REPRINTED FROM *NONPROFIT ISSUES*® VOL. XVI NO. 13 Revised September 2017

READY REFERENCE PAGE

NO. 92
FOR YOUR FILE

What Do We Mean When We Say "Nonprofit"?

Terminology obscures distinctions that are critical to understanding the rules that apply to organizations

We often start our lectures by quizzing the participants on their understanding of "nonprofits."

By show of hands, how many think the following organizations are nonprofits?

The Bill Gates Foundation; your church, synagogue, or mosque; the local United Way; the local community foundation; a major local university such as Harvard; a local social service organization; the Sierra Club; the local private golf club; the National Football league; the New York Stock Exchange.

A whole lot of people do not raise their hands very often. The hands particularly start to drop after the United Way or the community foundation. Yet all of these organizations are nonprofits except the New York Stock Exchange. And even the New York Stock Exchange was a nonprofit until 2006.

We all think we know what we mean when we say "nonprofit." But the key to understanding nonprofits is to understand that there are many different types of nonprofits. Different rules apply, depending upon the type of organization. An understanding of the difference is critical to understanding the world of nonprofit organizations.

Nonprofit

"Nonprofit" is a concept of state law, which means that an organization may not pay dividends or otherwise pass any surplus revenue, or "profits," from the enterprise on to shareholders, members, or other individuals. Although a nonprofit may pay reasonable compensation for services actually rendered to it, in general, any surplus generated by the organization must stay within the organization and be used for its stated purposes.

(New York Attorney General Eliot Spitzer's suit against Richard Grasso, former President of the New York Stock Exchange, was based on the provision of the New York Not-for-Profit Corporation Law which, like most nonprofit corporation laws, permits payment of reasonable compensation only. There is no corresponding limitation in the business corporation law. (See Ready Reference Page: "Spitzer Challenges Grasso Salary as 'Objectively Unreasonable'.")

A nonprofit corporation is not "owned" by anyone. It may be controlled by individuals or other entities, but those who control the nonprofit do not have an ownership interest in the organization. (See Ready Reference Page: "The Key Question: Whose Organization Is It?")

Tax Exempt

When we say "nonprofit" we are usually thinking of an organization that is exempt from taxation. Most, but not all, nonprofit organizations are exempt from paying *federal* income tax on their earnings.

Section 501(c) of the Tax Code now spells out 29 separate categories of exempt organizations. These categories include:

Section 501(c)(2) title holding companies (See Ready Reference Page: "Title Holding Companies Have Limited Uses."); Section 501(c)(4) social welfare and advocacy organizations like the Sierra Club or the new organizations set up to participate in political campaigns; Section 501(c)(5) agricultural or labor organizations; Section 501(c)(6) business leagues, professional and trade associations, like the National Football League (until it voluntarily gave up its exempt status in 2015); Section 501(c)(7) social clubs; Section 501(c)(8) and (10) fraternal organizations; cemetery organizations ((c)(13)); veterans organizations ((c)(19)) and so on down to (c)(29).

Charities

The largest category, and the one most people usually think of when they think of "nonprofit" or "tax exempt," is Section 501(c)(3) "charitable" organizations. Virtually all charities are nonprofits; but not all nonprofits are charities.

Under the Tax Code definition, a Section 501(c)(3) charitable organization is one which is "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals."

In addition, no part of the net earnings may inure to the benefit of any private shareholder or individual, no substantial part of the activities may consist of carrying on propaganda, or otherwise attempting, to influence legislation, ("lobbying"), and the organization may not participate in any political campaign for or against any candidate for public office ("electioneering"). (See Ready Reference Pages on Requirements for Federal Tax Exemption, and on Lobbying and Electioneering.)

When the U.S. Supreme Court decided in the *Citizens United* case in 2010 that corporations could spend unlimited amounts on "uncoordinated" political campaign advertising, many existing and newly created 501(c)(4) advocacy groups and 501(c)(6) trade associations significantly increased their electioneering activity, as they are permitted to do under the law. Unfortunately, in much of the media discussion of the expenditures, the media referred to spending by "nonprofits," without distinguishing between those allowed to participate in elections and charities that are not so permitted. While the media was not wrong in calling these organizations nonprofits, the use of the term was hugely confusing because many people equate "nonprofit" with "charitable" and charities cannot participate in election campaigns.

