
CHURCH & THE LAW UPDATE - No. 4

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Updating Churches on recent legal developments and risk management considerations.

1. INTRODUCTION

This is the fourth issue of Church & the Law Update. It is intended to provide an update for churches and charities on current legal developments, as well as providing recommendations on matters of legal risk management where appropriate. The Church & the Law Update is prepared as a service to churches and charities and is published approximately three to four times a year as legal developments occur.

2. CHURCH & THE LAW SEMINAR - 1995

The 1995 Annual "Church and the Law" Seminar will be held on **Wednesday, February 8th, 1995, at Queensway Cathedral in Etobicoke, Ontario**. Full details of the program and how to register for the seminar is set out on the back page of this Church and the Law Update.

3. THE NUTS AND BOLTS OF CHURCH INCORPORATION - PART II

This is Part II of a two part series on the "Nuts and Bolts" involved in the process of church incorporation. The first part appeared in the Church and the Law Update - No. 3 dated November 1st, 1994 that was published in conjunction with the CCCC Bulletin No. 5 dated November 30th, 1994. Reprints of the Church and the Law Update - No. 3 are available from the Canadian Council of Christian Charities.

The two part series on the "Nuts and Bolts" of Church Incorporation arose out of an earlier article on "The Incorporation of Churches in Ontario" that was published in the July, 1993 issue of the CCCC Bulletin. Since the July 1993 article there has been considerable discussions in churches concerning incorporation. Although some churches are open to the idea of incorporation in theory in order to obtain liability protection for church members, many of those churches are either confused about or do not know the procedure to be followed to complete the incorporation of their church.

To assist churches in Ontario in completing the mechanical process of church incorporation, the author prepared a further article for the *Law Society of Upper Canada*, which article has now been modified to make it relevant to church audiences and is entitled "To Be or Not To Be, Incorporation of Autonomous Churches in Ontario, together with Precedent Materials". Copies of the article together with an extensive set of precedents that include a draft Letters Patent and a draft General Operating By-Law, as well as copies of other relevant articles that may be of assistance in the incorporation process, are available from the Canadian Council of Christian Charities for a nominal charge of \$15 to cover the cost of printing, binding and postage. To order use the registration form on page ___.

The balance of this Church and the Law Update - No. 4 consists of Part II of a portion of that article dealing specifically with the "Nuts and Bolts" involved in the process of the church incorporation.

The first part of the two part series dealt with how to commence the incorporation process, what is contained in an application for letters patent, what is contained in the general operating by-law to be filed with the application for letters patent, how to obtain congregational approval for the corporate documentation, and what is involved in the issuance of letters patent. This second part of the series will deal with what is involved in the initial organization of the incorporated church after letters patent have been issued as well as how to effectively use a church corporation after it is initially organized.

For those churches considering incorporation, it is essential that legal advice be obtained before implementing any suggestions contained in this article. The information contained in the following article is for educational and discussion purposes only and is not intended to be relied upon as a legal opinion.

A. INITIAL ORGANIZATION OF THE INCORPORATED CHURCH

(1) Organizing Resolutions of Directors and Members

Once the Letters Patent have been issued by either the federal or provincial government, the incorporators as the first directors will need to convene to do the following:

- (a) formally adopt the General Operating By-law;
- (b) adopt a Borrowing By-law;
- (c) adopt a Banking By-law, if applicable;
- (d) adopt a banking resolution;
- (e) confirm the incorporators as the first members of the corporation;
- (f) adopt the corporate seal;
- (g) approve the use of any ministry names other than the full corporate name of the church and the necessary registration of these names under the *Business Name Act*;
- (h) approve the transfer of the charitable registration number from the unincorporated church to the incorporated church by Revenue Canada;
- (i) approve the transfer of assets from the unincorporated church to the incorporated church; and
- (j) appoint those officers to the church corporation who are to be appointed by the directors as opposed to the members.

