

# Legal Counsel for Churches

Corporate Governance for Churches and Their Leaders



October 2011

[www.LegalCounselForChurches.com](http://www.LegalCounselForChurches.com)

## When Is Church Work Not Church Work?

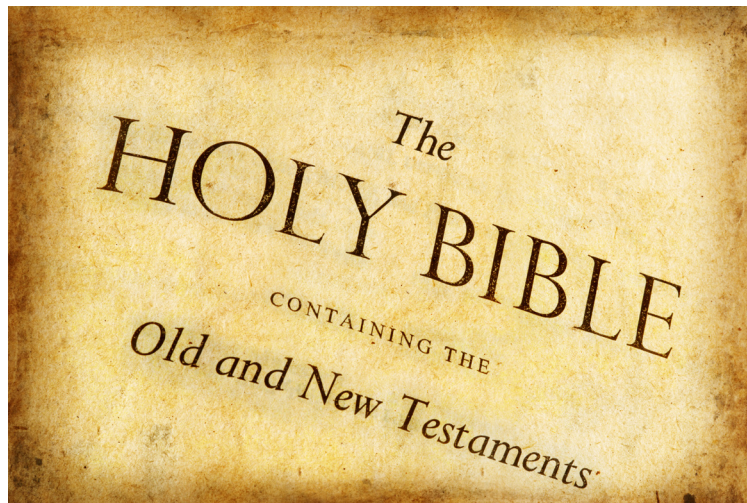
One of the advantages churches enjoy is a favorable tax treatment under Federal, state, and local laws. The reason churches are given favored treatment is public policy recognition of the special missions these organizations undertake. In exchange for the favorable tax treatment, churches must adhere to limitations on their activities. Churches that step over the line could face sanctions that may threaten their tax status. Understanding how courts draw this line is important for church management.

When Congress passed laws that granted tax-exemptions to churches, it did so with the condition that churches operate within a well-defined area of religious activities. It was presumed that the religious activities would not resemble business conduct. This understanding of separate roles was based on the basic idea that it would be unfair for non-profits to be allowed to compete with for-profit enterprises. In the meantime, many churches have embraced activities that nudge closer to commercial activity.

Churches today are big businesses. Some churches operate real estate, financial and retail businesses. Even today's average-sized churches are open to their members every day of the week for expanded purposes. Some churches maintain payrolls that include growing full-time staffs. Large churches and ministries are in charge of managing sophisticated operations.

### The Commerciality Doctrine

The Commerciality Doctrine is a legal principle that courts use to analyze the activities of tax-exempt organizations. The Doctrine applies when a tax-exempt organization is engaged in a non-ex-



empt activity. Courts will look to see if the activity is a commercial venture. A judge may look at the business market to see if the tax-exempt activity is essentially equivalent to taxable businesses.

If a judge finds nonprofit activity that competes with the for-profit business sector, a violation of the Commerciality Doctrine may be determined. When the Doctrine is applied to a non-profit, at a minimum, the organization may be ordered to stop the "commercial" activity or face the cancellation of its tax-exempt status.

It is important for church leaders to realize that Commerciality Doctrine cases are based on the facts. The court's judgment will be influenced by looking at all of the factors. The Doctrine is more

*see next page*

## Protecting Private Data Can Limit Church Liability

Churches, like many organizations, keep private information on their members. As leaders, you should consider the impact to your church should the sensitive information you have on your members be made public due to your negligence. Mistakes with member data could be a significant legal liability to a church, its leaders and congregation.

Church leaders have a responsibility to safeguard the private information entrusted to them by their members. Private information is that which would not ordinarily be discovered in the public realm. Private information includes members' social security numbers, unlisted telephone numbers, account details, tithes and offering records and facts relating to sensitive circumstances. Notes kept on counseling sessions with church officials are private information. One could argue the fact that someone sought counseling should be kept private.

*see next page*



*Maurice R. Smith*

Maurice R. Smith | Attorney & Counselor at Law

*Legal Counsel for Churches* is published four times per year by M Smith Law, PLLC. All rights are reserved. You are welcome to share this publication with colleagues and friends. We request that no commercial duplications be made without permission. Email subscriptions are available.

