EXHIBIT B

20100608A NYCBAR 1

City Bar Center for CLE-New York City Bar
New York City Bar
June 8, 2010

ABCs of Creating a Not-For-Profit Organization

ISSUES REGARDING CORPORATE STRUCTURE, IRS APPROVAL, STATE REGULATION, LIABILITY, GOVERNANCE & OPERATION OF NEW YORK & DELAWARE NONPROFITS

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I. INTRODUCTION

The nonprofit community is a fast-growing and important portion of our economic system. It is sometimes referred to as the third sector of our economy (after the private and the governmental sectors).

Current Number of Nonprofits. As of 2008 there were 1,536,134 registered nonprofit organizations filed with the U.S. Internal Revenue Service *(see the website of the National Center for Charitable Statistics, which compiles statistics from the IRS' Business Master Files, http:// nccsdataweb.urban.org/PubApps/profilel.php7state=US; for more information, see http:// nccs.urban.org/statistics/)*. Note that these numbers do not include nonprofits that do not file with the IRS because of exemptions or otherwise, such as churches (which are not required to register with the IRS but about half of which are registered) and smaller organizations, or the small number of entities that are exempt under other Section 501 provisions.

Number Will Drop Due to Failure to File Form 990. Note that these numbers should drop after May 17, 2010, when nofiprofits that have not filed a Form 990 (or the other variations of that form, such as the 990-EZ or 990-N) for three years running will have their exempt status revoked; undoubtedly the current numbers include many defunct or inactive nonprofits. ***Update: On May 18, 2010, the IRS announced that it would soon be issuing advise as to how nonfilers can still take action to avoid this automatic revocation; see http://www.irs.gov/newsroom/article/0,,id=223609,00.html?portlet =7 and http:// philanthropy.com/article/IRS-Allows-Small-Charities-a/65621/?sid=&utm_ source=&utm_medium=en.***

We won't know how many nonprofits will loose their exempt status until January 2011, when the IRS releases the information. But 40% of the approximately 1.5 million entities currently exempt (or about 600,000) are small organizations that did not have to file annual returns until the 2006 law change. Approximately 343,000 of had filed as of May 1 (note, however, that some nonfilers are on a tax year other than the calendar year, so only about 214,000 of these were in jeopardy of loosing their exempt status as of May 18th. The entities not current in their filings include 30,000 sports and recreation clubs, 15,000 student fraternity and sorority groups, 17,000 community service clubs, 17,000 veterans' organizations, and 8,000 parent teacher groups. While many of these are no-doubt defunct, some are probably just so poorly run that they have not realized the situation, notwithstanding the extensive IRS educational efforts publicizing the filing deadline. Since many of these groups are volunteer-based, their addresses may have changed from those on file with the IRS following changes in leadership. Donations to these organizations will remain tax deductible until public notification of the revocation is given on the IRS website, sometime in 2011. Revocations will be effective upon notification by the IRS; most of the revoked entities will have to refile with their exemption recognition only being effective when granted, not relating back to the time it was revoked. But entities that did not receive prior IRS notification of the change may be able to obtain retroactive reinstatement of their tax status if reasonable cause can be shown for the failure to file. At the Urban Institute's annual Form 990 meeting in May 2010, the director of the exempt organizations division of the I.R.S, Lois Lerner, stated that reasonable cause will not be found to exist for organizations that had received two or three notification letters, but did not find the time to file, but each case will be handled individually. *For more information, see Jeff Narabrook, Thomas H. Pollak, and Katie L. Roeger, "Time's Up! What You Need to Know about Your 990*," Nonprofit Quarterly, *Spring 2010, available at http:// www.nonprofitquarterly.org/index.php?option-com_ content&view= article&id= 2344:times-up-what-you-need-to-know-about-your-99 0&catid=153:web-articles*. A searchable database of organizations that should have filed but have not filed, organized by state, is available from the National Center for Charitable Statistics at *http:// nccsdataweb.urban.org/PubApps/statePicker.php? prog=epostcard&display=state*. The Form 990-N can be filed at *http:// epostcard.form990.org/*.

Different Types of Nonprofits in the Eyes of the IRS. There are approximately 70 different types of nonprofits under federal tax law. Of the 28 Section 501(c) categories,

- 70.9% of the organizations were charitable 501(c)(3) organizations, of which
  - 63.4% were public charities (31.5% were reporting public charities; 31.9% were nonreporting (*i.e.*, had less than $25,000 in gross receipts); it is estimated that about 25% of the total number of nonprofits are religious congregations, according to American Church Lists as cited by the National Center for Charitable Statistics)
  - 7.5% were private foundations,
- 7.2% were (c)(4) civic league / social welfare organizations,
- 5.1% were (c)(8) fraternal benefit societies,
- 4.7% were (c)(6) business leagues,
- 3.6% were (c)(5) labor, agricultural or horticultural organizations,
- 3.6% were (c)(7) social and recreation clubs,
- 2.1% were (c)(19 or 23) veterans organizations and
- 2.7% were other organizations.

According to the office of the New York Attorney General, approximately 50,000 nonprofit entities are required to register with the Charities Bureau of the Office of the Attorney General under the New York Estates, Powers and Trusts Law (EPTL), or Article 7-A of the New York Executive Law (Article 7-A) or both (and these numbers do not include churches, church-related entities, hospitals, membership entities, historical societies or schools chartered by the Board of Regents and other nonprofits that are exempt from such registration). The National Center for Charitable Statistics says that as of December 2008 there were 98,503 New York-based nonprofits, the highest number of nonprofits of any state other than California, which had 156,682 [FN2] (but note the New York nonprofits are larger, with total revenue of $244 billion compared to $217 billion from the California-based entities). *See http://nccsdataweb.urban.org/NCCS/VlPub/index.php -- Registered Nonprofit Organizations by State*.

We hope this CLE will give you the tools to form, obtain tax exempt status for and generally advise on the operation of nonprofit organizations located in New York State.

II. TYPES OF NOT-FOR-PROFIT ENTITIES

Nonprofit vs. Business Entities. Before we discuss the various types of nonprofits, let's first contrast the nonprofit with the for-profit entity.

The *sine qua non* of the not-for-profit organization is that its primary (not necessarily exclusive) purpose is not pecuniary ["of or relating to money"] (*i.e.*, it is not formed to make money although it may do so to further its eleemosynary goals) and that no part of the assets or income of the entity may be distributed or "inure" to the benefit of the organization's members, directors or officers (subject to certain limited exceptions, such as the payment of "reasonable" compensation for services rendered). This latter issue, called inurnment, will be the subject of further discussion in the context of tax exempt status, but it is a fundamental precept of the corporate existence of not-for-profit corporations.

A business entity is owned by its members (shareholders, partners, members); a not-for-profit is not owned by anyone. In a theoretical sense, you might say that a nonprofit entity is "owned" by the public (*i.e.*, the citizens of the state under which it is formed), who act through the offices of the attorney general of the state (or comparable officer under state law). Just as directors of a business corporation owe fiduciary duties to the shareholders, directors of a not-for-profit corporation owe duties to the public; if the organization has members, the directors have duties to the members as well. The attorney general might be compared to a proxy holder for the public.

What is the difference between a for-profit and a not-for-profit? One key difference is the primary beneficiary. In nonprofits, the public or a segment of the public is the primary beneficiary. In a for-profit, the prime beneficiary is the owners of the entity.

A Third Form? But there may be a third category of entity: a for-profit social enterprise, where both the owners and the public (or a segment of the public) benefit. These are sometimes called "B Corporations" or "Benefit Corporations": these are regular for-profit social enterprises (*i.e.*, business corporations) that have received a certification from a corporation called B-Lab, a Pennsylvania nonprofit, that they meet certain standards regarding social and environmental standards and corporate responsibility (including amending their articles to provide for duties to various stakeholder classes). The initial standards were issued in October 2007 and then updated in January 2010. The B-Lab literature claims that they are "legally recognized by the states [and] tax preferred by the IRS" but until recently the only state recognition appears to come from the states that recognize charter provisions that allow the corporation to recognize stakeholder interests (not just shareholder interests) -- a July 2007 article in *Inc. Magazine* indicates that 31 states have constituency statutes. The literature does not indicate what preference the organizations receive from the IRS. In April 2010, however, Maryland became the first state to legally create a new form of corporate entity, called a "benefit corporation," effective October 1, 2010. A similar proposal was introduced in Vermont and it is being studied in California, Colorado, New York (?), North Carolina, Oregon, Pennsylvania and Washington, according to *The Corporate Social Responsibility Newswire*, April 14, 2010. In December 2009 the City of Philadelphia reduced business privilege taxes for certified B Corporations. For more information, see *http:// www.bcorporation.net/resources/bcorp/documents/2009-B-Corp_Intro_Package.pdf*. [FN3]

Forms of Nonprofit Organizations. Nonprofits can be formed as nonprofit corporations, limited liability companies, for-profit corporations, unincorporated associations or charitable trusts.

1. Corporations. Nonprofit and for-profit corporations are statutorily created entities treated as separate legal persons, with their income subject to tax unless the taxing authority grants an exemption. The entities act through a board of directors and officers. The members (or shareholders of for-profit entities), directors and officers have limited liability.

Nonprofit corporations are the most common entity form for nonprofit organizations.

Virtues:

• limited liability of the members (or shareholders of for-profit corporations), directors and officers from the liability of the entity;

• established uniform procedure for formation and action;

• acceptance by the business world and donors;

• ability to borrow and raise funds;

• continuity of life (not dependent on life of members);

• relative ease of obtaining IRS and state tax-exempt status; and

• ease of owning property.

Drawbacks:

• expense of formation and operation;

• complications with operations and termination (especially in New York);

• need to meet strenuous IRS reporting requirements; and

• inflexibility.

2. Limited Liability Companies (LLCs). LLCs are statutorily-created entities treated as separate legal persons with their income not being subject to tax at the entity level (instead, income is subject to tax at the owner level). Through the operating agreement (or LLC Agreement in Delaware), the organization can set out its structure and rules of operation, which can be much more flexible than the corresponding procedure and rules for corporations. The entities act either through the members or, if desired, through designated managers. If the entity is member managed, it does not need the organizational structure with boards, committees and officers found in corporations. It can, however, if desired use such structure. The members and, if any, the managers and officers have limited liability.

Currently LLCs are rarely used by nonprofits but their use may be growing, especially as vehicles for joint ventures among nonprofits or for nonprofit subsidiaries. While a nonprofit entity can be formed under the Delaware Limited Liability Company Act and, based on recent changes, in California, Ohio and Missouri, this form is generally thought to be not available for nonprofits in many states like New York, which requires that LLCs be organized for a "business purpose." [FN4] Eventually, we suspect that most states will allow nonprofits to use the LLC form, at least for subsidiary operations, but it will take a long while before that becomes a universal practice.

LLCs are either pass-through entities, where the taxes are paid by the member owners, or, if there is only one member, are disregarded as an entity, with the owner treating the operations and finances of the LLC as its own for tax and information reporting purposes. A nonprofit LLC can therefore rely on the sole member's federal tax exempt status. *See Ann. 99-102, 1999-43 I.R.B 545 (discussed in an article by Richard A. McCray and Ward L. Thomas, "Limited Liability Companies as Exempt Organizations -- Update" published in the 2001 EO CPE, available at http://www.irs.gov/pub/irs-tege/cpeindexbytopic.pdf)*. The disregarded entity could, alternatively, seek separate entity treatment by filing for separate entity treatment on Form 8832 or by claiming exemption by filing a separate Form 1023 or Form 990.

An LLC may also file a form with the IRS electing to be taxed as a corporation, so as to avoid integration of its finances with its parent. This would be similar to the status of a wholly owned subsidiary, which is a form frequently used to isolate unrelated business activities that are so significant that the parent's tax exempt status may be jeopardized.

The IRS article also notes that the organizational papers of a disregarded wholly-owned LLC would not need to include the standard IRS requirements for tax exempt organizations but nothing in the disregarded entity's articles should prohibit the entity from operating exclusively for exempt purposes or from including exempt purpose language in the organizational papers (indeed, if the LLC intends to seek New York City real estate tax exemptions for property that it owns, it needs to include such language in the formation documents or the operating (or limited liability company) agreement). An "all purposes" clause is OK, as is a clause saying assets are to be distributed to the sole member upon dissolution. The article notes, however, that the IRS is still studying whether contributions to the disregarded entity would be eligible for charitable contributions deductions. Disregarded entities are, the article states, still allowed to choose between disregarded or regarded status for employment tax purposes.

While an LLC with multiple members is generally considered for tax purposes to be a partnership, and the IRS takes the position that generally tax exempt (c)(3) and (c)(4) entities cannot be partnerships, the IRS will allow multiple member

LLCs to be accorded (c)(3) or (c)(4) status if they meet the following 12 conditions designed to ensure that the organization is organized and operated exclusively for exempt purposes and to preclude private inurement:

1. the organizational documents must limit the LLCs activities to one or more specific exempt purposes;

2. the organizational language must specify that the LLC is operated exclusively to further the charitable purposes of its members;

3. each member must be a Section 501(c)(3) organization or a governmental unit or instrumentality (an "eligible person");

4. the organizational language must prohibit the direct or indirect transfer of a membership interest to a noneligible person;

5. the organizational language must state that the LLC, its interests and its assets may only be availed of or transferred to noneligible persons for fair market value;

6. the organizational language must guarantee that assets devoted to the LLC's purposes will continue to be so devoted upon dissolution;

7. the organizational language must require that amendments be consistent with Section 501(c)(3) of the Internal Revenue Code;

8. the organizational language must prohibit mergers with for-profits;

9. the organizational language must prohibit distribution of assets to noneligible persons;

10. the organizational language must include contingencies should a member cease to be an eligible person;

11. the organizational language must require all the members to expeditiously and vigorously enforce their rights and to pursue all legal and equitable remedies to protect their interests in the LLC; and

12. the LLC must represent that its certificate of formation and LLC agreement are consistent with the law of the state of formation and enforceable at law and equity.

The provisions required to be included in the governing documents to meet these 12 requirements should be included in the publicly filed document (articles of organization or certificate of formation) unless the state law precludes the addition of provisions beyond those required by law, in which case the material should appear in the operating agreement.

See the 2001 IRS Continuing Professional Education Technical Instruction Program (available at http://www.irs.gov/pub/irs-tege/cpeindexbytopic.pdf -- then look for "Limited Liability Companies as Exempt Organizations -- Update 2001-B).

It may not be prudent to use the LLC form where you wish to avoid attributing the tax attributes of the LLC to the sole member, as would be the case if the subsidiary would otherwise generate taxable income of such significance that the "tail might wag the dog," thereby jeopardizing the tax status of the parent nonprofit since it is not clear whether causing the LLC to be characterized as a corporation rather than a disregarded entity or partnership would be sufficient to avoid any taint.

If legally available under state law and if the applicable Section 501(c) status can be obtained, the LLC has the following virtues and drawbacks:

Virtues:

- flexibility, especially in the management structure and the lesser need for formality;
- limitation of the members and, if any, managers and officers from the liability of the LLC; and
- desirability from a standpoint of financing where the lenders want to loan to a special purpose entity; and
- ability to disregard the LLC if it has only one member

Drawbacks:

- general uncertainty regarding nonprofits as LLCs including issues related to tax exempt status; and
- possible lack of recognition in other jurisdictions. While an out-of-state LLC is required to qualify if it conducts business in New York, it is not clear that an out-of-state nonprofit LLC can so qualify in New York. If the formation document includes standard nonprofit language, the New York Department of State may raise objections. It will be interesting to see how this develops over time.

3. Business Corporations. The structure of a business corporation is similar to the structure of a nonprofit corporation except that it has shareholders with equity in the company instead of members who do not own the entity. While most nonprofits form under the statutes applicable to nonprofits, nonprofits can be formed as business corporations under the

Business Corporation Law (in New York) or the General Corporation Law (in Delaware) in certain cases. In New York, there are separate (but basically parallel) statutes governing for-profit and not-for-profit corporations but in Delaware the same statute applies to both types.

If the entity is willing to forgo tax exemption it could form as a for-profit corporation but run itself as if a nonprofit; any profit who be subject to taxation. For instance the new Google foundation (Google.org) is a for-profit, which gives it greater ability to make investments in companies working on social problems. A for-profit has greater freedom in making grants; when Google's affiliated charitable nonprofit foundation proposed to make a grant to an organization that was to provide laptops to children, there was a fear that such grants might be viewed as helping Google. That fear was obviated by making the foundation a regular tax-paying entity. It is also free from public disclosure requirements applicable only to nonprofits.

Title-holding companies (*i.e.*, entities that are formed to own real estate for nonprofits and to pay the income, less expenses, over to the nonprofit) are often formed as business corporations under the BCL because it is not clear what type of nonprofit they would be under the New York Not-for-Profit Corporation Law. Such organizations are exempt from income tax pursuant to either IRC Section 501(c) (2) [*see http://www.irs.gov/pub/irs-tege/eotopicc86.pdf] or 501(c)(25) [see http://www.irs.gov/pub/irs-tege/eotopicc95.pdf]. See also the discussion of title-holding companies in the IRS training material http://ftp.irs.gov/pub/irs-tege/eotopica01.pdf.* The IRS recognizes the tax-exempt status of such corporations if not formed under the applicable nonprofit law. The genesis of the title holding company dates back to times when many nonprofit laws precluded ownership of real estate by nonprofits, but now they are used more for liability limiting and other similar purposes (including making it easier to borrow or to satisfy gift restrictions).

A (c)(2) corporation can hold title for one entity where the property is either used exclusively by the entity or is leased to others for investment but the income is upstreamed to the parent. A corporation organized to hold title to property directly used by multiple nonprofits may also be granted (c)(2) status but the Service has generally been unwilling to extend that ruling to situations where multiple nonprofits own the property for investment purposes. The (c)(25) entity was therefore authorized in 1986 to allow up to 35 tax exempts (mainly smaller nonprofits that could not do so on their own) to pool funds for purposes of investing in real estate.

Note, however, that for-profit (c)(2) and (c)(25) entities may not be eligible for New York State real property tax exemption even if they meet the two part test set forth under RPTL 420-a (that the property be owned by a nonprofit, as defined, and used "exclusively" for nonprofit purposes).

4. Unincorporated Associations. These are organizations composed of a body of persons united without a charter for the prosecution of some common enterprise without legal entity status. They are not generally considered to be a "person." They are governed by the law of agency and, in New York, the General Association Law and, in Delaware, the Uniform Unincorporated Nonprofit Association Act, *available at http:// delcode.delaware.gov/title6/c019/index.shtml*.

Unincorporated associations are similar to, but not technically, partnerships (which have to be for "business" purposes). You usually find that this form of organization is used for "clubs" and other grass roots organizations relying on their members for funding and continuity. The largest categories of unincorporated associations are trade unions and political organizations; even the ABA was an unincorporated association until recently.

Organizations that are still in the formation process may find it good to first organize as unincorporated associations, to "test the water," using "fiscal sponsors" [FN5] to raise money.

Virtues:

- flexibility;
- cost (few legal expenses);
- informality;
- no governmental consents required (but still subject to Department of Law registration and, possibly, taxes);
- freedom to establish own practices;
- good way to "get feet wet" and see if the organization can have acceptance before becoming permanent -- allows the organization to find its "mission" before its purposes are "set in stone" in a certificate of incorporation;
- can convert to corporate form later; and
- good for activities intended to have only a short life (can avoid need for later formal dissolution).

Drawbacks:

• harder (but not impossible) to obtain tax-exempt status (if later incorporated, must start IRS approval process all over);

• risk of liability for all participants;

• harder to establish bank accounts and otherwise engage in commercial activities;

• difficult to get donations;

• difficult for them to own property (to do, the members may have to own it as joint tenants and need to transfer their ownership interest when departing the organization);

• although a uniform act for unincorporated associations was adopted by the Commissioners on Uniform State Laws, few states have adopted it or comparable statutes;

• must be governed by the law of agency;

• must file business certificates in the county in which operating (*i.e.*, "d/b/a"s) under General Business Law Section 130; and

• there is great uncertainty as to what an unincorporated association is.

5. Charitable Trusts. These are the oldest form of nonprofit vehicle, dating back to prior to the enactment of the Statute of Uses of 1601. Because of their benefit to the greater community, charitable trusts can be of unlimited duration without violating the rule against perpetuities governing private trusts. They are enforced by the attorney general instead of any private beneficiaries. If a trustee is not named, title will vest in the court until such trustee is chosen. They are governed by the Estates, Powers and Trust Law in New York. While still common in England, their usage in the United States is less common. They may be more commonly used when the only purpose is grant making to other charities.