The other critical distinguishing feature of charities, as opposed to almost all other types of federally exempt organizations, is that individuals and corporations may make charitable contributions to charitable organizations and claim a charitable contribution deduction on their own federal income tax returns.

Public charities and private foundations

Section 501(c)(3) charities are further subdivided under Section 509(a) of the Tax code between "public charities" which receive broad public support and "private foundations" which receive the great bulk of their income from a very limited number of contributors and investment income. All charities are deemed to be private foundations unless they show the Internal Revenue Service that they qualify as public charities. (See Ready Reference Page: "Calculating Public Support.")

Section 509(a)(1) describes publicly supported organizations such as churches, hospitals, and schools, which are considered publicly supported by virtue of what they do, and also organizations that receive

a specified percentage of their revenue from a broad range of contributions such as the United Way, or a community foundation.

Section 509(a)(2) describes those that are deemed publicly supported because they receive a broad range of public support from contributions and fees for service, such as many social service organizations or a nursing home.

Section 509(a)(3) describes those organizations that are deemed publicly supported because they are "operated, supervised, or controlled by or in connection with" a publicly supported charity or governmental unit. (See Ready Reference Page: "Supporting Organizations Are Public Charities.")

Charities that don't meet the criteria of Section 509(a) are considered private foundations. Like the Gates Foundation, essentially all of their income has come from a single or limited number of individuals, families, or corporations and income on their investments. Private foundations are subject to more stringent regulation. (See Ready Reference Pages on Private Foundations.)

Nonexempt nonprofits

Although rare, there are nonprofit organizations that are not tax-exempt, like the New York Stock Exchange immediately before it converted to a for-profit so that it could sell stock to provide an ownership interest to investors. A "nonprofit" organization partakes of some of the "halo effect" of the term, even though most people do not understand that the term is not completely descriptive.

Some state nonprofit corporation laws make distinctions between charitable, mutual benefit, religious and other types of nonprofit corporations, and apply different rules for each, but many nonprofit corporation laws have only a single classification that includes all nonprofits.

State tax exemption

State tax exemption in most states is an entirely separate matter. Although most nonprofits are likely to be exempt from state corporate income taxes, if any, many states have separate criteria, often more stringent than the federal 501(c)(3) criteria, for real estate or state sales tax exemption.

If you can't identify the category in which a nonprofit fits, you can't know the rules by which it is regulated.

Don Kramer's An Electronic Newsletter of "Nonprofit Law You Need to Know"
NONPROFIT ISSUES
www.nonprofitissues.com

Fall 2017

© 2017 Nonprofit Issues, Inc.
Donald W. Kramer
Editor and Publisher
Lisa T. Chatburn
Managing Editor
Virginia P. Sikes
Tax Editor

None of the materials included in *Nonprofit Issues* ® should be deemed legal advice or should be acted upon without prior consultation with appropriate professional advisors. Kramer and Sikes are attorneys with the Philadelphia, PA law firm of Montgomery, McCracken, Walker & Rhoads, LLP. Neither receipt of *Nonprofit Issues* ® nor discussion of any article with its author or anyone associated with *Nonprofit Issues* ® creates an attorney-client relationship between the recipient and any such person or Montgomery, McCracken, Walker & Rhoads, LLP. *Nonprofit Issues* ® is published regularly by Nonprofit Issues, Inc. It is available (in electronic format) by subscription for $129 per year for nonprofit organizations, and $164 per year for others. Multi-year, group discounts and site licenses are also available.

Nonprofit Issues ®
P.O. Box 482
Dresher, PA 19025-0482
Phone (215) 542-7547
1-888-NP-Issue
Fax (215) 542-7548
E-mail
info@nonprofitissues.com
www.nonprofitissues.com

House Tax Bill Would Significantly Affect Charities

National organizations say it would reduce incentives for charitable contributions

The "Tax Cuts and Jobs Act" (H.R.1) introduced by the Republicans in the House of Representatives contains a series of specific provisions that would affect charitable organizations but has drawn most of its criticism from national charitable organizations for its apparent impact in reducing the economic incentives for charitable giving and for partially repealing the "Johnson Amendment" to permit churches to engage in political activity.

