

# Legal Information

## Separate Incorporation



Evangelical Lutheran Church in America  
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### Separate Incorporation: Important issues to consider

While the following discussion deals with schools in particular, it is also applicable to other functions such as day care centers, latchkey programs, food pantries, thrift stores, etc. that may or may not be separately incorporated.

- **Legal liability.** The separate incorporation of the school, provided that it is thereafter operated as an entity distinct from the congregation (i.e., has its own board of directors, its own financial books and records, and in general, operates as a truly separate corporation) will result in the school not being liable for the debts or other obligations of the congregation, and the congregation not being liable for the debts or other obligations of the school. When the school and congregation are operated as one common entity then, of course, each may be liable for the debts and liabilities of the other. Accordingly, while separate incorporation does not necessarily ensure the non-liability for the debts and obligations of the other (because in those instances where, notwithstanding separate incorporation, the two entities continue to be operated as though they were one), separate incorporation at least ensures the opportunity to argue non-liability for the debts and obligations of the other.
- **Insurance.** Procuring proper and complete insurance is a significant issue. It is necessary that, if the school and congregation are operated as separate entities, clear disclosure of this fact is made to the insurance company, and that each of them be named as co-insured on any policy issued to the other.
- **Control.** The school that is not separately incorporated is subject to the direct control of the congregation. When separately incorporated, the school is subject to the control of its own board of directors. Control of the separately incorporated school by the congregation is indirect in that the congregation elects the board of directors of the school, and retains power to approve changes in the governing documents of the school. The congregation, however, is no longer responsible for the day-to-day control issues that the congregation is responsible for where both congregation and school are operated within the same corporation.
- **501(c)(3) status.** The Evangelical Lutheran Church in America (ELCA) churchwide organization has been afforded group exemption privileges by the Internal Revenue Service (IRS). Accordingly, entities that are "controlled or supervised" by the churchwide organization are eligible for inclusion in the group exemption. Obviously, neither the congregation nor the school is controlled by the churchwide organization. However, because congregations are in the ELCA denomination, they meet the criteria for recognition. In

addition, the IRS permits the inclusion of schools, that include kindergarten and above grades, as meeting the criteria of inclusion as part of the Congregation and Synodical Mission unit of the churchwide organization.

- **State regulation.** In many states, schools are subject to a varying degree of regulation by state authorities, whether separately incorporated or not. This frequently requires supplying information for the entire corporate entity that includes the school. Accordingly, separate incorporation of the school may render it more practical and feasible to comply with state regulatory requirements, since this may limit the detail of information about the congregation that may thereby have to be disclosed to the state authorities.
- **Discontinuation of operations.** It is possible that either the congregation or the school could experience financial difficulties which make desirable the discontinuation of one, but not both, of the functions. Where the two functions are conducted in the same entity, the discontinuation of one operation almost inevitably affects the continued operation of the other. However, where the two functions are separately incorporated, it is far easier to discontinue the operations of one of the entities without adverse financial repercussion on the operations carried on in the other entity. It is important to make sure that the governing documents clearly state that if a school or other entity should end operations, the remaining assets would go to the congregation or, if no longer in existence, to an appropriate ELCA ministry.
- **Number of employees.** Certain federal (and perhaps state) statutes are applicable to employers with more than a specified number of employees. For example, the employment provisions of the Americans with Disabilities Act are effective as of July 26, 1992, with respect to private employers with 25 or more employees. On and after July 26, 1994, the same provisions are applicable to private employers with 15 or more employees. (A congregation and its related school are private employers for this purpose.) Where the school is not separately incorporated, the number of employees of the congregation and the school may exceed the threshold number. Separate incorporation of the congregation and school may result in either the congregation or the school, or perhaps both, having less than the threshold number of employees and therefore not being subject to the legislation.
- **Monitoring separate financial records.** If separately incorporated, separate financial books, records and statements must be maintained. Without separate incorporation such separate financial books, records and statements may be separately maintained as a best practice.
- **Securing governmental or other third party grants.** Many governmental agencies and some charitable foundations have policies that preclude making financial grants to congregations as a religious organization. Without separate incorporation such policies may preclude grants for a congregational program that is not separately incorporated. Separate incorporation offers a far greater possibility, but not a guarantee, of being eligible to receive grants.
- **Leases and other agreements.** It is important to have a clearly written understanding of how a school or other entity may be using property, sharing personnel or other resources of the congregation. This is a best practice for

unincorporated entities that are controlled by the congregation, but it is required if there is a separate incorporation.

*This is a list of important issues for a congregation and related entities. It may not be a complete list of all important considerations, depending on the specific facts and needs of the congregations. Congregations should obtain legal and tax advice when making these decisions.*

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