Virtues:

• can be formed quickly and with little formality other than a declaration of trust, trust deed, will or contract by the settler in favor of a trustee;

• costs of maintenance may be cheaper as they have fewer housekeeping requirements (although still subject to reporting to the Attorney General);

• certain approvals required under the NPCL, such as court and AG approval for sales of assets, are not applicable to trusts;

• there is a greater possibility of the original grantor retaining a degree of continuing control; for instance, trustees can hold their positions for life, thereby enabling the grantor a greater level of comfort that the people named to manage the trust will remain the same (and, presumably, better reflect the wishes of the grantor, although that cannot be assured).

Drawbacks:

• trusts are more readily subject to actions for accountings than are corporate entities;

• according to the New York Attorney General, actions can be maintained against fiduciaries such as trustees for up to six years after the trustee resigns, even for actions that occurred many years in the past;

• the trust form may also restrict future activity; and

• vendors and others may be less used to dealing with trusts that with corporations.

III. TERMINOLOGY

In the not-for-profit world you will hear mention made of some terms that you may not be conversant with if your corporate involvement is as a business lawyer.

1. "Not-for-Profit" versus "Non-Profit"

In practical terms, there is no distinction between the two terms. In most jurisdictions, the applicable term that is used is "non-profit" organizations but New York uses the more cumbersome (but more accurate) term "not-for-profit" organizations. As many owners of business corporations will tell you, in any year commercial organizations can be "non-profit" even if they aim to make a profit. The emphasis in the not-for-profit world is that profit is not the goal -- public benefit is the goal.

Sometimes not-for-profit corporations do make what might be viewed as "earnings" or "profits" -- but instead of calling them as such on a profit and loss statement, they are shown as "increases in fund balance" -- in other words, more money to do good with. But, in a real world sense, both terms mean the same and are interchangeable.

2. Tax Exempt Status

Tax exempt status means that the organization does not have to pay taxes on what might otherwise be viewed as profits. It is not necessarily equivalent to not-for-profit status. Exempt status is generally a federal law matter whereas not-for-profit status is a state law matter.

The Internal Revenue Service will, upon submission of properly completed applications, recognize most not-for-profit organizations as **"tax exempt organizations."** Some nonprofit organizations, however, may not wish to seek tax exempt status, maybe because they do not anticipate making any taxable profits and won't be seeking public support.

Tax-exempt entities can include a broad range of organizations, from charitable organizations (sometimes referred to as "501(c)(3)s" for the section of the Internal Revenue Code under which they are exempt, which can consist of public charities or private foundations) to entities organized for a business or other economic purpose including trade associations, such as the National Association of Manufacturers or the American Medical Association, or unions to traditional clubs.

Tax exempt entities are different than "flow through" entities, such as partnerships or limited liability companies, where the taxes on the profits generated are not imposed at the entity level but rather at the owner level. Tax exempts do not generally pay any taxes, at least on their exempt income, either at the entity or member level. Note also that organizations that are tax exempt are not necessarily eligible to receive **tax-deductible contributions**. For that, the organization has to be a recognized **charitable organization**.

3. Charities

Charities are organizations formed to take on certain public obligations and are rewarded by the government with the ability to accept tax-deductible contributions from others. In traditional sense, charitable organizations were viewed as those helping the poor and needy. In a larger and more modern sense, however, any organization taking on a broader range of governmental type obligations, such as education, arts or recreation, and organizations that focus on religious and mental or moral improvement matters, are usually viewed as being charitable.

In determining whether to grant "tax exempt status" to a not-for-profit as a charity, the IRS uses this broader view. New York State, in separating nonprofits into various "types," considers corporations to be formed for charitable, educational, religious, scientific, literary, cultural or cruelty prevention purposes to be similar and calls them Type B not-for-profits. For real estate tax exemption purposes, "charitable" has a more restrictive interpretation, as discussed below. Also, the Department of State views the term charitable as more restrictive than all Type B organizations in determining whether they can be formed without a corporate indicator (*e.g.*, "Inc."); corporations that are "educational" are not considered "charitable" for the provision of the N-PCL allowing charitable corporations to be formed without such indicator.

Charities can either be **"public charities,"** a subset of charities that have a broad base of public support, or **"private foundations,"** which have a more limited source of funding and are subject to greater restrictions by the IRS. Private foundations are subject to greater regulatory restrictions than are public charities.

Another word sometimes used in describing charitable organizations is **"eleemosynary,"** a fancy word for "charitable" derived from the word "alms." These organizations are also sometimes called **"philanthropic,"** which means "dispensing or receiving aid from funds set aside for humanitarian purposes" (from the Greek for "loving mankind"). The term "philanthropic" is generally applied to grant-making organizations.

4. Private Foundations

Private foundations are charities which are not "public charities." They are generally formed by one or a select group of donors, such as wealthy individuals or families or corporations. Foundations are subject to greater limitations on their day-to-day practices, especially in the area of self-dealing with individuals and entities called **"disqualified persons"** (generally major donors, directors, officers and other insiders). This will be dealt with more fully when tax issues are discussed. Note, however, that a corporation may have the word "Foundation" in its name and still be a public charity.

5. NGOs (or Non-Governmental Organization)

The term NGOs is sometimes used to describe charities working in the international arena. They need to be formed without any participation or representation of any government; if the NGO is funded totally or partially by governments, the NGO maintains its non-governmental status by excluding government representatives from membership in the organization. The phrase "non-governmental organization" only came into popular use with the establishment of the United Nations Organization in 1945 with provisions in Article 71 of Chapter 10 of the United Nations Charter for a consultative role for organizations which are neither governments nor member states.

6. Type vs. Code Section

As will be discussed more below, New York has four types of nonprofits -- prosaically referred to as Types A, B, C or D. Another classification can be found in Section 501(c) of the Internal Revenue Code which divides certain types of nonprofits into 27 categories, from those under Section 501(c)(1) to those under Section 501(c)(27), not to count other subsections of Section 501 as well as other sections of the Code describing types of tax exempt organizations. While there may be certain correlations between New York types and IRS code sections, there is no exact parallel. Sometimes clients will refer to themselves as type "(c)(3)s" but that is not correct.

The term "type" is also sometimes used to describe certain types of "supporting organizations" -- Types I, II or III.

7. Inurement

You will hear this term spoken of in the context of eligibility for federal recognition of tax exempt status. A Section 501(c)3) organization must be organized and operated so that "no part of... [its] net earnings ... inures to the benefit of any private ... individual." *Webster's Ninth New Collegiate Dictionary* defines "inure" as "to accustom to accept something undesirable." This is a very curious definition since in the nonprofit community inurement is something that individuals would love to receive but for the fact that the law says that it can't be paid. Others note that the term also means "gravitate toward, flow to or transfer." This is tax meaning of the word.

In the nonprofit world, "inurement" (usually preceded by the word "private") is basically a benefit paid to individuals (or affiliated entities or family members) who have significant influence over the organization, whether in cash, in kind or otherwise, including a distribution of net earnings, which exceeds the value of the benefit provided by such individual. The most common example is excessive compensation, which the IRS condemns through significant excise taxes. These insiders (called by the IRS "disqualified persons") include high-level managers, board members, founders, major donors, highest paid employees, family members of any of the above, and a business where the listed persons own more than 35 percent of an interest. There is no *de minimis* restriction.

If a nonprofit is organized to benefit an individual, even while fulfilling its tax-exempt purpose, it cannot be a tax-exempt organization. Under the state law, an organization may lose its nonprofit status. See Hopkins, *The Law of Tax-Exempt Organizations*, Chapter 13.

8. Trustees vs. Directors

There is no difference between the term "trustees" and "directors" when dealing with not-for-profit corporations. You look to the certificate of incorporation of an organization to determine what the members of the governing body are called. Their duties are no greater if they are styled "trustees." While they have duties to the public, and that name probably more accurately reflects the nature of these duties, they are allowed to rely on standard defenses common in the corporate world for directors and probably are not held to the higher standard of care applicable to trustees under a formal trust instrument.

9. Department of Law, Office of the Attorney General and Charities Bureau

These three terms, found in New York, are functionally equivalent. The Charities Bureau is part of the Social Justice Division of the Department of Law, which is part of the Office of the Attorney General headed by the Attorney General. The terms will be used interchangeably.

IV. FORMATION OF A NOT-FOR-PROFIT CORPORATION

1. Jurisdictions -- New York vs. Delaware

Why Consider Delaware If the Organization is to Be Located in New York. Until recently, this program focused exclusively on New York nonprofits with maybe a paragraph or two discussion of the potentiality of forming in Delaware instead.

We are now starting off our discussion, however, with a strong recommendation that you first consider forming any new nonprofit in Delaware instead of New York. This is due to the growing number of problems now surfacing in the day-to-day life of New York nonprofits. It is probably safe to say that New York is the most time-consuming state in which to form and operate a new nonprofit and the formation and modification processes require more interaction with governmental agencies than in any other state.

• As we will discuss more fully later, there are 22 categories of purposes which trigger the need for approval (or waiver of approval) from various New York state or nongovernmental agencies. For instance, if the corporation has any arguably educational purpose, as many nonprofits do, you will have to seek the consent or waver of consent of the State Education Department, a procedure that can take up to several months (whereas a few years ago it only took a few weeks).

• Furthermore, the New York Secretary of State's office is growing increasingly obstructionist in clearing nonprofit certificates of incorporation. It reviews the purpose clause with a "fine tooth comb," objecting to many purposes, frequently saying they are "too vague." It is also become increasingly petty in reviewing the appropriateness of nonprofit names.

• New York also has some of the most onerous substantive provisions regarding major transactions such as dissolutions (notwithstanding recent statutory changes that were meant to expedite the process), asset sales and mergers.

Delaware, which makes much of its money from the formation of corporations, does not require such consents, it has a cooperative Department of State and it lacks many of the regulations affecting corporate transactions.

Accordingly, if it is imperative to form the entity quickly (for instance, if someone wants to make a contribution "right now," as may be the case with desired year-end contributions, and the entity doesn't yet exist) [FN6] and you might otherwise need to obtain state regulatory approvals or waivers in New York, then Delaware formation is definitely appropriate.

It has thus become common practice among not-for-profit lawyers to routinely form new nonprofits in Delaware, instead of New York, unless there is a legal or political reason for the entity to be New York-formed (for example, it was thought imprudent to form a new entity as a Delaware corporation when it was receiving major sponsorship from the City of New York). In fact, one wag joked that it may be malpractice to form a new nonprofit in New York.

Unauthorized Practice Issues? Some may ask whether forming nonprofits under foreign state law would raise the issue of engaging in the unauthorized practice of law. We do see that as a possible issue with forming a nonprofit under New Jersey law, since New Jersey is very aggressive in bringing unauthorized practice claims against New York lawyers. It may also be an issue in other states but we do not see it as an issue with forming corporations in Delaware. On the for-profit side of corporate practice, this firm, and most corporate practitioners nationwide, form Delaware corporations every day. We even give standard legal opinions based on the Delaware General Corporation Law, with the caveat that if the issue is not routine we will get a backup opinion of Delaware legal counsel. If there are sophisticated issues to be addressed regarding the formation or operation of Delaware nonprofits, however, you may need to consult Delaware counsel.

Still Need to Qualify and Face the Same Issues. If the organization is going to "conduct activities" (the nonprofit equivalent of "doing business" for for-profit corporations) in New York, you will then need qualify it in New York. At that time you will need to undergo the same New York regulatory process applicable to entities formed in New York. But at least the organization has been formed and you can start the process of seeking federal recognition of tax exempt status at the same time that you are seeking to qualify the organization and the organization can receive at least some charitable contributions sooner. Furthermore, the entity is not subject to New York's rules requiring state approvals for major transactions.

So Let us First Discuss How to Form an Entity in Delaware. Delaware not-for-profit organizations are formed as nonstock corporations under the Delaware General Business Law, the same law that is applicable to for-profit entities, or as LLCs under the Delaware Limited Liability Corporation Act.

Advantages of Forming in Delaware.

• Delaware's lack of statutory strictures may give you greater freedom in structuring the corporation (although, in truth, many of the restrictions found in New York law parallel Federal tax law considerations or other "good practices"). For instance:

• Section 141 of the Delaware General Corporation Law sets forth various provisions regarding management but Section 141(j) states that those provisions can be overridden by the corporation's certificate of incorporation. Similarly, Section 102 allows the certificate to set forth "[a]ny provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors ... or the members of a nonstock corporation; if such provisions are not contrary to the laws" of Delaware.

• It is not clear under the New York N-PCL whether you can have non-voting directors unless they hold their board seat by virtue of holding an office in the corporation (but not by virtue of other criteria, such as holding public office); it would be fine under Delaware law.

• You could have a one-person board (New York requires a minimum of three directors) with a three-person executive committee composed of people who are not directors or even members (in New York all standing or special board committees, such as an executive committee, must consist only of directors).

• You could obviate some of the practical problems with board size (*i.e.*, that for most nonprofts the size of the board must be set out in the by-laws) and committee structure (*e.g.*, that all members of standing committees must be named by a majority of the entire board) noted below that exist for New York entities.

• While it is generally assumed that members would elect directors, the charter could state otherwise (see Sections 102 and 255).

• Delaware allows unanimous action of directors by electronic communications (email); it is unclear if such procedure is allowed under New York law.

• If set forth in the charter, board "meetings" could be held in electronic chat rooms.

• Action could be approved by less than a majority of the board, which is the requirement for certain New York action.

• Quorums could be as low as one director.

• There are no mandated officers and you only need a minimum of one. Persons may hold multiple offices (even both President and Secretary).

• Dissolution procedures do not require any state-level approvals and are thus a lot easier than in New York (this is a real big benefit, as will be noted later).

• If desired, you can impose personal liability on members.

• You can limit the liability of directors for breaching fiduciary duty.

• Members do not have the right to approve amendments to the certificate of incorporation (see section 242); such right must be enumerated in the charter. If the members do not have the right to elect the directors, they similarly do not have the right to approve mergers, asset sales or dissolutions (see sections 255, 271 and 276).

• There is limited regulation of charitable activities -- no Delaware approvals or registrations are required upon formation or to solicit funds. Delaware does not require registration of charitable organizations and its laws regarding solicitation are substantive only. *(See the chart maintained by the Multi-State Filer Project available at http://www.multistatefiling.org/)*. Delaware does have a Charitable/Fraternal Solicitation Act while prohibits fraud, deception and material misrepresentations in connection with solicitation and requires professional solicitors to maintain certain records and have written contracts but otherwise. Note also that the registration requirements of New York and other states will be applicable if the organization conducts activities in those states (see discussion below). The Attorney General also generally lacks statutory authority to supervise nonprofits although it does have certain common law rights.

Drawbacks to Delaware. Delaware does have some drawbacks for nonprofits, however:

• The freedom to structure the operational aspects of nonprofits requires that more thought be put in the documentation for Delaware nonprofits, especially since the enabling statute is not geared to nonprofits.

• If the corporation will need to qualify in New York, the charitable purposes may need to be more clearly enunciated (if not clearly stated in the certificate of incorporation, they will need to be more clearly stated in the application for qualification). A clear statement of charitable purposes is, of course, also necessary for the IRS application, but ambiguous charter purposes could probably be fleshed out in the Form 1023 description of purposes.

• Delaware lacks a body of nonprofit law (both statutory and case) to fall back upon as exists for New York entities, meaning that reliance on cumbersome common law principles and procedures may be necessary.

• It is not clear under Delaware law whether the corporation must have members (under New York law, members are not required for Type B organizations). While case authority has clarified that references to "stockholders" in the Delaware statute should" not be read as references to "members" for nonprofits, the Delaware General Corporation Law is silent on whether there have to be members. The statute states that the conditions of membership must be stated in the certificate of incorporation or by-laws. In the past the Delaware Division of Corporations took the

position that members were required, but since 2001 it has changed that position, now allowing organizations to file certificates that state that conditions of membership shall be as stated in the by-laws and then state in the by-laws that the organization shall have no members. An alternative approach would be to state that those persons who are the directors from time-to-time shall be the only members; this procedure used to be used in New York when nonprofits had to be formed under the Membership Corporation Law.

• As New York lawyers, you may not have the day-to-day contact with Delaware law that would give you a comfort level to provide proper advise. While New York for-profit corporate lawyers generally feel comfortable advising on basic Delaware corporate law issues since the topic is widely discussed in the corporate bar, that same level of familiarity probably does not exist in the non-profit bar.

• You should also be careful in using the various flexible provisions of the Delaware law since some of these provisions might not meet with IRS favor, especially if they create too many rights on the part of insiders.

• Delaware filing fees are slightly higher (*e.g.*, $89 plus $9 per page to file a certificate of incorporation in Delaware versus a flat $75 in New York; and two-hour expedited service in Delaware of $500 versus $150 in New York). If the certificate of incorporation is four pages, it is estimated that the average state costs in New York would be $120 to $245 versus $285 to $740 in Delaware (the variation reflecting whether expedited filing services are needed).

• The organization may have to pay the franchise tax but this is at the minimum level of $30 (religious corporations, purely charitable or education corporations and organizations that include in their purposes the assistance of sick, needy or disable members or to defray such members funeral expenses or to assist the survivors of deceased members are exempt). All corporations, even if exempt from the tax, have to file an annual report and pay the filing fee.

• The entity will need to pay on an on-going basis for a registered agent in Delaware (which costs several hundred dollars per year) and, if it has to later qualify in New York or wherever operations will be based, it will have two levels of periodic filings. Starting January 1, 2007, Delaware law required that all registered agents be advised of the name, business address and business telephone number of the designated person at the corporation who is authorized to receive communications from the company and to update such information as it changes. The registered agent can resign if it does not receive such information.

• If the New York based nonprofit wants to conduct legal raffles, in order to satisfy the requirements of the New York Games of Chance Law it must be chartered in New York State! (See discussion at Section X.2.)

More Information on Delaware Law. *For more information on this issue and other Delaware nonprofit incorporation issues, see Carolyn Klamp and David Heinen, "Delaware Law Concerning Exempt Organizations," The Exempt Organization Tax Review, November 2001, p. 227 et. seq.*

2. Incorporation in New York under the NPCL, Education Law or Religious Corporations Law

(a) Most Non-Profits Are Formed under the N-PCL

Most newly formed New York not-for-profits are organized under the Not-for-Profit Corporation Law ("N-PCL"). The law took effect in 1970 and supplanted entities formed under the Membership Corporation Law and General Corporation Law (among other acts), and entities chartered by the state legislature.

A bill to radically revise the law was submitted by Assemblyman Brodsky in February 2009 (A5855); this bill was drafted by the New York State Bar Association Committee on Corporate Law. It is hard at this time to handicap its likelihood of success. Among other major changes, the new proposal would eliminate the need for most agencies' consents (and instead require that the filed certificate of incorporation be provided to such agency within 30 days after incorporation), eliminate the various "types" of nonprofits and eliminate the need for court and AG approval of asset sales.

Several other bills have also been introduced in the current 2009-2010 session to tweak certain provisions of the N-PCL including

• A5927/S1102, to require a commitment in the certificate of incorporation to include certifications that the initial directors will include in the by-laws a conflict of interest policy and will establish periodic trustee education programs.

• A6381, to drop the requirement to provide addresses for trustees in the certificate of incorporation.

• S2138, to allow the inclusion in the certificate of incorporation of a provision eliminating or limiting the personal liability of directors to the corporation or members unless the acts or omissions were in bad faith or involved

intentional misconduct, a knowing violation of law or personal financial or other gain (this provision would parallel a change adopted in the BCL in 1987 and would expand upon the limitation of liability provisions of N-PCL Section 720-a, which limits the liability of directors and officers for third party claims, and bring New York law into conformity with Delaware law).

• S3698, to eliminate the Type C corporation. Type C corporations would now be formed as Type B corporations (and previously formed Cs would be deemed to be Bs). The introductory paragraph indicates that it was introduced at the request of the Department of State. So maybe progress is being made in that bastion of archaic legal practices.

• S7253, at the request of the Office of Mental Retardation and Developmental Disabilities, to eliminate the consent by that office to the incorporation of not-for-profit corporations.