Once the initial directors' meeting has been held, the same individuals in their capacity as initial members of the corporation will then convene an initial membership meeting to do the following:

- (a) approve of the passing of the initial By-laws;
- (b) confirm the incorporators to be the directors of the corporation by electing the same individuals as directors until the first annual meeting of the new church corporation; and
- (c) elect those officers of the church corporation who are to be elected by the members as opposed to being appointed by the directors.

(2) Filing Government Forms

For a federal corporation, the following initial forms must be filed:

- (a) a Form 2 - Notice of a Provincial Corporation operating in Ontario pursuant to the *Ontario Corporation Information Act*;
 - (b) for any ministry name being used by the church corporation, a Form 2 under the *Business Name Act* of Ontario;
 - (c) an initial report to the Public Trustee of Ontario to include:
 - (i) copies of the Letters Patent and General Operating By-law;
 - (ii) a list of the directors and officers;
 - (iii) a list of the assets and liabilities of the church together with the financial statements of both the unincorporated church and the incorporated church;
 - (iv) the charitable registration number for the church; and
 - (v) an explanation that the unincorporated church will cease to exist and that all assets of the unincorporated church are to be transferred to the incorporated church as of a particular date;
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- (d) a Form 3 "Annual Summary" to be filed with the Federal government by June 30th of each year setting out the names and addresses of the directors and any change in the name or address of the corporation effective as of March 31st of each year.

(3) Transfer of Membership

One of the most difficult procedural matters involved in the incorporation of a church is to determine how best to transfer the membership of the unincorporated church to the incorporated church. Since it is recommended that all members of the incorporated church evidence their agreement to be under the authority of the church by virtue of a written application, it is preferable that all members, both existing and new members, sign the same form of application for membership. The difficulty is that the existing members may resent having to sign an application for membership in a church that they may have been members of for many years. As a result, a careful explanation needs to be given to all members of the existing church concerning the benefit to the church as a whole in having all members clearly evidence their agreement to be part of the church corporation and under its authority to avoid possible court intervention at a later time if disciplinary action needs to be taken against one of its members.

To facilitate the transfer of membership, it is generally recommended that the initial board of directors of the incorporated church pass a resolution which deems all members of the unincorporated church to be members of the new incorporated church automatically for a period of six months from the date of incorporation, during which period of time those members must either complete a written application for membership in the new church corporation, or at the end of six months, lose their membership in the church corporation.

While there may still be a few members who oppose the process by giving existing church members a period of six months in which to confirm their transfer of membership, in consideration of the input and approval by the congregation throughout the incorporation process, there is little substantial reason why existing members should expect that they be treated differently from new members who come into the church after the incorporation is completed. For those few members in question who continue to oppose such procedure as a matter of principle, the church board could authorize that in special circumstances evidence of agreement to become a member of the new church corporation could be established by means other than a written application for membership, i.e., by a written statement by a deacon or elder that he or she has interviewed the existing member and is satisfied that such person understands the new church constitution and has agreed to be a member of the church corporation and under its authority.

(4) Transfer Charitable Registration Number

Revenue Canada will generally cooperate in transferring the charitable registration number from the unincorporated church to the new incorporated church. This becomes particularly useful if the effective date chosen for the transfer to the incorporated church is the year end date of the congregation. What is required is for a letter be sent to Revenue Canada together with a certified copy of the Letters Patent, General Operating By-law, the list of the current officers and directors of the corporation, together with an explanation that the new church corporation is in essence one and the same congregation as the unincorporated church and is now functioning within the protection of a corporate shell. As a result, the letter will request that Revenue Canada assign the current registration number for the unincorporated church to the incorporated church.

In the event that the name of the church corporation is different from the unincorporated church, the new name should be clearly explained to Revenue Canada with a request that the records of Revenue Canada be changed to reflect the new name of the church corporation made effective as of the date of transfer between the unincorporated and the incorporated church.

