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Incorporation of Churches in Virginia: A New Day and Law

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Prior to the recent decision in *Falwell v. Lynchburg and the Commonwealth of Virginia* (*W.D. Va. 2002*), Virginia churches were not permitted to incorporate, under Virginia Constitution Article IV, § 14(20), which states, “The General Assembly shall not grant a charter of incorporation to any church or religious denomination.” This Virginia Constitutional provision was in part based on Thomas Jefferson’s Virginia Declaration of Rights that was adopted in the summer of 1776, which provided strong religious liberties for all people and all sects by stating, “The General Assembly shall not prescribe any religious test whatsoever or confer any peculiar privileges or advantages on any sect or denomination, or pass any law requiring or authorizing any religious society to levy on themselves or others any tax... in support of any church or ministry, but it shall be left free to every person to select his religious instructor...” Virginia Constitution AM.ART I § 16. **Now, the Virginia General Assembly has modified most of the laws on the books to better integrate church corporations into Virginia substantive law effective July 1, 2005.**

1. *The Benefits of Incorporation*

Prior to the *Falwell* case, Virginia and West Virginia were the only two states in the United States where churches and religious denominations could not incorporate. Thus, Virginia churches were unincorporated associations, which status subjected their members² and particularly their leaders, such as the pastors and boards, to all forms of liability and precluded a church’s ability to hold title to its property. There are many forms of liability where either an insurance policy does not cover the acts upon which a lawsuit against a church is based, or its coverage is limited. A Board of Directors (elders, deacons or pastors) could be personally liable for the liabilities that were essentially against the church. There were cases where a pastor, deacon or elder has suffered greatly

² Under VA Code §8.01-220.13 members of any church, synagogue or religious body shall not be liable in tort or contract for actions of any officer, director, employee or other member of such church solely because of membership. VA Code § 8-220.1.1 provides some limited immunity for volunteer officers, trustees and directors of 501(c)(3) tax exempt organization and limits liability in some cases for paid Directors & Officers to 1year salary and benefits.

due to this unincorporated association status and the imposed personal liability for the grossly negligent or reckless acts of the church or its officers, directors or agents.

Benefits for Church Incorporation include:

- 1) Incorporation will substantially limit liability of the Pastor(s), Board and members, providing a sure liability shield, provided the church board is not ‘grossly negligent’.
- 2) Incorporation often makes it easier for a church to buy, sell, and encumber real estate, operate bank accounts and engage in other business transactions.
- 3) Under the new law, trustees no longer will be needed to hold church property and court approvals for purchase, sale and encumbrance of church corporation property will no longer be necessary.
- 4) Incorporation protects the corporate name in Virginia and eases trade name registration and trade marking the name where appropriate.
- 5) Incorporation also lends to stability of an organization more so than an unincorporated association, since the members, directors, trustees, and officers of a church change over the years.
- 6) Churches must be incorporated to receive grants through government faith-based social service provider programs or private foundations.
- 7) Incorporation and tax exemption can often permit special nonprofit mailing rates and procure discounts from vendors.
- 8) Finally, some banks and lending institutions prefer to deal with an incorporated entity to assure its governance, purpose and legal status.

Even after the *Falwell* case, churches in Virginia need not be incorporated to be exempt from federal income tax. However, at least one court has observed that, “while not a prerequisite for exemption, a showing that an organization seeking a property tax exemption is incorporated as a church or religious association will lend credence to that organization’s claim that it is a *bona fide* church or religious organization”. Other than ill-placed theological concerns concerning separation of church and state³, the primary downside to incorporation may be the requirement that an informational report (Annual Report and a nominal fee must be paid annually to the State Corporation Commission (SCC) or suffer the loss of its non-profit corporate status.

2. *Process of Incorporation*

While the process of incorporation of churches and religious denominations remains somewhat unclear since the *Falwell* decision and SCC church incorporation process is relatively new, it would be understandable that the Virginia Non-Stock Corporation Act

³ Another concern may be the time involved in changing all legal documents (deeds, titles, bank accounts, loans, etc.) to reflect the new incorporation states. However, the word ‘incorporated or Inc.’ does not need to appear on stationery, checks, church signs, etc. and at this point a name change to Church Inc. will suffice for other legal documents. Some church leaders also believe incorporation makes a church more liable to government regulation. Church law expert Richard Hammar disagrees: “That argument fails to distinguish between the church as a corporate entity and the church as the Body of Christ. Any church that incorporates is not subservient to the state but provides advantages to its members and leaders.”