While the N-PCL resembles in many respects the corresponding Business Corporation Law, knowledge of the BCL may be problematic if you assume that similar problems are addressed similarly in both laws. For instance, a business corporation's by-laws may allow the board to set its own size from time to time within a range without amending the by-laws if this provision is in by-laws approved by the shareholders; while the language in the N-PCL is similar to the language in the BCL, it has a different effect since all for-profits have shareholders but most Type B nonprofits do not have members. See Section 702. Accordingly, great care should be exercised when forming a nonprofit corporation if your prior experience is with for-profit corporations.

(b) Exceptions to the N-PCL

Two current exceptions to the requirement that nonprofits be formed under the N-PCL are organizations that are required to be formed under the Education Law or the Religious Corporations Law. Other laws may also apply to corporate formation, such as the Private Housing Finance Law for dormitories and hospital housing.

(c) Education Corporations

Education corporations are subject to certain provisions of the N-PCL but are, more importantly, also subject to regulation by the State Department of Education and the Board of Regents.

What is Education? The definition of "education" in the Education Law is very broad, and it includes any "institution ... for the promotion of science, literature, art, history, or other department of knowledge or of education in any way" as well as organizations "whose approved purposes are ... of education or cultural value."

The Education Law requires all corporations coming within such definition to be organized under that law unless the Commissioner of Education otherwise consents. Many times one or more of a nonprofit's purposes fall within this all-encompassing definition of education. The Education Department, however, usually grants such consent (or, alternatively, waives the need for consent) unless education is the primary or dominant purpose of the entity. As a practical matter, education corporations are degree-granting schools, museums, libraries, historical society and public television and/or radio corporations.

Additional Substantive Approvals. In addition to granting charters, or consenting to formation under the N-PCL, the Education Department must separately register secondary, primary schools, nursery schools, kindergartens, private schools and private business schools; grant the power to confer post secondary degrees; register curriculum for higher education; and register libraries receiving public funding and museums.

Procedure. *Go to http://www.counsel.nysed.gov/home.html for the procedure for formation of education corporations. See also the Education Department's Pamphlet No. 9 (available at http://www.counsel.nysed.gov/pamphlet9/lp9.pdf) (note that this pamphlet was revised in October 15, 2007). For information about museums and historical societies, see http:// www.nysm.nysed.gov/charter/index.html#top. For a summary of the requirements as they relate to museums, see http://manyonline.org/NYS-Standards.htm*.

The process of obtain a charter or certificate of incorporation is lengthy, requiring review of legal documents by the Office of Counsel for legal sufficiency and by the appropriate program office, possibly one or more site visits, submission of staff recommendations to the Board of Regents and approval by the Board of Regents (which meets only once a month and requires an agenda two months before its meeting). Among other criteria, the organization has to show that its financial resources will be adequate and that it can meet the relevant statutory requirements within a reasonable period after incorporation. *For these standards, see generally 8 N.Y.C.R.R.*

Requirements for Cultural Agencies. If the organization is a "cultural agency" it will need to submit a questionnaire to the Chartering Program of the New York State Museum. Entities deemed to be cultural agencies include aquariums,

arboretums and botanic gardens, art centers, genealogical society, museums (including children's museums, general museums, history museums, natural history museums, sports museums and specialized museums), historic homes or sites, historical societies, libraries, nature centers, planetariums, preservation organizations, science or technology centers and zoos as well as "friends" or "support groups" for these institutions. The questionnaire asks about the entities' background, programs, collections, educational programs, exhibits and displays, leadership, facilities, hours and access, trustees (with biographies), collections management policy (addressing acquisition, preservation, access and deaccession), plans and finances. *Further information, including sample documents, can be obtained at http://www.nysm.nysed.gov/charter/.*

Difference between Charters and Certificates of Incorporation. The Regents can either issue "charters" including "provisional charters," which are issued for terms of one to five years, [FN7] and "absolute charters," which are usually issued after the term set forth in the provisional charter) or "certificates of incorporation." The former are issued when the purpose of the entity is such that it must adhere to specified educational standards; this generally applies to nurseries, preschools, kindergartens, primary and secondary schools, colleges, universities, libraries, historical societies and public television or radio corporations. The later is used for other organizations which it authorizes where the corporate purposes are of educational or cultural value "deemed worthy of recognition and encouragement." The process for issuance of certificates of incorporations is substantially the same as for charters.

Ownership of Historical Property. If a certificate of incorporation includes language about the ownership of historical properties, the Education Department has taken the position that it has to be formed as an historical society under the Education Law.

Collections. Many times the Education Department will require that organizations seeking its consent add language to their charter that "nothing herein shall authorize the corporation to operate or maintain a library, museum or historical society or to own or hold collections." This language could prove problematic if the organization thinks that it might ever own things that could be viewed as a collection even if it clearly does not intend to be a museum, library, etc. The Education Department defines a "collection" as

> "one or more original tangible objects, artifacts, records or specimens, including art generated by video, computer or similar means of projection and display, that have intrinsic historical, artistic, cultural, scientific, natural history or other value that share like characteristics or a common base of association and are accessioned; for purposes of this section, historic structures owned by an institution shall be considered as part of a collection when so designated by the institution." (underlining added)

The Education Department defines "accession" as "(a) adding an object to an institution's collection or (b) the act of recording/processing an addition to an institution's collection." (underlining added) and "institution" as "a museum or historical society with collections formed by the Board of Regents or otherwise incorporated as an education corporation under the laws of the State of New York."

Accordingly, an organization with one or more paintings, photographs, sculptures, items of historical relevance, etc. might be viewed as having a collection in the literal sense. But in order to be a collection as defined by the Education Department the objects must be "accessioned" and in order to be "accessioned" the owner must be a "museum or historical society," all of which is somewhat circular. If, however, this mandated language is added *in haec verba* to an entity's certificate of incorporation, the organization might lack authority to own anything that could be considered a "collection" in a dictionary sense even if it is not a museum or historical society. If you are requested to include this language, you may try to add the words "as such term is defined by the Education Department," which should limit the definition to collections of museums or historical societies. Whether the Education Department will accept such a limitation, however, remains to be seen; it has not been receptive to making other logical changes to the boilerplate consent clauses.

Overlap with N-PCL. The N-PCL also applies to education corporations but, if there is a conflict between the N-PCL and the Education Law, the later governs. Sometimes the provisions of both laws apply with respect to a particular matter. Some N-PCL provisions that do not apply to education corporations include those regarding visitation of the Supreme Court, provisions regarding transactions respecting real property, certain rights to remove directors and certain provisions regarding amendments, mergers and dissolution.

(d) Religious Corporations

Corporations created to enable members to meet for divine or other religious observations or other unincorporated assemblages of persons who are accustomed to meet for divine worship or other religious observations, can be formed under the Religious Corporations Law. The N-PCL also applies to religious corporations unless there is a conflict, in which case the later governs.

The Religious Corporation Law is written so that some of the provisions apply to all religious corporations and others only apply to corporations of specific religions.

Note that certificates of incorporation for religious corporations that maintain a place of worship are not filed with the Department of State but are instead filed in the county clerk's officer where the organization will be located; certificates for other religious corporations are filed with the Department of State. If you wish to obtain a copy of the as-filed certificate, it is available where filed.

3. Certificate of Incorporation. In New York and Delaware, the formative document is called the Certificate of Incorporation. In some other states it is called the Articles of Incorporation. It is also sometimes generically referred to as "the charter."

(a) Type: A, B, C & D

To confuse you further, there is not just one type of New York not-for-profit corporation; instead, there are four, prosaically called types A, B, C and D, for the subparagraphs of paragraph (b) of Section 201 of the N-PCL.

This is another area where New York is unique and gives you a reason to consider forming the corporation outside of New York, although the issue will eventually have to be addressed when seeking to qualify in New York if you do not form the organization here. The classification can be important as some of the burdens that fall on nonprofits vary depending on the type. For instance:

- The approval requirements for formation vary depending on the type of organization.
- All nonprofits must have members other than Type B entities. See Section 601.
- Types B and C corporations (*e.g.*, charitable organizations) are the most heavily regulated of the categories.
- Type B and C corporations are subject to the "visitation and inspection of a justice of the supreme court" (see Section 114). The visitation provision allows persons alleging misappropriation of funds, *ultra vires* actions and certain other offenses to have an accounting before the courts.
- The dissolution process is much simpler for Type A entities than for Type B, C or D entities, since they do not have to obtain judicial approval and maybe not even Attorney General approval.

You will find that most nonprofits are Type B corporations, but some fall within other categories even though they also have some Type B purposes. The dividing lines between these categories is not always crystal clear:

- **Type A** corporations are formed for "any lawful non-business purpose" including civic, patriotic, social, fraternal, athletic, agricultural, horticultural, animal husbandry organizations or professional, commercial, industrial trade or service associations. If a corporation could be a "B" or an "A," it is considered a "B."

This category is most often applied to membership organizations where the activities by or for members are foremost, such as clubs, civic associations, professional or trade groups, tenant organizations, PTAs and labor unions. Type As must have members, who are the beneficiaries of the nonpecuniary advantages of such organization.

Under Sections 1406, 1407 and 1410 of the N-PCL, medical societies, college alumni corporations, boards of trade and chambers of commerce must be "A"s. Since the list or organizations to be formed as Type As is nonexclusive, any nonprofit organization that does not fall within the other categories is a Type A.

Prior to 1993, all nonprofits other than Type As were required to obtain Attorney General and Court approval for formation. Now, with court and AG approval not generally required of Type B, C or D entities for formation (although it still is for dissolution), that distinction is no longer as relevant a benefit of Type A status. Note, however, that starting in 1994 trade or business associations require Attorney General approval for formation and dissolution, due to possible antitrust considerations, and consent of other state agencies or outside organizations may also required to for the formation of certain organizations such as YMCAs, labor organizations, American Legions, etc. See Section 404.

These organizations will usually qualify for federal tax exempt status under Sections 501(c)(4), (6) or (7) but they are not eligible to receive tax-deductible contributions.

• **Type B** corporations are formed for "any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals." You will note that this category covers more than just charitable entities; for certain purposes (such as the ability to avoid the use of a corporate indicator) only those organizations that are "charitable" will qualify.

Most of these organizations provide substantial public benefit (although that might be in question regarding religious organizations run for the benefit of their members), and generally derive their support from the public or other charitable donors. This listing correlates substantially to the classic definition of charities under the federal tax laws.

Under Sections 1401, 1402, 1404, 1405, 1408 and 140 of the N-PCL, private cemetery corporations, volunteer fire departments, "young men's [or women's] Christian associations, soldiers' monument corporations, historical societies and organizations to promote agriculture, horticulture or the mechanic arts, are "B"s.

These entities can, but do not have to, have members (other types must have members). Type B organizations are heavily regulated in respect of unusual corporate transactions such as amendment of their certificate of incorporation, dissolutions, mergers and sale of assets.

These corporations usually qualify as tax exempt under the oft-cited Section 501(c)(3) and, as "(c)(3)s," are eligible to receive tax deductible contributions.

• **Type C** corporations are formed for any lawful business purpose to achieve a "lawful public or quasi-public objective."

This is a confusing category. While the purpose of the organization must be to conduct "business," that business must still be for a purpose which is not pecuniary profit or financial gain. In other words, the ultimate objective of the organization must be public benefit. Any organization having a Type C purpose, even if predominantly within another type such as Type B, is considered a Type C corporation.

This category would clearly be appropriate for a thrift shop or other store designed to support a nonprofit purpose or an entity formed to hold, lease or sell real estate. Under Section 1411 of the N-PCL, local development corporations are "C"s. Antipoverty organizations may also appropriately be considered Type Cs.

When this type was first created, in 1969, most practitioners envisioned its use by small business in economically deprived areas where it was thought important to reestablish a business community (*i.e.* a hair salon in "the ghetto"); if the business became successful, it would transition to becoming a for-profit entity. Over time, however, the Department of State has viewed this category as being more expansive; it considers certain types of nonprofits that you would not normally think of a business purpose, such as nonprofit theater companies, dance companies, and companies to provide consulting services, to be Type Cs. See the discussion below under "Department of State Review" for more horror stories.

While Type Cs are subject to many of the provisions of the N-PCL governing Type Bs, they are allowed to merge with for-profit business corporations if the merger is approved by the court. See Section 908. Unlike Type Bs, however, Type C corporations must have members.

In 2008 legislation was introduced at the request of the Department of State, as noted above, to eliminate the Type C corporation and instead have them form as Type B corporations. These organizations should be able to qualify as tax exempt under Section (c)(3) if they are really charitable. No one can cite to a situation where the IRS has raised an objection based on the New York "type," but such objection is theoretically possible.

• **Type D** corporations are corporations formed under the N-PCL when the formation is authorized by some other corporate law for any business or non-business and pecuniary or non-pecuniary purpose, whether otherwise falling within the categories described as Types A, B or C. That is a mouthful!

Housing development fund companies formed under the Private Housing Finance Law are one example of this type of entity.

These companies are governed by the rules applicable to Type Bs, except as otherwise stated in the specific act authorizing their formation. They must have members. Whether or not they can become tax exempt depends on the statute involved.

You will also see in the public record for some not-for-profit corporations formed before the enactment of the N-PCL something called a Certificate of Type, where the entity had to state which type it would be if formed under the N-PCL. If it failed to file such a form, or amend its Certificate of Incorporation to add "type" language, it was deemed to be a Type B. (See N-PCL Section 113)

(b) Department of State Review

In recent years the Department of State has started to more assiduously review nonprofit incorporation papers, focusing on the type of organization and the purpose and powers clauses, as well as its more traditional focus on whether all necessary consents have been obtained.

In determining if you have chosen the appropriate "type," the examiner will sometimes view the powers of a new organization as allowing it to conduct what he or she considers business (even though the organization will not be charging for such services) and will therefore require formation or qualification as a Type C organization. For instance, with respect to a charity that had among its purposes raising funds for medical education in Africa and providing "consultation" to recipients of such funding, the first examiner from the State Department insisted that consulting was a "business purpose," thus requiring a refilling as a Type C corporation. But the examiner of the second filing said that he and others in the department could not find a "C" purpose. "Left hand knoweth not what right hand doeth," it seems.) In another instance, the Department of State said that a farm organized to show children about farming is a Type C corporation because the farm is a business, even though the stated purposes of the entity would otherwise cause it to be a Type B organization. As noted above, the Department views nonprofit theater companies to be Type Cs. I sometimes think that whether or not you get questions from the DoS depends on whether it is a "slow day" or they are bored and what some fun!

In one recent "run -- in" with the DoS, the examiner raised serious questions about the fact that a Delaware nonprofit seeking to qualify in New York had as a purpose the support of another nonprofit based in Rhode Island -- they could not grasp the concept that the fact that the funded operation was outside of New York although the headquarters was in New York. The examiner also raised objections regarding the claimed vagueness of the purpose. In this example we found it far more productive to deal with the supervising attorney, rather than the non-attorney examiner. But great care must be taken to not insult the examiner, as tempting as that may be! By offering to make modest changes when submitting revised language to the lawyer, we were able to get the filing approved. We doubt that we would ever get the language approved by the examiner.

The Secretary of State's office will review the proposed name in greater detail than seems appropriate. For instance, with a nonprofit that our firm was forming the Secretary of State's office said that the name did not sufficient imply what they were doing -- it was for a dance company with the word "drastic" in it. The solution was to elaborate on the purposes to show how the dancing will, if fact, be "drastic." If a non-New York entity was formed without the use of a corporate indicator (*e.g.*, "Inc."), the DoS will require that you add a corporate indicator to the name for purposes of New York qualification (but do not make the mistake of considering this to be a "factitious name").

One statistic that we heard from a representative of this group was that at least half of the nonprofit filings with the DoS get "bounced" at first.

Some commentators said that the office of the Secretary of State "seems to be the last bastion of the fussiness of eighteenth-century pleading." *See Victoria Bjorklund, James J. Fishman and Daniel L. Kurtz*, New York Nonprofit Law and Practice, *Michie, 1997, p. 52*. They will bounce a filing for a stray comma in the name, etc. In one instance we encountered, they bounced a certificate of dissolution for inclusion of language that the AG's office had required (we had to get the AG's office to withdraw its request). Another nonprofit practitioner, formerly with the Department of Law, noted that they seemed to have become, in recent days, even more pesky. To keep your sanity, treat dealings with the Department of State like a game -- and you might wish to advise your client up front that they may create mindless grief.

A group of leading nonprofit lawyers in New York, the Nonprofit Coordinating Committee, has been meeting with representatives of the DoS office to try to educate them about these problems; initial meetings (in 2007-2008) were somewhat unfruitful but we were advised (in March 2009) that they may finally be making some progress, at least in terms of having the office provide better guidance on its website regarding the need for consents, etc.

See http://www.dos.state.ny.us/corp/nfpcorp.html#certinc for the Department's website regarding nonprofit filings and a brochure the Department has prepared, available at http://www.dos.state.ny.us/corp/nfpguide.htm.

(c) Drafting Issues

The requirements for what must appear in the Certificate of Incorporation are clearly delineated in Section 402 of the N-PCL. (*See Law Pamphlet 9 of the Education Department for Education Corporations, available at http:// www.counsel.nysed.gov/, for education corporations; their charter has to include information about educational standards and financial resources.)*

(i) Name

Required Words. As with business corporations, generally the name must include a corporate indicator (Corporation, Incorporated, Limited or an abbreviation); this rule does not apply, however, to corporations with "charitable" or religious purposes, bar associations or corporations required to be approved by the Commissioner of Social Services or Public Health Counsel. (Note, however, that the Department of State views "charitable" in a very restrictive sense -- if the entity has any purposes that fall into any other category of exempt entity, such as educational purposes, they will bounce a filing for a new entity without such indicator, even though there are many existing nonprofits that were formed without such indicator that have purposes that are only charitable in a broad sense of the word.) The name cannot be confusingly similar to another existing name (the addition of another word, however, usually does the trick). *See Sections 301, 302 and 404*. Furthermore, you cannot use the name of an individual or another organization (*e.g.*, Friends of XXX) without that individual's or organization's approval. *See Executive Law, Section 174-d*.

Prohibited Words. Certain words or phrases are precluded:

• There can be no implication that the company is a governmental agency, nor can the name be indecent, obscene or ridicule other persons, groups, beliefs or governmental agencies. (The Secretary of State challenged the use of the word "Queer" under Section 301 of the N-PCL as obscene or intending to ridicule in a certificate of incorporation for Queer Awareness but eventually backed down.)

• Names cannot use the noun or adjective form of professions regulated by the Board of Regents (such as medicine, architecture, accounting, engineering, etc.) or the words "law," "lawyer," unless the members (and the incorporator) are members of such profession.

• The word "cooperative" or variants cannot be used.

• According to the Department of Education Pamphlet No. 9, no institution which does not possess degree-conferring powers may use the term "college" or "university" in its corporate name and no institution other than a secondary school may use the term "academy" unless it is clear from the context that the corporation does not operate a school of any kind.

• Section 404(w) precludes the use in a nonprofit formed under the N-PCL of "the words "school," "education," "elementary," "secondary," "kindergarten," "prekindergarten," "preschool," "nursery school," "museum," "historical," "historical society," "arboretum," "library," "college," "university" "conservatory," "academy," or "institute" (or any abbreviation or derivative of such words) unless Education Department consent is obtained..

• You should also avoid the following words: "diploma," "degree," treat," "design," "engineer," "psychology," "massage" [!!!] or "accounting" in the corporate name unless you plan to get a charter from the Education Department.

• Alumni associations must show a letter from the institution granting consent to the use of the name when seeking Education Department clearance.

IRS Concerns. Note also that it is wise to stay away from names including the name of the principal artist of dance companies or other artist entities involved primarily with one artist; the IRS has sometimes (but not always) taken the position that the corporation is being formed to promote the individual, not carry out a public purpose.

Procedure. As with for-profit corporations, consider whether to check the availability of the name and/or reserve a name first, especially since the approval process for not-for-profit companies can be lengthy and that process may need to be redone if the desired name is not available. (Such reservation is also appropriate when changing the name, since the process of getting AG, agency and court approval for the certificate of amendment can be lengthy.) It is

probably easiest to check the availability through a corporate service company (the state fee to check is $5.00 per name). The reservation costs $10 (plus any corporate agent's fee) and is good for 60 days, extendible for up to an additional two 60-day periods. (If the clearance process goes longer than 180 days, you can file anew shortly after the prior reservation lapses.) Similarly, the names should be checked in other jurisdictions where the entity plans to operate and it is also advisable to do a trademark search unless the name is truly unique (note that the company may wish to register its trademark to protect against interlopers).