(5) Effective Date of Transfer

As it will be necessary to determine a date on which the church will operate as an incorporated church, it is generally advisable that the year end of the unincorporated church be chosen as the effective date of transfer. By choosing the year end as the effective date, it will avoid having to prepare an additional set of financial statements for the few months beyond the financial year end to the date of transfer. An alternative to choosing the financial year end for the unincorporated church is to make January 1st the effective date of transfer. This has the advantage of allowing all charitable receipts to be issued in the year prior to the effective date under the name of the unincorporated church with all charitable receipts to be issued after January 1st being issued in the name of the incorporated church. The final decision concerning which date to choose as the effective transfer date needs to be done in consultation with the accountant for the church and its legal counsel.

(6) Transfer of Assets

Unless the church has decided to maintain the unincorporated church as a parallel organization to own the church's land and buildings and then lease it to the incorporated church, either for purposes of further liability protection or to allow the church to lease surplus lands for up to 40 years pursuant to provisions of R.O.L.A., it will be necessary for the unincorporated church to transfer its assets to the incorporated church as of the effective date.

The transfer of church assets involve two separate conveyances. The first conveyance involves the preparation and registration of a deed

from the trustees of the church appointed pursuant to R.O.L.A. in favour of the church corporation. In the event that the unincorporated church has a mortgage registered against the property, the written consent of the mortgagee would have to be obtained to transfer the said property together with the preparation and execution of a mortgage assumption agreement. If possible, the mortgagee should release the members of the unincorporated church from the terms of the mortgage, although such a release may not be easy to obtain.

The second conveyance involves a bill of sale for all moveable assets, such as, furniture, equipment, books, and bank accounts. The bill of sale should be signed by the duly elected leaders of the unincorporated church in addition to the trustee under R.O.L.A. in consideration of the fact that R.O.L.A. trustees only have authority over real property.

One of the considerations that need to be addressed in the registration of the deed for the land and buildings between the unincorporated and incorporated church is whether or not Land Transfer Tax needs to be paid. Since the deed is from the unincorporated church to itself in a new corporate format, there is no need to pay Land Transfer Tax. However, a supplementary affidavit will need to be filed with the deed to evidence that the transfer is by trustees to a beneficial owner, with the trustee under R.O.L.A. being the designated trustees and the church corporation being the intended beneficiary. To comply with the terms of the Land Transfer Tax Act, the supplementary affidavit would need to be signed by one of the trustees and filed at the time of the registration of the deed.

The directors of the incorporated church will also need to authorize the signing of a Transfer of Assets and Assumption of Liability agreement between the unincorporated and incorporated church whereby the incorporated church agrees that in return for the transfer of assets, all of the debts and obligations of the unincorporated church are to be assumed by the incorporated church. In addition, the agreement will specify that the incorporated church agrees to indemnify and save harmless the leaders, officers, and members of the unincorporated church in the event that legal action is commenced against any of them arising out of the debts and liabilities of the unincorporated church.

In the event that the unincorporated church owns a vehicle, such as a bus, the appropriate transfer of vehicle registration will need to be completed and filed with the Ministry of Transportation. In addition, in the event that the church is subject to a security agreement either with a bank or other secured party, notification will need to be given to the secured party so that the appropriate notice of change can be registered under the *Personal Property Security Act*.

(7) New Banking Documentation

Since the existing banking resolutions and other bank forms will no longer be applicable to the incorporated church, certified copies of the General Operating By-law, Borrowing By-law and banking resolution, together with other supporting banking forms, will need to be completed, signed and forwarded to the bank or trust company serving the church.

(8) Dissolution of Unincorporated Church

Subsequent to the board of the directors of the incorporated church holding the initial organizational meeting for the corporation and prior to the effective date of transfer of assets from the unincorporated to the incorporated church, a general membership meeting of the members of the unincorporated church will need to be held for the following purposes:

- (a) to advise the congregation that the incorporation process has been completed and that the church operations will be transferred to the incorporated church as of the effective date;
- (b) to authorize the transfer of assets of the unincorporated church to the incorporated church;
- (c) to authorize the transfer of the charitable registration number for the unincorporated church to the incorporated church; and
- (d) to authorize the dissolution of the unincorporated church as of the effective date, subject to the trustees of the unincorporated church having residual authority to execute whatever documentation may be subsequently required in accordance with any outstanding obligations.