The National Council of Nonprofits, the Independent Sector, and the Council on Foundations have all come out in opposition to the bill. The Council on Foundations says it "fails to enhance" the culture of charitable giving. The Independent Sector says it would "shift resources from charities and our communities to the wealthiest Americans." The National Council of Nonprofits says the decrease in the number of taxpayers who would itemize their deductions would decrease charitable giving by up to $13 billion annually.

The bill proposes to nearly double the standard deduction for individual taxpayers so that about 95% would no longer need to itemize deductions. It does not include a "universal deduction" advocated by national organizations to give a tax incentive for all taxpayers to make charitable contributions.

It also immediately doubles the exemption from the federal estate tax from about $11 million per couple to about $22 million per couple and repeals the tax altogether after six years. Many experts predict that the loss of estate tax will substantially reduce the bequest giving to charities. The House estimates that the bill will overall increase the national deficit by $1.5 trillion over 10 years, thus causing all taxpayers to fund the borrowing that will give most of the benefits to the wealthiest taxpayers and large corporations.

The bill would essentially repeal the Johnson Amendment prohibiting charities from engaging in political activity in support of or in opposition to candidates for public office. The actual bill available on the House website applies to all 501(c)(3) organizations, although the version released by the committee chair applies only to churches and their integrated auxiliaries that do not have to file for recognition of exemption. A charity would not be deemed to have intervened in a political campaign "solely because of the content of any statement made in the ordinary course of carrying out their exempt purposes

and with no more than “de minimis incremental expenses.” The church provision in the chairman's version would apply to "any homily, sermon, teaching or other presentation made during religious services.”

Long requested by some religious leaders, the provision has been opposed by others for injecting religion into politics and for providing not only another opportunity for undisclosed “dark money” in politics, but also money that is tax deductible. (See Commentary: “Keep Charities Out of Politics”) The Joint Committee on Taxation estimates that the church provision would reduce federal tax revenues by $2.1 billion over 10 years.

To pay for some of the lost revenue envisioned by the tax cuts, the bill would impose some additional taxes on the charitable sector.

Tax on Executive Compensation. The bill would impose a 20% excise tax on compensation in excess of $1 million paid to any of its five highest paid employees in any year. (Sec. 3803.) The House Ways and Means Committee staff says (incorrectly) that there is no limit on excessive compensation, apparently forgetting the excess benefits tax for unreasonable compensation, and says the proposal is consistent with the limitation on deductibility of executive compensation of C corporations at $1 million. The business corporate provision, however, allows additional performance based compensation, such as stock options, without any limitation on the deductibility. The Committee says that “given that exemption from Federal income tax constitutes a significant benefit conferred upon tax-exempt organizations, the case for discouraging excess compensation paid out to such organizations’ executives may be even stronger than it is for publicly traded companies.” (Does this mean that college football coaches can't earn more than $1 million a year?) The JCT estimates that the change would increase tax revenues by $3.6 billion over 10 years.

Tax on University Endowments. The bill would impose a 1.4% excise tax on net investment income of private (not public) colleges and universities with at least 500 students and having assets “(other than those assets which are used directly in carrying out the institution’s exempt purpose)” of at least $100,000 per student. (Sec. 5103.) The JCT estimate for this provision is $3 billion from such institutions over 10 years. (The chairman raised cut-off level to $250,000 per student two days after the initial release of the proposal, which would reduce the total estimated revenue.) (See Ready Reference Page: “Congressional Research Service Lists Options to Regulate University Endowments”)

Unrelated Business Income Tax on Research. The bill would provide that research is exempt from unrelated business income tax only if the results of the research are made freely available to the public. (Sec. 5002.) This provision would raise $0.7 billion.

Simplification of Tax on Private Foundations. Present law imposes an excise tax of 2% on the net investment income of private foundations, with an opportunity in some circumstances to reduce the tax to 1% by increasing distributions for charitable purposes. Foundations have long requested simplification of the system. The bill would impose a single excise tax of 1.4% on net investment income in all situations, which the JCT says would increase revenue by less than $50 million. (Sec. 5102.)