D/B/As. The organization can use an assumed name (a "d/b/a" for "doing business as") in addition to its corporate name but it must file a certificate with the Department of State pursuant to Section 130 of the General Business Law. Note that consent of the Education Department and other applicable agencies will also be necessary for "d/b/a"s names that trigger approval requirements for incorporations.

(ii) Purposes

Drafting. The purpose clause is probably the trickiest part of the certificate. The statutes of most states now allow business corporations to use the "all purposes" language (older attorneys will remember when New York business corporations -- but not Delaware corporations -- had to have specified purposes), but corresponding not-for-profit statutes in New York and most other states still require specific purposes. Furthermore, the purpose clause will be carefully reviewed by the IRS in ruling on the company's exemption request. Accordingly, the purposes should be drafted with the IRS standards in mind.

The Department of State's website, at *http:// www.dos.state.ny.us/corp/nfpguide.htm,* states the "purpose or purposes [set forth in the certificate of incorporation] must clearly and fully describe the activities of the corporation. The Department of State has said that it needs the certificate to include a list of activities to be conducted in order to determine (a) if the name meets the requirements of Section 301, (b) whether the correct type is indicated and (c) whether any state agency or other consents are required. Such requirement is not set forth in N-PCL Section 402, regarding the contents of the certificate of incorporation. (Section 1304(a)(4), however, states that an application for authority by a foreign corporation must include a "statement of its purposes to be pursued in the state and of the activities which it proposes to conduct in this state." The Department of State seems to be reading the Section 1304 requirement into Section 402.) The requirement to describe activities as well as purposes leads to certificates including needlessly detailed minutia. It also often leads to confusion between what is a purpose and what is a power (or how the nonprofit intends to achieve its purpose).

The clause is usually written with a "broad brushed" definition of the purpose in the first clause (for New York corporations, tracking the relevant categories of companies allowed under the appropriate type), followed by more specific non-exclusive activities which the company may (but does not necessarily have to) conduct, frequently ending with a "catch all" clause such as "to conduct any lawful activities which may be appropriate in carrying out the purposes noted above." It is wise to cast the net as wide as possible in drafting the purpose clause to avoid the need to later amend the certificate of incorporation but to not be so expansive in the definition that you would need to obtain more consents than you should. But you should not use such phrases as "including" or "such as," which will engender comments from the DoS.

Suggestion Regarding Consents. You should include the phrase "Nothing in this certificate shall authorize the Corporation to engage in any of the activities listed in Sections 404(a) through (w) of the Not-for-Profit Corporation Law," unless, of course, one of your purposes is so noted; in which case, you should include the phrase but add "without the consents required by such sections" and obtain the enumerated approvals. To expedite Education Department review, it is wise to add one or more specific disclaimers if the name or purposes imply activities that fall within the activities described in certain specific form disclaimers available on the Education Department website: *see http://www.counsel.nysed.gov/forms/ques.html#4*.

Compared to Powers. Note that purposes are not powers. Purposes state why the organization is formed; powers say what it can do to carry out those purposes. Some charters, especially of older organizations, conflate these two provisions and create confusion.

Compared to Mission. You will sometimes hear of an organizations "mission." This concept was somewhat of a popular fad in the last decade, and, while it may not be as much in vogue currently, it is still spoken of by nonprofits.

An organization's "mission" is not the same as an organization's "purposes." The mission will most likely be set forth in a "mission statement" and will sometimes be repeated in the by-laws, both of which are easy to change, whereas the purpose is set forth in the hard-to-change certificate of incorporation. A mission (sometimes phrases as "our current mission") is more transient than the corporate purposes. It might be better understood to be those purposes which the organization is currently carrying out, instead of all the purposes that it might be allowed to carry out.

A 2007 IRS preliminary staff discussion draft of "Good Governance Practices for 501(c)(3) Organizations" (*http://www.irs.gov/charities/charitable/article/0,,id=167626,00.html)* recommended that the organization adopt such a "clearly articulated" mission statement to help "explain and popularize the charity's purpose and serve as a guide to the organizations work." It should show why the charity exists, what it hopes to accomplish and what activities it will undertake, where and for whom. The draft does not have the force of law. While the IRS's new annual Form 990 does require a discussion of the organization's mission, the organization does not have to adopt a "mission statement."

(iii) Powers

It had been our practice to say that "the Corporation shall have all of the powers conferred upon or permitted to corporations organized under the N-PCL (including without limitation Section 202 of the N-PCL)" (Section details the corporation's statutory powers) but, starting in late 2006, some examiners in the Department of State's office have objected to inclusion of the parenthetical. Since such powers are in the N-PCL, there should be no objection to removing the language. The purpose of citing the specific statutory provision is more to educate the reader as to the provision of the N-PCL where most corporate powers are enumerated.

Some older companies have very detailed statements of powers, but that is no longer necessary. It is our custom, however, to add the powers to

"(a) solicit, take and hold any bequest, devise or gift or purchase, lease, or otherwise acquire any property [this is added since Section 115 of the N-PCL [FN8] may require that any such power be specified in the certificate and notes that it is illegal to solicit without registration with the Charities Bureau of the Department of Law];

(b) hold, maintain, use, convey, sell or otherwise dispose of such property and invest, reinvest, administer, collect and receive the income and profits, and expend the principal thereof and income as may be permitted by law and the Board determines ill best promote the purposes for which the Corporation is organized;

(c) apply the principal and the income for charitable, educational, religious, scientific, literary or cultural [as appropriate for the organizations] purposes, including by contributions to other 501(c)(3) organizations; and

(d) do any and all lawful acts and things which may be necessary, useful, suitable or proper for the furtherance, accomplishment or attainment of any or all of the corporation's purposes."

(iv) Members

An important issue for Type B corporations is whether or not to have members. Type A, C and D entities must have members. If the organization has members, they act much like shareholders of business corporations, electing the directors and approving major corporate actions such as changes in the certificate of incorporation and dissolution, as well as having the ability to amend by-laws.

Old Laws Required Members. Traditionally, all not-for-profit companies had members. Now, however, Type B entities may be managed solely by their boards of directors without the need to have members. In those companies, the board nominates and elects new members as a "self-perpetuating" entity unless the organization has voting bondholders.

You will in fact see some entities formed under older laws which satisfy the membership requirement by stating that those persons who are the directors shall also constitute the only members. In that case you will have the same people "wearing their member's hat" elect the board, and then "wearing their director's hat" take other action. This is a good trick to remember when you need to have members for Type A, C or D corporations or otherwise need to have members, such as may be the case in Delaware. See also the discussion below as to why it may be helpful to have members to be able to more easily change the number of directors.

Considerations. The decision of whether the organization should have members or not is one in which "political" or intangible considerations often come into play:

• By having a broad base of members, the organization may be better able to galvanize support, but that must be counterbalanced by the administrative burdens associated with the "care and feeding" of members.

• If the organization has a broad base of members, great care must be exercised to make sure that those members stay 1 involved in order to ensure that quorum and other requirements can be met. It is imperative that the governing documents set forth a clear procedure for determining who are, at any specific time, the members. For instance, the by-laws could expressly state that any failure to pay annual dues after a certain grace period shall result in forfeiture of membership. Otherwise you can end up in situations where it is impossible to determine who are the members entitled to vote on specific matters.

• There will be costs of preparing and mailing annual meeting and proxy mailings.

• There will also be a greater risk of litigation from disgruntled members.

Dynamics of Membership. It is helpful to understand the dynamics of many nonprofit groups. Since the pay or other financial reward of work with nonprofits is low, most people are involved due to noneconomic benefits, which may make them more likely to raise disagreements over minor noneconomic issues. The "pet peeve" that might be ameliorated in a business context with a small payment or continued employment can become a big issue with the nonprofit organization. Unless there is a real reason to have members and there has been a full discussion with the organization's sponsors regarding the virtues and drawbacks of having members, it is wise to form Type B nonprofits without members.

Founders as Members. One creative use of members is where founders are loathe to give up control to the board of directors. The founder or founders can be constituted as the only members, with the ability to control who can become members thereafter, and they can as members elect the board.

While this should logically give rise to questions by the IRS when the organization is seeking public charity status, it often does not. I could imagine, however, that this structure may limit the desire of some contributors to donate. It is frequently the case that the founders will eventually wish to drop the idea of members once the organization has become self sufficient and the board of directors reflects a broad constituency. Also, new outsider directors might insist on such a change to induce them to come on-board.

Note that sometimes organizations that have one or more initial members fail to remember that the new directors have to be elected by those members, assuming that they are like most nonprofits with a self-perpetuating board.

Family Foundations. Another case where it is likely to have a membership structure is in family foundations, where the parents might be the only members but all of the family constituencies, including the younger generation, sit on the board.

Location of Provisions. Whether there are to be members or not can be set forth in either the certificate of incorporation or by-laws. One virtue of including it in the by-laws only is that it can be more easily changed. See Section 601.

Drafting. The details regarding membership, such as eligibility standards, are usually set forth in the by-laws rather than in the certificate of incorporation.

• Members do not have to be individuals but can instead be corporations or other business entities.

• If dues are required, that fact should be set forth in the by-laws, along with a procedure for setting and assessing the dues and stating the consequence of nonpayment.

• You can have classification of membership, with corresponding voting rights. While some classes can be nonvoting, there must be at least one voting class.

• The provisions regarding membership should indicate whether it is transferable or not, although certificates or cards showing membership are not transferable. See Section 601.

• While there must be at least three directors of an N-PCL chartered corporation, it can have as few as one member.

• The certificate of incorporation (but not the by-laws) can include language allowing written consent by less than all the members. See Section 614. If there is no provision in the certificate on this issue, written consent can only be by all the members. While the certificate could include language requiring approval by greater than majority vote or higher quorum requirements, any such provisions are usually found in the by-laws due to the greater ability to revise the by-laws.

Members Who Aren't Members. With careful drafting, it is possible to have people designated as members but who are not really members in the N-PCL sense. You probably all recall hearing the repeated requests to become a "member of listener-support radio station [WYNC]" but the term member is used there as synonymous with "contributor." Care must be exercised, however, to make sure that such donors do not think that they are thereby acquiring a vote in the running of the organization. You might want to call them "members of our support group" or words with like import. You could include a provision in the certificate of incorporation noting that such members may exist but that they do not have any of the rights of members under the N-PCL.

(v) Board of Directors Issues

There must be at least three directors for New York nonprofits (Delaware allows boards of one director); some agencies which must consent may require more (*e.g.*, under New York law social service organizations must have at least seven of diverse backgrounds). Note also that the IRS in reviewing the application for recognition of tax exempt status will often look to see if the board is broad-based and therefore it may be prudent to have a larger board, at least by the time of filing with the IRS. It is advisable to have a large enough board so that a majority of the directors are independent of management. This is especially important when a new small nonprofit is formed by a founder who might otherwise populate the board with family members; the IRS may look askance at such a controlled board.

Under New York law initial directors must be named in the certificate of incorporation for Type A, B and C corporations. (Delaware law allows the nonprofit to name the initial directors by action of the incorporators, therefore keeping those names out of the public filing.) Additionally, the address of the initial directors must be included. The law does not state that this has to be the home addresses, and most filings use the address of the nonprofit (if it has one) or another business address, but in a bill introduced in 2009 the requirement to delete addresses was proposed to be dropped due to concern regarding disclosure of home addresses. It is possible to use nominee directors (*e.g.*, lawyers at the law firm filing the certificate) and have them replaced at the initial directors meeting if there are concerns regarding confidentiality. If the nonprofit wants to have more than three directors but is having difficulty at formation agreeing on who should be the directors, it can form with the minimum of three directors and add more directors later.

The by-laws will include provisions regarding the number of directors after formation (or, in certain cases, procedures for how the number is determined), as discussed below.

(vi) Capitalization; Membership Certificates

While a not-for-profit corporation cannot have shares of stock, which may rise or fall in value, there are certain analogous capital or capital-like vehicles that can be used. These include capital contributions by members, which must be reflected in capital certificates, and subventions.

Capital Contributions. Capital contributions may be authorized in the certificate of incorporation as being due from members on or subsequent to admission. The requirement may apply to all members, to the members of a single class or to members of different classes in different amounts or proportions. They must be paid by money, tangible or intangible property or services actually performed for the corporation's benefit prior to issuance. They are generally nontransferable except that limited transferability is allowed for Type A corporations to other members with the organization's consent. Repayment is allowed only upon dissolution or, if so stated in the certificate of incorporation, upon redemption by the corporation or, unless stated otherwise in the certificate, when a member's membership terminates. The payment upon dissolution or redemption must not exceed the amount of the capital contribution. See Sections 502 and 503.

Subventions. Subventions fall in between debt and equity in priority. They are basically a type of low-interest subordinated debt. Subventions are rare but they are used by some nonprofits, especially healthcare organizations. There may be accounting advantages to the use of subventions. They might be useful if an organization wants to fund the formation of an organization and then take out its investment after the organization gets off the ground. Their use is more likely in Type A or C corporations. The certificate of incorporation must note the ability to issue subventions. The maximum interest rate that can be paid is two-thirds of the maximum rate allowed by Section 5-501 of the General Obligations Law. Subvention certificates can be redeemable and the holders can be allowed to compel redemption. The rights of subvention holders are, however, subordinate to the rights of creditors. See Sections 504 and 505.

Loans. Nonprofit can "issue bonds" and "pay reasonable interest on its bonds," and issue promissory notes and grant security. See N-PCL Section 506 (note that such provision also imposes certain interest limitations on payments to members of the nonprofit). The text of the N-PCL does not seem to impose any statutory limitation on commercial loans other than to the extent that the restrictions on "bonds" may be viewed to be applicable to other loan types by analogy. The statute states that member consent is not required unless specified under the certificate of incorporation. See Section 506.

Dues, Fees, Etc. Nonprofits can also require members to pay initiation fees, dues, fines or assessments if so authorized by the certificate of incorporation or by-laws and, if set forth in the certificate of incorporation, have certain rights to distributions for such initial fees, dues or assessments in connection with dissolution, subordinate to creditors and capital or subvention certificate holders. See Section 507. Note that if a membership organization wishes to issue membership certificates, cards or like documents, the law requires the document to note that the entity is a not-for-profit corporation and the document cannot be transferred.

Charges for Services. If the organization conducts activities which entail the payment of fees or prices for services or products, the N-PCL requires that such incidental profits be applied to the "maintenance, expansion or operation of the lawful activities of the corporation" and not be distributed to members. See Section 508.

(vii) Boilerplate Provisions

Standard language is included if tax exempt status is to be sought, stating that

• nothing not permitted to the category of tax exempt organization can be carried out;

• no part of the company's assets, income or profit will inure to the benefit of, or be distributed to, any private persons (including members, trustees or officers) (other than reasonable compensation);

• the entity cannot attempt to influence legislation except as permitted by the tax code or be active in the campaign of any 3 candidate for public office; and

• upon dissolution the assets will be distributed to organizations which qualify under Section 501(c)(3) (or other section corresponding to the applicant's exempt purpose) of the tax code or to the government for a public purpose, subject to court approval.

(viii) Carrying Over of Prior Activities

If the organization is a continuation of a prior unincorporated association, the incorporators signing the certificate must constitute at least a majority of the committee of that organization which has been authorized by the group to seek incorporation. An affidavit to that effect must be submitted. See N-PCL Section 402(b). Note that the Secretary of State's office, however, interprets this provision not merely to require that an affidavit be submitted with the filing but that the persons signing the affidavit also act as the incorporators. We see no support for this interpretation in the statutory language, however.

(ix) Duration

Most entities will have an unlimited life but some regulatory bodies require that entities formed with their approval have a stated life. This is the case for day care centers and social services agencies authorized by the Commissioner of the Office of Family Services or the Department of Family Assistance.

(x) Optional Provisions

You are free to add provisions not mandated by statute but it is usually best to leave those for the by-laws, which can be amended without the need for governmental approvals or state filings. These provisions might include:

• a requirement of members to make capital contributions or subventions

• if a membership organization is allowed to act upon the written consent of less than all the members (*e.g.*, a majority of the members approving), that must be set forth in the charter; and

• certain provisions regarding required distributions or other restrictions on private foundations required under tax law may be set forth but they are automatically deemed included by New York law whether expressly set forth or not (see Section 406).

(d) Approvals

The need to obtain approvals from various government agencies is one of the unique, and more painful, aspects of New York's nonprofit law. You need to review Section 404 of the N-PCL, which sets forth 22 subsections setting

forth when approvals are required, but you also need to realize that approval requirements may also be set forth in substantive statutory provisions, such as the Private Housing Financing Law. Most required approvals are from state agencies but sometimes approval of private entities (*e.g.*, the ASPCA or YMCA) is required. Accordingly, you should review all laws which may have bearing on the purpose of the organization, if there are any questions as to whether approvals are required.

(i) Attorney General. In the "old days" (*i.e.*, before 1992), the approval of the Attorney General was required for formation of all not-for-profit corporations. Since then, only trade associations or business associations must be approved (by the Antitrust Bureau of the AG's office) pursuant to Section 404(a). Note that many not-for-profits must still register with the Charities, Trusts & Estates Bureau of the Department of Law, but that registration comes after formation (this will be discussed later). Additionally, changes in corporate purposes, sales of significant assets, mergers and dissolutions must be AG-approved; these will be discussed later. Accordingly, make sure that the entity's initial purposes as set forth in its certificate of incorporation are broad enough to cover all envisioned activities to avoid the need to later seek Department of Law approval.

(ii) Education Corporations. As noted above, due to the broad definition of Education Corporations under the Education Law, Education Department "consent" or "waiver" is required for any not-for-profit having an arguably educational approval or using certain words in its name which imply such educational activities. See Sections 404(d) and (w). See *http:// www.counsel.nysed.gov/forms/ques.html#3* for the department's procedure. (You need to submit two copies of the proposed certificate of incorporation with appropriate disclaimers, along with a completed consent form -- available on the website, an explanatory cover letter, a stamped return envelope (or overnight delivery papers) and a check ($10 for nonprofits).

The Education Department used to be fairly responsive to requests for such consent or waiver, with a turn-around time of several weeks to a month, but in the few years the time for response has become much longer, sometimes several months. We understand that it is a matter of understaffing plus not being computerized. In meetings with representatives of the Nonprofit Coordinating Committee, the Education Department has recognized the problem but little improvement is forecast to occur in the near future. The Department has expressed the view that the language of its legislation may need to change to eliminate certain required reviews.

Consent is usually given where the activity involves educational activities which are less formal than those found in a school and waiver of consent may be used where the educational activities are only such in a broad sense of the word, as you might find when you are trying to characterize the organization as "educational" for Section 501(c)(3) purposes (*e.g.*, "educating the public" about a certain issue). Note that at one time it was thought that it was better to get a waiver rather than a consent on the theory that the Education Department would then not need to consent to any later dissolution or other action requiring its consent; the New York Department of Law, however, advised us (in January 2006) that they will still require consent for dissolutions and therefore, presumably, other later action. It may, however, be easier to get that later consent from the Education Department if they previously had waived the need for consent. You can contact the Counsel and Deputy Commission's office for guidance, if needed. If they feel that formation under the Education Law is required, the Education Department will not give or waive consent.

(iii) Social Services Corporations. The N-PCL states that either the Office of Children and Family Services (OCFS) or, for adult care, the Commissioner of Health, must approve agencies serving destitute, delinquent, abandoned, neglected or dependent children or other dependent groups, such as day care centers or shelters for children, invalids, aged or indigents, or raising funds for such groups. See Sections 404(b)(1) or (2). (Note, however, that the OCFS states that its consent is no longer required, with the change having been made in a budget bill instead of the N-PCL (according to a January 30, 2007 telephone conference with John Canino; 518-402-6722) and that the Department of State is supposed to be aware of this change; as of March 2009, however, the brochure available on the DoS website does not reflect this position.) Such elimination of the need for consent for incorporation does not obviate any approvals that may be necessary to conduct certain activities, however.

