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Since its inception, FERGUSON, SCHETELICH & BALLEW, P.A. has maintained a special relationship with churches, Christian schools and Christian ministries throughout Maryland. It maintains a website at www.marylandchurchlaw.com as a service to these clients.

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We trust that you will find this handbook a useful reference in matters that impact religious corporations in Maryland.

Thomas J. Schetelich *Craig F. Ballew*

MARYLAND LAW
OF
RELIGIOUS CORPORATIONS

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MARYLAND LAW
OF
RELIGIOUS CORPORATIONS

PART ONE

RELIGIOUS CORPORATION FORMATION AND STRUCTURE

~ Thomas J. Schetelich

A. FOUNDATION CONCEPTS

A.1 HISTORICAL OVERVIEW

Maryland's law concerning Churches and Religious Corporations grows out of the State's history of religious freedom, which is the oldest such tradition in the Nation. The General Assembly of Maryland, meeting in St. Mary's City, adopted *The Act of Toleration* (formally "An Act Concerning Religion") on April 21, 1649. This Act secured religious freedom for all Christians "inhabiting, residing, traffiqueing, trading or comerceing within this Province." The Act established both policy and protection for religious worship:

> AND WHEREAS THE ENFORCING OF THE CONSCIENCE IN MATTERS OF RELIGION HATH FREQUENTLY FALLEN OUT TO BE OF DANGEROUS CONSEQUENCE IN THOSE COMMONWEALTHES WHERE IT HATH BEEN PRACTISED, AND FOR THE MORE QUIET AND PEACEABLE GOVERNEMENT OF THIS PROVINCE, AND THE BETTER TO PRESERVE MUTUAL LOVE AND AMITY AMONG THE INHABITANTS THEREOF, BE IT THEREFORE ALSO BY THE LORD PROPRIETARY WITH THE ADVISE AND CONSENT OF THIS ASSEMBLY ORDERED AND ENACTED … THAT NO PERSON OR PERSONS WHATSOEVER WITHIN THIS PROVINCE … PROFESSING TO BELIEVE IN JESUS CHRIST, SHALL FROM HENCEFORTH BE ANY WAIES TROUBLED, MOLESTED OR DISCOUNTENANCED FOR OR IN RESPECT OF HIS OR HER RELIGION NOR IN THE FREE EXERCISE THEREOF WITHIN THIS PROVINCE … NOR ANY WAY COMPELLED TO THE BELIEF OR EXERCISE OF ANY OTHER RELIGION AGAINST HIS OR HER CONSENT …. AND THAT ALL AND EVERY PERSON AND PERSONS THAT SHALL PRESUME CONTRARY TO THIS ACT … WILLFULLY TO WRONG DISTURB TROUBLE OR MOLEST ANY PERSON WHATSOEVER WITHIN THIS PROVINCE PROFESSING TO BELIEVE IN JESUS CHRIST FOR OR IN RESPECT OF HIS OR HER RELIGION OR THE FREE EXERCISE THEREOF … SHALL BE COMPELLED TO PAY TREBLE DAMAGES TO THE PARTY SO WRONGED OR MOLESTED, AND FOR EVERY SUCH OFFENCE SHALL ALSO FORFEIT 20S STERLING IN MONEY …

Prior to the adoption of the Bill of Rights (passed by Congress in 1789), Freedom of Religion was not guaranteed in the various States. Nine of the thirteen States went so far as to have State sponsored

religions. Only Maryland and Rhode Island guaranteed religious freedom at the time the Constitution was adopted.

The First Amendment to the United States Constitution guarantees freedom of religion:

> CONGRESS SHALL MAKE NO LAW RESPECTING AN ESTABLISHMENT OF RELIGION, OR PROHIBITING THE FREE EXERCISE THEREOF; OR ABRIDGING THE FREEDOM OF SPEECH, OR OF THE PRESS; OR THE RIGHT OF THE PEOPLE PEACEABLY TO ASSEMBLE, AND TO PETITION THE GOVERNMENT FOR A REDRESS OF GRIEVANCES.

Finally, the Maryland Declaration of Rights (Article 36, 1867) secures Freedom of Religion to all persons within the State:

> **ART. 36.** THAT AS IT IS THE DUTY OF EVERY MAN TO WORSHIP GOD IN SUCH MANNER AS HE THINKS MOST ACCEPTABLE TO HIM, ALL PERSONS ARE EQUALLY ENTITLED TO PROTECTION IN THEIR RELIGIOUS LIBERTY; WHEREFORE, NO PERSON OUGHT BY ANY LAW TO BE MOLESTED IN HIS PERSON OR ESTATE, ON ACCOUNT OF HIS RELIGIOUS PERSUASION, OR PROFESSION, OR FOR HIS RELIGIOUS PRACTICE, UNLESS, UNDER THE COLOR OF RELIGION, HE SHALL DISTURB THE GOOD ORDER, PEACE OR SAFETY OF THE STATE, OR SHALL INFRINGE THE LAWS OF MORALITY, OR INJURE OTHERS IN THEIR NATURAL, CIVIL OR RELIGIOUS RIGHTS; NOR OUGHT ANY PERSON TO BE COMPELLED TO FREQUENT, OR MAINTAIN, OR CONTRIBUTE, UNLESS ON CONTRACT, TO MAINTAIN, ANY PLACE OF WORSHIP, OR ANY MINISTRY; …

This historical tradition has been reflected in Maryland statutory and case law from the earliest days of the State, and has created a body of law by which there is less interference from the legislature and the courts than exists in other jurisdictions. These protections are jealously guarded by the Maryland Courts, and secure great latitude to Religious Corporations and Churches. This legal tradition manifests itself in two important, general areas:

1. Maryland Courts will neither permit law nor undertake any matter which requires an examination of religious doctrine, practice or government. "The General Assembly of this State, in its earliest legislation, exhibited the utmost solicitude to avoid all interference with the ecclesiastical affairs

of the several denominations of Christians." *Tartar v. Gibbs,* 24 Md. 323 (1865). *See also for example, Evans v. Shiloh Baptist Church,* 196 Md. 543 (1950). This doctrine finds broad application in such matters as tort liability, property disputes, employment, application of civil rights statutes, and property use, among others.

2. Maryland Courts extend broad charitable immunity protection to religious corporations. Charitable immunity will protect the institution against suits from negligence and other torts, including negligent selection of its employees and agents. *Howard v. Bishop Byrne Council Home,* 249 Md. 233 (1968). This immunity is extended to charitable organizations, and not to the individual actor themselves. *Wood v. Abel,* 268 Md. 214 (1973).[1] The immunity only protects the assets of the charitable institution, and cannot be raised by an insurer which has issued a policy covering the liability. MARYLAND CODE, INSURANCE §19-103.

These two concepts combine to give Maryland Religious Corporations extended freedom from litigation or court oversight.

A.2 THE CHURCH AND THE RELIGIOUS CORPORATION

Maryland law creates a dichotomy in religious organization, by establishing that the Church[2] and the Religious Corporation are different entities. (*Tartar v. Gibbs,* 24 Md. 323 (1865).

[1] Protection from negligence claims is extended to individuals under the Federal Volunteer Protection Act of 1997. A volunteer, for purposes of this Act is anyone who: (1) performs services (including officers, directors, trustees, and direct service volunteers); (2) for a nonprofit organization or governmental entity; and (3) either: (a) receives no compensation (although reasonable reimbursement for expenses incurred is allowed), or (b) does not receive anything of value in lieu of compensation, in excess of $500 per year. A volunteer, acting within the scope of his/her duties, has a complete defense and no liability for negligence.

[2] The term "Church" is used in the Religious Corporation Subtitle to include a religious society, congregation of any sect, order, or denomination. MARYLAND CODE, CORPORATIONS & ASSOCIATIONS ARTICLE §5-301(b). The

The Church exists as a religious society. The determination of its membership, beliefs, operations, and government are independent of any governmental control or direction, and left to the Church itself, to be governed by its own ecclesiastical rules and traditions. *See, for example, Evans v. Shiloh Baptist Church,* 196 Md. 543 (1950); *Smith v. Church of God*, 326 F. Supp. 6 (D. Md. 1971).

The Religious Corporation is created under Maryland statutory law, to hold legal title to real and personal property, for the benefit of the Church. *Hayman v. St. Martin's Evangelical Lutheran Church,* 227 Md. 338 (1962); *Jenkins v. New Shiloh Baptist Church,* 189 Md. 512 (1948). A Religious Corporation is more than a charitable corporation, under the control of a religious body. *Baltzel v. Church Home & Infirmary,* 110 Md. 244 (1909). Rather, the Religious Corporation exists to facilitate the worship of the Church.

Regardless of how the Church is governed, the Religious Corporation is governed by Trustees. The Trustees, and not the congregation, constitute of the membership body of the Religious Corporation and the controlling legal authority. *Babcok Mem. Presbyterian Church v. Presbytery of Baltimore,* 296 Md. 573 (1983), *cert. denied* 465 U.S. 1027 (1984); *Shaeffer v. Klee*, 100 Md. 264 (1905).

B. FORMATION OF A RELIGIOUS CORPORATION

A Religious Corporation is a non-stock corporation. As such, the provisions of the Maryland general statutory corporate law will apply to it, unless the provisions of the statute clearly require otherwise. MARYLAND CODE, CORPORATIONS & ASSOCIATIONS ARTICLE § 5-201.

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term "Church" will be used in this discussion in the same broad way, to include religious organizations of various beliefs.

A Religious Corporation is created under Title 5, Subtitle 3 of the MARYLAND CODE, CORPORATIONS & ASSOCIATIONS ARTICLE. This subtitle sets out the means of forming a religious corporation under a "congregational form of church government" contemplated by the statute. *Mt. Olive African Methodist Episcopal Church of Fruitland, Inc. v. Board of Incorporators,* 348 Md. 299 (1997). However, the subtitle provides particular §s for the formation of a religious corporation by a congregation of the Roman Catholic Church, the United Methodist Church, the United Presbyterian Church of the United States of America, the Protestant Episcopal Church, Diocese of Maryland, and the Protestant Episcopal Church, Diocese of Easton. The specific provisions relating to each of these denominations are found in Subtitle 3. The reason for the exceptions is discussed in Section H, below.

The Religious Corporation is formed by filing Articles of Incorporation with the State Department of Assessments and Taxation (§ 5-304). These Articles of Incorporation are also called the "Charter" of the Religious Corporation. The Articles of Incorporation are filed by not less than four (4) Trustees (§ 5-302). The central part of the Articles is the "Plan" of the Church, which is adopted by a majority of the Trustees (§ 5-303). This Plan includes:

- The purpose for which the religious corporation is formed
- The name of the Religious Corporation and of the Church
- The time and manner of election and succession of Trustees
- The exact qualifications of individuals eligible to vote in elections and be elected to office.

The Plan may also include any regulation adopted by the Church (§5-301(c)). The Plan is maintained by the Church in a "Record Book" in which the proceedings of the Religious

Corporation are recorded. The Record Book must be available for inspection by the members of the Religious Corporation.[3]

The Articles of Incorporation must also state the address of the principle place of worship, and the name and address of the resident agent.

The Articles of Incorporation should also contain language designed to satisfy the requirements of § 501(c)(3) of the Internal Revenue Code, to ensure that the organization will qualify under that section as a tax-exempt organization. This language is not required by Maryland statutes, but will be required by the Internal Revenue Service upon application for exemption status.

Many Churches include in the Plan and/or the Articles of Incorporation a doctrinal statement, and other matters concerning the religious beliefs on the Church. These matters are superfluous to the legal requirements of the Plan or the Articles of Incorporation, and are best maintained in some other document, which is not subject to the legal requirements of the State. In practice, a statement of religious beliefs in the Charter does not secure doctrinal purity at the Church. To the contrary, the inclusion of doctrinal matters or statement of faith can only be a source of confusion and conflict, by asking secular institutions to oversee spiritual issues. In short, the Charter is a document directed toward Caesar and not toward God. It should render the necessary legal observances to Caesar, and leave the rest to God. *The Gospel of Matthew Chapter 22, Verse 21.*

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[3] There is no case law explaining the detail to which the Record Book must be maintained, and what material must be included in it. In particular, it is not clear the extent to which financial records must be made available to Church members. Maryland law provides for members of a charitable corporation to have access to financial records, and other States have compelled church officers to present financial records for inspection. However, in the absence of express Maryland law and in light of its historical reluctance to interfere with internal church operations, it is not certain the extent to which (if at all) Trustees of the Religious Corporation can be compelled to submit their financial records to inspection by members. It is likely that trustees can be compelled to give an accounting, under the Maryland general law applicable to trustees.

