

Legal Counsel

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Corporate Governance for Churches & Their Leaders

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Corporate Governance Tips from the IRS

Corporate governance is a vital duty for church leaders. Effective governance protects the church and its officers.

Most organizations recognized under the 501(c)(3) law must file a tax return. The tax return form is called Form 990, *Return of Organization Exempt from Income Tax*. The Form 990 calls for reporting on the organization's financials, accounting methods, property, activities, vendors, and compliance. For the purposes of this article, we focus on the governance and management section of the Form 990.

The IRS asks a series of questions on the Form 990 to assess the wherewithal of the organization to comply with tax rules. The IRS does not mandate a particular business formation. The IRS does take the position that organizations that practice good governance are more capable of tax compliance.

We have taken a close look at the questions the IRS asks on the Form 990 to get a sense of what qualifies as good governance. The inquiries themselves hint to what the IRS believes are important for church management. Regardless of whether a church is recognized under the 501(c)(3) tax code, these questions provide clues for areas in which to improve governance practices.

Did any officer, director, trustee, or key employee have a family relationship or business relationship with any other officer, director, trustee, or key employee?

This question gets to the risk of interest conflicts and self-dealing in an organization. While family relationships among officers is not inherently wrong, these connections can lead to trouble spots. Family relationships can cloud the judgment of a church officer. Church leaders should avoid becoming involved in decisions that affect family.

Did the organization delegate control over management duties customarily performed by/under the direct supervision of officers, directors, trustees, or key employees to a management company or other person?

Officers have specific fiduciary duties to the church. Officers may delegate these duties to another. The IRS signals here that such delegation should require extra scrutiny. While others may be tasked with performing governance duties, the church officers remain responsible for the ultimate results.

Did the organization contemporaneously document the meetings held with written actions undertaken during the year?

This question emphasizes the importance of keeping accurate minutes of governance actions. The minutes should provide a record of matters discussed during a meeting and the

decisions the board undertook. The meeting minutes should be approved by the governing body and preserved.


Did the process for determining compensation of the top management official include a review and approval by the independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?

The IRS points to the charge of the governing board to supervise its chief executive. For churches, this person is usually the senior pastor or head clergy. One of the most important roles for a board is determining appropriate compensation. The decision to reach suitable compensation should come after a discussion among independent directors using relevant market data.

Form 990 asks for the existence of certain policies in the organization.

The IRS implies these policies are important for good governance. Church leaders should ensure they have policies such as: 1) Whistle-blower, 2) Document Retention & Destruction, and 3) Conflict of Interests.

The questions on the Form 990 let us know what the IRS considers important subjects. These questions are asked to help churches and other types of nonprofits meet their legal requirements for compliance and good corporate governance. ■



The Importance of Recording Dissenting Votes

A Lesson on the Duty of Loyalty

Church board members are generally not held personally responsible for the business decisions they make on behalf of the institution. This is one of the advantages of serving a corporation or an organization that has separate legal recognition.

The protection from personal liability comes with strings attached. Directors are expected to uphold their fiduciary duties and act as any prudent corporate officer would under the circumstances. For the occasions when a church officer violates corporate law or commits an illegal act, the shield from personal liability becomes ineffective. This is when individuals can face personal liability.

Governing boards often take actions by casting voting. Regardless of whether your church is governed by a separate board, deacons, trustees, or other officials, the governing officers may reach decisions through a voting process.

If a church operates under a rule of order, such as Roberts, the voting process usually consists of someone presenting a motion, a second is made to show support, discussion ensues, and the members cast votes for or against the action.

Occasionally, a director or group of directors disagree with the proposal on the floor. In such instances, these directors may feel compelled to vote no to a motion. It is important that the directors who oppose an action vote as such and have their dissenting voices recorded in the meeting minutes.

There are good governance reasons for having an official record of dissenting votes in the meeting minutes.

Recording dissenting votes shows outside parties the church directors engaged in a healthy debate about an important issue. Church directors are bound to a fiduciary duty of loyalty to the organization. This duty mandates each director make decisions he/she believes is good for the church. No other interests should compete for a director's loyalties... including the opinions of fellow directors. Directors who vote nay to a motion because it is believed the decision does not serve the church's best interests shows the kind of independence the duty of loyalty demands.