(iv) Health Corporations. Hospitals or facilities providing health related services (as defined in Article 28 of the Public Health Law) or organizations soliciting funds for hospitals must have the approval of the Public Health Council. Medical corporations (as defined in Article 44 of the Public Health Law) must have the approval of the

Commissioner of Health and the Public Health Council. Facilities for the treatment of mental health or mental retardation and developmental disabilities (as defined in Article 31 or 16 of the Mental Hygiene Law), or to raise funds for such organizations, must have the approval of the Commissioner of Mental Health or Mental Retardation and Developmental Disabilities. See Sections 404(o)-(r) and (t). A bill was introduced in 2010, at the request of the Office of Mental Retardation and Developmental Disabilities, to eliminate the consent by that office to the incorporation of not-for-profit corporations.

(v) Other Purposes. In the listing of purposes for which approval is required under Section 404 you will also find the following types of organizations:

- cemetery corporations,
- fire corporations,
- corporations to prevent cruelty to animals,
- YMCAs,
- corporations soliciting funds for soldiers,
- corporations to improve working conditions,
- corporations to promote savings banks or savings bank life insurance,
- associations of insurance professionals,
- labs testing for public safety,
- corporations with names of political parties,
- corporations with the words "American Legion" in their name,
- health maintenance organizations,
- substance abuse facilities, and
- nonprofit insurance companies.

Approvals may be required from the Industrial Board of Appeals, Superintendent of Insurance, Superintendent of Banks, Cemetery Board, Commissioner of the Office of Alcoholism and Substantive Abuse Services, as well as local governmental officials or from political parties or other private organizations.

(vi) Approval Requirements Under Other Laws. Laws other than the N-PCL may dictate that nonprofits obtain other approvals. For instance, nonprofit corporations formed under the Private Housing Finance Law to build college dorms and hospital staff housing and other similar buildings must obtain approvals from the Commissioner of Housing. See Article 2 of the PHFL. Note that similar approval is required for any amendment of the certificate of incorporation, which is broader than the approval requirements under the N-PCL.

(vii) Court. As with Attorney-General approvals, court approval used to be required for formation of Type B or C corporations and trade associations, but it is not now required. The courts can be asked to approve formation of corporations for the prevention of cruelty to animals or corporations using the name of a political party if the mandated approving authority unreasonably withholds approval. Court approval is still required for major changes, as discussed more fully below.

(viii) Considerations. Most of the agencies from which approvals are required are very responsive to phone enquires in advance of submissions, if you are considerate in your requests. You should work through the offices of legal counsel, with a copy of the applicable statutory provision in-hand. Follow up calls several weeks after a submission are also fine. You may wish to preclear proposed purpose clauses with the agency to make sure that it includes the language they like to see (or what language will get you out of approval requirements).

If approvals are required from several agencies, you should send separate duplicate originals to each agency at the same time. Many of the agencies that need to consent request that you send two copies of the documents to be approved; some insist that it be in a backer with the name of the processing law firm.

Addresses of the various agencies appear at the end of this memo; they may also be found in the Department of State's brochure available at http:// www.dos.state.ny.us/corp/nfpguide.htm.

(e) Filing Procedures

The certificate of incorporation as signed (or with conformed signature) along with all required consents, waivers and affidavits -- and name reservation certificate, if previously obtained -- must be placed in a backer that includes the

name and address of the submitter (as required by Section 150.1 of the New York Codes, Rules and Regulations) and submitted to the Division of Corporations and State Records of the Secretary of State's office (Attn.: Special Handling, if applicable) or hand delivered to the Secretary of State's New York City office, along with the $75 filing fee (a law firm check is acceptable but if a personal check is used it needs to be certified), for filing.

Use the expedited 24-hour services (for which a separate $25 check should be submitted and the package should be marked "Special Handling Section"), since otherwise it can take up to six weeks to get confirmation of filing. You should also request a certified copy, for which the charge is $10.00, a copy of which is necessary for the tax application as well as just being good practice. (One of the primary reason that IRS applications are bounced is failure to show proof of filing of the certificate of incorporation.) You should also include a stamped return envelope or FEDEX envelope and voucher completed with appropriate billing information.

As with for-profit companies, it is probably cost-effective to utilize the services of CT or CSC to process the papers but you will first have to ascertain if the firm or the client will cover those costs. It is also quicker to use these services since you will receive confirmation by overnight, fax or email from the service company rather than waiting for the by-mail delivery from the Department of State.

The Secretary of State will send a copy to the local county clerk for filing; this is a good fact to now if you need to get a certified copy of a charter document and there are problems with Albany's paper generating processes, as used to be frequent occurrence in New York.

4. Qualification

Foreign not-for-profit corporations are required to qualify under the N-PCL if they "conduct activities in this state." Section 1301 (a). This procedure is similar to the qualification to "conduct business" by business corporations.

Exemptions. The statute sets forth a non-exclusive listing of actions not deemed the conduct of activities, which listing includes holding meetings of directors or members, granting funds and distributing information to members. The Model Business Corporation Act and at least 30 states have exemptions for temporary activities (*e.g.*, "an isolated transaction completed within a period of thirty days and not in the course of a number of repeated transactions of like nature;" Tennessee and North Carolina say six months, California says one year and some states have no specified time period) but New York does not have that exemption in its statutes. A 1905 Court of Appeals case held that the phrase "doing business in this state," in a statute requiring foreign corporations to obtain certificates of authority to transact business, "implies corporate continuity of conduct in that respect; such as might be evidence by the investment of capital here, with the maintenance of an office for the transaction of its business and those incidental circumstances which attest the corporate intent to avail itself of the privilege of carrying on business." "The facts should show more than a solitary, if not accidental, transaction..." *Penn Collieries Co. v. McKeever*, 183 N.Y. 98, 75 N.E. 935 (Court of Appeals, 1905).

Consents. If an organization has to qualify, it will be faced with the same consent issues as are faced by New York not-for-profit corporations. Please bear in mind the need to allot adequate time for the entity to obtain such approvals before it formally starts its activities in New York.

5. Initial Organization

(a) Initial Meetings/Consent

As with for profit companies, you need to hold an organizational meeting of the directors (or, for corporations formed in Delaware, the incorporator if directors are not named) or have a written consent in lieu of meeting signed by all directors. This meeting or consent is required to approve the by-laws, elect directors (unless the certificate states that they shall hold office until the first annual meeting) or directors in addition to those named in the initial certificate of incorporation, elect officers, appoint auditors, fix the fiscal year, approve a corporate seal, authorize bank accounts, authorize the filing of the tax exemption and other applications, approve necessary agreements and generally get the "show on the road."

(b) By-Laws

Private Document but Seen by Public. By-laws set forth internal governance rules and procedures. By-laws of not-for-profits (sometimes also called the "constitution" or "constitution and by-laws") are similar to those for for-profit companies, especially if the entity has members (akin to shareholders of a business corporation). The certificate of incorporation is a bare-bones public document; by-laws are usually more detailed "road maps" as to how the organization should act. While they do not need to be filed with the Secretary of State, they will need to be filed with

the IRS and with the Charities Bureau of the Department of Law if the organization is required to register with such agency because it holds charitable assets in New York or seeks charitable contributions in New York. Thus they need to be written with an eye to their becoming public.

Easier to Revise Provision in the By-Laws Than Provisions in the Charter. Since by-laws can be changed without prior governmental approval (although changes will need to be filed), it is better to include provisions here than in the certificate of incorporation, unless legally required otherwise (or you wish the provisions to be hard to change).

Items Addressed. The by-laws focus on the structure, management, operation and procedure used in running the organization. Since the law specifies many aspects of the corporation's behavior, by-laws could be written to address solely the matters not covered by law. But, in fact, most by-laws repeat (and sometimes -- maybe even most times -- incorrectly vary from) statutory provisions, on the theory that it is helpful for the laymen who run these companies to have all the relevant provisions available to them without having to check the statutes. It is therefore crucial to make sure that the by-laws are not inconsistent with legal requirements. Some by-laws include bracketed references to the provisions of the applicable law related to that by-law provision; this may be helpful for readers of the by-laws but language should be included in such by-laws indicating that the statutory citations are not part of the formal by-laws.

Problems with Older By-Laws. Often organizations that have been in existence for some time have provisions in the by-laws, especially regarding such matters as quorums, action, committees and appointment of members, that are inconsistent with the requirements of the NPCL. A careful review of an organization's by-laws on a frequent basis is therefore appropriate. Clients who have been living under long-standing by-law provisions will frequently be surprised to find out that they provisions are not legal.

Freedom to Establish Internal Operating Procedure. The law allows a significant measure of freedom to corporations to establish internal operating procedures. While most law firms have basic standard by-laws, it is important to work with the client to make sure that the provisions in the by-laws are acceptable and workable, or to work out appropriate legal modifications. Start-ups will frequently be less fussy in this respect but you should ask them to review “boilerplate” by-laws after some period of operation to ascertain if refinements might not be appropriate.

Issues. Some things to consider in fixing the by-laws include the following:

(i) Rights of Members, if any

The by-laws should state whether or not there are members unless 1 the issue was addressed in the certificate of incorporation. If there are members, the discussion regarding the procedures for members should be fairly fulsome.

(ii) Number of Directors

Size in Relationship to Role of Board. New York law requires a minimum of three with no legal maximum; Delaware does not require any miniumum. See N-PCL Section 702(a). There is no “magic number.” Smaller boards may have the advantage of ease of management, ability to gather on shorter notice and an increased sense of involvement. Larger boards, on the other hand, offer more diversity and expertise, and a large board can be a real advantage in fund raising.

Large nonprofit boards, upwards or 30 or more, have not been unusual. For instance, Citymeals-on-Wheels, had 43 directors as of 2008 and hoped to increase that to 55 as a way to raise additional funds since each director is charged with raising $50,000 per year (*Crains*, April 28, 2008, p. 8)); as of April 2010 the board had 46 members This contrasts with business corporations, which usually are much smaller (in the range of five to 15), even for major corporations, with the size going down as the duties on directors are increased under the Sarbanes-Oxley Act.

Many nonprofit organizations historically have felt that it is important to have a large board for fund raising purposes; these groups work on the theory that each director should either *“give [money], get [money from others] or get off [the board]”* This is sometimes called the “3 Gs.” (Other alphabetic phrasings of the commitments expected from directors are the “3 Ts” (give treasure, time and talent) and the “3 Ws” (give your wealth, work and wisdom); these later two phrasings may be more appropriate to envision contributions by directors who do not have deep pockets to give only wealth -- they can satisfy their duties through time or talent. Many donor organizations require 100% board financial participation as a way to keep the doors open, with the larger donation-oriented boards setting very large minimums for board positions (you might even say that the organizations are selling board seats). According to a survey by BoardSource, 61% of the non-profits said that they require board members to make a personal contribution (*http:// www.boardsource.org/Knowledge.asp?ID=3.128*).

A better phrasing might now be that "*the board needs both dollars and sense*" (spelled s-e-n-s-e, not c-e-n-t-s). Money alone is not the reason to bring on board a director. That director also has to be sensible -- in other words, the director has to be willing to devote time and his or her skills. Each director also has to be willing to work as part of a team, not as a *prima donna*.

Nonprofits may use the board as a way to obtain certain talents, such as legal or financial services, without paying for it. This is especially the case in recent days, as boards have been trying to meet the needs for inclusion of more members to meet the needs for diversity as well as various skills, especially financial statement acumen. With boards that are composed of various skill sets, the give/get/or get off rubric is no longer appropriate. Nevertheless, all directors should at least give some contribution, minimal if that is all that the director can afford, so that the organization can show 100% participation to funding sources.

But, as the board size grows, the natural result is that each member of the board feels less connected to the organization and is therefore less likely to attend meetings. If the organization has a large board, it is important to have a more active executive committee that can act during meetings of the full board, and certain governance proposals (including one proposal by the New York Attorney General) have talked about making this a requirement for larger organizations.

Accordingly, more organizations are reducing the size of the board to more manageable numbers, in the range of 12 to 21. According to BoardSource Nonprofit Governance Index 2007, the average board size was 16 members, the median being 15 *[http://www.boardsource.org/Knowledge.asp?ID=3.101]*.

How to Determine/Change Number. Note that there is confusion in the statute as to whether nonprofits without members must specify a fixed number of directors in the by-laws, with any changes thereafter being by formal board amendment of the bylaws (which may require prior notice), or whether the by-laws can state that the size shall be within a range with the board from time to time setting its size within that range. This second procedure is clearly allowed if the organization has members (but only if the by-laws establishing this procedure were approved by the members or by the incorporator, whose approval is considered, under Section 602, to be tantamount to approval by the members).

The problem arises because N-PCL Section 702 says that the number of directors shall be "fixed by the by-laws" (presumably meaning a number is stated in the by-laws) or, if there are "specific provisions of a by-law adopted by the members" determined "by action of" the members or the board. It goes on to say that the number may be increased or decreased "by amendment of the by-laws, or, in the case of a corporation having members, by action of the members, or of the board under the specific provisions of a bylaw adopted by the members," subject to certain limitations. This language is similar to that governing business corporations under the BCL but, of course, all business corporations have shareholders (although, in truth, the by-laws of the corporation don't always have to have been approved by the shareholders). The problem in the N-PCL context usually arises because Type B corporations are not required to have, and rarely have, members.

This seems to be a problem that arose due to careless incorporation of BCL-type language in the N-PCL. *White on New York Corporations* (see Volume 7, ¶702.02) says that a "close reading of Section 702 leads one to believe that in corporations having no members the number of directors must be fixed in the bylaws rather than left for determination by resolution of the board." Another commentator (Victoria Bjorklund, Victoria, James J. Fishman, James J. and Daniel L. Kurtz. *New York Nonprofit Law and Practice: With Tax Analysis)*, however, merely states that the number of actual directors can be fixed "by action of the board pursuant to the bylaws" without flagging this problem. I suspect that many non-profits have included in their by-laws provisions allowing the board to set the number of directorships within a stated range without giving consideration to this issue.

Some proponents of the current language in the N-PCL say that the requirement to specify the number of directors in the by-laws is a good provision, since it puts that number in a place where anyone who wants to know the number can easily find it. If the board size can be set by board action from time-to-time, then it is easier to loose track of the number of directors that is needed. In truth, the answer is that whatever approach is used the nonprofit needs to have good record keeping and compliance procedures so that either the by-laws are periodically amended (if so required) as the board grows or contracts or that the board routinely resets the size of the board when adding or dropping directors and records such action in the board meeting minutes. If the range approach is validly used, each time a

new director is added (or an old director resigns, is not reelected or is removed), the board should adopt a resolution such as "RESOLVED, that the size of the boards is fixed at xx". Note that some nonprofits use the range approach but assume that the highest number in the range is the size of the "entire board," meaning that the quorum and vote approvals are based on that number, not on the number of actual sitting directors. While this approach may work if the variation from the maximum is slight, it could create great problems if the variation is large.

Problems if Board Not Validly Constituted. If a board is not validly constituted, its actions may not be valid. Counterparties or disgruntled members or directors may raise objections. Even the AG can object, as it has in a recent case in which we were involved (where the charter specified a fixed board size and the by-laws specified another size!). Additionally, legal counsel may have difficulty rendering a legal opinion if so asked. The fix would require an affirmative amendment of the by-laws to change the numbering provisions and fix the number as the current incumbents and reapproval of the matter in question.

Procedures for Board Change of Number; "Entire Board." If the by-laws validly allow the board to change the number of directors, either by amendment of the by-laws or by independent action, such board action has to be by a majority of the entire board, not just a majority of a quorum. The entire board is considered to be the board size as set by the by-laws including vacant positions. See N-PCL Section 702(b)(1).

The issue becomes one of some importance especially when you realize that quorum determinations are based on the size of the "entire board" (see Section 707) and certain other provisions of the N-PCL require that action be approved by a majority of the entire board. If a board size is later reduced without formally amending the by-laws, actions later taken by that board might not meet the necessary approval percentage based on the size of the entire board, as opposed to a majority of directors in attendance. This issue becomes a particular problem with boards that are loosing directors; the number of sitting directors may eventually fall so low that it is impossible to obtain a quorum.

Amending By-Laws to Change Number. Consideration might be given to including in the amendment sections language allowing increases or reductions in the number of directors without as formal a procedure (including advance notice of proposed changes) as may be required for other amendments. This would allow the board to specifically amend the by-laws from time to time to specify the number as being equal to the number of directors as then-elected.

If such a procedure were in place, as a practical matter the change in the by-laws can be done at the same time as the election of new directors or the acceptance of resignations of old directors.

Although I have not seen it in nonprofit by-laws, consideration might be given to adding language in the amendment section to the effect that the by-laws are automatically amended without other action to increase the size of the board when the board elects a new director and decrease the size of the board when the board accepts the resignation of a director, on the theory that such vote of the board is, if so stated in the by-laws, consistent with Section 602(b) of the N-PCL which states that "the by-laws may be ... amended ... by the board" unless otherwise provided in the certificate or the by-laws.

Compensation of Directors. While it is legal to provide directors with reasonable compensation, it is frowned upon by critics and is rare in the nonprofit world. According to a recent BoardSource survey, only three percent of the respondents compensate their board members, with compensation being more common in larger private foundations or charities such as health care systems. *(http://www.boardsource.org/Knowledge.asp?ID=3.96)*.

Honorary or Emeritus Directors; Boards of Advisors. Many corporations wish to elect persons who are not members of the board of directors to positions that sound similar, such as advisory council members or honorary or alumni or emeritus directors. Alumni or emeritus directors are those who have previously served as directors while honorary directors and councils of advisors can include anyone. The virtue of such positions is that the nonprofit can honor those who have provided significant benefits and thereby obtain their services. If the individuals holding such positions are known in the community that the nonprofit services, the nonprofit can benefit from having their name on the letterhead. It is important that the rights and duties of such individuals are expressly set forth in some legal document (presumably the bylaws or a board resolution authorized by the by-laws); they should not have the right to vote on any matters but can be invited to attend meetings (other than executive sessions) and receive board

material if appropriate. For the special status to remain special, such positions should be few in number; they should not be awarded to all retiring directors but should, instead, be earned.

The procedures should specify for how long the titles should last (*i.e.*, should they be annual, for a term of years or perpetual).

(iii) Members Meetings

Annual Meetings. The N-PCL requires an annual meeting of members, if there are members, to elect directors. See Section 603. While the provision does not say when the meeting should be held other than to note that the date should be fixed "by or under" the by-laws, the provisions of the law relating to annual reports (Section 519) requires the report be given at an annual held within six months after the end of the fiscal year (see discussion at IX.2 regarding the annual report). Failure to hold a meeting will not work a forfeiture of any rights, however.

Special Meetings. The N-PCL also has a procedure allowing special meetings to be called by 10% of the members. Some commentators (*White on New York Corporations*, 13th edition, ¶N603.02) have said that the by-laws could set higher percentages for such call but since the statute says that this right exists "[i]n any case," I would think that the by-laws could only lower the percentage. See Section 603(b).

Consequence of Failing to Hold Meetings. If a meeting has not been held for one months since the date set in or by the by-laws or 13 months since the prior annual meeting, members who can cast 100 votes or 10% of the total number of votes (whichever is less) can cause such meeting to be held. See Section 604.

Delegates and Proxies. The law does allow the appointment of representatives or delegates who can act in lieu of members. See Section 603(d). Proxies are allowed for membership meetings (see Section 609).

Members List. Section 607 requires that a list of members be produced at the annual meeting if so requested; note that this section does not require the inclusion of members' addresses but Section 519 regarding annual reports, requires the listing of home addresses.

(iv) Board Meetings

Smaller boards usually meet monthly or every other month; larger boards with active executive committees frequently meet on a quarterly basis. I do not recommend putting the number of meetings into the by-laws or, if you do (as some clients wish), make sure that the language is precatory, not mandatory.

Proxies are not allowed for director meetings (on the theory that directors need to listen to what is said at the board meetings in order to properly exercise their voting responsibility; there should always be a chance that a director can be convinced to change his or her thinking on a topic by the discussion at the board meeting).

It is not clear under New York law whether you could have nonvoting *ex officio* (or other nonvoting) directors if such *ex officio* directors are not officers. Section 708, by saying that the vote of a majority of the directors present, if a quorum, is the act of the board (unless otherwise provided in the N-PCL - *e.g.*, where there are high vote requirements) could be viewed as support for the positon that all directors must have equal voting power. But Section 713 regarding officers says that the "certificate ... or ... by-laws may provide that one or more officers shall be *ex-offlcio* members of the board, with voting rights unless otherwise specified." Therefore it seems that *ex officio* directors who are officers of the corporation may be nonvoting, but maybe not other *ex officio* directors (*e.g.*, those holding directorships by virtue of public office). Only New York law would have provisions regarding director voting rights buried in the officer section!