Because the property of the religious corporation is controlled by the trustees, and not by the congregation (*Hayman v. St. Martin's Evangelical Lutheran Church,* 227 Md. 338 (1962); *Jenkins v. New Shiloh Baptist Church,* 189 Md. 512 (1948)) it is not uncommon for the Articles of Incorporation to contain some restrictions on the powers of the trustees to sell or encumber that property. Such provisions are valid, if clearly expressed in the Articles. *Starr v. Minister & Trustees of Starr Methodist Protestant Church,* 112 Md. 171 (1910).

The Plan and the Articles of Incorporation may be amended by action of the majority of the Trustees, who adopt a resolution which declares that the particular amendment is advisable. The amendment may be approved by the affirmative vote of the adult members of the religious corporation, at a meeting called for that purpose, for which at least ten (10) days notice is given (§ 5-308). Upon approval of the amendment, Articles of Amendment are filed with the Department of Assessment and Taxation, pursuant to § 5-309.

The Religious Corporation may, but is not required to, maintain By-laws for its operations. These By-laws should establish the positions and duties of officers, as well as rules governing meetings of the Religious Corporation. Once again, statements of doctrine and other religious convictions are superfluous in these legal documents.

C. DUTIES OF TRUSTEES AND OFFICERS

Trustees are appointed by the Church to take title to its property, "and to manage the same in the most upright and careful manner." *Tartar v. Gibbs,* 24 Md. 323 (1865). The Trustees have, by virtue of their office, no controlling authority over the religious activities of the Church. They are rather empowered by statute concerning the property and assets, described as "very broad

powers" in *Mt. Olive African Methodist Episcopal Church of Fruitland, Inc. v. Board of Incorporators of the African Methodist Episcopal Church,* 348 Md. 299 (1997).

MARYLAND CODE, CORPORATIONS AND ASSOCIATIONS ARTICLE, § 5-306(a) defines the statutory powers of Trustees of Religious Corporation:

The trustees have the power to:

(1) Have perpetual existence under the name of the religious corporation;

(2) Purchase, take, or acquire by gift, bequest, or in any other manner and hold any interest in any assets in the State;

(3) Use, lease, mortgage, sell, or convey the assets in the manner that the trustees consider most conducive to the interest of the religious corporation;

(4) Generally manage any assets of the religious corporation; and

(5) Adopt rules and ordinances for conducting their affairs as necessary and convenient to accomplish the purpose of the religious corporation, including:

(i) Appointing the time and place of a meeting of its members; and

(ii) Determining the number of members necessary to constitute a quorum.

The position of Trustee, by its nature, creates obligations to the members of the Church. A trustee is a fiduciary, obligated to act in the best interests of the beneficiaries, using his/her good faith judgment of its best interests. As a general rule, fiduciaries must manage the affairs entrusted to them with the same degree of care and prudence that is generally exercised by person in managing their own affairs. In doing so, a trustee may rely upon the information, advise, and opinions of others. A trustee who acts in good faith, without fraudulent intent, and with care fulfills his/her responsibilities. *Compare* MARYLAND CODE, CORPORATIONS AND ASSOCIATIONS ARTICLE § 2-405.1.

A Trustee also may not profit at the expense of the beneficiary, nor use the information and power entrusted to him for his/her personal benefit.

A Trustee is not liable individually for the debts and obligations of the Religious Corporation. It is unlikely that a trustee of a Religious Corporation will have any liability to those outside of the Church for acts in his/her fiduciary capacity, as the fiduciary duty runs to the Church members directly.

Officers of the Religious Corporation are established (if at all) by the Charter and By-laws. Their powers, duties, and responsibility are governed by those documents. However, officers of the Religious Corporation can be clothed with "apparent authority" to bind the Corporation, regardless of the extent of the authority actually given to them by the organizational documents and the Trustees.

Maryland law recognizes the doctrinal of apparent authority. *B.P. Oil Corp. v. Mabe*, 279 Md. 632 (1977) adopting the Restatement (Second) of Agency, § 267. The doctrine has been applied in other States to officers of religious corporations. *See Carter v. United Pentecostal Church,* 2000 WL 1752760 (Ohio App. 2000), where the Court ruled that a church was bound by a contract modification signed by an associate pastor because he had "apparent authority" to sign the modification.

D. SELECTION OF TRUSTEES AND RESOLUTION OF DISPUTED ELECTIONS

The Church is given great latitude in determining how the trustees of the Religious Corporation are to be selected, although the means of that selection must be established in the Charter. Trustees may be selected by any means established by the Church, as it sees fit in its religious tradition. Trustees may be selected by the congregation, appointed by a pastor or other

church official, or appointed by the Board of Trustees itself. A dispute in the selection of trustees is required to be arbitrated under to MARYLAND CODE, CORPORATION AND ASSOCIATIONS ARTICLE, § 5-310. This statute requires the appointment of three arbitrators from the same denomination as the Church in which the dispute arose. Each disputing faction can name one arbitrator, and then those two arbitrators name a third. It is required that the three arbiters meet together at the place where the conflict arose to hear and resolve the matter.

The arbitration is to be conducted pursuant to the Maryland Uniform Arbitration Act, which is set out in the Courts & Judicial Proceeding Article of the Maryland Code, Title 3, Subtitle 2.[4] The decision of the arbitrators is final, and can be the basis for a court judgment declaring the correct trustees of a religious corporation. § 5-310; *Seat Pleasant Baptist Church Board of Trustees v. Long,* 114 Md. App. 660 (1997).

E. THE MERGER OF TWO CHURCHES

Two churches may merge or consolidate, on any terms that they see fit. Religious Corporations are non-stock corporations. CORPORATIONS AND ASSOCIATIONS § 5-207(b) provides that a non-stock corporations may consolidate or merge by the same procedures as the merger of stock corporations.

To accomplish a merger, the board of trustees for each religious corporation must pass and present a resolution to the members of the religious corporation setting forth that it believes that it is in the best interest of the religious corporation to merge with the other. Once

[4] In the case of *American Union of Baptists v. Trustees of Particular Primitive Baptist Church at Black Rock, Inc*., 335 Md. 564, (cert. denied 173 U.S. 1111 (1995)). Citation, the Court decided that arbitration in a disputed church election was to be conducted under common law rules of arbitration and was not subject to the Maryland Uniform Arbitration Act. Subsequent statutory changes would change this result and bring disputed church elections under the Maryland Uniform Arbitration Act.

resolutions have been adopted by both religious corporations, Articles of Merger must be filed with Maryland's State Department of Assessment and Taxation. The Articles of Merger should contain the following information:

1. Names of the two religious corporations merging and that there is an agreement to merge;
2. Name of the religious corporation that will survive as the successor;
3. The principal office of both religious corporations;
4. That the terms and conditions as set forth in the Articles of Merger were advised, authorized and approved by both religious corporations in the manner required by their bylaws and Maryland law;
5. The adoption of the successors bylaws (if any);
6. The names and addresses of the Trustees of the successor entity;
7. The principal place of worship for the successor or surviving religious corporation;
8. The resident agent of the successor or surviving entity.

Once the two religious corporations have merged, the separate existence of the two corporations ceases. The assets of each religious corporation transfer to and rest in the successor corporation. The successor corporation is liable for all debts and obligations of each non-surviving corporation. CORPORATIONS & ASSOCIATIONS, § 3-114.

F. VOLUNTARY DISSOLUTION OF RELIGIOUS CORPORATIONS

Religious corporations are non-stock corporations and therefore statutes regarding non-stock corporations generally govern their existence and dissolution. CORPORATIONS & ASSOCIATIONS, § 5-201. The voluntary dissolution of a religious corporation is governed in the same law as the dissolution of a stock corporation. CORPORATIONS & ASSOCIATIONS § 5-208.

The first step in a voluntary dissolution is to review the Articles of Incorporation of the religious corporation to determine if the procedure for the voluntary dissolution is laid out in the corporate documents. Any specific procedure should be followed, along with the requirements of the Maryland statute. The next step is for the trustees to adopt a resolution recommending that the religious corporation be dissolved and directing that the dissolution be submitted to a vote at a meeting of the members entitled to vote. The meeting can be either the annual meeting or specially called. In the notice of the meeting, the members must be informed that at the meeting there will be a vote on whether or not to dissolve the corporation. In order for the resolution to pass, two-thirds of the members entitled to vote must vote in favor of the dissolution. See generally *Carter v. Glen Burnie Volunteer Fire Company, Inc.*, 292 Md. 165, 438 A.2d 278 (1981). Once the resolution is passed the trustees must file Articles of Dissolution with the Maryland State Department of Assessment and Taxation. The Articles of Dissolution should contain the following information:

1. Name and address of the corporation;
2. Name and address of the resident agent who will serve for a specific term after the dissolution;
3. Names and titles of the corporate officers;
4. Members of the corporation;
5. The status of taxes and debts of the corporation;

6. That the dissolution was properly approved by the members of the corporation;
7. That the religious corporation is dissolved.

The corporation will be dissolved when the Maryland State Department of Assessment and Taxation accepts the Articles of Dissolution. CORPORATIONS & ASSOCIATIONS § 5-208 and § 3-408. The corporation continues to exist for the purpose of paying, satisfying, and discharging any existing debts or obligations, collecting and distributing its assets and doing all other acts required to liquidate and wind up its business. CORPORATIONS & ASSOCIATIONS § 3-408(b).

G. <u>INVOLUNTARY DISSOLUTION OF A RELIGIOUS CORPORATION</u>

A religious corporation is a non-stock corporation. Involuntary dissolution of a non-stock corporation is governed by CORPORATIONS AND ASSOCIATIONS ARTICLE, § 5-208, which in turn incorporates Title 3 of the Article, so that dissolution of non-stock corporations follows the procedures established for stock corporations. Title 5 of the Article clearly anticipates the use of this procedure to dissolve a religious corporation, in that § 5-208(b)(3) and 5-209 expressly govern the distribution of property in the event of the dissolution of a religious corporation.

Non-stock corporations have members rather than stockholders; and the definition of "stockholder" includes members of non-stock corporations. CORPORATIONS AND ASSOCIATIONS ARTICLE, § 1-101(t).

Section 3-413 establishes the grounds for a petition to the Court for involuntary dissolution. The Court can dissolve a corporation if stockholders (members) entitled to cast twenty five per cent (25%) of all votes petition the Court for dissolution if the directors are so

divided respecting the management of the corporation's affairs that the votes required for action by the board cannot be obtained; or the members are so divided that directors cannot be elected. Trustees of a religious corporation fill the duties of directors, in that they act as a board to govern to the corporation, and so, presumably, trustees can be read for directors in this statute.

The religious corporation can also be involuntarily dissolved if it has failed, for a period of more than two years, to elect a board of trustees. Any member can petition the Court for dissolution on this basis. *See,* § 3-413(b)(1).

In the event of an involuntary dissolution, the Circuit Court having jurisdiction must determine the distribution of its assets pursuant to § 5-209 of the CORPORATIONS AND ASSOCIATIONS ARTICLE.

H. SELECTED REAL PROPERTY ISSUES

H.1 PROPERTY OWNERSHIP

As noted above, legal title to real property is held by the Religious Corporation, in trustees. There have arisen cases in which the beneficial ownership of property is at question, particularly when a local congregation separates itself from a parent church or national denomination. There are three ways by which the parent or national organization can retain ownership in such a situation: (i) requiring the local church to place a reverter clause in the deed to the property; (ii) expressly providing in their constitutional documents for the reversion of local church property upon the withdrawal of the local congregation; or (iii) obtaining from the Maryland General Assembly an Act providing for that result. *Maryland and Virginia Eldership of Churches of God*

v. Church of God at Sharpsburg, 249 Md. 650 (1968).[5] In the absence of such provisions in the deed, formation documents, or legislation, the local religious corporation will hold legal title, and the right to convey or use the property, as the local church corporation deems best. *Mt. Olive African Methodist Episcopal Church of Fruitland, Inc. v. Board of Incorporators of the African Methodist Episcopal Church,* 348 Md. 299, 315 – 318 (1997).

H.2 **TAX-EXEMPT STATUS OF REAL PROPERTY**

Property owned by a Religious Corporation is not subject to property tax, if it is used for public religious worship, for a parsonage or convent, or for educational purposes. MARYLAND CODE, TAX-PROPERTY § 7-204. This use must be "actual" and "exclusive." *Supervisor of Assessments v. Trustees, Bosley Methodist Church Graveyard,* 293 Md. 208 (1982) (where a one acre lot with a caretaker's residence, located across the road from a church building and graveyard was found to be neither "actual used" for public worship nor burial, and therefore subject to taxation). Anticipated usage of a property is not sufficient to justify the exemption. *Friends School v. Supervisor of Assessments,* 314 Md. 194 (1988).