Tax on certain fringe benefits. Under current law, tax-exempt entities are situated similarly to taxable entities with regard to providing their employees with transportation fringe benefits and on-premises gyms and other athletic facilities free of tax at both levels. The bill would impose a tax on such benefits from exempt entities by treating the funds used to provide those benefits as unrelated business taxable income. The committee says this would create parity between different types of entities so that one does not have an advantage over the other with regard to recruiting and retaining employees. (Sec. 3308.)

Charitable deduction issues. The bill would make a number of changes with regard to charitable contributions in general. It would increase the percentage limitation on deductibility of cash gifts to charity from 50% of adjusted gross income per year to 60% of AGI, and continue the five year carry-over provision.

It would repeal the provision that permits a charitable deduction of 80% of the amount paid for the right to purchase tickets to college and university athletic events.

It would permit the amount deductible per mile driven in service to a charitable organization to be adjusted for inflation.

It would repeal the provision, seldom used, permitting a donor to dispense with a contemporaneous written acknowledgment of a gift of $250 or more if the organization reported the gift on its annual Form 990 tax return, including the donor's social security number.

In other provisions, the bill would:

Require art museums to be open to the public at least 1000 hours a year to qualify as a private operating foundation.

Require additional reporting with regard to donor advised funds. Because of concerns that some donor advised funds do not make distributions on a regular basis, the bill would require sponsors of donor advised funds to disclose annually their policies on "inactive" funds and the average amount of grants made from their funds.

The Newman's Own exception. Present rules for private foundations prohibit a foundation from owning more than 20% of a non-functionally related for-profit business for more than 5 years (or 10 years with an exemption from the IRS). When actor Paul Newman died, he left his stock in his food company to his foundation so that it was the sole owner and received the profits of the food company. The foundation is running up against the 10 year limit and sought a legislative fix. The bill includes a provision (Sec. 5104) excluding from the excess business holding provision a business wholly owned by the foundation that provides all profits to the foundation within 120 days of the close of the taxable year and is managed by a board of independent directors.

Private Activity Bonds. The Bill would eliminate "private activity bonds" by which many charities are able to finance new construction or rehabilitation of facilities with bonds at tax-exempt interest rates. (Sec. 3601.) It would also eliminate the ability to issue "advance refunding bonds" to obtain a lower interest rate. (Sec. 3602.)

YOU NEED TO KNOW

This bill is a long way from passage and may be significantly modified in the House and particularly in the Senate before it is passed, if ever. But it presents an opening bid for consideration. It also reveals, especially in the limitation on executive compensation provision, the tax on fringe benefit provision, the tax on private university endowments, and the elimination of private activity bonds an especially antagonistic view toward the charitable sector.

Don Kramer's An Electronic Newsletter of "Nonprofit Law You Need to Know"
NONPROFIT ISSUES
www.nonprofitissues.com

Fall 2017

© 2017 Nonprofit Issues, Inc.
Donald W. Kramer
Editor and Publisher
Lisa T. Chatburn
Managing Editor
Virginia P. Sikes
Tax Editor

None of the materials included in *Nonprofit Issues* ® should be deemed legal advice or should be acted upon without prior consultation with appropriate professional advisors. Kramer and Sikes are attorneys with the Philadelphia, PA law firm of Montgomery, McCracken, Walker & Rhoads, LLP. Neither receipt of *Nonprofit Issues* ® nor discussion of any article with its author or anyone associated with *Nonprofit Issues* ® creates an attorney-client relationship between the recipient and any such person or Montgomery, McCracken, Walker & Rhoads, LLP. *Nonprofit Issues* ® is published regularly by Nonprofit Issues, Inc. It is available (in electronic format) by subscription for $129 per year for nonprofit organizations, and $164 per year for others. Multi-year, group discounts and site licenses are also available.

Nonprofit Issues ®
P.O. Box 482
Dresher, PA 19025-0482
Phone (215) 542-7547
1-888-NP-Issue
Fax (215) 542-7548
E-mail
info@nonprofitissues.com
www.nonprofitissues.com

Senate Tax Bill Adds UBIT, Saves Johnson Amendment

Tax would be imposed on royalties, and on organizations for excess benefits

The Senate Tax Bill being considered simultaneously with the House Tax Bill in the Republicans' effort to get something to President Trump by the end of the year, would not modify the Johnson Amendment to allow churches to engage in political activity, but would impose new unrelated business income taxes, deny across-the-board deductions for expenses in generating the unrelated business income, and would impose a tax on organizations involved in excess benefit transactions.