(9) Report to Church

As part of the incorporation process, a detailed report should be provided to the members of the controlling board of the church by the lawyer who has completed the incorporation process to explain the following:

- (a) the incorporation and initial organization of the new church entity;
 - (b) the requirements that will need to be met to operate the church within the context of a corporate structure;
 - (c) the duties and responsibilities of directors of an incorporated church;
 - (d) the responsibilities of a director of a charitable corporation in relation to the requirements of the *Income Tax Act* of Canada;
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- (e) the transfer of assets from the unincorporated church to the incorporated church; and
 - (f) the dissolution of the unincorporated church.

B. EFFECTIVE USE OF CHURCH CORPORATION

It is not sufficient to simply incorporate a shell for a church, transfer its assets and membership to it and then leave it to function on its own without guidance or direction. What is required is for the lawyer completing the incorporation to provide an explanation both verbally and in writing to the leaders of the church concerning how the new church corporation is to be used to effectively protect its members and leaders from liability.

(1) Effective Use of Corporate Name

Since the incorporated name of the church should be similar if not identical with the unincorporated name of the church, it is important that the church be advised on how to correctly use the corporate name to avoid either directors, officers or members being found personally liable. This can be done through adopting the following procedures:

- (a) All creditors and suppliers of the church should be informed in writing that the church is now operating as an incorporated entity. Copies of these letters should be kept in the church records.
- (b) Generally, on all of the printed materials showing the church name, as well as on all advertisements, notices, bulletins, and signs, the full corporate name of the church should be shown together with a brief description below the name that the church is either a federal or provincial corporation for at least the first 1 to 2 years after the date of incorporation. For instance,

ABC Church of Toronto
(a federal corporation)

Although it is not necessary to indicate that the new church entity is a federal or provincial corporation, as the case may be, it is recommended to do so when the name of the incorporated and the unincorporated church are similar, otherwise creditors and suppliers of the church may be able to argue that they thought they were still dealing with the unincorporated entity and as such might be able to make a claim against the members of the church personally. However, it is important to balance this liability risk against the practicalities of how the church wishes to present its image to the community. As a result, some churches may decide to not use the suggested form of the name designation as stated above on all printed material with the church name, such as a Minister's business card.

- (c) Whenever documents are to be signed on behalf of the church, the authorized individuals should be careful to sign in their designated capacity as an officer of the corporation as opposed to signing the document in his or her own name.

For instance, documents should be signed

ABC Church of Toronto

"signature"
per chairperson - authorized signing officer

(2) Registration of Ministry Name

If a profit-making corporation was operating under various business names other than its corporate name, there would be little question that each of the business trade names would be registered separately under the *Business Name Act* of Ontario. However, this is seldom done in relation to an incorporated charity, particularly a church corporation. There is no particular reason for this deficiency, other than general oversight. However, the church runs a very serious risk of not being able to defend a legal action brought against it involving a business name unless that name has been registered under the *Business Name Act* of Ontario.

The church should determine if there are areas of on-going ministry where the specific ministry name has become separately recognizable. For instance, if the church operates a day care centre under a name different from the church which has not been separately incorporated, all documentation, advertisement and correspondence for that ministry would need to clearly indicate that the ministry name of the day care centre in question is a part of the church corporation.

Suggested wording to ensure that a ministry name is effectively used is as follows:

ABC Day Care Centre,

a ministry division of ABC Church of Toronto

"signature"
per chairperson - authorized signing officer

(3) Maintaining Corporate Records

To ensure that the church corporation maintains its corporate records, the board of directors will need to be advised of the following:

- (a) the procedure to be followed to record a change of head office;
- (b) the procedure to be followed to record a change in the number of directors;
- (c) the requirements for filing government forms with either the federal or provincial government, as necessary;
- (d) the need to annually file with the Public Trustee of Ontario copies of financial statements together with the names and addresses of all directors and officers; and
- (e) the need to hold and duly record annual meeting of members to elect directors, approve financial statements and appoint an auditor.