In *Supervisor of Assessments of Baltimore County v. Keeler,* 362 Md. 198 (2001), the Maryland Court of Appeals addressed the question of whether 16.5 acres of a 27 acre parcel should be included within the exemption for actual and exclusive religious worship, when development of the entire parcel was restricted to a 7.5 acre envelope and the 16.5 acres was zoned as open space. The Court determined to treat the entire property as a single parcel, there being no showing that the property could be divided or that another use was employed for the

[5] The Supreme Court vacated this judgment and remanded the case for reconsideration. On remand, the Court of Appeals of Maryland affirmed its prior holding, at 254 Md. 162, *aff'd* at 396 U.S. 367.

open space. In effect, the Court determined that property owned by a religious corporation, and part of a parcel which qualifies for tax-exemption, is itself tax-exempt, unless some other use if made of it.

The definition of "a parsonage" is narrowly drawn, and includes only the residence of a minister who serves an identifiable parish or congregation to which the residence is adjunct. *East Coast Conference of Evangelical Covenant Church of America, Inc. v. Supervisor of Assessments,* 40 Md. App. 213 (1978).

H.3 RELIGIOUS DISCRIMINATION IN THE SALE OR RENTAL OF CHURCH PROPERTY

The Fair Housing Act (Title VIII of the Civil Rights Act of 1968) prohibits discrimination in the sale or rental of residential property on the basis of race, color, national origin, religion, or sex. However, the Act specifically exempts religious organizations from the ban on religious discrimination.

> Nothing in this subchapter shall prohibit a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, from limiting the sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same religion, or from giving preference to such persons unless memberships in such religion is restricted on account of race, color, or national origin.

MARYLAND LAW
OF
RELIGIOUS CORPORATIONS

PART TWO

<u>OBTAINING AND MAINTAINING TAX-EXEMPTION</u>

~ Thomas J. Schetelich

Most Churches and Religious Corporations seek (1) to be exempt from income taxes, and (2) for persons making contributions to be able to deduct those gifts for their income for tax purposes. To do so, the Church must qualify under § 501(c)(3) of the Internal Revenue Code. The IRC does not define the term "church". While the term "church" is used throughout the IRC, Congress specifically decided not to create a definition for the term. A reason for not providing a definition was given by the Supreme Court of the United States in *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772 (1981), where it noted that "the great diversity in church structure and organization among religious groups in this country … makes it impossible, as Congress perceived, to lay down a single rule to govern all church-related organizations". Left without a definition for "church", the Internal Revenue Service has created a list of fourteen criteria that it sees to embody a "church". The criteria are:

1. a distinct legal existence
2. a recognized creed and form of worship
3. a definite and distinct ecclesiastical government
4. a formal code of doctrine and discipline
5. a distinct religious history
6. a membership not associated with any other church or denomination
7. an organization of ordained ministers
8. ordained ministers selected after completing prescribed studies
9. a literature of its own
10. established places of worship
11. regular congregations
12. regular worship services

13. Sunday school for religious instruction of the young

14. schools for the preparation of ministers

While all fourteen of the criteria need not be met, courts have used the criteria to decide whether of not an entity is a church for federal tax purposes. See *American Guidance Foundation v. United States*, 490 F.Supp. 304 (D.D.C. 1980); *United States v. Jeffries*, 854 F.2d 254 (7th Cir. 1988). Generally, the IRS will look at the facts and circumstances of each situation and apply the fourteen factors to decide whether or not an entity is a church for federal tax purposes.

A. Nonprofit v. Tax-exempt

The decision to apply for recognition of exempt status must be made on a case-by-case basis. An organization may be formed under Maryland's non-stock (non-profit) corporation statute, yet not be tax-exempt.

1. Tax-exempt status.

   a. U.S. Code Chapter 26 § 501[6]: Exemption from tax on corporations, certain trusts, etc. This § provides for an organization's exemption from taxation.

   b. U.S. Code Chapter 26 § 170[7]: Allows persons to deduct charitable contributions from one's personal tax filing.

[6] § 501(c)(3) reads: "Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or to animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in sub§ (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

c. Churches and religious organizations, like many other charitable organizations, qualify for exemption from Federal Income tax under IRC § 501(c)(3) and are generally eligible to receive tax-deductible contributions. To qualify for tax-exemption, such organizations must meet the following requirements:

i. The organization must be organized and operated exclusively for religious, educational, scientific, or other charitable purposes;

ii. Net earnings may not inure to the benefit of any private individual or shareholder;

iii. No substantial part of its activity may be attempting to influence legislation;

iv. The organization may not intervene in political campaigns; and

v. No part of the organization's purpose or activities may be illegal or violate fundamental public policy.

2. Who should apply.

a. Churches that meet the requirements of IRC § 501 (c)(3) are automatically considered exempt and are not required to apply for and obtain recognition of tax-exempt status from the IRS. Although there is no requirement to do so, many churches see recognition of exempt status from the IRS because (i) such recognition assures church leaders, members and contributors that the church is recognized as exempt and qualifies for related tax benefits, (ii) Maryland is taxing authorities will require IRS recognition before granting an exemption

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[7] § 170(a)(1) reads: "General rule.- There shall be allowed as a deduction any charitable contribution (as defined in sub§ (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary."

from sales taxes, (iii) such recognition provides a *prima facie* basis to claim charitable immunity, and (iv) Foundations issuing grants will require recognition for those entities receiving grants.

b. Unlike churches, religious organizations that wish to be tax-exempt generally must apply to the IRS for tax-exempt status unless their annual receipts are $5,000 or less.

3. When to apply. Generally speaking, it may be best to make application to the IRS for tax-exempt status after the organization has been in existence for 8 months, but before the end of its 15th month of existence. The following explains why. If the organization has not completed a tax year of at least 8 months, it may only request an advance ruling and must complete and sign two Forms 872-C and attach them to the application. If the organization has been in existence for less than one year at the time of filing, it must provide a proposed budget for 2 years. If the filing is made within 15 months from the end of the month in which the organization was created or formed, the organization does not have to fulfill certain "technical requirements." A religious organization must submit its application within 27 months from the end of the month in which the organization is formed in order to be considered exempt and qualified to receive deductible contributions as of the date the organization was formed.

B. Application Procedures

1. Employer Identification Number (EIN)- every tax-exempt organization, including a church, should have an Employer Identification Number, whether or not the organization has any employees. There are many instances in which an EIN is necessary. For example, a religious organization needs an EIN when it opens a bank account, files returns with the IRS, etc. The application for Employer Identification Number is made on Form SS-4.

2. The Application for Recognition of Exemption (Form 1023 or Form 1024). Organizations, including churches and religious organizations, that wish to be recognized as tax-exempt under IRC § 501(c)(3) must use IRS Form 1023. This form is comprehensive and extensive, requiring careful attention. It is likely that the IRS will respond to the initial application with questions. The IRS has recently made the process more manageable by providing fill in forms at www.irs.gov/formspubs/lists. It may take up to six (6) months or more for the IRS to provide a ruling.

C. Maryland Tax-exemption

1. Income Tax

    a. An organization's exemption under § 501 of the Internal Revenue Code provides a presumption of exemption from Maryland income tax.

    b. Application for exemption from Maryland income tax requires that an organization register with the Comptroller by filing a copy of the IRS determination letter (recognizing the entity as a tax-exempt entity under the IRS' guidelines).

c. Withholding Income Taxes: Non-profit organizations must withhold Maryland and federal income tax from wages paid to employees in the same manner as for-profit organizations; and report and pay payroll taxes as do for-profit organizations.

2. Unemployment Compensation

a. Services performed for a 501(c)(3) organization are excluded from taxation under the Federal Unemployment Tax Act (FUTA).

b. All states, including Maryland, are required by federal law to provide unemployment insurance coverage for employees of most 501(c)(3) organizations.

3. Sales Tax- Churches and religious organizations are not automatically exempt from sales tax, but they may apply for a sales tax-exemption. This exemption would allow churches and religious organizations to purchase tangible personal property without paying sales tax if the personal property is purchased to "carry on the work" of the charitable institution (MARYLAND CODE, TAX-GEN. § 11-204).

4. The State Application for Tax-exemption- may be obtained from the Internet website: www.comp.state.md.us/forms , and requires that the organization attach its letter of determination from the IRS.

D. Group Exemption Letters

1. A group exemption letter is a ruling or determination letter issued to a central organization recognizing on a group basis the exemption under Code § 501(c) of subordinate organizations on whose behalf the central organization has applied for recognition of exemption.

2. How to apply for a group exemption letter

   a. Central Organizations – a central organization is an organization that has one or more subordinates under its general supervision or control.

   b. The Central Organization must submit the following information to the IRS:

      i. Verification that the subordinates:

      ii. Are affiliated with the central organization;

      iii. Are subject to its general supervision or control;

      iv. Are all eligible to qualify for exemption under the same paragraph of Code § 501 (c), though not necessarily the paragraph under which the central organization is exempt;

      v. Are not private foundations as defined in Code § 509 (a) if the application for a group exemption letter involves Code § 501(c)(3);

      vi. Are all on the same accounting period as the central organization if they are to be included in group information returns;

vii. Were all formed within the 15 month period preceding the date of submission of the group exemption application if they are claiming Code § 501(c)(3) status and are subject to the requirements of Code § 508(a) and wish to be recognized as exempt from their dates of creation;

viii. A description of the purposes and activities of the subordinates, including the sources of receipts and the nature of expenditures;

c. Subordinate Organizations- a subordinate organization is a chapter, local, post, or unit of a central organization. A subordinate organization may or may not be incorporated, but it must have its own organizing instrument. A subordinate that is organized and operated in a foreign country may not be included in a group exemption letter. A subordinate described in Code § 501(c)(3) may not be included in a group exemption letter if it is a private foundation described in Code § 509(a). Each subordinate must have its own EIN, even if it has no employees. The central organization must send with the group exemption application a completed Form SS-4 on behalf of each subordinate not having an EIN.

E. JEOPARDIZING TAX-EXEMPT STATUS

All IRC § 501 (c)(3) organizations, including churches and religious organizations, must abide by certain rules:

1. Their net earnings may not inure to any private shareholder or individual;
2. They must not provide a substantial benefit to private interests;
3. They must not devote a substantial part of their activities to attempting to influence legislation;
4. They must not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office; and
5. No part of the organization's purposes or activities may be illegal or violate fundamental public policy.

    i. Private Benefit- A tax-exempt organization's activities must be directed exclusively toward charitable, educational, religious, or other exempt purposes. Such an organization's activities may not serve the private interests of any individual or organization. Rather, beneficiaries of an organization's activities must be recognized objects of charity (such as the poor or the distressed) or the community at large (for example, through the conduct of religious services or the promotion of religion). Private benefit is different from inurement to insiders. Private benefit may occur even if the persons benefited are not insiders. Also, private benefit must be substantial in order to jeopardize exempt status.

    ii. Substantial Lobbying Activity: In general, no organization, including a church, may qualify for IRC § 501(c)(3) status if a substantial part of its activities is attempting to influence legislation (commonly known as *lobbying*). An IRC § 501(c)(3)

organization may engage in some lobbying, but too much lobbying activity risks loss of exempt status.

a. *Legislation* includes action by Congress, any state legislature, any local council, or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative confirmation of appointive offices) or by the public in a referendum, ballot initiative, constitutional amendment or similar procedure. It does not include actions by executive, judicial, or administrative bodies.

b. A church or religious organization will be regarded as *attempting to influence legislation* if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if the organization advocates the adoption or rejection of legislation.

c. Churches and religious organizations may, however, involve themselves in issues of public policy without the activity being considered lobbying. For example, churches may conduct educational meetings, prepare and distribute educational materials, or otherwise consider public policy issues in an educational manner without jeopardizing their tax-exempt status.

F. EXCESSIVE COMPENSATION

IRC § 501(c)(3) prohibits all tax-exempt organizations from paying unreasonable compensation to any employee or other person. A violation of this requirement will jeopardize an exempt organization's tax-exempt status.

IRC § 4958 permits the IRS to assess "intermediate sanctions" in the form of excise taxes against insiders (called "disqualified persons") who receive an excess benefit from a tax-exempt organization. These rates are 25% of the amount of an excise benefit, and 200% of the amount of the benefit if the insider does not "correct" the excess benefit (i.e., return it) within the "taxable period" defined by law.

An "excess benefit" is any benefit paid to an insider in excess of the reasonable value of services performed. It includes (1) excessive salaries; (2) "bargain sales" to an insider (sales of an exempt organization's property at less than market value); (3) use of any exempt organization's property at no cost; and (4) payment of an insider's personal and business expenses under a "non-accountable" plan (without a proper accounting of business purpose), unless the payment is reported as taxable income on the insider's W-2 or Form 1040.

Members of a disqualified person's family are also considered disqualified persons.

