III. What is a Corporation?

It is essential to understand basically what a corporation is, and particularly a non-profit corporation.

A. HISTORY AND LEGAL IDENTITY

Historically, corporations were developed not only to limit liability among investors, but to provide a mechanism for broad ownership (through stockholders, which are analogous to members) and yet provide for management in a smaller, more select group, usually called directors.

The directors are the managers of the corporation. The stockholders are the owners. One of the unique features of a business corporation is that usually (though not necessarily) the stockholders/owners are not the active managers. They elect the directors, but once elected the directors provide the leadership. Thus it is often said that in a corporation, ownership is separated from management.

A corporation is a legal fiction. It is treated by the law as a separate legal entity from its members and those who manage or otherwise participate in its activities. Unlike an association, it is not simply a collection of individuals. It is rather a new individual. Thus corporations, unlike associations, have had no problems owning property, entering into contracts, suing and being sued -- all in their own name. Since the corporation is a "person" on its own, it can do the things that individuals could do.
B. NONPROFIT CORPORATIONS

1. Distinctives of a nonprofit corporation

Nonprofit corporations are, like their business counterparts, separate legal entities/persons. The difference between a nonprofit corporation and a business corporation is not in their legal characteristics, but in their purposes. This is illustrated in the definition provided in the North Carolina statutes:

"Nonprofit corporation" means a corporation intended to have no income or intended to have income none of which is distributable to its members, directors, or officers. . . 28

The term "nonprofit" may be misleading. The words "intended" and "distributable to its members. . . ." in the statute are critical. Nonprofits are not prohibited from making a profit. Many nonprofit corporations are very successful financially, and their income may greatly exceed their expenses. They may operate businesses which are very profitable. They may even "make money" from investments, rents, royalties.

The limits on the "profit" aspect of a nonprofit corporation are that it is not organized for the purpose of making a profit, and the profits it may make do not go to the members or corporate leadership. A nonprofit corporation cannot, after a good year, divide up the excess funds among its members, nor can it distribute them to its directors. 30

KEY: The restrictions are on the INTENT in regard to profit, HOW you make a "profit," and how you USE it, not IF or HOW MUCH you make.

2. Types of nonprofit corporations

There are a wide variety of nonprofit corporations. They range from small charities to large, multi-billion dollar foundations. One major division with important legal implications is the distinction between public benefit nonprofits, and private nonprofits. 31

Public benefit corporations are enterprises like charities and churches whose purposes are to serve more than just their own members. Other types of nonprofits include private enterprises like social clubs, fraternities, and unions where the purposes are more directed to the members than a public charitable purpose.

The Internal Revenue Service in its regulations dealing with tax exempt organizations, provides separate IRS categories for many different kinds of tax exempt, nonprofit bodies. 32

Main types of nonprofits include charitable organizations (religious, educational, hospitals and civic groups), social organizations (fraternal organizations, clubs, mutual benefit societies), political organizations; trade associations (unions, chambers of commerce, employee associations, manufacturer's groups), and governmental associations.
Fortunately, the complexities of different types of nonprofit corporations and the legal implications for each are not immediately relevant to churches. Generally, churches whether incorporated or not, are accorded the most favorable treatment of all to both by state law and federal taxing agencies.

C. GOVERNING CORPORATION LAW

While federal law, and particularly the Internal Revenue Code, is very central to an analysis of tax exempt questions related to nonprofits, the actual legal status as a nonprofit corporation is governed by state law. One incorporates within a particular state and the law of that state governs.

Thus, churches in North Carolina which consider incorporation would look to the North Carolina statutes. North Carolina in 1966 adopted a Nonprofit Corporation Act, modeled in part after a Model Nonprofit Corporation Law developed by the American Bar Association and American Law Institute. The North Carolina governing statute is North Carolina General Statutes, § 55A.

The statute is not complex, nor does it, as some states such as New York, divide nonprofits in different groups with different applicable statutes. There is one basic nonprofit corporation law, regardless of the particular type or purpose of the corporation.

Any Nonprofit Corporation Act will contain the primary elements which would be of most concern to any church considering incorporation:

1. What are the conditions for incorporation?
2. What duties and rights do corporations have?
3. What structural requirements are imposed?
4. What procedures are required to incorporate?

1. What are the preconditions for nonprofit corporate status

Nonprofit corporations may be formed in North Carolina "for any lawful purposes." There are no limits on who may form corporations, nor for what purposes except the requirement of lawful purposes and the completion of the procedural requirements discussed below.

The only effective limit is that the corporation be, in fact, nonprofit in the sense already noted. Since most local churches rarely engage in activities which raise questions regarding their nonprofit status, the only remaining conditions are complying with the procedural requirements set forth in the statute for incorporation.
2. What are the Legal Duties and Rights of Corporations?

