

Legal Counsel for Churches

Corporate Governance for Churches and Their Leaders



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Multi-Level Marketing As A Church Fundraiser

During difficult economic times, many organizations look for new sources of revenue. For churches, the consideration of additional lines of income carries special significance. Notwithstanding the doctrinal concerns, churches should scrutinize new businesses just as any organization would.

Business opportunities may be brought to church leadership by its membership. Members often mean well. However, such proposals should be viewed with an objective, arms-length approach. One type of business venture that may be presented to churches is multi-level marketing.

Multi-level marketing is a type of business model that offers income opportunity for its participants. These programs often enlist the enrollment of individuals to further the business' objective. Some multi-level marketing programs include selling consumer products, magazine subscriptions, retail discounts or travel benefits. The common element to multi-level marketing is often the residual income component.

Churches and individuals considering involvement in a multi-level marketing business should perform careful due diligence to make sure the company is right for them. From a legal standpoint, there are two considerations a church should make. First, do the church internal doctrines permit an involvement in multi-level marketing? Secondly, is the multi-level marketing program being presented legal?

Does Internal Church Doctrine Agree?

Each church has its own set of doctrines it follows. These principles outline the permissibility of certain

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Private Benefit Rule Applies to Churches

Churches must operate in such a way as to not violate their tax exempt status. Churches that operate as 501(c)(3) organizations must follow specific rules to keep their tax exempt designation. One of the rules that apply to these churches is the Private Inurement (Benefit) Rule.

The purpose of the Private Inurement Rule is to make sure that tax-exempt organizations are not misused for private interests. As a result, churches should be prepared to prove that they do not operate for the benefit of private persons, such as the leaders, trustees, directors and officers. The prohibition applies to family members of entrusted individuals as well.

The Private Inurement Doctrine is notated in section 4.76.23 of the Internal Revenue Code. This section of the Code, entitled Inurement, Excess Benefit Transactions, Private Benefit, provides guidance for examinations. The code states...

During the examination of an IRC § 501(c)(3) organization, the examiner should determine if the organization is engaged in any financial transactions, including payment of compensation, which may result in inurement of earnings, an excess benefit transaction, or an impermissible amount of private benefit.

Some ways churches may violate the Rule include:

1. Providing excessive compensation to church officials
2. Having unreasonable housing arrangements
3. Making unreasonable lending arrangements to officers
4. Conducting unreasonable sales transactions

Internal Revenue Service (IRS) General Counsel Memorandum #38459, states that private inurement is "likely to arise

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activities. A church may not engage in a line of business that is outside the scope of its defined purpose. Leaders of a church should ensure that its activities do not conflict with the defined purpose of the church.

The charter and bylaws should not preclude the involvement in the prospective activity. Church policies may in fact dictate that all income be derived from tithes and offerings. If this is the case, marketing programs may be impermissible.

Is The Activity Legal?

When evaluating a program that offers income based on the subsequent enrollment of others, one should scrutinize the program with particular wariness. The first concern is to ensure that the program is not an illegal pyramid or chain scheme.

North Carolina criminal statutes define pyramid and chain schemes. North Carolina General Statutes §14-291.2(a) states that “No person shall establish, operate, participate in, or otherwise promote any pyramid distribution plan, program, device or scheme whereby a participant pays a valuable consideration for the opportunity or chance to receive a fee or compensation upon the introduction of other participants into the program, whether or not such opportunity or chance is received in conjunction with the purchase of merchandise.”

Churches should test the validity of businesses that offer income based on the recruitment of other participants. When in doubt, seek legal counsel to ensure the opportunity is legal and appropriate. ■

where the financial benefit represents a transfer of the organization’s financial resources to an individual solely by virtue of the individual’s relationship with the organization, and without regard to accomplishing exempt purposes.”

Courts look at the specific situation to determine if the Rule has been violated. First, the law looks at the purpose of the church. If its basic purpose is to benefit a population of persons without regard to private interests, there is a strong argument to retain the tax exempt status. If it is shown that there is no exempt purpose being pursued, then the church cannot be tax-exempt, regardless of exempt activities that may be performed. Incidental benefits to private individuals will not defeat the exemption.

The Rule may be broken when a church official receives personal benefits just because of his/her position.

The Rule applies a reasonableness standard test to transactions under scrutiny. The reasonableness standard relies on comparing the activities to similar organizations. Courts will look to see if the transaction was negotiated on an arm’s-length basis. The potential cost for violating the Private Inurement Rule is the revocation of the church’s tax-exempt status.

To protect your church from a Private Inurement Rule violation, follow good corporate governance in all decisions. Be sure all conveyances of benefits, including compensation, are reasonable. Avoid conflicts of interests. When in doubt, consult your attorney to make sure major transactions are properly conducted. ■



Managing Risk Requires A Balanced Approach

The only thing worst than mismanaging risks is not seeing the risk in the first place. This could put a church between a rock and a hard place. Helping clients manage legal risks is our business.

We believe that our church clients should not be put at a disadvantage. Church officers should fully understand what they sign and agree to perform. To this end, we review each contract carefully for unexpected risks.

Manage your risks. Choose an advocate who will leave no rock unturned.



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