The IRS can revoke an exempt organization's tax-exempt status if it pays an excess benefit to a disqualified person. However, in most cases, the IRS will pursue intermediate sanctions rather then revocation of exempt status.

In four private rulings issued in 2004, the IRS assessed intermediate sanctions against a pastor because of the personal use of church property by himself and members of his family, and

the reimbursements of expenses by the church under a nonaccountable plan without any substantiation of business purpose. Most importantly, the IRS concluded that nonaccountable reimbursements that a church pays its pastor are "automatic" excess benefit transactions resulting in intermediate sanctions, regardless of the amount, unless they are reported as taxable income on the pastor's W-2 or Form 1040 for the year in which the reimbursements are paid.

Churches that allow persons who serve on the governing board to use church property (vehicles, cell phones, credit cards, computers, etc.) for personal purposes, or that reimburse business or personal expenses of a pastor under a nonaccountable arrangement, may be engaged in an "automatic" excess benefit transaction that will subject the pastor, and possibly church board members, to intermediate sanctions under § 4958 regardless of the amount of these benefits. The same rule applies to personal use of church property by a member of the pastor's family. This result can be avoided if the church, or the pastor, reports the benefits as taxable income during the year the benefits are provided; and, they may be partly or completely "abated" if the pastor "corrects" the excess benefit within the "tax-period" defined by § 4958.

G. UNRELATED BUSINESS INCOME

G.1 What is Unrelated Business Income and is it taxable?

Unrelated business income is the income from a trade or business that is regularly carried on by an exempt organization and is taxable. While tax-exempt organizations, including churches and religious organizations, may engage in income-producing activities that are unrelated to their tax-exempt purpose, the unrelated activities must not be a substantial part of the organization's activities. If the income producing activity is a substantial part of the

organization's activities, the organization will be taxed on that income. An activity is an unrelated business and subject to "unrelated business income tax" (UBIT) if the following three criteria are met:

1. The activity constitutes a trade or a business;
2. The trade or business is regularly carried on; and
3. The trade or business is not substantially related to the organization's exempt purpose

The term *trade or business* has been interpreted to include any activity carried on for the production of income from the sale of goods to the performance of services. The term may include such activities as selling advertising in a church bulletin, selling goods at a church bazaar, operation of bingo games, newspapers, parking lots, restaurants, or record companies. It is not difficult to have an activity classified as a trade or a business.

If the activity is considered to be a trade or business, the next criteria is whether the activity is *regularly carried on*. The treasury regulations clarify that the "frequency and continuity with which the activities … are conducted and the manner in which they are pursued will be used in making the determination of whether the activity is *regularly carried on*. Treas. Reg. §1.513-1(b). The manner that the activity is pursued by the church or religious organization as compared to how a commercial business performs the activity will be used to make the determination of whether the activity is regularly carried on. For example, if the church or religious organization only engages in the activity for a short period of time, while the commercial business is engaged in the enterprise year round that would tend to indicate that the church was not engaged in regularly carried on business. However, if both the church and the commercial business are only engaged in the business during a certain time or season that would

tend to indicate that the business is pursued in the same manner and thus would tend to indicate that the church is engaged in a regularly carried on business.

Lastly, the unrelated business income must be substantially unrelated to the church or religious organization to be taxed. IRS regulations hold that for the trade or business to be substantially related the activity "must contribute importantly to the accomplishments of those purposes". Treas.Reg. §1.513-1(d) (3). The facts and circumstances of each case need to be evaluated to determine if the business activity "contributes importantly to the success of the church's exempt purposes". For example, the rental of a church's parking spaces to the public Mondays through Fridays does not contribute importantly to the church's exempt purposes.

It does not matter if a church uses all of the unrelated income to further its religious purposes, such as repairing the church or purchasing books for the worship service. If the income is deemed to come from an unrelated trade or business it is taxable. Even if the business is related to the church's exempt status, the size and extent of the business will be evaluated "in relation to the nature and extent of the exempt function which they purport to serve", Treas. Reg. § 1.513-1(d) (3). For example, if a church publishes religious music which it uses itself but also sells to numerous other organization, and receives substantial income from these other organizations, while the purpose is related, the proportionality of the music that is used by the exempt church compared to that used by other organizations, would cause the income that is earned by the other organizations to be taxable.

G.2 EXCEPTIONS TO UNRELATED BUSINESS INCOME

While the three criteria required to be met for a church's income to be considered unrelated business income seem rather stringent, there are a number of exceptions to the

taxability of unrelated business income. IRC § 513 (a) has certain exceptions to unrelated business income. Specifically, unrelated trade or business does not include:

1. Activities in which substantially all of the work is performed by unpaid volunteers;

2. Activities carried on by a church or other religious organization primarily for the convenience of its members, students, or employees,

3. Selling merchandise substantially all of which has been received by the tax-exempt organization as gifts or contributions.

These exceptions help many churches and religious organizations obtain income without paying taxes on that income. For example, most church bake sales are run by volunteers and the bake sale items are usually donated items, making all income produced from the sales, non-taxable. Likewise, church thrift stores are also usually exempt because the items are donated and the sales persons are volunteers. Conversely, if a church operates a kitchen solely for the purpose of producing and selling bake goods, hires and pays employees, the church would not fall under the exemptions and would be responsible for payment of taxes on said income.

Passive income (for example, investment income, income from dividends, royalties, rents, and real estate) is generally NOT considered "business income". (See IRS Pub. 598, Tax on Unrelated Business Income of Exempt Organizations.)

A religious corporation with unrelated business income may have deductions against that income. To qualify as allowable deductions in computing unrelated business taxable income, the expenses, depreciation, and similar items must qualify as allowable income tax deductions and be directly connected with carrying on an unrelated trade or business. To be

directly connected with the conduct of unrelated business, deductions are allowable only if they have proximate and primary relationship to carrying on that unrelated trade or business. See, IRC § 162.

Unrelated business income tax is levied on exempt organizations that are corporations at corporate income tax rates. If a religious corporation, or other exempt organization, has gross income of $1,000 or more for each taxable year from the conduct of any unrelated trade or business, it is required to file IRS Form 990-T, "Exempt Organization Business Income Tax Return", and attach any required supporting schedules and forms.

MARYLAND LAW
OF
RELIGIOUS CORPORATIONS

PART THREE

<u>Religious Employment Issues</u>

~ Craig F. Ballew

A religious corporation is a business and an employer for purposes of federal and Maryland employment laws. Its position as an essentially religious organization allows it an exemption from some, but not all, provisions of the employment laws. In general, if an employment decision is directly related to a religious tenant of the institution, that decision will not be subject to review by secular institutions. If the employment decision is not reasonably related to an aspect of religious beliefs of the Church, the employment decision will require compliance with employment laws.

The first step in the analysis is whether an individual providing services to the religious corporation is (1) an employee, (2) an independent contractor, or (3) a volunteer.

A. Employees, Independent Contractors and Volunteers

An employer must accurately differentiate between individuals who are employees of the business and those who are independent contractors. This distinction affects the business on many levels. First, the business is liable in tort for the acts of an employee committed while acting within the scope of his or her employment. Exposure for the acts of an independent contractor is more limited. Employee status also brings with it many other considerations. The employer must make withholdings from the wages of an employee. The employer must ensure compliance with many federal and state anti-discrimination, worker's compensation, workplace safety, and unemployment laws for employees. These laws do not apply to independent contractors. In addition, employee status often involves additional benefit costs shouldered by the employer.

Religious corporations face many of the same issues experienced by other employers struggling with the employee/independent contractor distinction. In addition, they often deal

with a third status: volunteers. To avoid potential liability, a religious corporation must be familiar with the standards frequently applied when addressing these distinctions.

There is no single, universally applied standard differentiating between an employee and an independent contractor. Although there are common themes that run through many of the standards, an employer must recognize that the standards applied by the Internal Revenue Service are different from those applied by the Equal Employment Opportunity Commission, as well as other state agencies addressing issues such as unemployment insurance compensation. For religious corporations, the most frequently disputed issue is the status of a minister as either an employee or a self-employed individual for tax purposes.

The Internal Revenue Service has found that ministers are, in some cases, employees for federal income tax reporting purposes. Alternatively, others have been found to be self-employed. In reviewing this issue, the agency and the courts have at various times applied one of the four tests:

1. the common law employee test;
2. the IRS 20-factor test;
3. Tax Court's 7-factor test; and
4. the Supreme Court's 12-factor test.

Regulation 31.3401(c)-1(b)-(c) sets forth that the common law employee test:

> Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is

> sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services.

The seven and twelve-factor tests articulated by the Tax Court and the Supreme Court expand on the concepts set forth in the common law test:

The Tax Court's "7-Factor" Test	The Supreme Court's "12-Factor" Test
Factor	**Factor**
(1) the degree of control exercised by the employer over the details of the work	(1) the hiring party's right to control the manner and means by which the product is accomplished
(2) which party invests in the facilities used in the work	(2) the skill required
(3) the opportunity of the individual for profit or loss	(3) the source of the instrumentalities and tools
(4) whether or not the employer has the right to discharge the worker	(4) the location of the work
(5) whether or not the work is part of the employer's regular business	(5) the duration of the relationship between the parties
(6) the permanency of the relationship	(6) whether the hiring party has the right to assign additional projects to the hired party
(7) the relationship the parties believe they are creating	(7) the extent of the hired party's discretion over when and how long to work
	(8) the method of payment
	(9) the hired party's role in hiring and paying assistants
	(10) whether the work is part of the regular business of the hiring party
	(11) whether the hiring party is in business
	(12) the provision of employee benefits

In 1998, the Eighth Circuit Court of Appeals considered the status of an Assemblies of God's minister and, in so doing, applied the Supreme Court's 12-Factor Test. The minister had reported his income taxes as a self-employed person while serving as a pastor of the church. The

Internal Revenue Service concluded that he should have reported as an employee. This affected the business expenses that the minister could deduct. Seeking a refund, the minister brought suit in District Court asserting that he was self-employed. The District Court found that the minister was an employee because of the significant control by his church through its supervision of the District Council and the national church over the manner in which he performed his work. The minister appealed and the Eighth Circuit reversed the District Court's decision.

In applying the Supreme Court's 12-Factor Test, the Eighth Circuit confirmed that all aspects of the relationship "must be assessed and weighed with no one factor being decisive." The Court noted that there were facts which suggested employee status and facts suggesting self-employed status. Ultimately, it concluded that the facts suggesting self-employed status were controlling.

Religious corporations that employ staff members other than ministers will apply the same test for determining whether those individuals are employees or self-employed for federal income tax reporting purposes. Non-minister staff who are employees for income tax reporting purposes must be treated as employees for purposes of social security. Unlike the minister, they are subject to social security and Medicare taxes.

The Volunteer

Volunteers frequently engage in activities similar to employees. They operate under the control of a religious corporation, the manner and means by which they provide their volunteer services are directed by it, and the religious corporation initiates or terminates the volunteer relationship. Unlike the employee, however, a volunteer does not receive the payment of wages or other compensation for his or her services. This is the principal distinction between the volunteer and an employee. In *Tony & Susan Alamo Foundation v. Secretary of Labor*, the

Supreme Court defined a volunteer as "an individual who without promise or expectation of compensation, but solely for his own purpose or pleasure, works in activities carried on by others either for their pleasure or profit."

In 1993, Maryland's courts considered whether a female volunteer firefighter in Rising Sun, Maryland was a volunteer or an employee. She had asserted a claim for sexual harassment under Title VII, and her employee/volunteer status was critical to whether that claim could proceed. In considering the issue, the Fourth Circuit noted that the volunteers received benefits. The female firefighter claimed that receipt of these benefits made her an employee. The Fourth Circuit held that benefits which would be sufficient to support an employment relationship must be more than "incidents of an otherwise gratuitous relationship" and must amount to "significant remuneration." Considering the range of benefits offered to the volunteer firefighters (group life insurance, tuition reimbursement, survivor's benefits for dependents, and a disability pension) the Court concluded that these benefits were sufficiently significant to deem the firefighter an employee and, thus, press her claim for harassment.

Any religious corporation engaging volunteers but then providing those volunteers with benefits, must assess whether the benefits they provide are similarly sufficient to place the individual in the status of an employee.

B. EMPLOYMENT DISCRIMINATION LAW

1. Substantive Law

Maryland employers are covered by federal, state and, frequently, local laws prohibiting employment discrimination. Title VII of the Civil Rights Act of 1964 makes it an unlawful employment practice for an employer:

> To fail or refuse to hire or discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, age or national origin.

The Maryland law prohibiting discrimination is even broader than Title VII and prohibits discrimination based on race, color, religion, sex, age, national origin, marital status, sexual orientation, genetic information, or disability. Federal and state antidiscrimination law is frequently reinforced by local city or county laws. On occasion, the local laws are even broader than the federal and state law.