Like the House Bill, the Senate Bill would double the standard deduction for individual taxpayers, which the National Council on Nonprofits estimates would cause individuals without a specific tax incentive to give $13 billion less to charities each year. It would double the limit for imposition of the federal estate tax to about $22 million per couple, but would not phase the tax out entirely as in the House Bill.

The new provisions would impose unrelated business income tax on royalties for use of name and logos, which would hit hard against colleges and universities. It would also change the rule that now allows charities with unrelated business income activities to deduct all expenses in producing that income so that activities with significant losses can shield income from more profitable ones. The Senate proposal would require each type of business activity to be treated individually so that any profitable activity would be taxed.

The other new provision would impose an excess benefit tax directly on the 501(c)(3) or (c)(4) organization involved in an excess benefit transaction, unless the transaction was not willful and was due to reasonable cause. It would reduce the ability to rely on a legal opinion as showing reasonable cause. Present law imposes a tax on the recipient of the excess benefit and on managers who knowingly approve the excess benefit transaction. The new rule would impose a tax of 10% of the excess benefit on the organization as well.

The Bill also expands the definition of "disqualified persons" to include athletic coaches at educational institutions (many of whom would apparently be subject to excise taxes on compensation in excess of $1 million in both the House and Senate bills), and certain

financial advisers to donor advised funds. It would also extend the excess benefit rules to 501(c)(5) labor unions and (c)(6) trade associations.

The Senate Bill would repeal the 501(c)(6) tax-exempt status of professional sports leagues. The National Football League was heavily criticized for having tax-exempt status and reportedly voluntarily gave up the exemption several years ago.

The Senate Bill does not include provisions comparable to the House provisions for exclusion of research income from UBIT, requirements for private operating foundation status for art museums, the Newman's Own provision to allow a private foundation to own 100% of certain unrelated businesses, and additional reporting requirements for donor advised fund sponsoring organizations. (See *Nonprofit Issues®* story.) The Senate Bill would not kill private activity bonds that provide charities the opportunity to borrow at tax-exempt interest rates. It would not change the investment interest excise tax provision for private foundations or the mileage reimbursement provision for charity volunteers.

The Bill parallels the House bill in imposing a 1.4% excise tax on large college and university endowments, an excise tax on executive compensation of more than $1 million, denial of deduction for payments in exchange for seating rights at college and university sporting events, and increasing the allowable deduction for cash contributions to 60% of adjusted gross income each year.

If each house of Congress is able to pass its own bill, the differences will have to be worked out in a Conference Committee.

YOU NEED TO KNOW

There is still a long way to go before any of these provisions are enacted. Charities concerned with specific provisions of the bill, or the proposal to increase the national debt by $1.5 trillion to provide tax cuts to high income earners and corporations over the next 10 years, should make their views known to their members of Congress.

READY REFERENCE PAGE

NO. 136
FOR YOUR FILE

Commentary:

Keep Charities Out of Politics

Don't put more "dark money" into elections —and make it tax-deductible

President Donald J. Trump has promised to "destroy" the so-called "Johnson Amendment" that prohibits 501(c)(3) charities from participating in election campaigns. Several Republicans in Congress have introduced bills to do just that.

And yet, the National Council of Nonprofits, the Independent Sector, the Council on Foundations and many operating charities have taken strong positions against a change. Is this an issue that makes much of a difference? Is it really something to get worked up about?

We think it is. It would undermine the trust in the charitable sector and make them less effective in pursuing their missions. But equally important, it would put more unaccountable "dark money" into our political system —and make it *tax-deductible!*

The impetus to eliminate the prohibition has come primarily from religious organizations that argue that their freedom to promote their religious views is impaired by not being able to support candidates who will promote their views in legislation and oppose those who won't. But the principal legislative proposals presently pending in Congress do not limit the change to churches and other religious organizations. They cover all organizations exempt under Section 501(c)(3).