North Carolina is a rather “friendly” environment for nonprofit corporations. Nonprofit corporations may form for any “lawful purposes,” and relatively few duties are imposed, in spite of a national trend to increasingly oversee such corporations, particularly those engaged in substantial fundraising and charitable activities. The Nonprofit Corporation Act, the following duties are noted.

a. A duty to secure the corporate charter through lawful means

The corporate charter is basically the grant of corporate status by the state, and the duty is to acquire this lawfully; that is, by following the prescribed procedures, and not fraudulently completing the application.37

b. A duty not to exceed or abuse its corporate authority

That is, the corporate charter will note the purposes of the corporation, and the corporation must live within its own stated purposes. The corporation must not only not exceed the powers that are granted by the corporate charter, but must not abuse the powers it does have.

c. Appoint and maintain Registered Agent in the state

The statute38 requires that

Each corporation shall have and continuously maintain in this State: (1) A registered office . . . (2) A registered agent . . . having an office identical with such registered office.39

The purpose of this requirement is so that the state or other party who seeks to give notice to the corporation, such as in a lawsuit, will have public notice of who is an agent of the corporation and who may be served with papers.

The registered agent’s name and address are matters of public record and provide a legally authorized means of communicating with the corporation. While in the case of churches, it is usually easy to locate them, some nonprofit corporations might not be so easily located, perhaps not even having an office. Officers and directors may change frequently and the public or government agencies might find it difficult to identify who is in charge. Thus the registered agent requirement.40

Any person may serve as the registered agent including an attorney, church official or corporation. It ought to be a person who would promptly notify the church of any communications received as their agent, and someone whose address is likely to remain the same so that the church does not have to file notice of changes frequently. Some churches have used their church office as the registered address and the pastor as the agent. If this is done, it is necessary when pastor’s change to file such notice of the new agent with the Secretary of State.
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d. Maintaining Records

(1) Records which must be retained under the statute.

The statute provides that

"Each corporation shall keep correct and complete books and records of account and shall keep minutes of the proceedings of its members, board of directors, and committees having any of the authority of the board of directors. It shall keep at its registered office or principal office in this State a record of the names and addresses of its members entitled to vote and may keep all other books, records, and minutes without this state.

(2) Church records which ought to be maintained

In order not only to comply with the legal requirements for maintaining corporate records, but to exercise good stewardship and management, churches should carefully maintain accurate and up to date records of at least the following:

(a) Complete books of financial accounts (budgets, receipts, expenditures, bank statements, donor records, audit reports, etc.)

(b) Minutes of all meetings at which the church's business is conducting, including meetings of members and any governing committees or boards such as Deacons, Directors, etc. The minutes should include the date, persons present, notice of approval of previous meeting's minutes, elections or appointments, reports given, resolutions proposed, resolutions adopted, and the vote approving or rejecting any proposal. They may, but need not necessarily, include a general overview of the discussion regarding certain items of business.

(c) Current list of voting members

(d) Charter (Articles) and Bylaws with any amendments

(e) Business correspondence (contracts, agreements, proposals, guarantees, insurance policies, warranties, employment agreements)

(f) Legal papers regarding property, vehicles, licenses, etc.

(g) Government records file (copies of reports to state and federal agencies such as Social Security Tax reports, W-2 and withholding filings, etc.)
(3) What records must be open to members?

The statute provides in part that

"All books and records of a corporation may be inspected by any member, or his agent or attorney, for any proper purpose at any reasonable time."\(^{42}\)

This would include general church financial reports, church documents such as the Charter and By-laws, and minutes of meetings of members, boards or committees charged with the management of the church.\(^{43}\)

It is unclear precisely the scope of this right, except by analogy from cases construing similar provisions in the Business Corporation Act.\(^{44}\) It seems clear that certain records are automatically open to inspection, but other materials such as correspondence and internal office memorandum would depend on the specific situation and whether the proposed inspection would relate to "a proper purpose."

Certain records such as personnel records would not generally be open to member inspection. Some highly confidential and privileged records such as counseling folders would not be open to member inspection.\(^{45}\)

e. Complying with court orders for the production of records

This duty simply requires that corporations comply with court orders regarding the production of corporate books and records in connection with any investigation or proceeding.

f. Reporting requirements

North Carolina presently requires no annual or periodic reports except as noted above to report a change in registered agent/address, or as noted below, where the charter (Articles) is amended.

The Model Nonprofit Corporation Act upon which North Carolina's act was modeled did provide for annual reports to the Secretary of State noting corporation activities and providing financial summaries. The basic purpose behind such reporting was to assure continued non-profit status. The North Carolina Act, however, omitted those reporting requirements.

It is clear that there is some trend nationally toward financial reporting. Should the North Carolina Act be amended to provide for reporting, it might or might not include churches and religious nonprofit corporations within the reporting requirements.\(^{46}\)
3. What are the consequences for a failure to perform these duties?