Post Office Box 27461, Raleigh, North Carolina 27611 919.362.0744 (voice) 888-321.9047 (fax) [maurice.smith@msmithlaw.us](mailto:maurice.smith@msmithlaw.us)  
© M Smith Law, PLLC 2011 Printed in USA.

likely to be found by courts when the organization's practices also violate other principals of law. For instance, excessive compensation levels paid to executives can inflate the set of facts. Without the excessive compensation levels paid, a court might otherwise determine that the commercial activity was merely incidental.

A church should be aware of how it appears to the public and its members. Perception is important in these kinds of cases. This is particularly so if the case goes to a jury trial.

A church should be prepared to show that its activity is directly and casually related to accomplishing the organization's authorized tax-exempt purposes. Even if the activity is commercial in nature, it may be argued by a church that the conduct still furthers its mission.

Some activities that look commercial may not actually be commercial after all. A church could show that it does not compete with commercial firms because its activities do not duplicate the products and services businesses offer. Commercial practices include offering comparable products, competitive prices, promotional channels and profit objectives. If these elements are not present, the church activity may be safe. Keep in mind, just showing a profit is insufficient to make a finding that the Commerciality Doctrine has been overstepped.

Finally, church leaders should examine their internal policies to ensure that the activities are allowed. If the articles of incorporation and bylaws do not specifically allow the conduct in question, it may be more difficult to present to a court that the activity is in furtherance of the church's mission. ■

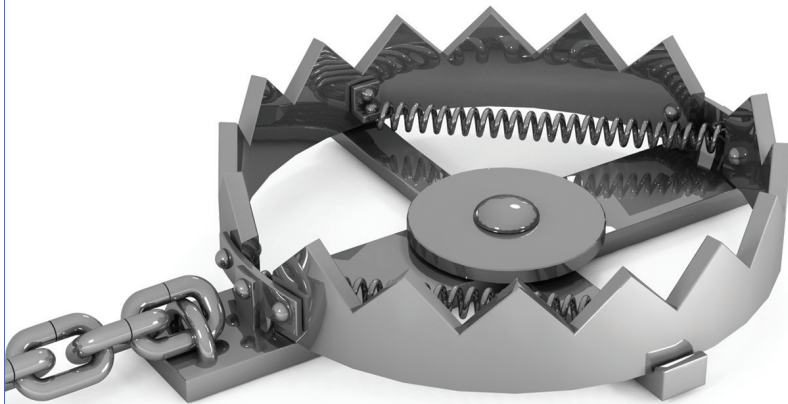
In order to protect members' privacy, the church should understand where all sensitive data is kept. Church leaders should conduct a survey of systems used to store member data. The first place to look is computers and computer files. Computers and their backup files should be secure from electronic intrusions. Church leaders should be aware of how sensitive data is transported and stored. Church officials who routinely store sensitive information on unsecured USB devices and can pose a significant liability risk.

There is another risk to private data called social engineering. Social engineering is the risk that people will make mistakes that could pose a risk to member data. For instance, a vendor could accidentally or intentionally gain access to member data because an employee did not safeguard his/her password. Data breaches have occurred because passwords were written on the side of the computer that contained sensitive information. Churches can face liability for the lack of physical security to prevent trespassers from gaining access to office files.

To protect your church and officials from legal liability, develop a comprehensive program to safeguard your member data. It could be wise to hire an outside firm to give you an objective assessment of where you stand. Failure to protect member sensitive data could be a costly lesson to learn.

There need not be a particular contract involved to have an obligation to protect private information. There may be an implied duty to do such. In any event, the unintended breach of member data by the church could be an embarrassment at best, a legal liability at most. ■

## Some Contracts Have Hidden Traps



Negotiating a contract for your church can be dangerous business. Not all contracts are fair and balanced. Some agreements are filled with hidden traps and mysterious clauses.

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.

Helping church leaders manage contracts is our business. If you would like to stay clear of dangers, give us a call. We will help you avoid the traps.

**M** SMITH | LAW  
PLLC

CORPORATE GOVERNANCE | COMMERCIAL TRANSACTIONS | CONTRACT LAW

**Legal  
Counsel**  
*for Churches*



*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. If you have questions, feel welcome to contact us.

Communication from M Smith Law, PLLC does not automatically create an attorney-client relationship nor necessarily constitute an offer or acceptance of representation. Representation by Maurice R. Smith is established by a mutual affirmative decision to enter into an attorney-client relationship. While every effort is made to protect the privacy of all conversations, until an attorney-client relationship is established, any information disclosed by you may not be deemed confidential.