There are many reasons important to the charitable sector for keeping the current limitation in place. It has been effect for more than 60 years, and, as described by the National Council of Nonprofits, "has a proven track record of working well to protect against politicization."

Ironically, a provision that was allegedly passed to protect politicians like Lyndon Johnson from attack by charities is now being defended as a provision to protect charities from an onslaught by politicians.

Charities like the rule because it protects them from demands by candidates for campaign contributions that would divert limited funds from mission-related work. Many charity leaders want to avoid appearing partisan because they know that their issues are likely to outlast any incumbents in office and they want to be able to deal with all elected officials on the basis of the public interest, not narrow political interest. They recognize how hard it might be to get a sympathetic audience with someone they had unsuccessfully opposed in the last election.

They view their nonpartisan role as a "safe haven" in a sea of partisan rancor, where parties of all beliefs can work together to resolve community problems. Some point out that public trust in charities is usually higher than the public trust in politicians.

They recognize that the Tax Code allows them to advocate on issues, and also allows individual officers or directors of charities to endorse or oppose candidates on their own time and in their private capacity. But the organizations try to avoid the partisan taint that would come with putting the organization behind or against specific candidates.

There would be even broader implications for our society if the rule were to be repealed, however. It would allow more unaccountable "dark money" in politics and would make it tax-deductible, unlike any other political contributions.

One of the pending bills (H.R. 172) would eliminate the restriction entirely. Two other bills (S. 264 and H.R. 781) would provide that an organization would not be deemed in violation of the prohibition if a statement is made "in the ordinary course" of "regular and continuing activities" and requires "not more than *de minimis* incremental expense."

If the provision were eliminated entirely, it would have a significant impact on politics in the country. We have already seen the rush of political money into 501(c)(4) social welfare organizations since the Supreme Court's decision in the *Citizens United* case allowed corporations to spend unlimited amounts of money in political campaigns so long as it is not coordinated with a candidate. This rush of money is not because (c)(4) organizations don't have to pay tax on their income. Political parties and political action committees are likewise exempt. The rush is because (c)(4) organizations do not have to reveal the names of their donors.

As a result, this kind of "dark money" is totally unaccountable and not subject to the disclosure requirements for candidates, political parties and political action committees. The IRS has not even ruled on the question of how much political activity is permitted within the social welfare exemption (See Ready Reference Page: "IRS Proposes New Regulations for 501(c)(4) Social Welfare Organizations") and was prohibited by Congress from making such a ruling before the last election. (See *Nonprofit Issues*®, 1/1/16)

If charities are released from their prohibition on participation in political campaigns, they are likely to see a flood of new unaccountable money, not only because the donors don't have to be disclosed to the public, but also because the "charitable" contributions to 501(c)(3)s would be tax-deductible, unlike contributions to (c)(4)s and political organizations. It would be a seismic change in our tax policy of keeping tax-deductible charitable money entirely separate from non-deductible political money. The opportunities for abuse, through the creation of new "charities" or the capture of existing ones, would be huge.

The potential for abuse with churches is even greater. "Churches" don't have to obtain recognition of exemption from the IRS. Anyone can create a church and claim exempt status without the IRS even knowing that it exists. In addition, churches don't have to file tax returns of any type. At least with (c)(4)s, we have some idea of the total amount spent on political activities to the extent that they accurately report on their Form 990 tax returns. We are unlikely to ever know anything about the extent of political activity of a church. They have no reporting requirements at all.

The bills permitting statements in the ordinary course of regular activities are not a whole lot more protective. They would be almost impossible to administer. Every activity would become an opportunity for supporting or opposing candidates, undermining all of the reasons charities like to be non-partisan. "Regular" activities could be amped up during election season. The increased activity could be funded with tax-deductible charitable contributions and would presumably be okay so long as making a political statement didn't cost significantly more than making a non-political statement. The IRS certainly doesn't have the personnel to police this effectively. With churches, it would be almost impossible to tell whether a political statement cost any more because they don't have to disclose their costs.

The proposals to eliminate the prohibition on charitable participation in election campaigns may sound benign. But they would seriously undermine the long-term trust, and therefore effectiveness, of charities, and would significantly and adversely affect our political system.