The ultimate sanction against a corporation for failure to comply with the law and perform its legal duties would be the involuntary dissolution of the corporation. Such action is very rare, and the statute provides in most cases that the Secretary of State must provide notice to the corporation of its deficiencies so that it may correct the errors before any action to dissolve the corporation is taken. The statute provides that

A corporation may be dissolved involuntarily . . . when it is established that the corporation procured its charter through fraud, or . . . has, after written notice by the Attorney General at least 20 prior thereto, continued to exceed or abuse the authority conferred upon it by law . . . or . . . has, after written notice . . . failed for 30 days after change of its registered office or registered agent to file . . . a statement of such change . . . or has without justification refused to comply with a final court order for the production of its books, records or other documents.47

Notice that except for those situations where the Charter has been obtained through fraud, no action is taken against the corporation for failure to comply with the statutory duties until the corporation has been notified and given an opportunity to respond, and presumably correct the deficiencies.

4. What structures are required of nonprofit corporations?

As will be noted more thoroughly in the section dealing with Articles of Incorporation and Bylaws, there are some minimal requirements related to the management structure of the corporation. Essentially, the statute requires that there be a management group, usually referred to as "directors," and that there be some officers. Where there are members, there rights and duties must be spelled out.

These requirements seem only obvious and seem to pose no special problems for churches. The details are discussed below.

5. What procedures must be followed to incorporate?

This is the subject of the next section.
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Notes

26 In most cases where the law provides rights to persons, that would include legal persons, such as corporations.

27 Some states and writers use the term "not for profit" rather than "non-profit." The former terminology may be more accurate in its focus on intent rather than result, but the terms mean the same thing.

28 § 55A-2(3).

29 Though they will be taxable on the profits from unrelated business income. See chapter VII below.

30 Even though an association is not bound by the nonprofit corporation laws, if it wishes, to be tax exempt, it must also follow certain basic "nonprofit" requirements which would be imposed by the Internal Revenue Service and state taxing authorities. Remember, tax exemption is a separate question from incorporation. An association can be tax exempt if it meets IRS requirements.

31 Some states, such as New York, provide different incorporation sections for different types of nonprofit corporations based on their purposes. N.Y. Not-for-Profit Corp. Law § 201(b) (McKinney Supp. 1970). Some states provide a special statute for church and/or religious incorporation. For example, see Ohio Rev. Code, c. 1715 (1977); N.Y. Relig., Corp. L., c. 51 of N.Y. Consol. L. (1978 supp.); Nev. Rev. Code, c. 82 (1977).

32 Section 501(c) which deals with certain tax exempt organizations and the rules applicable to different types notes several broad categories: charitable-type (those "organized and operated exclusively for religious, charitable, scientific . . . literary or educational purposes . . ." § 501(c)(3)); title holding companies, social welfare organizations (civic organizations and associations of employees organized for educational charitable or recreational purposes)§ 501(c)(4); labor, agricultural and horticultural organizations, § 501(c)(5); trade associations, § 501(c)(6); Social clubs (organized for pleasure, recreation and other nonprofit purposes), § 501(c)(7); fraternal lodges and benevolent societies, § 501(c)(8); cemetery companies, § 501(c)(13); credit unions, § 501(c)(14)(A); veteran's organizations, § 501(c)(19); and others.

33 A number of states have specific information statutes for churches. These statutes are often designed with the special needs and interests of religious communities in mind.

34 §55A-5.

35 Until the modern incorporation statutes, corporations could only be formed with the direct authorization of the state legislature. For example, the Baptist State Convention of North Carolina was incorporated by an act of the North Carolina legislature.

36 In a few cases, churches have been found to have been engaged in impermissible political activities which voided their nonprofit character. Religious organizations other than churches have occasionally been held to have lost their non-profit status. Note, however, mere loss of tax exempt status does not mean one would lose the non-profit status.

37 Fraud might consist in concealing a profit motive, or misrepresenting the real purposes or the identity of the directors or registered agents.

38 § 55A-11.

39 Other provisions: § 55A-12 provides for changes in registered agent or office and requires filing with Secretary of State and the county of any such change a statement noting the change in office and/or agent and that such a change was duly authorized by the proper corporate authorities. Registered agents may be persons or other state corporations § 55A-12(a)(2); Registered
agents may resign as such. §55A-12(d) provides for resignation by filing a written notice in duplicate with Secretary of State. Resignation is effective thirty days after receipt of such by Secretary of State.

40 In some states there are companies that act as registered agents for nonprofit corporations, charging a fee for this service. For churches, this would be quite unnecessary.

41§ 55A-27.

42§ 55A-27.

43 Members inspecting such records are permitted to extracts of such records. (Inferring from business corp practice see Robinson, North Carolina Corporation Law and Practice (3d ed.) (1983) §8-5.


45Certain records would fall within the confidentiality of the clergy-penitent relationship.

46 As noted below, the regulations of the Internal Revenue Service which do require that most nonprofit corporations which have been determined by the IRS to be exempt must file annual financial reports, but the regulations exclude churches from this reporting requirement.

47§ 55A-50.