangement is not a con before it's too late. ■

Legal Counsel for Churches is a service provided by M Smith Law, PLLC for members of the religious community. This periodical is intended to help churches and their officials become better prepared to address important legal and governance issues. We hope you find *Legal Counsel for Churches* a valuable resource. For each issue, we try to raise relevant issues and offer some practical alternatives. We welcome your comments and input.

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