The objective of federal, state and local antidiscrimination laws is to ensure that factors such as race, sex and age are treated neutrally in the employment process. These statutes are not affirmative action statutes; thus, they do not attempt to favor one group over another.

a. <u>Disparate Intent Discrimination</u>

Most charges of discrimination involve an allegation that an employer intentionally treated an employee or applicant differently because he or she fell within one of the protected categories. When a charge is based upon intentional discrimination, it is referred to as a "disparate treatment" claim. In such a case, the charging party must prove that the employer had a discriminatory intent. Proof can be provided by either direct evidence (such as comments that were made communicating a discriminatory intent) or by inference. Because direct evidence of discriminatory intent is very rare, the courts have created a system which allows the jury to infer discrimination if certain evidence is presented. Initially, the charging party must prove a <u>prima</u> <u>facie</u> case of discrimination. This requires that the charging party show that:

1. He belongs to a protected category;

2. He applied and was qualified for a job for which the employer was seeking applicants;

3. Despite his qualifications, he was rejected;

4. After his rejection the position remained open and the employer continued to seek applicants from persons with his level of qualifications.

After an employee establishes a prima facie case, the burden shifts to the employer to "articulate some legitimate non-discriminatory reason for the employee's rejection." If the employer can show a legitimate non-discriminatory reason for rejecting the employee, then the case proceeds to the third stage where the plaintiff must prove that the reason presented by the employer was a pretext and that the real reason was prohibited discrimination.

b. Adverse Impact Discrimination

In the early 1970's, the Supreme Court recognized that an individual could prove a violation of Title VII without showing that the employer engaged in intentional discrimination. In such cases, the charging party must show that although the employer's policy was neutral on its face, it had a significantly adverse impact on a protected group and was not demonstrably job-related. These types of cases are referred to as "adverse impact" claims. To prove adverse impact discrimination, the plaintiff must have a significant number of employees or applicants who were adversely affected by the facially neutral policy. In such cases, there are three steps.

Step One - the plaintiff must prove that the employer uses a selection standard or system that has a significant adverse impact on plaintiff's group.

Step Two - The employer must prove either that the selection standard did not have a significant adverse impact or that despite the impact, the standard was demonstrably job-related.

Step Three -If the standard was job-related, the plaintiff can still prevail by showing that an alternative standard was reasonably available which had a less adverse impact but was not used.

Most adverse impact cases involve the use of statistical evidence. Thus, adverse impact cases usually involve larger employers and the application of standardized tests or procedures which can be tested by statistical means.

c. **Retaliation**

In addition to prohibiting certain forms of discrimination, federal, state and local anti-discrimination statutes also protect individuals who file charges from discrimination. Title VII provides:

> It shall be an unlawful employment practice for an employer to discriminate against any of his employees or applicants for employment...because [the employee or applicant] opposed any practice made an unlawful employment practice by this subchapter or because [the employee or applicant] has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this subchapter.

2. **Discrimination and Religious Corporations**

Discrimination based upon religion is prohibited by federal, Maryland, and local law. Employers are required to "reasonably accommodate" an employee's religious beliefs or practices unless the accommodation would create an "undue hardship" on the business. The same statutes which impose this standard, however, create exemptions for religious organizations. Title VII clarifies that it does not apply

> to a religious corporation, association, educational institutions, or

> society with respect to the employment of individuals of a particular religion to perform work connected with the carrying on by such corporation, association, educational institution, or society of its activities.

42 U.S.C. §2000e-1(a). Maryland's employment discrimination law contains a parallel exemption. Notwithstanding the religious bias exemption, religious organizations are required to comply with all other federal, state and local discrimination prohibitions.

Maryland and Federal courts have repeatedly held that employment decisions of religious corporations undertaken for religious reasons are not reviewable by secular courts. This law is particularly prominent in the decision of a church to hire, discharge, or change the terms of employment for those in ministry. The landmark case in this field was *Watson v. Jones,* 80 U.S. 679 (1871). However, if the minister has a contract of employment, he can enforce that contract against the religious corporation as against a secular employee.

Despite these federal and state exemptions, Maryland's religious corporations faced a challenge to their ability to apply a religious standard to employment for individuals who are not involved in performing purely religious functions. In *Montrose Christian School v. Walsh*, 363 Md. 565, A.2d 111 (Md. 2001), the Maryland Court of Appeals reviewed a Montgomery County anti-discrimination law. The Montrose School had terminated a group of employees in positions such as teachers aides, bookkeepers, secretaries, and cafeteria workers because they were not members of the church. The former employees brought suit asserting that they were terminated on the basis of their religious creed in violation of the County's employment discrimination law. The School argued that there was a conflict between the state employment discrimination law and the County Code, that it was protected by the doctrine of charitable immunity, and that the

County statute violated the First Amendment of the United States Constitution as well as Article 36 of the Maryland Declaration of Rights.

Like federal and Maryland law, the Montgomery County provision did contain an exemption for religious corporations, associations and societies; however, the exemption was limited to employees who "perform purely religious functions."

Although the Court of Appeals rejected the School's claims that there was a conflict between the state and local law, as well as the claim of charitable immunity, it affirmed the School's contention that the limitation "to perform purely religious functions" violated the free exercise clause of the First Amendment and Article 36 of the Maryland Declaration of Rights. With this decision, the Court reaffirmed the ability of a religious corporation to apply a religious affiliation standard to its employees regardless of whether they perform purely religious functions or not.

C. Sexual Harassment

I. INTRODUCTION

The liability of religious institutions for sexual harassment is a matter in which the law is still developing. As noted earlier in these materials, religious corporations enjoy charitable immunity, and there is no reported case in Maryland finding a religious corporation liable for sexual harassment. However, because the obligation is statutory rather than a tort liability at common law, a religious corporation is likely to be subject to liability in the event of sexual harassment of an employee.

Public awareness of sexual harassment dramatically increased in the early 1990's with Anita Hill's claim of sexual harassment against Clarence Thomas during his 1991 Supreme Court

confirmation hearings. Shortly after the Anita Hill/Clarence Thomas testimonies, sexual harassment claims quadrupled. Public awareness also influenced Congress to include compensatory and punitive damages for sexual harassment in the Civil Rights Act of 1991.

II. DEFINITIONS AND LEGAL APPLICATIONS

A. 1980 EEOC Guidelines on Sexual Harassment

The 1980 EEOC guidelines provide:

> Harassment on the basis of sex is a violation of Sec. 703 of Title VII. Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitute sexual harassment when (1) submission to such conduct is made either explicitly or implicitly a term or condition of an individual's employment, (2) submission to or rejection of such conduct by an individual is used as the basis for employment decisions affecting such individual, or (3) such conduct has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile or offensive working environment.

29 C.F.R. '1604.11(a).

B. Meritor Savings Bank v. Vinson

The U. S. Supreme Court adopted the EEOC definitions in *Meritor Savings Bank v. Vinson*, 477 U.S. 57, 106 S. Ct. 2399 (1986). The Court ruled that (1) sexual harassment is a form of sexual discrimination under Title VII of the Civil Rights Act of 1964, that (2) sexual harassment which creates a hostile and abusive environment may violate the Act even though there is no loss of tangible economic benefits for the employee, and that (3) an employee's voluntary submission to an employer's sexual advances will not necessarily defeat a claim of harassment, the true issue being whether the advances were "unwelcome."

C. Two Types of Sexual Harassment

The courts normally divide sexual harassment claims into two categories--"Quid Pro Quo" and "Hostile Working Environment." The type of harassment alleged may have important consequences for the burden of proof and standards of employer liability. In many cases, the same harassing conduct can establish both types of harassment.

1. Quid Pro Quo

Quid pro quo, which in Latin means "something for something," involves actions by management or supervisors where job benefits are granted, withheld, or otherwise affected based upon an employee's willingness or refusal to submit to sexual demands. Such actions can involve:

- threats such as firing, blocking promotion, transferring, or giving a bad evaluation, if the employee does not submit to the sexual advances.

- rewards such as hiring, promoting, improving work assignments, or giving a raise, if the employee does submit to the sexual advances.

Courts consider several factors when reviewing a claim of quid pro quo harassment. Some of these factors include:

a. An employer is strictly liable for quid pro quo harassment by its supervisors which causes job detriment to an employee, regardless of whether specific acts were authorized or forbidden.

b. A single incident of sexual harassment may sustain an action for quid pro quo harassment.

c. A key factor is whether the sexual advances were unwelcome; in other words, whether the person voluntarily or involuntarily participated in the sexual activity is of no consequence.

d. To be actionable, the harassment must result in a loss of tangible economic benefits for the employee.

2. Hostile Working Environment Harassment

Hostile working environment involves abusive treatment based on the victim's gender that is sufficiently severe or pervasive to alter the conditions of employment and create an offensive or intimidating working environment. Such actions can be:

- Verbal--such as offensive jokes, language, comments, threats, or suggestions of a sexual nature.

- Nonverbal--such as staring at a person's body, leaning over someone at a desk, offensive gestures or motions, circulating letters or cartoons, and other sexually oriented behavior.

- Physical--such as touching, holding, grabbing, hugging, kissing, "accidental" collisions, and other unwanted physical contact.

Courts reviewing claims of hostile working environment harassment consider several factors, including:

a. An employer will be liable for the actions of co-workers if the employer's supervisors knew or should have known of the harassment and took no effective remedial action.

b. Where a supervisor creates a hostile work environment, an employee who is harassed may recover against the employer without showing that the employer knew or should have known of the supervisor’s actions. Where no tangible employment action (such as hiring, firing, or failing to promote) occurs as a result of the harassment, the employer may avoid liability by demonstrating:

(1) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior and

(2) that the employee unreasonably failed to take advantage of any preventative or corrective opportunities provided by the employer or to avoid harm otherwise. *Burlington Industries v. Ellereth*, 1998 WL 336326; *Faragher v. City of Boca Raton*, 1998 WL 336322.

c. The harassed employee must be prepared to show that the conduct is severe or pervasive throughout the workplace--isolated instances, unless they are particularly offensive, will not be enough.

d. An employer can be legally responsible for sexual harassment if it creates or allows a situation where an employee will be sexually harassed by customers, salespeople, visitors, or passersby.

e. Hostile acts related to an employee's gender can be sexual harassment, even though they may not involve sexual overtures. Typically, this involves jobs predominantly filled by individuals of one gender, who, when confronted with gains made in the workplace by the other gender, present opposition.

f. Whether co-worker conduct constitutes sexual harassment turns on the facts of each circumstance and the seriousness of the conduct. The resolution of a claim often depends on the credibility of the parties.

g. The psychological wellbeing of the employee may be a relevant factor in determining an abusive environment, but it is only one of several factors that may be considered.

h. Harassment, even of a sexual nature, that is addressed to all employees regardless of gender, may not constitute actionable sexual harassment.

D. Maryland Law

Maryland law interprets sexual harassment as a form of sexual discrimination under fair employment statute. Md. Ann. Code Art. 49B. The Maryland Commission on Human Relations has jurisdiction on such issues.

E. Employees Covered

1. Under federal laws

Title VII of the Civil Rights Act of 1964, as amended, provides coverage against sexual harassment for employees of public and private employers in the United States who employ 15 or more employees. Coverage also includes U.S. citizens working for a U.S. company in a foreign country.

2. Under Maryland law

Protection against sexual discrimination is provided for employees of private, state, and local government employers that employ 15 or more employees. The statute includes labor organizations, but, excludes coverage for bona fide private membership clubs. Elected officials and appointed staff members are also excluded.

F. Conduct of a sexual nature

The EEOC definition of sexual harassment includes the phrase "conduct of a sexual nature," which can include:

1. Sexual advances and propositions.

a. Advances from a supervisor are scrutinized closely due to the possibility of intimidation and abuse of power. In cases that involve tangible job benefits (quid pro quo harassment), the

employer is presumed to have knowledge and is thus legally responsible.

b. Unwelcome sexual advances or demands from a co-worker are considered less direct and require review of surrounding circumstances. The employer's presumption of knowledge does not apply to co-workers.

2. Pornographic and vulgar behavior.

Although not normally directed to a specific individual, pornography and vulgar behavior are viewed from a cumulative standpoint in relation to the overall environment. Lewd and vulgar behavior is often sexist and can reveal a double standard for male and female employees.

G. Conduct that is unreasonable

The law prohibits only unreasonable sexual conduct. However, the conduct complained of must be offensive both from an objective and a subjective standpoint. Therefore, courts begin their analysis by applying an objective test to determine whether a "reasonable person" would find the conduct offensive. The reasonable person standard in recent years has developed somewhat into a "reasonable woman" or "reasonable victim" standard. The change was a result of studies which indicated that men and women perceive "unwelcome" sexual advances differently. In a recent decision, however, the U.S. Supreme Court has continued to apply the "reasonable person" standard. *Harris v. Forklift Systems, Inc.*, 114 S. Ct. 367 (1993).