(Code of Virginia §13.1-803 *et. seq.* 2002 Supp.) may be applicable, since at present there is no special incorporation for religious corporations. It appears that the Virginia Non-Stock Corporation Act (the “Act”) is modeled after the Revised Model Non-Profit Incorporation Act that has been adopted by many states across the country. However, since the right to incorporate came through judicial ruling and not Constitutional or statutory revisions, all of the prior laws applicable to churches, incorporated and unincorporated, have remained unchanged until the passage of Senate Bill 1267, effective July 1, 2005, which will be addressed more in-depth in the FAQ section.

The general procedure for incorporation consists of the initial following steps: (1) preparation of duplicate Articles of Incorporation setting forth the Corporation’s name, period of duration, registered agent and address within the state, registered office address, purposes and names and addresses of the Board of Directors and incorporators; (2) the signature(s) of the incorporator(s); and (3) submission of the Articles of Incorporation with the prescribed filing fee of \$75.00 to the Secretary of State.

After approval by the Secretary of State, the SCC issues a Certificate of Incorporation. The church’s corporate existence begins the moment the Certificate of Incorporation is issued. However, after a Certificate of Incorporation is issued, the Act specifies that an organizational meeting of the Board or congregation (depending on church government) shall be held at the call of the incorporator(s) for the purpose of adopting the initial Bylaws and Constitution of the Corporation, accepting members from the unincorporated entity to new church incorporation, confirming Directors and Officers, authorizing new bank accounts and changing legal documents to reflect corporate status (See my article entitled ‘**New Church Corporation Law-The Real Power is in the Bylaws and Policies**’), and such other purposes as may come before the meeting. After reviewing hundreds of Constitutions and Bylaws over the past years, we have concluded that it is imperative that Constitutions and Bylaws be reviewed and amended for legal compliance, governance changes, updated to conform to current church practice and best practices of risk management.

Some of the typical provisions in the Articles of Inc. will be whether the Corporation is to have members or not, the right of the members to vote, statement of the manner in which directors shall be elected, appointed or designated, statement of the tax-exempt purposes and limitations, and the powers of the non-profit tax-exempt corporation, as well as a statement of what happens upon dissolution. While some of these provisions are mandatory and others are permissive, it is essential that a number of the provisions, including the tax-exempt provisions, be strictly adhered to, to both protect and promote the corporate status and powers.

3. *Frequently Asked Questions*

Q. Who should serve as the Church’s Registered Agent?

A. Ideally, the Incorporator and Registered Agent should generally be a member of the Virginia Bar since Virginia Law provides for that qualification and most, if

not all, of the papers which will be delivered to the registered agent will be legal in nature. Some documents, such as lawsuits and Annual Reports, will contain important deadlines that could incur significant liability on the part of the church if not met. To minimize the chances of important legal papers being lost, the registered address of the church should be a law office or other location with a system in place for recording all incoming mail and facsimiles. Churches may designate their own registered agent or Simms Showers, LLP can provide this service for an *annual fee* of \$200; If the registered agent is not a Virginia licensed attorney, he or she must be a director of the corporation and the registered address must be the same as the individual's business address.

Q. What is an organizational meeting?

A. After incorporation, every new corporation is required by law to hold an Organizational Meeting at which officers are elected, the Bylaws are formally adopted, and other powers and policies are authorized for the new corporation and/or officers. Depending on the form of church governance and possible resistance to incorporation, upon request, the author will either schedule a phone conference with the directors of the church corporation after the Certificate of Incorporation is received, and the Bylaws and Constitution are redrafted and/or send a sample agenda and minutes for a congregational meeting to be conducted.

Q. Who should serve as the Directors of the Corporation?

A. Typically, it is wisest to simply designate the Church's current governing Board (Leadership Team, Church Council, Elders or Deacons) as the Directors of the new church corporation. This avoids extra meetings and confusion, since it allows most of the duties and responsibilities of the governing individuals to remain the same.

Q. Is it necessary to revise the Church's Constitution and Bylaws after incorporation?

A. *Absolutely Yes.* In incorporating many Virginia churches over the years, the author has found that all churches' Constitution and/or Bylaws are either outdated, legally inadequate or inconsistent with the new Articles of Incorporation. In order to ensure legal compliance and clear, best practices for operating the church, Simms Showers strongly advises that a church revise its Constitution and/or Bylaws at the time of incorporation. Moreover, some revisions of such Constitution and Bylaws can be contentious but incorporation provides an excellent reason to finally solve these problems. The organizational meeting provides a good opportunity to adopt these new governing documents.

Q. Does the Commonwealth of Virginia require an annual report after a church is incorporated?

A. Yes. Every year the State Corporation Commission will mail to your registered agent an Annual Report form containing the name and address of the corporation, registered agent's name and address, and the names and addresses of the officers and directors. Updates to the information on record can be made at that time.