(v) Quorum Requirements

Members Meetings. The usual quorum requirement for members meetings is a majority of the members but membership quorums can be set as low as members entitled to cast 100 votes or one-tenth of the total membership, whichever is less. See Section 608.

-- ***Low Quorums***. With a large and somewhat disinterested membership, it is important to set the quorum requirements low to avoid the situation where the membership can never take action.

-- ***Greater Quorums***. A greater quorum can also be established in the certificate or by-laws (see Section 615) but bear in mind that amendments to adopt or amend such high quorum must be approved by a two-thirds vote and any such higher quorum requirement must be specified on the membership card or certificate. In determining whether to set a high quorum for member action, you should be aware, as discussed below, that for actions for which a majority vote or two-thirds vote are required by the N-PCL that affirmative votes must equal the required quorum.

Directors Meetings. For directors meetings, the general rule is a majority but the law allows the quorum percentage to be less and drop as the size of the board increases.

-- ***Low Quorums***. If the board size is 15 or fewer, the minimum quorum is one-third of the "entire board." If the board is more than 15, the quorum can be as low as five plus one for every 10 members in excess of 15. Note, however, that such provision must be approved by the members (or incorporator) in a membership corporation, not by the directors.

-- ***High Quorums***. To include a by-law provision fixing a quorum percentage at higher than a majority requires approval by two-thirds vote of the members (or incorporator) in a membership corporation or two-thirds vote of the directors in a nonmembership corporation.

(vi) Approval Percentages

Members Meetings

-- ***General*** The norm for approval of an action at member's meetings is a majority of the votes cast provided that where the law requires an affirmative "majority vote" or "two-thirds vote" (as it does for dissolutions), the affirmative votes must also equal or exceed the quorum of members or directors unless otherwise set forth in the certificate or by-laws, but some actions (*e.g.*, a merger or nonjudicial dissolution) require two-thirds approval percentage (see Sections 903 and 1002).

-- ***Directors Elections***. Unless otherwise specified in the nonprofit's charter or by-laws, directors are elected by plurality vote (*i.e.*, the number of candidates equal to the vacancies to be filed who receive the highest number of votes are elected) when elected by members. See Section 613. If directors are elected by other directors, however, Section 703 says that the manner shall be set forth in the by-laws or certificate of incorporation, which means that election could be by plurality, or by vote of a majority of the directors present at a meeting at which a quorum is present, or by some other agreed procedure. Note, however, that Section 705 says that newly created directorships resulting from an increase in the number of directors or vacancies "may be filled" by vote of a majority of the directors then in office, regardless of the number. The question is whether the Section 705 provision overrides the ability under Section 703 to set other standards. Since Section 703 says "may" and the Section 703 procedure is based on the number of directors then in office, the Section 703 procedure may be intended to cover situations where other procedures cannot be met (*e.g.*, where so many directors have resigned that you cannot obtain a quorum).

-- ***Higher Vote Levels***. Higher vote levels can be specified in the certificate or by-laws (see Section 615) but amendments to adopt or amend such high vote requirement must be approved by a two-thirds vote and any such higher vote requirement must be specified on the membership card or certificate.

-- ***Abstentions***. Blank votes or abstentions are not considered "cast."

-- ***Class Voting/Cumulative Voting***. Class voting and cumulative voting are allowed. See Section 613.

-- ***Written Consent***. Members can act by unanimous written consent whether or not so authorized in the by-laws. The certificate of incorporation (but not the by-laws) can include language allowing written consent by less than all the members. See Section 614. Note that emailed consents are not specifically authorized under the N-PCL but are allowed in Delaware.

-- ***Agreements.*** Members can enter into written agreements like stockholders agreements regarding their voting but voting trusts are not allowed for nonprofit corporations. See Section 619.

Directors Meetings

-- ***General.*** For directors meetings, the general rule is that a majority of directors at a meeting at which a quorum is present can approve action.

-- ***Higher Requirements***. Note, however, that purchase (!), sale, mortgaging or leasing (!) of real estate must be approved by two-thirds of the entire board (although if the board is more than 21, approval by a majority of the entire board of real estate transactions is allowed). See Section 509. This is a very onerous requirement, especially as to routine transactions. Since nonprofits may adopt low thresholds for a quorum (*e.g.*, 33% of the board, or even lower for boards with more than 15 members), many meetings are held without the presence of a supermajority of the board (or even a majority of the board), meaning no real estate actions could be approved. This provision is often ignored by nonprofit corporations, especially as to leasing of property as a tenant (and especially so when such leasing is a normal course activity). Note that an argument could be made that the reference in the N-PCL to leasing

real property means only leasing as a lessor (*i.e.*, a disposition) since it comes in the clause referring to other forms of disposition such as sales and mortgages and the clause applicable to acquisitions of real estate does not include the concept of leasing; the language, however, is too vague to take comfort in such argument.

The certificate or by-laws can impose a higher percentage requirement. If there are members, the members must approve such higher vote percentage and any changes by a vote of two-thirds of the members entitled to vote (note: not just two-thirds of a quorum!). If there are no members, the provision must be approved by two-thirds of the entire board (or any higher percentage as required by the certificate or by-laws). See Section 708 and 709. If the quorum is low, it may be wise to adopt some form of high vote requirement so that action is not considered adopted by the mere approval of a majority of a minority of the board. For instance, the approval percentage could be the lesser of a majority of the entire board or two-thirds of a quorum. Otherwise, a mere majority of a small minority could approve actions.

-- ***Written Consent***. Directors, and members of committees, can act by unanimous written consent whether or not so authorized in the by-laws. See Section 708. There is currently uncertainty under New York law as to whether such electronic communications constitute "written consent." Relying on provisions of New York law that say that certain documents can be signed by electronic signatures *(see the Electronic Signatures and Records Act (ESRA), available at http://www.oft.state.ny.us/esra/esra.htm# for information)*, however, it may be possible to argue that a resolution sent by email to all directors which is then signed and returned by such directors either in paper (including PDF or fax form) or via an electronic medium is valid. The Lawyers Alliance for New York is of the opinion that this satisfies the requirement under N-PCL Section 708 which allows unanimous "consent in writing" in lieu of action at a meeting. Such conclusion, however, is not without question. Delaware's corporate law (see Section 141(f) of the Delaware General Corporation Law, which allows action by "electronic transmission" with the electronic transmissions to be "filed with the minutes of proceedings.") has sanctioned such electronic communications for several years. At a minimum, each email should include or reference the text of the same resolution and say that it is "signed." Whether a law firm would be willing to issue an opinion that a resolution has been approved is something that firm's opinion committee would need to consider.

-- ***Telephonic Meetings.*** Attendance at a meeting through conference phone or "similar communications equipment allowing all persons participating in the meeting to hear each other at the same time" is allowed unless restricted by the certificate of incorporation or by-laws (until 2007, such telephonic attendance was not allowed unless set forth in the certificate of incorporation or by-laws). See Section 708.

-- ***Format of Meetings.*** Regular board meetings generally entail updates regarding the entity's finances, a report from the chief executive or operating officer, committee reports, and matters needing to be voted on at the board level. A "board book" including an agenda, management reports, financial reports and minutes of prior board and committee meetings should be distributed to the board sufficiently in advance of the meeting to allow the directors to review the material; alternatively, the components of the board book can be distributed electronically as the parts become available.

-- ***Number of Meetings.*** The number of full board meetings is primarily a function of how active the board is in the management of the entity. Newly formed and board-run organizations may need more meetings, especially until a routine develops. The boards of more mature organizations and those with larger boards generally meet less frequently, with more action handled at the committee level. Many organizations establish calendars of meetings such that the executive committee meets monthly and the full board meets less often, from every other month to every quarter to only once or twice a year. There need to be enough meetings to ensure that the directors are informed about major and nonroutine developments and can exercise proper supervision of management.

(vii) Terms and Classification of Directors

Basic Rule. Unless otherwise stated in the by-laws, terms are one year. The terms of office cannot exceed five years, except for *ex officio* directors elected by virtue of a public office or other position held. See Section 703. Unless precluded by the by-laws, directors can be reelected to an unlimited number of terms.

Provisional Terms. Some companies with terms longer than one year elect new directors to a one year provisional term, allowing them to more gracefully leave (or not be renominated) after the look-see period.

Staggered Terms. It is not uncommon for directors to have staggered terms, so that a certain percentage (*e.g.*, one third) is up for reelection each year. That means that the directors are elected to multiple year terms equal in years to the number of classes (in other words, if you have three classes, each term is three years). The N-PCL requires that the classes be of substantially equal size. When new directors are added, some may need to be elected to longer or shorter terms within that range to keep the classes of substantially equal size; this especially becomes an issue when directors resign or refuse to stand for reelection, giving rise to unequal class sizes. Continued attention needs to be paid to the need to keep class size substantially equal; other than in New York, which requires substantially equal class sizes, you may wish to exclude any provisional directors from the need to keep sizes equal.

Term Limits. Limits on the number of terms a director may serve are not required by statute but many nonprofits have provisions in their by-laws limiting directors to a maximum number of consecutive terms, such as three three-year terms. Most such provisions allow the directors to become eligible for reelection after having been off the board for a year.

Advantages of a term limit policy include the following:

• The organization will continue to get new blood; it will avoid stagnation

• The risk of concentration of power in an "in group" is lowered.

• Newer members will have more new directors similarly situated to bond with, avoiding intimidation of newer members.

• The organization will have a greater likelihood of staying in tune with newer constituencies.

• Older members will not become complacent or jaded; passive, ineffective, or troublesome board members can be more easily rotated off.

• It will be easier to obtain diversity.

• The board will have a better balance of continuity and turnover.

• Board members may get a better rotation of committee assignments with seats opening up

• There will be a regular infusion of fresh ideas and new perspectives.

• Limits will enlarge the circle of committed supporters and allow retired board members be become involved at the volunteer level.

Conversely, the downsides to having terms limits can mean:

• The loss of expertise and organizational memory;

• The need to spend more time on recruitment and orientation;

• The need to spend additional efforts on keeping the group cohesive.

Adoption of a rotation policy can be painful since many long-standing board members see their future role as thereby lessened. It should be noted that many nonprofits have board members who are somewhat cantankerous; without rotation policies fellow board members may be loathe to not renominate them but, once they have rotated off, they are not quick to reinvite such persons back.

Some nonprofits allow exceptions, such as allowing waiver of the provision by a high vote. Other exceptions include directors to stay on at the request of the President or allowing the President to remain on the board while holding office and for one year after even if otherwise subject to term limits; the one year period after leaving office allows the board to benefit from such person's experience in a transition period.

Life Members or Emeritus Directors. To minimize a fear that term limits will result in loss of continuity and board historical knowledge, some companies also have what they call "life [or founder] members," a limited number of people who were involved in the founding of the organization and not subject to term limits, or *emeritus* directors who may be elected for terms or hold the position forever. If such positions exist, the rights and duties of persons holding such position and selection and reelection procedures need to be described in the by-laws.

Voting or Non-Voting Ex Officio Directors. The certificate of incorporation or by-laws may state that certain officers shall be *ex officio* members of the board, with voting rights unless otherwise specified. Note that this provision is buried in the section of the N-PCL dealing with officers (Section 713(d)); the provisions of the N-PCL regarding directors imply that each director other than *ex officio* directors must have voting rights. Section 708, by saying that the vote of a majority of the directors present, if a quorum, is the act of the board (unless otherwise

provided in the N-PCL - *e.g.*, where there are high vote requirements) could be viewed as support for the position that all directors must have equal voting power.

(viii) Committee Composition

Like for-profits, not-for-profits can (and should) have committees. See Section 712. In fact, committees are one of the best ways for any larger corporate board to act since with their smaller size the committees are more practical and all the members can be more educated on the issues being addressed. Smaller boards often have difficulty staffing committees, meaning the full board must carry out functions normally delegated to committees.

Recommended Committees. Larger organizations should have an executive committee; some governance proposals require executive committees for organizations with large boards. Most nonprofits should have an audit committee (sometimes called and audit and governance committee), as the primary committee for self correction. Other traditional committees include nominating (sometimes this function is now carried out by a governance committee) and financial (and, for companies with portfolios to manage, investment) committees. Smaller nonprofits will generally combine the audit and finance committee functions, although they should be separated (or there should be separate subcommittees) if there are a sufficient number of directors to staff both. It is important that members of management and other "insiders" should not serve on the audit committee since the prime role of that committee is to ensure that the insiders are doing their job.

Two Types; Two Subtypes. Under New York's confusing N-PCL provision regarding committees, there are two types of committees and two subsets of the first type. The two types are "committees of the board" and "committees of the corporation."

-- ***Committees of the Board.*** Committees of the board are of one of two types: "standing committees" and "special committees:"

Standing committees are generally named in the by-laws but they can also be approved by board resolution so long as the by-laws allow that process. They are usually intended to have permanence. Standing committees traditionally include such committees as the executive, finance, audit, and comparable committees.

Special committees are generally viewed to be more task-oriented and usually have a shorter life span. These would include search committees.

The type of committee is important to determine how it can be composed and what authority it can have.

Committees of the board must be composed of just board members and can exercise delegated authority of the board within their area of expertise (or generally all matters for the executive committee). The law does impose certain logical limits on things that the committees can do on their own; no such committee shall have authority as to the following matters: (1) the submission to members of any action requiring members' approval under the N-PCL; (2) the filling of vacancies in the board of directors or in any committee; (3) the fixing of compensation of the directors for serving on the board or on any committee; (4) the amendment or repeal of the by-laws or the adoption of new by-laws; and (5) the amendment or repeal of any resolution of the board which by its terms shall not be so amendable or repealable.

Members of standing committees of the board must be "designated" by the board by a majority of the entire board. Members of special committees, unless the by-laws state otherwise, are appointed by the chairman (or president if there is no chairman) "with the consent of the board;" the by-laws can eliminate the consent requirement or establish other procedures for selection of members of special committees but the requirement for board "designation" of the members of standing committees cannot be modified by the by-laws. Because of these differences in appointment procedures, a company may want to establish certain committees as "special" rather than "standing."

-- ***Committees of the Corporation.*** Committees of the corporation, however, serve more in an advisory or administrative, not a policy making, role and can include nondirectors as members. Members of committees of the corporation are elected or appointed in the same manner as officers of the corporation, which generally means they are elected by the board or, if the by-laws allow it, appointed by the president.

Selection of Committee Members. The by-laws for many organizations erroneously give the Chair of the Board the ability to name members to all the committees but the law requires that the board actually name the members of the standing committees and, unless the by-laws state otherwise, consent to the naming of the members of special

committees by the chairman or president. The Chair of the Board can usually designate the chair of the committees but many by-laws are silent on this issue.

(ix) Officers

The standard offices are President, one or more optional Vice Presidents, Secretary and Treasurer. The N-PCL allows the use of alternative titles. The most common substitution is to give the duties associated with the President to a Chairman (or Chairperson or just "Chair") of the Board. This often reflects the fact that the person holding the highest elective office is more in the nature of a team leader than a true executive. If the organization has a strong executive director (or other management leader), it is more likely that the organization would not have a separate President, with that function instead carried out by the Chair. In that case it is important that the by-laws note that the Chair will perform the duties of the President if such office is noted in the by-laws.

As with for-profit companies, under New York law the President and Secretary cannot be the same person.

If the board can elect multiple Vice Presidents, it may wish to include in the by-laws or by a board resolution a procedure to indicate in which order the various Vice Presidents assume the power of the President (e.g., by title "First," "Second," etc. or by seniority of election or age).

The certificate of incorporation or by-laws approved by members may call for the election of officers by the members or may authorize the president to appoint the other officers (or some of them) but such appointment must be subject to approval by the board.

Generally officers hold their position until the next annual board meeting but are fully removable with or without cause by the board.

The certificate of incorporation or by-laws may state that certain officers shall be *ex officio* members of the board, with voting rights unless otherwise specified.

(x) Indemnification; D&O Insurance; Limitation of Liability

The by-laws should, at a minimum, obligate (rather than merely allow) the entity to indemnify directors, officers and nominees to serve on the boards or as officers of other entities to the maximum extent allowed by law. It is, however, advisable to delineate these rights in detail and make it clear that these by-law provisions should be treated as contract rights, meaning that they cannot be eliminated as to a covered person without that person's consent as to past actions. Otherwise, you can have the situation where new management might "pull the rug out from under" old management.

Nonprofits are allowed to carry directors and officers liability ("D&O") insurance. Many people will refuse to serve on boards that do not have such insurance coverage. According to BoardSource, 93% of surveyed nonprofits provide D&O insurance (*www.boardsource.org/Knowledge.asp?ID-3.151*). While nonprofits, and their directors, may have a lessened degree of liability that do public and private for-profit companies, there is still a significant risk that someone will sue even if that suit is not successful. The key component of D&O coverage is that it applies to defense costs as well as any ultimate liability. The Nonprofit Coordinating Council has a policy that is available at relatively reasonable rates. To get the D&O coverage offered through the Nonprofit Coordinating Committee the entity has to be a member. Dues are based on the operating budget for nonprofits and range from $25 to $1,000. For more details, see the listing of nonprofit groups below.

Delaware allows the certificate of incorporation to include language providing certain limited liability to directors; legislation was introduced in the New York legislature in 2009 to similarly allow New York nonprofits to so limit liability, which is currently allowed for New York for-profits.

(xi) Whether to Include Provisions in By-Laws or in Separate Policies Regarding Governance Issues, Including Conflicts of Interest, Ethics and Whistleblowers.

Conflicts Provisions. In the post-Sarbanes era, it is wise to include conflicts-of-interest language, either in the by-laws or in a board-approved corporate policy. The IRS now asks the question in the Form 1023 that is filed by organizations seeking tax exempt status to state whether they have included such language in the by-laws or in a separate document; while the applicant could say "no," virtually all nonprofits now include such language in some form. The annual report form, Form 990, applicable to larger nonprofits also asks whether the company has such a policy and whether annual disclosure by affected parties of interests that could give rise to conflicts is required

and whether compliance is regularly and consistently monitored and enforced - with a description of how such monitoring and enforcement is done.

Whistleblower and Ethics Policies. It is also clearly desirable for the Board to adopt written whistle-blower policies, and possibly ethics policies, which all staff and governing board personnel should be aware of and, ideally, periodically agree to. As with conflicts policies, larger nonprofits must indicate on their Form 990 whether they have these policies. The policies must have been adopted by the end of the fiscal year being reported on in order to answer "yes"

Other Policies. If the entity pays relatively high levels of compensation it should have a compensation policy; depending on the activities of the nonprofit, policies on confidentially of information, grantmaking, investments and collecting (for museums) might be wise. Many organizations, especially those that have major scandals, adopt ethics policies.

Location. While most companies that have such policies adopt them independent of the provisions in the by-laws, some commentators (including the Charities Bureau of the New York Department of Law) recommend that they instead be put in the by-laws. We are still inclined to keep them as separate board-approved policies, especially where they are detailed or envision distribution to (and, ideally, signing by) the employees and other staff. The reason for this is that greater attention is paid to the policy at the time of its adoption if it is set forth in a separate policy; too often board members view the by-laws to be the exclusive provenance of legal types and fail to consult them. If the organization requires annual certification of compliance with policies, they are more likely to be followed and, as advisable, reviewed periodically. For more on this topic, see Section IX.5 below.

V. TAX EXEMPTION

1. Federal Tax Exemption

Federal Issue. While most of the laws that pertain to the concept and creation of a nonprofit organization originate at the state level, the laws concerning tax exemption are for the most part generated at the federal level. Although almost every nonprofit entity is formed under state law, there are a few nonprofit organizations chartered by federal law.

Terminology. A nonprofit organization is not necessarily a tax-exempt organization. To be exempt, a nonprofit organization must meet the criteria established under federal law. Thus, there are nonprofit organizations that are taxable under both federal and state law.

The term "tax exempt" organization refers to a nonprofit organization that is exempt from the federal income tax. Tax-exempt organizations, however, are subject to other forms of federal tax. The tax that is potentially applicable to nearly all tax-exempt organizations is the tax on unrelated business income.