Next, the court asks whether the particular plaintiff subjectively found the conduct offensive. This element of the test focuses on the premise that conduct which a reasonable person would find offensive might not offend the plaintiff in question. Not surprisingly, courts consider evidence regarding plaintiffs which shows that their own behavior might prevent them from claiming they were offended by the defendant's conduct.

H. Conduct that is severe or pervasive

1. The courts apply a "totality of circumstances standard" in considering if the conduct is severe or pervasive. A variety of factors are considered, such as frequency of the discriminatory conduct, its severity, whether it is physically threatening or humiliating, or a merely offensive utterance, and whether it unreasonably interferes with an employee's work performance. All factors need not be present, nor must they persist for a long time.

2. A single incident of quid pro quo harassment is considered severe without anything further.

3. Physical actions of harassment are considered more serious than words. Intrusive types of touching or fondling are usually considered severe even if the act occurs only once.

4. The more severe the harassment, the less need there is to show repetition.

5. A few isolated leers or rude comments will not usually constitute a cause of action.

6. Harassment suffered by others can be introduced to show that the harassment was pervasive.

I. Conduct that is unwelcome

Under Title VII the sexual conduct must be "unwelcome," meaning it was uninvited and unwanted. Unwelcomeness is often a significant issue in sexual harassment cases, typically resulting in a credibility issue between the parties.

1. The recipient of the harassment must communicate that the conduct is not welcome, except in situations where the conduct is obviously unwelcome or where the conduct is threatening.

2. Whether the employee voluntarily or involuntarily participated in the sexual activity is not a factor. The key element is that the sexual advances were unwelcome.

3. The offending sexual activity must be unwelcome at the time the advances occurred, not unwelcome at some later date.

4. Courts often impose a greater duty upon the plaintiff if the parties maintained a prior, consensual relationship. Under these circumstances, the individual claiming harassment must show that clear signals were given to indicate that sexual conduct, once a part of the relationship, is no longer welcome.

5. Sexually provocative speech or dress can be considered along with other evidence to determine if the sexual conduct was unwelcome. Such determinations are subjective.

J. Sexual attraction vs. sexual harassment

The distinction between sexual attraction and sexual harassment in the workplace involves whether such attractions are welcomed. Sexual attraction occurs when two people working together are attracted to each other and are receptive to the interaction. Sexual attraction can become a problem, however, when one of the employees exceeds the limits of what the other considers desirable interaction. Sexual attraction becomes sexual harassment when the boundaries established by either of the employees are intentionally challenged or violated by the other.

K. Victim need not be direct target of harassment

An employee can be the victim of sexual harassment even though not directly harassed themselves. Job benefits obtained by other employees through their sexual favors could affect job benefits of non-participants.

L. Harassment of males by females

Although sexual harassment most often occurs where women are harassed by men, it is not uncommon for men to be harassed by women. The courts and EEOC guidelines make no distinction as to which gender is harassing or being harassed. The key factor is that the victim is being treated differently because of his or her sex.

M. Harassment by members of same sex

The Supreme Court has recently recognized that claims of sexual harassment by members of the same sex are actionable under Title VII. In reaching this conclusion the Court reasoned that nothing in Title VII necessarily bars a claim of sexual harassment merely because the plaintiff and defendant or the person charged with acting on behalf of the defendant are of the same sex. Title VII=s prohibition against discrimination because of sex extends to harassment of any kind that meets the statutory requirements. Harassing conduct need not be motivated by sexual desire to support an inference of discrimination on the basis of sex, but there must be proof that the conduct at issue was not merely tinged with offensive sexual connotations. *Oncale v. Sundower Offshore Services, Inc*, 76 FEP Cases 221 (1998).

IV. DEFENDING CLAIMS

A. Employer Liability

Courts ordinarily impose liability on employers based on the two different types of harassment--quid pro quo and "hostile working environment."

1. Quid Pro Quo

a. Employers strictly liable

The courts have uniformly held that an employer is strictly liable in quid pro quo harassment cases where the perpetrating supervisor has the authority to affect tangible job benefits of the employee. The supervisor, through the authority vested in him by the employer, is considered to be acting on behalf of the employer. Liability is thus imposed on the employer regardless of whether the employer approved or even knew of the supervisor's actions.

Likewise, EEOC guidelines advocate automatic employer liability in quid pro quo cases.

b. Supervisor and employee relationship

The relationship between the employer or supervisor and the employee is sometimes at issue in quid pro quo cases, since harassment can only be accomplished by a person who has authority to affect tangible job benefits of the harassed employee. It is not necessary for the alleged harasser to be the employee's direct supervisor. It is sufficient that the alleged harasser has sufficient authority or significant control over personnel matters relating to the claimant's employment. The term "employer" is considered to include "any agent" of the employer.

2. Hostile Working Environment

a. Harassment by co-workers

An employer can be liable for non-supervisory co-worker harassment under some circumstances. EEOC guidelines state:

> With respect to conduct between fellow employees, an employer is responsible for acts of sexual harassment in the workplace where the employer (or its agents or supervisory employees) knows or should have known of the conduct, unless it can show that it took immediate and appropriate corrective action.

29 C.F.R. '1604.11(d). The courts have uniformly applied this rule.

(1) Knowledge of the offensive conduct is imputed to the employer where an employee has notified company officials of the harassment.

(2) An employer may be liable even if notice is not given. Knowledge of the harassment may be imputed to the employer if the conduct is so severe or pervasive that a reasonable employer would have discovered the facts.

(3) An employer may be absolved of liability if it takes prompt and appropriate corrective action on the employee's claim. Such corrective actions should be calculated to end the harassment.

(4) A significant number of co-worker harassment claims result from male dominated jobs in which women make up a small percentage of the workforce. The harassment may not be of a sexual nature, but is nevertheless directed towards the victim's gender. Supervisors should be trained to recognize and correct such conduct.

b. Harassment by non-employees

Under some circumstances, an employer may be liable for harassment of its employees by non-employees. EEOC guidelines state:

> An employer may also be responsible for acts of non-employees with respect to sexual harassment of employees in the workplace, where the employer (or its agents or supervisory employees) knows or should have known of the conduct and fails to take immediate and appropriate corrective action. In reviewing these cases the Commission will consider the extent of the employer's control and any other legal responsibility which the employer may have with respect to the conduct of such non-employees.

29 C.F.R. '1604.11(e). This is an extension of the employer's responsibility to maintain the working environment free from unlawful harassment.

As with harassment by co-workers, the employer may be absolved of liability if it takes prompt, appropriate corrective action on such claims.

c. <u>Harassment by supervisors</u>

An employer is subject to strict liability to a victimized employee for an actionable hostile environment created by a supervisor with immediate or successively higher authority over the employee. When no tangible employment action is taken, a defending employer may raise an affirmative defense to liability or damages. The defense comprises two necessary elements:

(1) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior and

(2) that the plaintiff employee unreasonably failed to take advantage of preventative or corrective opportunities provided by the employer to avoid harm.

No affirmative defense is available, however, when the supervisor's harassment culminates in tangible employment action such as discharge, demotion, or undesirable reassignment.

B. Burdens of proof

Four of the five elements of a prima facie case are the same for both quid pro quo and hostile working environment harassment. A claimant must prove the following:

1. The employee belongs to a protected group. This normally requires merely a recitation that the claimant is a man or woman.

2. The employee was subject to unwelcome sexual conduct.

3. The harassment was based on sex or gender.

4. There is basis for imposing respondeat superior (employer) liability.

   (a) Under quid pro quo, courts hold that the employer is strictly liable for the conduct of a supervisor regardless of actual knowledge of the act or whether it took corrective action upon learning of the harassment.

   (b) If a hostile work environment is created by a supervisor, the employer will be held strictly liable if a tangible employment action occurs as a result of the harassment.

   (c) If there is no tangible employment action, the employer will be strictly liable for hostile work environment harassment perpetuated by a supervisor, unless the employer can establish the affirmative defense discussed above.

   (d) If the hostile work environment is created by a co-worker the employer will be responsible if the employer's supervisors knew or

should have known of the harassment and failed to take prompt remedial action.

5. Quid pro quo--The harassment had a tangible effect on aspects of the employee's compensation, terms, conditions, or privileges of employment.

6. Hostile working environment--The harassment was severe and persistent enough to create an intimidating, hostile, or offensive work environment. At one time, courts also required proof that the harassment seriously affected the individual's psychological wellbeing. However, in *Harris v. Forklift Systems*, 114 S. Ct. 367 (1993), the U.S. Supreme Court held that psychological harm is simply one factor that may be considered.

C. Employer Defenses

1. Refuting Claims

In defending claims of sexual harassment, an employer may offer evidence that:

- the conduct did not occur
- that any conduct that did occur was not based on sex
- that the conduct was not unwelcome
- claimant's response did not affect a term or condition of employment
- no basis exists on which to hold the employer liable
- some reason other than sexual harassment actually motivated the adverse employment action

2. Prompt and Adequate Remedial Action

To avoid liability, an employer's remedial action should be both prompt and adequate. Absence of further complaints is a factor for courts to consider when evaluating the sufficiency of an employer's remedial response. When an employer=s remedial response results in cessation of complained of conduct, liability must cease as well. *Spicer v. Commonwealth of Va. Dept. of Corrections*, 66 F.3d 705 (4th Cir. 1995).

3. After-Acquired Evidence

Recently, the U.S. Supreme Court limited an employer's use of so-called "after-acquired evidence" to avoid liability for the discriminatory termination of employment. After-acquired evidence is evidence found by the employer, after the employee's termination, which would have justified termination had it been known earlier. In general, where discharge would be the appropriate action based on the after-acquired evidence, employers should not have to reinstate or pay future damages to the employee. Liability for back pay would exist, however, until the time the new evidence was discovered. *McKennon v. Nashville Banner Publishing Co.*, 1995 WL 20463 (U.S. Tenn.).

4. Mixed Motives

Where a claimant proves an unlawful employment practice such as sexual harassment has occurred, an employer may still prevail where other motivating factors can be shown. If the employer demonstrates that the same action would have occurred in absence of the unlawful discriminatory practice, the employer is not liable for damages associated with the employment action. The employer may, however, be subject to declaratory relief, injunctive relief, and costs attributable to the employee's pursuit of the claim. 42 U.S.C. Sec. 2000e-5(g)(2).

D. Damages

An employee prevailing in a sexual harassment case can be awarded the following damages.

1. Title VII of the Civil Rights Act of 1964

a. Back pay

Back pay can be awarded for any lost wages or benefits resulting from an improper discharge, penalty, reassignment, demotion, etc., or from the failure to receive a proper promotion.

b. Combined compensatory and punitive damages

The Civil Rights Act of 1991 permits recovery of a combined award for compensatory and punitive damages in the amounts as follows. Compensatory damages can include actual medical expenses as well as future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other nonpecuniary losses. Punitive damages can be awarded against nongovernmental employers where it is determined the discrimination was intentional. The combined compensatory and punitive award is limited by the number of employees of the employer as follows:

$50,000 for employers of 15 to 100 employees

$100,000 for employers of 101 to 200 employees

$200,000 for employers of 201 to 500 employees

$300,000 for employers of 501 or more employees

c. Injunctive Relief

The courts can issue orders for employers to cease the harassing conduct, educate employees about sexual harassment, and implement or change sexual harassment programs and grievance procedures.

d. Attorney's Fees

The courts can require the employer to pay all or part of the prevailing employee's attorney's fees.

2. Maryland Fair Employment Laws

a. Back pay

Back pay can be awarded for any lost wages or benefits.

b. Compensatory or punitive damages

No compensatory or punitive damages may be awarded either through the Maryland Commission on Human Relations or by private lawsuit.

c. Injunctive Relief

Injunctions can be obtained.

d. Attorney's Fees

No attorney's fees are recoverable

3. Mitigating Damages

The claimant has a duty to mitigate (lessen) any damages suffered by sexual harassment.

D. Negligent Hiring/Retention

1. Generally

Maryland recognizes a cause of action against an employer for negligently hiring or retaining an employee who is unfit or incompetent to perform the assigned duties of his or her position and who consequently injuries a third person. The tort of negligent hiring is distinguishable from the doctrine of "respondeat superior," where an employer is liable for the negligence of employees acting within the scope of their duties or in furtherance of the employer's interests. Where the elements of the independent tort have been satisfied, an employer will be liable even where the acts of the offending employee are outside of the scope of his or her employment.

