



Ellis | Li | McKinstry

Governance: Private & Religious
Schools

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A. Integrated ministry of a local church

- Legally considered part of the church
- Automatically exempt under 501(c)(3); no 990 filings; exempt from employment security; exempt from charitable solicitation regulations; potential public accommodation defenses
- Separate school “board” does not relieve church leadership of fiduciary obligations; potential tension between school board and church leadership

B. Denominationally affiliated

- May or may not be separately incorporated
- Differing degrees of denominational control
- If separately incorporated, church-specific advantages unlikely to apply because not likely an “integrated auxiliary.”

C. Standalone nonprofit

- Governed by board of directors (details in next section).
- May be self-perpetuating board, could be appointed by parent organization, could be elected by “members.”
- Bylaws should be clear about allocation of decision-making authority

Functions of a Nonprofit Board



- A. Governing body of the corporation
 1. Ultimate authority and responsibility for the affairs of the corporation
 2. Relationship to members depends upon bylaws, but members do not have the same fiduciary duties

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Functions of a Nonprofit Board

B. Basics of the corporation

1. Nonprofit – no shareholders, no equity interests of members or directors
2. Exempt under 501(c)(3)
 - a. Organized and operated for charitable purposes
 - b. No private inurement
 - c. No political campaigns
 - d. No more than insubstantial lobbying

Functions of a Nonprofit Board

- C. Functions (vary between organizations)
 1. Set strategy
 2. Oversee implementation of strategy
 3. Hire and oversee executive director
 4. Protect assets and reputation
 5. Ambassador for the organization

Legal Duties of Board Members



- A. Major duties (do *not* vary between organizations)
 1. Duty of care
 2. Duty of loyalty
 3. *Duty of obedience?*

Legal Duties of Board Members



B. Duties imposed by state law:

A director shall perform the duties of a director, including the duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. RCW 24.03.127

Legal Duties of Board Members



C. Duty of care

1. Attend meetings
2. Be informed
3. Exercise good and independent judgment –
may rely on experts

Legal Duties of Board Members

D. Duty of loyalty

1. Act in best interests of corporation
2. Avoid / manage conflicts of interest
3. Understand corporate opportunities
4. Maintain confidentiality

Intermediate Sanctions

A. Background

1. IRS tool to deter and penalize private inurement
2. Private inurement = benefit to insider
3. Previously limited to the death penalty – rarely used.

Intermediate Sanctions

B. What is it?

1. Transaction with disqualified person at other than fair market value
2. Penalty taxes of up to 225% on the disqualified person
3. Penalty taxes of up to 10% (max \$20,000) on nonprofit board members – joint and several

- C. Disqualified person (5-year look back)
 1. Board members
 2. Executive officers
 3. Financial officers
 4. Family members of disqualified person
 5. Organization more than 35% owned by disqualified person
 6. Facts and circumstances (major donors)

D. Excess benefit transaction

1. Value of benefit conferred by organization is greater than the consideration received
2. Reasonable compensation for services is allowed if properly documented as such in advance (written minutes or contract, W-2, 1099)
3. Automatic excess benefit transaction for taxable but unreported benefits even if overall compensation is reasonable

E. Penalty taxes

1. 25% of excess benefit on the disqualified person
2. 200% of excess benefit if the transaction is not unwound
3. 10% on all board members and others who approved / participated in the transaction, up to a cap of \$20,000. Joint and several liability.
4. Taxes can be abated if transaction unwound

- F. Establishing a rebuttable presumption of reasonableness
 1. Decision made by directors who have no conflict of interest with respect to the transaction
 2. Disinterested directors relied on appropriate comparability data (salary surveys, appraisals, etc.)
 3. Contemporaneous documentation in minutes (including individual yes/no votes)

Liability of Board Members

A. Contract

1. Generally protected by corporate form
2. Sign contracts properly; watch guarantees

B. Tort

1. Liable for gross negligence or intentional misconduct
2. Federal and state volunteer protection statutes give qualified immunity for ordinary negligence

C. Statutory liability

1. Unpaid wages (be careful of exempt/non-exempt and “interns” who are paid, but below minimum wage)
2. Unpaid taxes (failure to remit payroll taxes)
3. Intermediate sanctions
4. Securities violations

D. Mitigating risk

1. Limitation of liability (must be in articles of incorporation)
2. Indemnification by corporation
3. D&O insurance
 - a. Side A
 - b. Side B
 - c. Side C

A. Governance models

1. Patron
2. Management team
3. Policy governance
4. Hybrid / others

B. Strive for clarity in roles and responsibilities

1. Board self-evaluation
2. Job descriptions

Time and again, board passivity and deference has permitted moral and legal failures to fester.

- Hidden deficits
- Poor staff morale
- Fear of addressing sexual harassment or child abuse

Yet the board cannot micromanage the executive director or entertain regular staff gripes

Suggestions

1. Read governing documents
2. Read most recent tax return; understand form 990
3. Read financial statements and annual report
4. Understand organizational structure
5. Attend board meetings
6. Meet at least quarterly if not monthly; insist on good financials before every meeting
7. Wear the hat of a skeptic
8. 360 review of executive director annually
9. Consider strengths and weaknesses of board and management
10. Know the requirements of 501(c)(3)
11. Regularly review and disclose conflicts of interest
12. Insist on strong sexual harassment and child protection policies with alternate reporting options

Examples

A. Conflict of interest

1. Hiring corporation owned by board member as a vendor
2. Engaging in a real estate transaction with relative of a board member

B. Fundraising corporate opportunity

1. Board member sits on multiple boards
2. To which organization are donors directed?

Examples

C. Unpaid withholding taxes

1. Executive director didn't pay over to IRS
2. IRS came after individual board members

D. Penn State

The Board's over-confidence in [the president]'s abilities, and its failure to conduct oversight and responsible inquiry of [the president] and senior University officials hindered the Board's ability to deal properly with the most profound crisis ever confronted by the University.

The Board should consider taking the following public actions to increase public confidence and transparency, realign and re-focus its responsibilities and operations, improve internal and external communications and strengthen its practices and procedures.

Freeh Report, page 134

Q&A

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