Q. Is there an annual fee to keep the Corporation's status active?

A. Yes. Currently, the annual fee to remain active with the State Corporation Commission is \$25.00. This fee is submitted along with the Annual Report form.

Q. What is the best way to introduce the new bylaws, constitution and new members' covenant for members of the old unincorporated church?

A. Treat the Organizational Meeting as a Charter Celebration and have the members sign the members' covenant as Charter Members. The more positive the process and celebration, the easier it will be received. Inclusion about the Bylaws changes generally will serve you better than exclusion, so treat the process as you would if you amended the Constitution or Bylaws as to the information flow to the congregation. Also, explain that the 21st Century brings new challenges and risks and these new Bylaws and Member Covenants best meet the increasing 21st century risks of the church.

Q. Do we have to change the legal documents (deed, mortgages, bank accounts etc.) after we incorporate our church?

A. Yes. With the passage of SB 1267 as described below, which became effective July 1, 2005, under amendments to Virginia General Statutes Sections 57-8 and 57-10, Trustees are no longer required for church corporations to hold, manage buy, sell, encumber or transfer real property and court appointment of such trustees are obviously no longer required. Thus, upon incorporation being finalized (Constitution and Bylaws revised and Organizational Meeting held) Trustees may now transfer real and personal property to the new incorporated church without the need for court approval by simply sending a transfer deed or letter of transfer property to the clerk of the county court where the property is located with instructions to transfer to the new church corporation. See new Section 57-16 for further instructions or contact a knowledgeable church law attorney or the author to assist with this process.

Q. What are the significant law changes with the passage of SB 1267 that became effective July 1, 2005 as to church corporations?

A. Under Section 57-8, trustees are no longer needed for church corporations and court appointment of such trustees is not required to hold, manage, buy, sell, transfer or encumber real property of the church corporation. Of course, church corporations may still authorize trustees to have that legal authority with the church members' approval or it can delegate it to one of its Officers or Directors. Unincorporated churches, however, must comply with all the old law provisions requiring court approvals for appointment of Trustees and buying, selling, encumbering or transferring land to another entity (other than the new church corporation).

Under Section 57-10, real or personal property for church corporations no longer need to be held by trustees but can be held in the name of the church corporation or a separate property holding nonprofit corporation under the new section 57-16.1. Further, pursuant to 57-15(B), church trustees may now transfer real or personal property to the incorporated church without need of court approval. If no petition opposing this semi-automatic transfer is filed within one year of recordation of the trustee's deed transferring property, it shall be conclusively presumed that the transfer was made in accordance with the church's polity insofar as a good faith purchaser or lender is concerned.

Under Section 57-15(C), each transfer will not accelerate any indebtedness and all transfers of real property shall be entitled to the exemptions set forth in § 58.1-811. All insurance policies connected to property transferred shall be contemporaneously assigned to the incorporated church at the time of transfer (57-15(D)). Section 57-15.1 states that a treasurer or other fiscal officer may sign a note, deed of trust, or mortgage on behalf of a church without incurring any personal liability.

4. *Conclusion*

The author has devised a simple incorporation questionnaire and retainer document for churches and has agreed to incorporate churches at a reduced fixed fee, plus filing costs, upon completion of the questionnaire and providing the requested documents. Incorporation also provides a great opportunity for churches to revise, update and make its Constitution and Bylaws legally compliant and more workable from a governance point of view. Due to the many requests of the author and his firm to both incorporate and review and revise the Constitution and Bylaws of churches, we have agreed to complete the entire process for a reduced fixed fee, plus any expenses (please see the Questionnaire for the actual fee). If the church wishes to retain the author and his law firm to do such work or any other church or tax-exempt law-related work, the church may contact him at the following address:

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We would consider it a privilege and a pleasure to incorporate your church under this new fairly new law, bring your Constitution/Bylaws up to date, into legal compliance and using the best risk management practices to help your church or religious ministry in any other way that you need. We have devised an easy-to-use Church Incorporation Questionnaire for a church to fill out and return with the requested documents, fees and costs to facilitate this process.

Legal Disclaimer: *This Article and related material have been prepared specifically for churches seeking to incorporate in the Commonwealth of Virginia. It is not meant to provide legal advice or substitute for competent legal counsel that can address the specifics of each church. Any reader is encouraged to seek appropriately trained and experienced professional legal counsel who specializes in tax exempt and church law prior to taking the step of incorporating and redrafting governing documents and policies for legal compliance and risk management.*

Attachment: Virginia Church Incorporation Questionnaire

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