Unless the church corporation is properly advised concerning the steps required to maintain corporate records, the corporation may face the possibility of losing its incorporated status as well as incurring significant legal fees in trying to recreate corporate records after the fact.

(4) Multiple Corporations

The operation of some churches may be large enough that the exposure to increased risk, may justify the use of multiple corporations. For instance, if a church operates a Christian school, a day care centre, a summer camp, or is involved in high risk ministries such as an outreach mission to abused street children, the church will generally be exposed to greater risks, such as allegations of sexual abuse. As a result, it would be prudent for the church to contain these high risk ministries within the context of a separate corporation. The operations of such associated corporation could be effectively controlled by the church through including provisions within the Letters Patent and By-laws of the associated corporation, requiring that as a qualification to be either a member or a director of the associated corporation, such person must be first approved by the board of directors of the church corporation.

If the church has significant equity in either investments, endowment funds or lands and buildings, it may be worthwhile to have some or all of those major assets owned by a separate corporation set up as parallel foundation for the church. If land and buildings are part of the assets transferred to the foundation, the foundation would then lease the land and buildings to the church corporation pursuant to a net lease. There are numerous issues, however, that would need to be addressed in establishing an effective church foundation which are beyond the scope of this paper, such as whether the net lease constitutes a business of the charity or an investment, whether the foundation would qualify as a "religious organization" under the *Assessment Act* to insure that the tax exempt status of church property under that Act was not lost, how to establish effective control over the membership and board of directors of the foundation, as well as how to maintain the traditional use of the foundation as a funding vehicle for the operations of the church corporation. Notwithstanding these issues, the option of establishing a separate corporation to own some or all of the major assets of the church through the use of a foundation is a viable option that some larger churches may be in a position to consider and as such should be discussed with the church as part of an overall risk management review of its operations.

10. CONCLUSION

Whether or not the option of incorporation is appropriate is a decision that each church will have to make after reviewing its own particular circumstances. However, given the limitations inherent in *Religious Organizations Land Act* of Ontario and in consideration of the considerable benefits that are available through incorporation, local churches would be well advised to place the issue of incorporation before their congregation as a viable option either now or sometime in the near future.

For those churches that do decide to incorporate, the process of incorporation is much more complicated than simply obtaining Letters Patent from either the federal or the provincial government. The issues of by-law provisions, transfer of membership, transfer of assets, initial organization of the incorporated church, and the dissolution of the unincorporated church all need to be addressed and properly recorded. Failure to fully document the incorporation process and the wind down of the unincorporated church could leave the congregation in a worse position than before it was incorporated. As such, the incorporation of an autonomous church should be approached cautiously and with considerable attention being given to detail. It would be better for the church not to incorporate at all than to leave the church with a corporate organization that is either irrelevant to the actual workings of the congregation or has not been made practical so that the benefits of limited liability protection of the corporate structure can be implemented by the church.

Hopefully, the explanation of the process of incorporation contained in this two part series of articles and in the binder containing the longer article and precedent materials entitled "To Be or Not to Be, Incorporation of Autonomous Churches in Ontario" available from the Canadian Council of Christian Charities will assist in making the incorporation process result in the establishment of an effective church structure with the benefit of limited liability for its members. However, the success of attaining this goal is very much a factor of how carefully the corporate documentation are assembled. For this reason, a church that may want to do a "simple" incorporation must either have the task done in a careful and thorough manner or not at all. This paper has been prepared to assist those churches that wish to follow the first alternative, as the establishment of a practical church corporation is a worthwhile and useful undertaking that will provide a firm organizational foundation for the congregation for years to come□

DISCLAIMER: This *Church & the Law Update* is a summary of current legal issues provided as an information service. It is current only as of the date of the Update and does not reflect changes in the law that have occurred subsequent to the date of the Update. The Church & the Law Update is distributed with the understanding that it does not constitute legal advice or establish the solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision making. Readers are advised to consult with a qualified lawyer and obtain written opinion concerning the specifics of their particular situation.

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