

## **When is it important to establish separate incorporation? Why?**

**This information is applicable to functions such as schools, day care centers, latchkey programs, food pantries, foundations, etc. that may or may not be separately incorporated.**

**Legal Liability.** The separate incorporation of a mission entity such as a school or day care center, provided that it is thereafter operated as a body *distinct* from the church (i.e., its own board of directors, its own books and records, and in general, its operation as a truly separate corporation), will result in that mission entity not being liable for the debts and other obligations of the church, and the church not being liable for the debts or other obligations of the mission entity. When the mission entity and church are operated as one, then of course, each is fully 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 as though they were one), separate incorporation at least ensures the operated opportunity to argue non-liability for the debts and obligations of the others. Without separate incorporation, this argument can not even be made.

**Insurance.** Procuring insurance is not a significant issue, surely not from a cost standpoint. If the entity and church are operated as separate entities, it is necessary that clear disclosure of this fact be made to the insurance company, and that the mission entity and the church be named as co-insured on any policy issued to the other.

**Control.** The mission entity that is not separately incorporated is, of course, completely subject to the control of the congregation. When separately incorporated, the entity is subject to the control of its own board of directors. Control of the separately incorporated entity by the church is indirect, in that the church normally elects the majority of the board of directors of the entity and retains power to approve changes in its governing documents. The church, however, is no longer responsible for the day-to-day control issues that it would be responsible for if both church and mission entity were operated within the same corporation.

**501(c)(3) Status.** The Evangelical Lutheran Church in America (ELCA) has been afforded group exemption privileges by the Internal Revenue Service (IRS). Accordingly, entities that are "controlled or supervised" by the churchwide organization of ELCA are eligible for inclusion in the group exemption. Obviously, neither the congregation nor the mission entity are controlled by ELCA. The congregations are, however, supervised by ELCA, for IRS purposes, because they meet the criteria for recognition. In addition, for schools, the IRS permits the inclusion of schools that include kindergarten and above grades, as meeting the criteria of supervision by the unit for Domestic Mission.

**State Regulation.** In many states, some mission entities such as schools, whether separately incorporated or not, are subject to a varying degree of regulation by state authorities. This frequently requires supplying information for the entire corporate entity that includes the school. Accordingly, separate incorporation of the school or mission entity may render it more practical and feasible to comply with state regulatory requirements, since this may limit the detail of information about the church that may thereby have to be disclosed to the state authorities.

**Discontinuation of Operations.** It is possible that either the church or the mission entity 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.

**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 after 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 employing 15 or more employees (a church and its related mission entity is a private employer for this purpose). Where the mission entity is not separately incorporated, the number of employees of the church and the entity may exceed the threshold number. Separate incorporation of the church and entity may result in either the church or the entity, 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. If functioning as one entity, financial books, records, and statements may be separately maintained.

**Securing Governmental or Other Third-Party Grants.** Many governmental agencies and some charitable foundations have policies that preclude making financial grants to churches. Without separate incorporation such policies probably preclude grants for a church program that is not separately incorporated. Separate incorporation offers a far greater possibility, but not a guarantee, of being eligible to receive grants.