Church boards can face legal challenges for making a wrong decision. A decision must so bad that no reasonable board would have made this choice. A plaintiff would need to prove the directors violated their fiduciary duties for personal liability to attach. Directors who cast dissenting votes may protect themselves from the personal liabilities of the majority's choice.

Dissenting directors often cause their colleagues to rethink their position on a governing question. It is helpful for directors who intend to oppose a motion to announce in advance their intention during the debate. This notice avoids surprising others when the votes are counted. Dissenting votes should be individually noted with the names of the directors who objected to the action.

Dissenting votes by directors should include for the record the reason(s) a proposal may have been resisted. It is important that churches have a clear account of how issues were addressed. For this reason, the viewpoints of dissenting directors should be included in the meeting minutes. This record is useful when such issues return someday for consideration. Church boards who understand how issues have evolved over time make better decisions for the future.

Churches should welcome dissenting voices on their governing boards. In our practice, we have seen where boards that rubber-stamp actions without robust debate miss opportunities to make better decisions. Directors should come to meetings thoroughly prepared with pre-reading materials. Board chairs should have enough situational awareness in the room to understand when directors oppose an action. Dissenting votes should be respectfully treated so all directors will feel welcome to speak up when their turn arrives.

When it becomes clear that the votes for a matter will not be unanimous, care should be taken not to rush the process. A thorough debate helps ensure the matter is exhausted. Parking lot conversations about the vote can be avoided by giving room for complete litigation during the meeting.

Church boards should listen to directors who dissent to official actions. Recording both sides of a matter is how boards improve governance. ■



The Feeling

You get when you know your church's governance is right.

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Board Rotation is Good Practice

One of the signs that an organization is ripe for underperformance is the stagnation of its board. A healthy board accepts the idea that rotation of its directors is good for its growth. In this article, we will explore why turnover can be an important governance strategy.

All organizations go through turnover of its officers. People leave for various reasons. In some instances, officers leave for voluntary choices. There are also occasions when board members and officers are forced to move on.

High performing organizations recognize the inevitability of board and officer turnover. These leading companies understand change is inescapable. Consequently, proactive boards prepare for the turnover of directors.

If turnover is unavoidable, organizations should seek a systemic way to make change manageable. Turnover can be an opportunity to make the church ministry more effective. Handled badly, turnover can lead to disruption and inefficiency.

An argument can be made for turnover on a regular basis. For churches that are governed by a board, rotations can be good for the members and the body.

Some organizations mandate turnover among officer positions by enforcing term

limits. Individuals who serve in governance roles may only do so for a limited time. The time is defined in years or number of terms. When the time expires, the officer relinquishes the seat and give someone else an opportunity to serve.

Forced term limits is not the only way to schedule regular board rotations. In some cases, directors reach a voluntary consensus among themselves to serve in certain capacities for a limited time. The orderly transfer of power sets a good example for succeeding leaders.

Boards that have a long-time presiding officer can appear stifling to fellow directors. Board members who don't see a path to leadership can become complacent. The drive to continually hone one's leadership skills may seem futile to individuals who have little opportunity to advance in the leadership ranks.

Some boards have a policy that the chairman may occupy the position for a limited period. The orderly successions give others a chance to serve at the helm. This process encourages directors to be mindful of all processes, develop their leadership talents and actively contribute to the board's growth.

The encouragement of orderly board rotations may assist in the recruitment of new directors. New board members can refresh a board with diverse ideas, fill experience gaps, and offer new perspectives. Prospective directors may feel inspired to join a board that has a culture of fostering opportunities.

A board that allows predictable rotations of its officers will eventually find itself with a roster of experienced members in its ranks. A board with seasoned leaders is more capable of handling future challenges.

Former church officers have skills that can be used in other ways. These past leaders can mentor new officers with the experience they have garnered. Former chairs know firsthand the demands of leadership. These individuals can be supportive in ways that only experience affords.

Former chairs make great leaders to head committee assignments. The work of some board governance tasks can be delegated to standing and ad hoc committees. Persons who know how to preside over a meeting, supervise a team, and operate within a budget may be trusted to move effectively with an assignment.

Board rotations raise an important corporate governance matter for churches. This issue arises when we consider the fiduciary duty of care all officers share. Officers are obliged to consider decisions that are best for the church. If one believes it is better to have more experienced directors than less, board rotations become a reasonable strategy. ■

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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