Increasingly, religious organizations have faced suits arising out of the alleged sexual misconduct of clergy. Many of these suits have sought recovery from the religious organizations based upon a negligent hiring/retention theory. In response, many religious organizations have asserted that such actions are barred by the First Amendment to the U.S. Constitution and that the organization is protected by the doctrine of charitable immunity. To date, Maryland's appellate courts have not directly addressed this issue. The conclusions reached in other states have been mixed.

In those cases which have found such actions barred by the First Amendment, the courts have often focused upon the fact that the choice of an individual to serve as a minister is one of the most fundamental rights belonging to a religious institution and one of the most important exercises of a church's freedom from government control. Those courts have concluded that

governmental intervention through a negligent hiring claim would substantially burden the religious institution's free exercise of crucial power to control the future of the church.

Not all state courts have found this analysis persuasive. A recent decision by the Supreme Court of Florida held that imposing tort liability on the church based upon an allegation of sexual misconduct neither advanced nor inhibited religion. The Court went on to note that the First Amendment could not be used to "shut the court house door" on a plaintiff's claims of harm based upon a sexual assault by the religious institution's clergy.

2. Elements of the Cause of Action

In order to state a claim for negligent hiring or retention, a plaintiff must satisfy four elements: (1) the employer owed a duty of care to the plaintiff to use reasonable care in selecting its employees; (2) the employer failed to exercise reasonable care in selecting an employee (i.e. the employer breached the duty of care that it owed to the plaintiff); (3) the employer's failure to exercise reasonable care was the proximate cause of an injury to the plaintiff; that is: (a) if the employer had exercised reasonable care, it would have discovered or properly considered information that would have prevented a reasonably prudent employer from hiring or retaining the employee and (b) the employee's employment placed him in a position to cause harm to the plaintiff; and (4) the plaintiff has suffered damages. *Cramer v. Housing Opportunities Commission*, 304 Md. 160, 712-13, 501 A.2d 35, 39 (1985).

a. Workers' Compensation and Anti-Discrimination Act Preemption.

Claims for negligent hiring and retention by injured employees against their employers face several obstacles. Acts of negligence in the workplace that cause injury to an employee are generally preempted by Maryland's Workers' Compensation Act. Mazaroff, Maryland

Employment Law, Second Edition, § 5.07 (1990). Moreover, where an employee alleges that he or she was subjected to illegal discrimination as a result of an employer's negligent hiring or retention of another employee, the negligent hiring claim will be preempted by Article 49B of the Maryland Code and/or the appropriate federal statute addressing the underlying discrimination. Id.

b. The Duty of Care.

In determining whether an employer owes a duty of care to an injured plaintiff, the primary inquiry involves the issue of foreseeability. An employer is not liable to every person who might conceivably be injured by an employee. Liability extends only to those persons who a reasonable employer could have foreseen. For example, a suspected vandal is within the class of persons subject to injury as result of the negligent selection of s security employee. *Henley v. Prince George's County*, 305 Md. 320, 503 A.2d 1333(1986).

c. Breach of the Duty of Care.

In determining whether an employer has breached the duty of care, Courts will examine whether "in the exercise of reasonable care, the employer knew or should have known" that an employee or applicant was potentially dangerous. Mazaroff at § 5.07. While an employer has no general obligation to inquire concerning the possible criminal record of every prospective employee, where an employee is expected to come into contact with the public, the employer must make a reasonable inquiry to ascertain his or her fitness for duty. *Evans v. Morsell*, 284 Md. 160, 395 A.2d 480 (1978). Depending upon the circumstances, the failure to obtain a criminal history may constitute a breach of the duty of care. Liability will be tied to the specific facts and circumstances of each case. The nature of the criminal history and the duties of the particular employment are critical factors in the analysis. Id. at 167, n. 4, 395 A. 2d at 484, n.4.

d. Proximate Cause.

The issue of whether an employer's negligence proximately caused injury to a third party involves two inquires: (1) Would a reasonable inquiry have produced information that would have disqualified the offending employee; and (2) was there a causal relationship between the hiring of the employee and the injury to the plaintiff. Mazaroff, § 507. Where an employer negligently fails to conduct a background check, that negligence is actionable only if the background check would have revealed negative information concerning a prospective employee. In addition, where the employment did not place the employee in a position to injure a third person, the plaintiff can not establish a causal relationship between his or her injuries and the negligent hiring decision. *Id. See also Cramer*, 304 Md. 705, 713, 501 A.2d 35, 39; *Henley v. Prince George's County*, 305 Md. 320, 334, 503 A.2d 1333, 1340(1986).

E. TAX RULES FOR MINISTERS

Definition of a "minister" for federal tax purposes

"Minister" is not defined in the Tax Code. The IRS publication "Tax Guide for Churches and Religious Organizations" published in 2002 explains its reference to minister in its publication as denoting members of the clergy of all religions and denominations and includes priests, rabbis, imans, and similar members of the clergy. However, merely holding the title of priest or rabbi will not be sufficient to be considered a minister for federal tax purposes. While there is no set definition, there are certain criteria that help with the determination of whether or not an individual is a "minister". First and foremost, the Tax Court has held that an individual must be a "duly ordained, commissioned, or licensed minister of a church". *Knight v.*

Commissioner, 92 T.C. 199 (1989). The *Knight* case also noted four other factors that must be looked at in making a determination of whether an individual is a minister. Those factors are:

1. Does the individual administer the "sacraments"?
2. Does the individual conduct worship services?
3. Does the individual perform services in the "control, conduct or maintenance of a religious organization under the authority of a church or religious denomination?
4. Is the individual considered to be a spiritual leader by his or her religious body?

These four additional factors will be used by the Court as additional help to make a determination if an individual is a minister, but none of the additional four have been labeled as necessary by a Court in order for an individual to be deemed a "minister". Courts after the Knight case have looked at the five factors and found that in some cases only three of the five factors have been met, but the Court still found the individual to be deemed a "minister" for federal tax purposes. This five factor test has been adopted by the IRS in its 1995 Guidelines for Auditing Ministers and is what the IRS uses when auditing ministers.

Minister's Exemption for social security taxes

For social security purposes ministers are always deemed to be self employed with respect to their ministerial services. Because of their status as self-employed persons, ministers are required to report and pay their social security as a self-employed person and not as an employee. This means that the minister is responsible for the full amount of taxes due, instead of the employee situation where the employer would be responsible for half of the taxes. However, a minister may elect to exempt himself or herself from payment of social security. Ministers are

able to make this exemption based on the First Amendment Guaranty of Religious Freedom. In order to make this exemption, the following six conditions must be met:

1. The minister must be an ordained, commissioned, or licensed minister of a church.

2. The church or denomination that ordained, commissioned, or licensed the minister is a tax-exempt religious organization.

3. The minister must file an exemption application (Form 4361) in triplicate with the IRS. (Form 4361 contains a certification from the minister that he is opposed to, or because of religious principles is opposed to, the acceptance of any public insurance that makes payments in the event of death, disability, old age, retirement, or that makes payments towards the cost of, or providing services for, medical care. The opposition must be based on religious reasons.)

4. The exemption application must be filed on time. The application must be filed at the same time that the minister's tax return for the second year that he has earned more than Four Hundred Dollars as part of his ministry is filed.

5. Ministers seeking the exemption must notify their "ordaining, commissioning, or licensing body" that they are opposed to Social Security Coverage for the services they perform in the exercise of ministry.

6. IRS verification. IRS will verify that the individual is aware of the grounds for the exemption and that the exemption was sought on those grounds.

The most important factor is that the minister is making the exemption on religious reasons. Non-religious or economic factors are not a basis for the exemption. A minister should be fully advised of the ramifications of his/her decision to be exempt from social security taxes. All of the benefits that the minister is waiving should be fully discussed with the minister.

Minister's Housing Allowance

Ministers of the gospel may exclude the rental value of homes furnished by churches as part of their compensation (IRC §107(2)). This includes the portion of a retired minister's pension designated as a rental allowance by the national governing body by a religious

denomination having complete control over the retirement fund. The exemption also applies to the rental value of a residence furnished to a retired minister (but not a widow).

A minister is entitled to deduct mortgage interest and real property taxes paid on a personal residence even if the amounts expended are derived from a rental allowance that is excludable from the minister's gross income (IRC § 265(a)(6)).

In practice, this benefit can be distributed to ministers in one of three ways:

1. Parsonages. Ministers who live in a church-owned parsonage that is provided "rent-free" as compensation for ministerial services do not include the annual fair rental value of the parsonage as income in computing their federal income taxes. The annual fair rental value is not (deducted" from the minister's income. Rather, it is not reported as additional income anywhere on Form 1040 (as it generally would be by non-clergy workers).

2. Parsonage allowances. Ministers who live in a church-provided parsonage do not pay federal income taxes on the amount of their compensation that their employing church designates in advance as a parsonage allowance, to the extent that the allowance represents compensation for ministerial services and is used to pay parsonage-related expenses such as utilities, repairs, and furnishings.

3. Housing allowances. Ministers who own their home do not pay federal taxes on the amount of their compensation that their employing church designates in advance as a housing allowance, to the extent that the allowance represents compensation for ministerial services, is used to pay housing expenses, and does not exceed the annual fair rental value of the home (furnished, plus utilities). Housing –related expenses include mortgage payments, utilities, repairs, furnishings, insurance, property taxes, additions, and maintenance. Ministers who rent a home or apartment do not pay federal income taxes on the amount of their compensation that

their employing church designates in advance as a housing allowance to the extent that the allowance represents compensation for ministerial services and is used to pay rental expenses such as rent, furnishings, utilities, and insurance.

Regardless of which category the Minister falls into, the amount of the allowance cannot exceed the “fair rental value” of the housing. The allowance must be adopted by the religious corporation in writing in advance of the calendar year in which it is granted. The allowance can never be applied retroactively.

MARYLAND LAW
OF
RELIGIOUS CORPORATIONS

PART FOUR

Confidentiality & Required Reporting

~ Craig F. Ballew

A. Confidentiality

Maryland law recognizes that communications arising in certain contexts are confidential and, therefore, a party cannot be compelled to testify about those communications. Clergy are protected by such a privilege. In Maryland, the statutory privilege for the clergy states:

> A minister of the Gospel, clergyman, or priest of an established church of any denomination may not be compelled to testify on any matter in relation to any confession or communication made to him in confidence by a person seeking his spiritual advice or consolation.

This statutory privilege is expansive and no published case has addressed whether there are limitations placed upon the privilege.

The fact that Maryland law contains a clergy person privilege does not mean that all documents possessed by a religious corporation are confidential. Pursuant to § 5-306 of the MARYLAND CODE, CORPORATIONS AND ASSOCIATIONS ARTICLE, a Board of Trustees manages the assets of a religious corporation. § 5-307 of the same Article requires Trustees to keep an accurate record book recording the proceedings of the religious corporation. A demand can be made to produce such documents.

Courts have required the production of internal church documents, the minutes of deacons' meetings, in litigation between parishioners in the church played some role. The most common area in which production has been required is domestic disputes, where one or both spouses have brought a civil action, and of which there was some record in the church files. The most effective way to prevent the required disclosure of these materials is to couch the minutes or other written record as a spiritual (rather than temporal) matter, and as the advise given or action taken as the expression of religious beliefs.

B. Required Reporting Regulations

Maryland law imposes reporting requirements on persons who suspect that an employee has been subjected to either abuse or neglect. These provisions are applicable to religious corporations. In order to fully understand the reporting requirements, we must begin with an understanding of the terms "abuse" and "neglect."

Under Maryland's Family Law Article, abuse is defined as:

> The physical or mental injury of a child by any parent or other person who has permanent or temporary care or custody or responsibility for supervision of a child, or by any household or family member, under circumstances that indicate that the child's health or welfare is harmed or at substantial risk of being harmed; or (2) sexual abuse of a child, whether physical injuries are sustained or not.

Neglect is defined as:

> The leaving of a child unattended or other failure to give proper care and attention to a child by any parent or other person who has permanent or temporary care or custody or responsibility for supervision of the child under circumstances that indicate: (1) that the child's health or welfare is harmed or placed at substantial risk of harm; or (2) mental injury to the child or a substantial risk of mental injury.

1. Educators and Human Service Workers

Maryland's reporting requirements are divided into two categories. The first is applicable to health care practitioners, police officers, educators, or human service workers. The second is related to other persons. A professional employee of a parochial or private educational institution is considered an educator or human service worker. This definition includes any (1) teacher; (2) counselor; (3) social worker; (4) case worker; and (5) probation or parole officer.

When such a person has reason to believe that a child has been subjected to abuse, then that individual must notify either the appropriate "law enforcement agency" or the local social services department.[8] The local social services department contacted would either be the one having jurisdiction in the county where the alleged abused child lives or, if different, where the alleged abuse took place. If an educator or human service worker has reason to believe that a child has been subjected to neglect, then he or she is to notify the local social services department.