Don Kramer's An Electronic Newsletter of "Nonprofit Law You Need to Know"
NONPROFIT ISSUES
www.nonprofitissues.com

January 2017

© 2017 Nonprofit Issues, Inc.
Donald W. Kramer
Editor and Publisher
Lisa T. Chatburn
Managing Editor
Virginia P. Sikes
Tax Editor

None of the materials included in *Nonprofit Issues* ® should be deemed legal advice or should be acted upon without prior consultation with appropriate professional advisors. Kramer and Sikes are attorneys with the Philadelphia, PA law firm of Montgomery, McCracken, Walker & Rhoads, LLP. Neither receipt of *Nonprofit Issues* ® nor discussion of any article with its author or anyone associated with *Nonprofit Issues* ® creates an attorney-client relationship between the recipient and any such person or Montgomery, McCracken, Walker & Rhoads, LLP. *Nonprofit Issues* ® is published regularly by Nonprofit Issues, Inc. It is available (in electronic format) by subscription for $129 per year for nonprofit organizations, and $164 per year for others. Multi-year, group discounts and site licenses are also available.

Nonprofit Issues ®
P.O. Box 482
Dresher, PA 19025-0482
Phone (215) 542-7547
1-888-NP-Issue
Fax (215) 542-7548
E-mail
info@nonprofitissues.com
www.nonprofitissues.com

Failure to follow bylaws invalidates corporate action

The failure to follow specific provisions in the bylaws of a church has led to more than six years of litigation and the invalidation of the actions purportedly taken on behalf of the corporation. The Supreme Court of Idaho has reversed a trial court and held that a new pastor was not properly selected and that a special meeting of members at which new directors were elected was improperly called and ineffective.

The New Life Missions church was formed in 2001, but was administratively dissolved in 2009 for failure to file an annual report with the Idaho Secretary of State. A woman acting as secretary/treasurer filed an application for reinstatement, which was approved. The application said that James Tapani was president/senior pastor and that the board consisted of Karen Kemmer, Ruth Smith, Duane Kemmer, and Tim Dolph.

In February 2010, Tapani resigned as senior pastor. The board met and asked if Bob Newman would be interested in serving. He indicated he would be willing to do so. Although the bylaws set forth an elaborate procedure for selecting the senior pastor, including ultimately a vote of the membership, the board did not follow the procedure. Newman nevertheless functioned in that role.

Shortly thereafter, members of the board met with leadership of another church to consider a merger. Duane Kemmer made statements to several, including Newman and Smith, that he no longer wanted to be on the board, but nevertheless attended several subsequent board meetings. Dolph told members of the church about the proposed merger and left the meeting when a member did not react favorably. Thereafter, Smith, acting on her own, called a special meeting of the members who elected new directors to replace Kemmer and Dolph. Dolph and the two Kemmers filed suit.

The trial court decided in 2014 that the meeting was properly called because Duane Kemmer and Dolph had "resigned and/or absented themselves" as directors and that Newman had been properly appointed senior pastor by the board. The Supreme Court has reversed.

The Supreme Court pointed to the elaborate procedure included in the bylaws for filling a vacancy in the position of senior pastor. It provides that the board will consider candidates and that qualified candidates will "present themselves to the voting membership." Af-

ter the "voting membership" had a chance to review all candidates set forth by the board, a special meeting was required to vote on the final appointment.

"There is no evidence that Newman was ever voted on by the membership," the Court wrote. "Rather the only evidence is that Newman was asked if he was interested in being pastor … and replied in the affirmative." That was not sufficient evidence to show that he was properly appointed, it said.

On the resignation of Kemmer and Dolph from the board, the Court noted the bylaw provision that a director may resign at any time "by delivering written notice" to the board, the president or the corporation. Therefore, it said, although a director may resign at any time, "the exclusive method for doing so" is by written notice. Since there was no written notice, they had not resigned and Smith had no unilateral authority to call a special meeting of members.

The Court also pointed out that no membership roster had been maintained by the church even though required in the bylaws. Therefore, the meeting could not have been called by two-thirds of the voting membership. (*Kemmer v. Newman,* Supreme Ct., ID, No. 42566, 12/30/16.)