Advantages of Tax Exempt Status. The primary advantage of tax-exempt status is, of course, exemption from federal income tax. In some instances, federal status as an exempt organization will mean comparable status under state and local law and may also involve exemption from certain federal excise and employment taxes. Another advantage of tax-exempt status for those entities which are exempt as "charitable" organizations is eligibility for deductible charitable contributions from individuals and corporations. Tax-exempt organizations are also the likely recipients of grants from charitable organizations. In some instances, federal and state governmental agencies can make grants or enter into contracts only with tax-exempt organizations. Several types of tax-exempt organizations are eligible for preferential postal rates. Charitable organizations are exempt to a great extent from the provisions of the Securities Act, the Securities Exchange Act and Investment Company Act. Other relatively minor advantages derive from tax-exempt status, such as the exemption of charitable organizations from federal (but not necessarily state) gambling prohibitions and federal price discrimination law.

Disadvantages of Tax Exempt Status. Disadvantages of tax-exempt status for charities include the absolute prohibition from engaging in campaigns or similar political activities; prohibition from engaging in "substantial" legislative activities; and the availability to the general public for inspection of the annual returns filed by the organizations.

Code Provisions. The source of the federal tax exemption is Section 501(a) of the Internal Revenue Code, which states that an organization described in Section 501(c) or Section 501(d) or Section 401(a) of the Code is exempt from income tax (unless such exemption is denied under Section 501 or 503). An organization which seeks to

obtain tax-exempt status bears the burden of proving that it satisfies the requirements of the exemption statute involved. While Section 501(c) of the Code shows 28 separate exemption categories, the federal government actually recognizes almost 70 different types of tax-exempt organizations. Apart from charitable organization, the primary categories of exempt organization are social welfare organizations, labor and agricultural organizations, business leagues, social and recreational clubs, fraternal beneficiary societies, and homeowner associations.

Our primary focus is tax-exempt status under Section 501(c)(3) for charitable organizations. The test for qualifying under Section 501(c)(3) is whether the organization is "organized" and "operated" "exclusively" for "charitable" purposes.

Liability. Note that we have added a discussion in Part VIII regarding liability by private foundations for violating rules applicable to self-dealing, excess business holdings, jeopardizing investments, and taxable expenditures. While these rules currently only apply to private foundations, proposals are often made to extend such rules to public charities.

IRS Resources. Whether the IRS has adequate resources to monitor existing or expanded regulation is dubious. According to Lois Lerner, the director of the Exempt Organizations Division as of 2008, the division had only 838 employees, of whom 461 did examinations. The number of returns examined between fiscal 2004 and 2008 jumped from 5800 to 7861 and the number of compliance contacts jumped from 1475 to 7566. But these numbers look minimal when you realize that there are at least 1.5 million nonprofits registered with the IRS (and the number of exemption applications is about 70,000 per year). [FN9]

(a) Organizational Tests. The organizational tests are fairly easy to meet.

(i) Form; governing instrument: The organization must be organized as a corporation, trust or an incorporated association. (The terms used in Section 501(c) such as "clubs," "associations," "societies," etc. are not terms referring to legal forms.) An LLC with more than one member may file for tax-exempt status, if all of its members are Section 501(c)(3) organizations. At a minimum, an exempt entity must have an organizing instrument, some governing rules and regularly chosen officers. The organization's organizing document (certificate of incorporation or trust instrument or articles of association) must limit its purposes to those described in Section 501(c)(3), and must not expressly empower the organization to engage in activities that do not further its exempt purposes (unless they are insubstantial).

(ii) Statement of purposes: The charity's purposes, as set forth in its certificate of incorporation, may be as broad as, or more specific than, one of the eight charitable purposes set forth in Section 501(c)(3), namely, "religious, charitable (a category which is very broad), 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 animals." Similarly, a certificate of incorporation which states that the organization is created solely to receive contributions and pay them over to organizations described in Section 501(c)(3) would be sufficient for the purposes of the organizational test.

(iii) Prohibited activities: Under IRS regulations, an organization is not considered exclusively organized for one or more exempt purposes if its articles of incorporation authorize it to (i) "devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise," or (ii) directly or indirectly "participate in, or intervene in" any political campaign "on behalf or in opposition to any candidate for public office." According to the IRS, only the "creating document" may be looked to in meeting the organizational test; however, the law of the state in which the organization is created is controlling as to construing the terms of the certificate of incorporation. *For further information, see IRS Rev. Ruling 2007-41 regarding prohibited political activities*.

(iv) Dissolution requirements: The governing document must provide that upon dissolution of the entity, its assets will be distributed "to or for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose, or would be distributed by a court to another organization to be used in a manner as in the judgment of the court would best accomplish the general purposes for which the dissolved organization was organized." If the organizational document does not so provide, federal exemption will be denied, unless said

provisions apply by operation of state law. The IRS has published guidelines identifying those states where an express dissolution clause is not required, and includes that information in the instructions in the application for tax-exempt status.

(b) Operational Tests

In order to meet the requirement of "operated exclusively" for exempt purposes, a not-for-profit organization must satisfy several operational requirements, which are more difficult to satisfy than the organization tests:

(i) No substantial activities unrelated to exempt purposes: Although Section 501(c)(3) provides that an organization must be operated "exclusively" for exempt purposes, "exclusively" as employed in this context has been interpreted by the IRS to mean "primarily." The presence, however, of a single nonexempt purpose--if it is substantial in nature, will destroy the exemption regardless of the number or importance of the truly exempt purposes. Application of these rules is an issue of fact. One court has suggested that where a function represents less than 10% of total efforts, the primary purposes will not be contravened. Another court has stated that an organization which received approximately one-third of its revenue from an unrelated business could not qualify for tax-exempt status.

An organization may, however, meet the federal tax laws requirements even though it operates a trade or business. The core issue is whether the substantial business activity is in furtherance of exempt purposes. An interesting demonstration of the application of these rules was a court decision concluding that an organization whose purpose was to administer donor-advised funds qualified as a tax-exempt charitable entity. The IRS unsuccessfully argued that the organization lacked an exempt purpose, since it was simply an association of individuals for which it performs commercial services for fees. The Court rejected that argument and found that the organization's goal was to create an effective national network to respond to worthy charitable needs.

(ii) Private inurement: Under Section 501(c)(3), there is an absolute prohibition against "private inurement" of the organization's "net earnings" to the benefit of any "private shareholder or individual." The IRS interprets "private shareholder or individual," to mean "persons who because of their particular relationship with an organization, have an opportunity to control or influence its activities."

Traditionally, the typical targets of private inurement were founders of the organization. In recent years, the Service has extended this definition of insiders to include others, and has broadened the rules as to the type of income flows it considers inurement.

Excessive compensation is one type of private inurement. Until 1996, the IRS had only one sanction against excessive compensation--the revocation of the organization's exempt status -- and accordingly was loathe to use such a severe penalty. In 1996 Congress enacted IRC Section 4958, which imposes penalty taxes on insiders who receive "excess benefits" from a tax-exempt organization and on managers and board members who participate in granting the excess benefits, giving the IRS a less draconian weapon to use in its arsenal. The issue of what constitutes excess benefits is an area of increasing focus.

(iii) Private benefit: An organization is operated for charitable purposes only if it serves a public rather than a private interest. Thus the organization must establish that it is not organized to operate for the benefit of a private interest such as designated individuals, the founder's family, shareholders of a particular organization or persons controlled by such private interests.

While private benefit must be more than insubstantial to defeat exemption, there is no clear definition of what insubstantial means. The courts have held that where an organization operates to confer more than an "incidental" private benefit, tax exemption is to be denied. For example, an otherwise qualifying school which trained individuals for careers as political campaign professionals did not qualify as an exempt entity since nearly all of its graduates became employees of or consultants to entities related to a particular political party. The court in this case was concerned not with the primary benefit accruing to the students, since this was an educational institution, but with the secondary private benefit accruing to the political party and its candidates.

It is clear, however, that name recognition in connection with a charitable contribution is deemed to be only an "incidental" private benefit. The ability to promise a major donor that the new building to be constructed with that donor's funds will be named after the donor, or even the ability to list all of an organization's donors in an annual report, are strong motivating factors in fundraising and the IRS has blessed such benefits.

(iv) Commerciality and commensurate tests: The U.S. Tax Court often applies tests of commerciality and competition in conjunction with the operational test. For example, the court denied tax-exempt status to an organization associated with the Seventh Day Adventist Church which operated a vegetarian restaurant and health food stores in advancement of its religious doctrine. The court wrote that the organization's activity was conducted as a business and was in direct competition with other restaurants and health food stores.

And yet, the Ninth Circuit afforded exempt status to an organization formed by private businesses to construct a parking facility. The court concluded that the city involved was the primary beneficiary of the organization's activities, since the facility attracted shoppers to an economically depressed area. While the organization carried on business activities similar to activities engaged in by for profit entities, it was carried on only because it was necessary for the attainment of a public end.

The IRS afforded tax-exempt status to an organization formed to attract a physician to a medically underserved rural area (by providing the doctor with building facilities at a reasonable rent), because the physician's personal benefit did not detract from the public benefit of these activities.

Similar arguments were applied to approve the tax-exempt status of an organization the primary purpose of which was to promote the handicrafts of disadvantaged artisans in underdeveloped societies where the organization's primary activities were the purchase, import and sale of handicrafts.

Thus, while the mere fact of profit-making activity should not, as a matter of law, adversely affect an organization's tax-exempt status, and the pertinent inquiry should be whether the organization's exempt purpose transcends the profit motive rather than the other way around, the IRS may use the existence of a profit to characterize the activity as being commercial in nature, thus placing at issue the question as to whether the organization's activities are devoted exclusively to tax-exempt purposes.

Another recent test developed by the IRS is the "commensurate test," where the IRS assesses whether a charitable organization has maintained program activities that are commensurate with its financial resources. The IRS has developed a check sheet, in which its agent is asked to determine whether the charitable organization is engaging in sufficient charitable activity in relation to its available resources, including gifts received and fund-raising campaigns, as measured against the time and expense of fund-raising.

(v) Action organization: Although a charitable organization may engage in a limited amount of legislative activity (see paragraph (vi) below), an organization will not qualify for exemption under Section 501(c)(3) if it engages in a substantial amount of lobbying or any amount of electioneering, even if such activities are in furtherance of its exempt purposes. The question is whether the organization is an "action" organization. An organization is an "action" organization if "a substantial part of its activities is attempting to influence legislation" or "it participates or intervenes, directly or indirectly in any political campaign" or, if its primary objectives may be obtained only by legislation or defeat of proposed legislation and it advocates or campaigns for the attainment of such objective (as distinguished from engaging in nonpartisan analysis, study or research and making the results thereof available to the public).

(vi) **Political activity of charitable organizations and lobbying**: It is essential to distinguish between participation in **"political campaign activity"** (*i.e.*, with respect to an individual who is a candidate for public office, which is absolutely prohibited), **"political activity"** (*i.e.*, influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office other than in the context of legislative confirmation, which political activity may be subject to a special tax) and **legislative activity** (***i.e.*** **"lobbying"** which a charitable organization can engage in so long as no "substantial part" of its activities consists of attempts to influence legislation). Legislation means a bill that has been introduced, or a draft bill that may be introduced, in any legislative body such as a city council, state legislature or Congress or any action with respect to direct actions such as referenda, initials or proposed constitutional amendments.

Many nonprofits think that nonprofits are prohibited from lobbying. That is clearly not true. They are prohibited from engaging in political campaign activity and political activity is taxed, but lobbying (within IRS limits) is totally appropriate and often necessary to carry out the mission of the nonprofit.

What is Not Lobbying? Actions which are not considered lobbying include:

• communications on any legislation that would affect that organization's continued existence, powers, duties or tax-exempt status, or deductibility of contributions to such organization.

• technical advice to a governmental body in response to a written communication from that body (*e.g.*, responses to written requests for assistance from a legislative committee or other legislative body).

• non-partisan analysis or research, if it is "an independent and objective exposition of a particular subject matter ... (which) may advocate a particular position or viewpoint so long as their is a sufficiently full and fair exposition of pertinent facts to enable the public or an individual to form an independent opinion or conclusion."

• communication with the organization's own members with respect to legislation which is of direct interest to them, so long as the discussion does not address the merits of a specific legislative proposal and does not call for action.

• communication with governmental officials or employees on non-legislative (*i.e.* administrative) matters such as rule-making.

• Communications and discussion regarding board social, economic and similar problems.

Note that for purposes of state and city registration, however (discussed below under operational matters), lobbying has a much broader definition and includes action at the administrative level.

"No Substantial Part" Test for Allowed Lobbying. I.R.C. Section 501(c)(3) allows nonprofits to engage in legislative activity so long as no "substantial part" of its activities consists of attempts to influence legislation. The term "substantial part" has never been meaningfully defined. One court opinion indicates that expenditures of less than five percent of an organization's time and effort do not represent a substantial part of activities. Other courts have rejected the fixed percentage test. Charities that exceed the substantiality limit risk loss of tax exempt status. Accordingly, groups that seek to remain within the amorphous substantial part test will frequently work within artificially limiting constraints.

Annual Election. However, Section 501(h) allows most public charities to elect (by filing a single page Form 5768 -- *"Election/Revocation of Election by an Eligible 501(c)(3) Organization to Make Expenditures to Influence Legislation"*), to replace the vague "substantial part" test with a mechanical test based on expenditures. This test calculates the cost of lobbying activity in terms of staff time, overhead, postage, etc. but does not include volunteer time. The form will indicate the first year for which such election is applicable. Some of the benefits of election include:

• The organization can rely on specific clear definitions of the various kinds of lobbying communications, thus enabling electing charities to better determine whether they are or are not lobbying.

• The organization can have the comfort of specific lobbying dollar limits and knowing better what items count toward the exhaustion of those limits.

• There is no limit on lobbying activities that do not require expenditures, such as unreimbursed activities conducted by bona fide volunteers.

• There is a lower likelihood of losing tax exemption because the exempt status may be revoked only from electing organizations that exceed their lobbying limits by at least 50% averaged over a four-year period.

• Individual managers of an electing charity that exceeds its lobbying expenditure limits are not subject to personal liability, as might be the case for non-electing entities.

• The election can be revoked and reinstated at any time by the nonprofit, if so desired.

Some organizations are of the mistaken belief that filing a Section 501(h) election will increase the risk of IRS audit. IRS spokesmen have long denied such claim and evidence seems to support the IRS position.

If the organization makes an election under Section 501(h), the organization can expend annually (subject to an upper limit of $1 million) 20% of the first $500,000 of its exempt purpose expenditures, 15% of the next $500,000, 10% of the next $500,000 and 5% of all expenditures in excess of $1.5 million. The only nonprofits that are at risk of hitting the $1,000,000 cap are those with more than $17 million in exempt purposes expenditures. Note that volunteer lobbying activities are not incuded in such dollar thresholds (whereas they may need to be considered under the "no substantial part" test).

The Section 501(h) rules divide lobbying into two types: direct lobbying and grass roots lobbying. Direct lobbying entails communications with a legislator, an employee of the legislator or another government employee who may be participating in the legislative process regarding specific legislation. Gross roots lobbying consists of attempts to encourage the public to make its views known to legislators regarding specific legislation. No more than one-fourth of such expenditures may be for "grass roots lobbying" (*i.e.*, when the entity states its position on specific legislation to the general public and asks the general public to contact legislators or other government employees who participate in the formulation of legislation).

Furthermore, if the election is made, the organization will be denied exempt status only if it "normally" exceeds said lobbying expenditure levels by at least 50%. "Normally" is measured by an average based on the four years preceding the taxable year. Once the election is made, an excise tax is imposed upon spending in excess of the four year threshold at the rate of 25% on the excess) (under the "no substantial part" test the excise tax is 5% on all lobbying expenditures, with the potentiality of a 5% excise tax on officers or directors if lobbying is willfully or unreasonably authorized).

Note that churches and their affiliates are not allowed to make a Section 501(h) election; they have to rely on the "no substantial part" test.

Organizations that make a Section 501(h) election have long had to report their lobbying activities on their Form 990. Previously it was reported on Schedule A; currently it is reported on Schedule C.

Foundation Grants. Another fear is that private foundations will not make grants to organizations that engage in lobbying. While private foundations may not themselves lobby, they can make grants to nonprofits that do, subject to certain limits:

• The foundation should not designate the use of funds for lobbying or direct that a grant be so used. This does not prohibit the nonprofit from disclosing to the foundation that it lobbies.

• Grants by the foundation can either be for general support, in which case the foundation does not limit the funds to specific projects, or as a specific project grant but if the grant is for a specific project that includes lobbying the foundation grant cannot exceed the amount that the grantee has budgeted for nonlobbying expenses.

Community foundations are similarly allowed to make grants with one lesser limitation - their grants can be used for lobbing but the amount of a grant so used will need to be included within the foundation's own Section 501(h) limits.

Federal Registration of Lobbyists. Note that there are separate federal, state and New York City rules requiring registration when an organization engages in lobbying activities over certain thresholds.

(c) Scope of the Term "Charitable"

(i) Definition: Although the term "charitable" is only one of the eight descriptive words and phrases used in the federal tax law to describe the various organizations exempt under Section 501(c)(3), organizations that are so exempt are often simply referred to as "charitable" organizations. While in a historical sense, charities were restricted to limited purposes, the term "charitable" in the federal tax law is considered in its expansive sense, and includes educational, religious and the other entities. (Note that the same term, when used in New York State real property tax exemption, however, is used in its more limited historical meaning, focusing on relief of poverty.)

Treasury Regulations state that "charitable" is used in its general accepted legal sense and includes "relief of the poor and distressed or of the underprivileged, advancement of religion and advancement of education or science, erection or maintenance of public buildings, monuments or works, lessening of the burdens of government, and promotion of social welfare by organizations designed to accomplish any of the above purposes or to lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law or combat community deterioration and juvenile delinquency." The expansion of the scope of charity is evolutionary; originally activities for the betterment of the aged were not considered charitable unless such persons were in economic or medical need; now aid to the elderly is in itself a sufficient charitable purpose. Similar evolution can be seen with recreation for the general public. Another change over time is that the words "poor and distressed" may now be read as "poor or distressed" (or, in the terms found on an IRS website, "needy or distressed" -- *see*

http:// www.irs.gov/charities/charitable/article/0,,id=147311,00.html -- in other words the members of the eligible class can either be poor OR distressed. This would allow charitable aid to the victims of disaster who are not "poor."

Since the promulgation of these 1959 regulations, Congress--despite many opportunities to do so--has refrained from enacting a statutory definition of the term charitable and has accepted the broader meaning of the word as articulated by the Department of Treasury and the IRS. Courts have stated that Congress intended to apply these tax rules to organizations designated as charitable under the law of trusts. The Supreme Court has observed, that a "charitable use, when neither law nor public policy forbids, may be applied to almost anything if it tends to promote the well-being and well-doing of social man." For example, over the years, the IRS has recognized that the elderly can constitute a charitable class *per se.* Where there is a sufficient class or community, the fact that benefits may be continued indefinitely, is irrelevant. Nor is economic status necessarily a factor. For example, the IRS has determined that recreational facilities can be charitable if they are provided for the general public as a community.

(ii) Public policy doctrine: The U.S. Supreme Court has ruled that tax-exempt status may be granted only where organizations are operating in conformance with public policy. The Supreme Court has found that racial discrimination in education is contrary to public policy. An educational institution that has racially discriminatory policies cannot qualify for tax-exempt status as a charitable organization. The IRS has included discrimination on the grounds of national origin as being within the scope of racial discrimination.

While the public policy doctrine has not been much extended, in one case, an organization was deemed ineligible for tax exemption because it engaged in violent or illegal activities. In another case, an organization was not eligible because it conspired to impede the IRS in performing its duty to determine and collect taxes. The IRS also adheres to this doctrine in determining whether activities such as economic boycotts, strikes and picketing are permissible means for furthering charitable ends.

While there is recognized federal public policy against support for racial discrimination, there is some developing policy against support for institutions that engage in gender-based discrimination.

(iii) Charitable class: A charitable class must be large ***or*** indefinite enough (*i.e.*, more people might join the class in the future) that providing aid to members of the class benefits the community as a whole. The size of a class is not necessarily relevant. For example, a charity may be formed to provide scholarships for the inhabitants of a particular town or the employees of a particular company because the class is indefinite. Because of this "large or indefinite" test, you cannot have a (c)(3) public charity for the benefit of a specific person, such as an accident victim (e.g., the little girl who feel in the well) or a family in need since you need a broad or otherwise indefinite class of beneficiaries. Similarly, the donors cannot earmark contributions to a charitable organization for a particular individual or family and the beneficiaries cannot be solely relatives of the donors or organizations or social clubs and fraternal organizations. It is best to work through other more broad-based charities to aid such individuals.