In addition to advising the appropriate law enforcement agency and/or local department of social services, the educator or human service worker is required to immediately notify the head of the institution or his or her designee.

When abuse or neglect is suspected, an oral report should be made "as soon as possible." Within forty-eight (48) hours of the contact, the individual is expected to submit a written report containing the following information:

1. Name, age and home address of the child;

2. Name and home address of child's parent or other person responsible for child's care;

3. The whereabouts of the child;

4. The nature and extent of the abuse or neglect of the child including any evidence or information available to the reporter concerning possible previous instances of abuse or neglect; and

5. Any other information that would help to determine:

[8] The term law enforcement agency includes a state, county or municipal police department, a sheriff's office, a State's Attorney's office, or the Attorney General's Office.

a) the causes suspected abuse or neglect; and

b) the identity of the individual responsible for the abuse or neglect.

In the case of either abuse or neglect, the written report is to be submitted to the local social services department. In the case of abuse, a copy should also be provided to the local State's Attorney. In addition, all information in the report should also be provided to the head of the institution.

2. Other Persons

Individuals who are not health care practitioners, police officers, educators or human service workers do have an obligation to report suspected abuse to the local Department of the Social Services Agency or appropriate law enforcement agency. In the case of suspected neglect, the notice is to be made to the local Department of Social Services. The statute specifically addresses how this notice obligation applies to clergy:

> A minister of the Gospel, clergyman, or priest of an established church of any denomination is not required to provide notice under Paragraph (1) of this Sub§ if the notice would disclose matter in relation to any communication described in §9-111 of the Courts Article and: (i) the communication was made to the minister, clergyman, or priest in a professional character in the course of discipline enjoined by the church to which the minister, clergyman, or priest belongs; and (ii) the minister, clergyman, or priest is bound to maintain the confidentiality of that communication under cannon law, church doctrine, or practice.

C. Counseling and Tort Liability

Clergy often provide counseling to members of their religious organization. On occasion, this counseling is mishandled and the member is actually injured by the clergy's actions. Concerns about such events can prompt a religious organization to consider its own legal

exposure. In 1999, the Maryland Court of Special Appeals, Maryland's second highest court, considered and rejected a series of attempts to impose such liability on a church. In *Borchers v. Hrychuk*, 126 Md. App. 10, 727 A.2d 388 (Md. App. 1999), an employee at a church camp conveyed to a pastor that she was experiencing marital difficulties. When she sought advice from the pastor, he exploited his position and initiated a sexual relationship with her. In the suit against both the pastor and the church, the plaintiff asserted claims for intentional infliction of emotional distress, marital counseling malpractice, clergy malpractice, and gross negligence. The Circuit Court dismissed all counts and the plaintiff appealed.

In analyzing the claim for intentional infliction of emotional distress, the Maryland Court of Special Appeals noted a prior distinction drawn between cases in which such conduct arose within officially-sanctioned treatment relationships and situations in which such an officially-sanctioned relationship did not exist. The Court concluded that this case did not involve such a unique treatment relationship and was more akin to contexts in which a friend or even a stranger engaged in such behavior. Since there was not an officially-sanctioned treatment relationship between the pastor and the employee, the actions of the pastor were not considered outrageous as that term was defined by law. Thus, dismissal of the claim for intentional infliction of emotional distress was deemed appropriate.

The Court then considered the claim for marital counseling malpractice. The plaintiff had noted that within the church all aspiring pastors received training on counseling at their colleges and seminaries. According to the plaintiff, the church encouraged members who were experiencing marital difficulties to seek counseling from pastors, and pastors were expected to respond to requests for counseling by providing appropriate counseling. Despite all these facts, the Court was not satisfied that the allegations established "a professional counselor-patient

relationship" between the pastor and the employee. The Court noted that the record did not establish the type of counseling training received, whether the training was extensive or cursory, whether there was any official recognition or certification of the program for pastors. It also noted there was no suggestion of any governmental acknowledgement or licensing of such counseling training. Unable to find sufficient evidence to establish a professional counselor-patient relationship, the Court concluded that the claim for marital counseling malpractice could not be made.

In considering the claim for clergy malpractice, the Court of Special Appeals noted that neither the Maryland General Assembly nor the Court of Appeals of Maryland had ever recognized the tort of clergy malpractice. As such, the Court of Special Appeals was not prepared to pronounce such a new substantive legal rule.

This case has established a particularly high standard for a plaintiff who seeks to assert such claims against a church arising out of inappropriate behavior in a counseling context. A religious organization providing counseling should consider whether its arrangement is akin to the one in this case or whether the facts suggest an officially-sanctioned treatment relationship between the parties. In the latter case, the religious corporation should recognize the potential for such claims and seek to reduce its risk through training, supervision, and appropriate insurance coverage.

MARYLAND LAW
OF
RELIGIOUS CORPORATIONS

PART FIVE

<u>POLITICAL MATTERS</u>

~Thomas J. Schetelich

The involvement that Churches, Religious Corporations, and Clergy may have in political matters in governed by the interaction of (1) constitutional rights with (2) the statutory election laws and (3) the requirements for organizations which seek to establish and/or maintain tax-exempt status.

All individuals have a constitutional right of Freedom of Speech, and the right to support such political candidates of their choice. This right is fundamental and unlimited. A Church may take a position on any political position and endorse any candidate, and do so in any way it chooses, limited only by the restraints placed on free speech by constitutional law.

However, most (if not all) Churches and Religious Corporations seek favored treatment under the Internal Revenue Code, by which the organization is exempt from income taxes (I.R.C. § 501); and individuals may deduct contributions made to it, (I.R.C. § 170). There are similar Maryland State Tax advantages that follow recognition by the Internal Revenue Service. This favored tax treatment is not a constitutionally right of any Church; but is rather a creation of the tax statutes. To maintain this status, Churches and Religious Corporations must abide by the rules established by Congress.

§ 501(c)(3) of the tax code exempts from federal income taxation any church organized and operated exclusively for religious, charitable, educational, or other exempt purposes so long as it "does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." This prohibition is much stricter than Federal election law restrictions. Often, what is permissible under the Federal Election Laws (and thus altogether legal) will cause a forfeiture or penalties under the Federal Tax Laws.

Churches (like all non-profit organizations that hold 501(c)(3) tax-exempt status) must abide by Internal Revenue Service regulations barring any involvement in partisan politics. The blanket prohibition concerns *only races for public office, not issues.* Religious leaders may speak out from the pulpit or in other forums on moral and political issues. However, churches and pastors may not endorse candidates for public office or advise congregants to vote for or against certain candidates. The IRS has indicated that it follows a "zero tolerance" policy toward violations, and election activity by charities, including churches, continues to be a subject of intense IRS interest. The Church at Pierce Creek in Binghamton, N.Y., lost its tax-exempt status in 1995 after the IRS determined it had violated federal tax law by publishing a full-page ad in *USA Today* in late October of 1992 telling people that voting for presidential candidate Bill Clinton was to participate in sin. ("The Bible warns us not to follow another man in his sin nor help him promote sin lest God chastens us. How then can we vote for Bill Clinton?") The church sued in federal court to regain its tax-exempt status but lost in federal district court. A federal appellate court later upheld the ruling denying the church tax-exempt status.

Involvement in political activities need not be overt or intentional to violate the tax laws. Subtle and inadvertent violations are not permitted and there is no “excusable neglect” which is permitted.

To address some specific issues:

a. Minister’s Right to personally support a candidate

While the IRS prohibits a minister from speaking from the pulpit or to his congregation regarding political candidates, a minister is free to endorse a political candidate personally. The IRS is clear that it is not trying to take away a minister’s constitutional

right to freedom of expression. The key to not violating the church's tax-exempt status is that the minister must make it clear to the audience that the opinions are his/her personal opinions and have no relation to his/her role as a minister. The minister must be careful not to engage in partisan activities or speeches in church publications or at official church functions, even if the minister personally pays for the publication or indicates in the official publication that the views are personal. Religious leaders who write or speak about their personal political views should clearly indicate that they are expressing their personal views and not the views of their church. The minister's personal political views should never be written in official church publications.

b. Ability to discuss issues of public policy

A minister is able to strongly advocate for a certain public policy issue, even if that issue is in the forefront of a political campaign, as long as the minister is advocating for the public policy issue, and not the candidate. The minister must be careful not to mention which political candidate supports or opposes the public policy issue. A Church can support or oppose a ballot referendum.

c. Church is not restricted from general voter education

Churches are allowed to engage in general voter education. Churches are able to create voter guides that outline the positions of the various candidates on relevant issues in the campaign. Churches are cautioned to create these voter guides with extreme caution. The Guides must be completely non-partisan and objectively outline the positions of the candidates. Any hint of trying to persuade the congregation to vote one way or the way could jeopardize the church's tax-exempt status.

Churches are also allowed to hold "get out to vote" campaigns as long as the church is not advocating for or against a certain candidate. The "get out to vote" campaigns should clearly emphasis the importance of voting in general, and in no way discuss issues or candidates.

d. Churches can invite candidates and public official to speak to the congregation

Political candidates and governmental officials may be acknowledged as visitors at a church, and can be invited to speak at a church. If a candidate is speaking at a church event, the church must ensure that:

i. It provides an equal opportunity to the political candidate seeking the same office;
ii. It does not indicate any support or opposition to the candidate;
iii. No political fundraising occurs.

The church must clearly and unambiguously state to the audience that the fact that the candidate is speaking at the church does not in any way show the church's support or opposition for the candidate.

e. Religious organization's ability to retain a lobbyist to influence legislation

A church or religious organization may attempt to influence legislation. An organization will be considered to be engaged in lobbying activities if it contacts, or urges the public to contact members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation or advocates for or against certain legislation. The religious organization's lobbying activities must not constitute a substantial part of the

organization's activities. To determine what constitutes a "substantial part", the IRS looks at the pertinent facts and circumstances of each case. Particularly, the IRS will look at the time devoted to the lobbying activity as well as the financial expenditure committed to the activity. If the IRS determines that a substantial part of the religious organization's activities are committed to lobbying activities the religious organization will lose its' tax-exempt status, resulting in all income being subject to tax. The religious organization may also be imposed an excise tax equal to five percent of its lobbying expenditures for the year in which it lost its tax-exempt status.

What a Religious Corporation MAY NOT DO:

- Churches and Religious Corporations MAY NOT endorse candidates or oppose them, whether verbally or in writing.

- Churches and Religious Corporations MAY NOT contribute to political campaigns, solicit contributions on their behalf or donate to candidates' political action committees.

- Churches and Religious Corporations MAY NOT set up their own Political Actions Committees.

- Churches and Religious Corporations MAY NOT display campaign literature on church property.

Churches and Religious Corporations should be extremely wary of voter guides produced by outside groups (some of which hold tax-exemption under § 501(c)(4), which allows

organizations to engage in some political activity, such as disseminating partisan voter guides). Before agreeing to distribute a voter guide prepared by another organization, a church must ensure that the guide is truly nonpartisan and does not endorse or oppose any candidate, either explicitly or by implication. It does not matter that the church may not intend any political intervention. The IRS and the courts do not look to the church's motive, but to whether the voter guide in fact favors one candidate over another. Further, a Church which distributes voter guides are responsible for the accuracy of the materials and the neutrality of the presentation. *If a voter guide produced by an outside group is determined to be partisan in character and is distributed in church, the IRS has the legal right to penalize the church even though it did not produce the guide*.

Likewise, Churches that post material on their website which concerns political matters, must be careful as links to other (and overtly political sites) will be considered in violation of the tax laws.

No person, clergy or otherwise, is prohibited from discussing personal or the church's beliefs on political matters, provided that it is not the endorsement or support of a candidate. Should a clergy member desire to be politically active, he must be explicit about speaking as a private citizen, not as a church leader.

The IRS has acknowledged that the campaign activity prohibition is not intended to restrict free expression on political matters by leaders of churches or religious organizations speaking for themselves, as individuals. Nor are leaders prohibited from speaking about important issues of public policy. However, "religious leaders cannot make partisan comments

in official organization publications." The IRS has provided the following example in its IRS Announcement 2000-84.

> *Minister B is the minister of Church K. Church K publishes a monthly church newsletter that is distributed to all church members. In each issue, Minister B has a column titled "My Views." The month before the election, Minister B states in the "My Views" column, "It is my personal opinion that Candidate U should be reelected." For that one issue, Minister B pays from his personal funds the portion of the cost of the newsletter attributable to the "My Views" column. Even though he paid part of the cost of the newsletter, the newsletter is an official publication of the church. Since the endorsement appeared in an official publication of Church K, it constitutes campaign intervention attributed to Church K.*