Sometimes, however, there is a specific legislative exemption. For example, in 2006 a law was enacted to allow payments made on behalf of any firefighter who died as a result of a specific October 2006 fire in Southern California to any family member of such firefighter, of which there were only five (a number too small to otherwise constitute a class). Similar legislation has been passed regarding September 11th and the Virginia Tech shooting. Based on these congressional actions, the IRS seems to be considering whether the charitable class rule can be "fudged a bit" if the charity is willing to open up the class of eligible recipients to individuals who suffer the same type of hardship in the future. *See EOTR Weekly, May 5, 2008, p. 25, citing 2008 TNT 83-5.*

(d) Public Charity versus Private Foundation

Organizations which are exempt under Section 501(c)(3) as charitable organizations are divided into two categories: public charities and private foundations. Under Section 509 of the Code, an organization is presumed to be a private foundation unless it meets one of the public charity tests.

Public charity status is preferable both from the donors' and the charities' perspective for the following reasons:

From the Donors' Perspective:

• The maximum charitable contribution deduction which a donor can utilize in a given year is 50% of the donor's adjusted income for cash contributions made to public charities and 30% for contributions of capital gain property made to public charities. For contributions to private foundations, the ceilings are reduced to 30% for gifts of cash and 20% for gifts of appreciated property.

• A donor who makes a contribution of closely held stock or real estate to a public charity is entitled to a charitable contribution deduction equal to the full fair market value of that property as of the date of contribution, provided the value is substantiated by an appropriate appraisal. A donor who contributes closely held stock or real estate to a private foundation is limited to a deduction equal to his or her basis in the property. (Donors can obtain a deduction for the full fair market value of stock contributed to a private foundation only if the stock is traded on a national securities exchange.)

From the Charity's Perspective:

• Public charity status is preferable because many for-profit corporations which make charitable contributions and many private foundations which make grants to other charities will not make grants to a private foundation, since the administrative requirements involved are burdensome (they have to exercise "expenditure responsibility").

• Private foundations (but not public charities) are subject to a special set of rules, including:

• requirements to make "qualifying distributions" in an aggregate amount at least equal to 5% of the aggregate fair market value of their noncharitable assets (less any related acquisition indebtedness) (with certain rights to carryover excess distributions from prior years);

• liability for a 2% excise tax on investment income;

• prohibitions against virtually all transactions (even at market value) between the foundation and its "disqualified persons," who are the persons with certain relationships to the foundation (e.g., substantial contributors and officers and directors of the foundation and family members of the contributors, officers and directors);

• prohibitions against holdings by the foundation and its disqualified persons of more than 20% of a business interest;

• an absolute prohibition against legislative activities; and

• cumbersome requirements for grants to individuals for study and certain other purposes.

We will discuss in greater detail some of these rules in Section VIII.5.

There are, however, three types of private foundations which offer some of the benefits of public charity status (mostly, with respect to the deductibility of contributions), the most common of which is the private operating foundation (*e.g.*, a museum which is open to the public but privately funded), but these foundations remain subject to these special rules (with some exceptions) targeted at private foundations

The tax law imposes excise taxes on foundations which violate these rules. The taxes are generally imposed on the foundation, and in some cases, their managers; a second tier tax applies if a target offense is not remedied. Second tier taxes are sufficiently high (in some cases, 200% of the amount involved), so these provisions function effectively as prohibitions rather than mere taxes.

There are three categories of public charities: "public" institutions; "publicly supported" charities; and "supported" organizations.

(i) Public Institutions: Charitable organizations are recognized as public charities under IRC Section 509(a)(1) by virtue of the nature of their programs, how they are structured and their relationship with the general public. This category comprises:

• Churches;

• Educational organizations that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of students at a place where studies are regularly carried on (schools, colleges and universities);

• Hospitals and medical research organizations;

• Governmental units, including a state, a possession of the United States, a political subdivision of either of the foregoing, the United States or the District of Columbia.

These are sometimes call "per se" public charities.

(ii) Publicly Supported Charities: There are two types of publicly supported charities: **donative** publicly supported charities and **service provider** publicly supported organizations. If an organization could qualify under both tests, it is generally considered better to qualify as a donative organization since they are granted certain rights (such as the ability to operate pooled income funds) that are not granted to service provider organizations.

(1) **"Donative" publicly supported organization**: A charitable organization qualifies as a donative publicly supported organization under IRC Section 509(a)(1) if it normally derives at least one-third of its financial support from qualifying contributions and grants--the **"one-third public support"** test. The key to applying this test is to construct a fraction, the numerator of which consists of eligible public and governmental support, and the denominator of which consists of total support. Total support includes all income received by the organization, including: gifts, grants, contributions, membership fees, investment income, income from unrelated business activities and the value of services or facilities furnished by a governmental unit without charge. (Excluded from the denominator are "unusual grants" (as defined below), amounts received from the performance of the organization's exempt purposes, capital gains and contributions of services.) The numerator includes all gifts, grants and contributions from governmental units and the general public, subject to the following restriction: contributions from an individual, trust or corporation count only to the extent that the total amount from any one person or entity over the taxable period (a five year period including the current taxable year) does not exceed 2% of the organization's total support for that period. As an example, if the organization receives $100,000 over the five-year taxable period, it would need at least 17 donors, each of whom contributed at least $2,000, to meet the public support test.

All grants from the government or from other public charities are included in full in the numerator, since these grants are deemed to be public support (albeit indirect public support).

In calculating public support, an organization may exclude "unusual grants" from both the numerator and denominator. Under Internal Revenue Service Regulation § 1.170A-9(e)(6)(ii), an unusual grant is a substantial contribution or bequest from a disinterested party which (a) is attracted by the publicly supported nature of the organization, (b) is unusual or unexpected with respect to the amount and (c) would adversely affect the organization's classification as a public charity (i.e., the organization would otherwise meet the support test in that year if it had not received such grant) if it meets the requirements of Reg. § 1.170A-9(e)(6)(ii), which refers to nine factors that determine if a grant is unusual. All pertinent facts and circumstances will be taken into consideration and no single factor will necessarily be determinative. The IRS has also published a "safe harbor" test which potential grantors and grantees can rely on. *See Rev. Proc. 81-7, 1981-1 C.B. 621, available at http://www.irs.gov/pub/irs-tege/rpl981-7.pdf. This test is also set forth in IRS Publication 557, Tax Exempt Status for Your Organization, available at http://www.irs.gov/publications/p557/ch03.html#0e5423 (search for "unusual grant").*

If an organization fails to meet the one-third support test, it will be treated as publicly supported if it meets the **"facts and circumstances"** test. To satisfy such test, the entity must normally receive 10% of its support from the government and/or general public and must be operated so as to attract new additional public support on a continuous basis. Factors to be considered include: whether support is received from various persons rather than members of a single family; whether the governing body represents the broad interests of the public; whether the organization provides facilities or services directly to the public, whether the organization's sponsors include public officials, community leaders and members of the public with special expertise; whether the organization maintains a definitive program to accomplish its charitable work in the community; whether the organization receives a significant part of its funding from a governmental agency or entity to which it is in some way accountable as a condition of a grant; and, if the organization is a membership organization, whether efforts are made to enroll substantial members at affordable dues and whether the organization's activities are likely to appeal to people having some broad common interests.

(2) **"Service provider" publicly supported organization**: An organization qualifies for public charity status under IRC Section 509(a)(2) if it receives more than one-third support in any combination of contributions, grants, membership fees and gross receipts from admissions, sales of merchandise, and performances of services from activities related to its exempt purposes. This test is similar to the one-third public support test described above except that income from exempt services may be counted towards the required one-third support. For purposes of the numerator in any tax year, includable gross receipts from any person or from any bureau of similar agency of a governmental unit cannot exceed the greater of $5,000 or one percent of the organization's support for the year. Furthermore, receipts from a disqualified person (which, among other things, includes "substantial contributors" (*i.e.*, those who contribute more than $5,000 to a charity where that amount is more than 2% of the total contributions and

bequests received by the organization in such year) are excluded. An additional requirement is that the organization cannot receive more than one-third of its support from the sum of its gross investment income and its unrelated business income (in excess of the tax paid on such income). This is a good test to use for organizations that charge for services such as daycare centers.

Elimination of Advance Rulings and Continual Assessment of Public Charity Status: Historically, the IRS did not issue a definitive classification of an organization as a publicly supported organization prior to the close of the organization's first taxable year, consisting of at least 8 months. Instead, new organizations could request an "advance ruling" for treatment as a publicly supported organization for the first five taxable years, which the IRS granted where the organization can "reasonably be expected" to qualify based on its proposed structure, programs and method of operation. If an organization received an advance ruling, then at the end of the five-year advance ruling period, the IRS examined whether the organization had met the requirements, based on a filing on Form 8734 submitted by the nonprofit within 90 days after the end of the fifth year which set forth the aggregate data for the completed five years and, if the organization continued to meet the public support tests the IRS would issue a "definitive ruling."

On September 9, 2008 the IRS issued temporary income tax regulations which eliminated the advance ruling process. Under the new regulations, a new (c)(3) organization will be classified as a publicly supported charity if it can show that it reasonably can be expected to be publicly supported at the time it applied for (c)(3) status. The organization will retain such public charity status for its first five years, regardless of the public support actually received during that time. Beginning with the organization's sixth taxable year, it must establish that it meets the public support test on Schedule A to its Form 990, which is the annual return filed by public charities, discussed further below.

Under these new regulations, a (c)(3) organization that received an advance ruling as a public charity which will expire on or after June 9, 2008 does not have to file the Form 8734 but must instead demonstrate the nature of its public support in its Form 990 for its sixth taxable year. Organizations with rulings that expired prior to June 9, 2008, however, still have to submit documentation to the IRS establishing that they have met the public support test.

If a charity satisfies either of the donative or service provider tests for the five year period covered by the Form 990, it will be deemed publicly supported for the current year and the immediately succeeding tax year (note that IRS Regulation § 1.509(a)-(3)(c)(1) says the test is assessed on a four-year basis, but the instructions to the Form 990 clarify that it is now done on a five-year basis).

While the IRS application will require the nonprofit to state whether the organization will qualify as a public charity as a donative or as a service provider organization, the determination made thereafter can be based on whichever test is more appropriate for the facts as they occurred over the five year period. In other words, failure to pass the elected test will not be held against the organization if it actually passed the other test.

If an organization fails to satisfy the public support tests in the future, it will be treated as a private foundation only going forward, but it will be liable for the 2% excise tax on investment income from the date of incorporation.

While the IRS always had the right to revoke a nonprofit's public charity status if it did not continue to meet the public support test, in the past it rarely exercised such right after it issued its definitive ruling since the data necessary to make such determination was not easily discernable. Now that the public support data is in one place, some think that the IRS will be more likely to begin to evaluate compliance with the public support test on a continuous basis. The IRS has said that organizations that validly file 990-Ns should monitor their public charity status on their own since the IRS will not have any means to confirm such continued status.

(iii) Supporting Organizations: A supporting organization under IRC Section 509(a)(3) must be organized and operated exclusively for the benefit of one or more other public charities, and may not be controlled by one or more disqualified persons. Further, the relationship between a supporting organization and the supported organization must be one of three types:

• "operated, supervised or controlled by," called a "Type I" supporting organization (which is akin to the relationship between a parent and a subsidiary), or

• "supervised or controlled in connection with," called a "Type II" supporting organization (when the two entities having interlocking boards and/or officers), or

• "operating in connection with," called a "Type III" supporting organization (where the supporting organization is responsive to and significantly involved with the supported organization).

There are very technical requirements defining each of these three relationships. The Pension Protection Act of 2006 enhanced the requirements for supporting organizations. The third relationship, which is the most flexible, has been the subject of some abuse, and thus, recent tax legislation effectively treats "Type III" supporting organizations as private foundations for many purposes. In addition, the new legislation and new regulations: modified the tests that Type III supporting organizations must meet to satisfy the relationship requirement; required that Type III supporting organizations report annually to the supported organization; prohibited Type HI supporting organizations from supporting a foreign organization; and applied the excess business holdings rules to certain types of Type III supporting organizations (i.e., "non-functionally integrated" supporting organizations)

The Pension Protection Act also said that a Type I or Type III supporting organization will fail to qualify (or lose its status as a supporting organization) if it accepts a contribution from:

a. A donor (except a public charity that is not a supporting organization) who, alone or together with family members or 35 percent owned entities noted below, directly or indirectly controls a supported organization;

b. A family member of such a donor (determined under §4958(f)(4)); or

c. An entity 35 percent controlled by either of the foregoing (defined with reference to section 4958(f)(3) and potentially including 35 percent controlled charities).

In determining whether a donor or a person related to a donor controls a supported organization of the grantee, the control standards established in Treas. Reg. Section 53.4942(a)-3(a)(3) will apply. Under these standards, a supported organization is controlled by one or more donors if any such persons may, by aggregating their votes or positions of authority, require a supported organization to make an expenditure, or prevent a supported organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. See *Interim Guidance Regarding Supporting Organizations and Donor Advised Funds*, Notice 2006-109, 2006-51 I.R.B., p. 15 (December 18, 2006), available at *http://www.irs.gov/pub/irs-drop/n-06-109.pdf.*

Pursuant to Treas. Reg. § 53.4942(a)-3, *Qualifying Distributions Defined*. "..., an organization is "controlled" by a foundation or one or more disqualified persons with respect to the foundation if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. "Control" of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner in which the distribution is to be used, unless such conditions or restrictions are described in paragraph (a)(8) of §1.507-2 of this chapter (Income Tax Regulations). In general, it is the donee, not the distribution, which must be "controlled" by the distributing private foundation for the provisions of subparagraph (2)(i)(b) of this paragraph to apply. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the distributing foundation's control within the meaning of this subparagraph. Such "budgetary procedures" include expenditure responsibility requirements under section 4945(d)(4). The "controlled" organization need not be a private foundation; it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization."

(iv) Fiscal Sponsorship: New charitable organizations which have applied for but have not received a ruling of tax-exempt status under Section 501(c)(3) of the Code often cannot secure grants and contributions. Thus, on an interim basis, an organization may accomplish its goals by hooking up with a "fiscal sponsor," which typically is an organization with Section 501(c)(3) status and public charity status. Such arrangements are legitimate only if the sponsor has control over the funds which are ultimately disbursed to the new organization and only if those funds are used to further the sponsor's exempt purposes. The sponsor cannot simply serve as a conduit. Thus, if a donor makes a contribution to the sponsor and earmarks it for a non-exempt organization, the IRS may treat the contribution as

a non-deductible donation from the donor to the new organization. Typically, successful sponsorship arrangements are structured in terms of one of the following three models.

(1) **Project Model**: The new organization is actually a project of the sponsor and belongs to the sponsor. The new entity has no separate legal identity and its employees are employees of the sponsor. Its assets, creations, liabilities and requirements are all those of the sponsor. The chief difficulty in this model is the terms and conditions under which this "project" will be permitted to leave the sponsor and become independent.

(2) **Grant Model**: Under this model, the new organization approaches the sponsor with a grant request prior to doing any fundraising. If the sponsor determines that the proposal is consistent with the sponsor's purposes, the sponsor enters into a written grant agreement with the organization which details the terms of the grant. The sponsor then solicits funds to support this grant. Although the new organization is a separate legal entity, the sponsor is responsible for the use of the money and must retain the right to use the funds in any way it sees fit to accomplish its purposes. Thus, if the sponsor deems that the new organization is unable to carry out the project, the sponsor is obligated to use the assets in other ways. A common problem with this model is the situation where the new organization raises funds prior to approaching the sponsor and then requests that the funds be contributed to the sponsor, so that donors can obtain a tax deduction. This is the typical scenario where the IRS challenges the grant as having been earmarked.

(3) **Group Exemption**: A Section 501(c)(3) organization can apply to the IRS for a group exemption letter which covers its subordinates. The parent must attest that each of the subordinates are under its general supervision and control and that each qualifies separately as a 501(c)(3) public charity. Once the ruling is issued, tax deductible contributions can be made directly to the subordinates. Such group exemptions are used by national organizations with local affiliates, such as the YMCA.

(e) Form 1023 - Application for Tax-Exempt Status. Most charitable organizations (organizations meeting the requirements of I.R.C. Section 501(c)(3)) must file a Form 1023 to obtain IRS recognition of exempt status; most other Section 501(c) organizations file a Form 1024. Note that certain changes were made regarding the Form 1023 effective January 2009 that may not be reflected in the actual form; these include the address to which the form should be sent and how to complete the projected financials (the later change was made to reflect the IRS changing the procedure for advance rulings as to public charity status as discussed above); the form as it appears on the IRS website includes at the beginning a one-page notice detailing these changes.

(i) Who must file: There are two types of organizations that can qualify for Section 501(c)(3) status without filing Form 1023: (i) churches (including synagogues, temples and mosques), integrated auxiliaries of churches and conventions or association of churches and (ii) any organization that has gross receipts in each taxable year of normally not more than $5,000. These organizations may choose to file a Form 1023, however, in order to receive a ruling from the IRS and be listed on the IRS Cumulative Bulletin of Exempt Organizations, thereby increasing the likelihood of receiving charitable donations. We understand that about half of the congregations in the U.S. have obtained an IRS determination letter, according to the National Center for Charitable Statistics (http://nccsdataweb.urban.org/PubApps/profilel.php? state=US).

(ii) Filing fee: The applicant must submit a user fee along with the application. The fee for most filers is $850 (an increase from $750 since 2006 and $300 before then) but for those organizations with annual gross receipts that have not exceeded and are not expected to exceed $10,000 per year over a four year period, the fee is $400 (an increase from $300 and before that $150). The check should be placed in a separate envelope on top of the application packet. The Form 1023 provides a website and a phone number for current filing fee information.

The IRS is in the process of implementing a Web-based software program designed to help 501(c)(3) applicants prepare a complete and accurate Form 1023 application, called Cyber Assistant. That program is expected to become available during 2010. Once the IRS announces the availability of Cyber Assistant, the user fees will change again so that organizations that use the program to prepare their Form 1023 will pay only $200 and organizations that do not use the program will continue to pay $850. The IRS announcement only applied to (c)(3) organizations and is unclear if the reduced fee will also apply to Forms 1024 and 1028 (which logic says it should). The IRS will announce when Cyber Assistant is available and the effective date of the user fee change.

(iii) Additional forms: The only form that must be filed prior to filing Form 1023 is Form SS-4, the application for employment identification number. The number can be obtained online, by phone, by fax or by mail. The IRS now requires that its checklist be filed with the application. And, the application must be accompanied by copies of the charity's organizing document (certificate of incorporation, trust instrument or articles of association), as amended thereto, and the by-laws or the rules of operation. Frequently, a power of attorney (Form 2848) is submitted together with Form 1023 to allow an attorney or CPA to act on behalf of the organization.

(iv) Deadline for filing: The Form 1023 should be filed within 27 months after the end of the month in which the entity was legally formed. Assuming the filing deadline is met and the IRS approves the application, the legal date of formation will be the effective date of exempt status. If Form 1023 is filed after the 27-month deadline, the organization is considered exempt only from the date of the ruling, unless it meets very narrow exemptions.

(v) Public inspection: The Form 1023, any attachments and all correspondence with the IRS in connection with the application are available for public inspection. The public can contact the IRS for copies of the information or may request inspection of the information or a copy from the exempt organization.

(vi) **Amplification of specific questions**:

(1) **Tax Year (Part 1, Line 5)**: The organization must select a taxable year. If it selects the calendar year, which is convenient for many, the annual return will be due May 15 (prior to extensions). Academic organization frequently have fiscal years that end June 30th. Often, however, an organization will select the taxable year which allows it to delay as long as possible its first required annual filing. For example, an organization incorporated on March 2 might select the fiscal year ending February 28. For some organizations, a longer fiscal year will allow the organization to apply for a definitive ruling of public charity status, since the organization will be in existence for at least eight months within its first fiscal year. Typically, the by-laws empower the organization's directors to select the first fiscal year; some by-laws, however, fix the fiscal year.

(2) **Description of Activities (Part IV)**: This part requests a description of past, present and planned activities in narrative form. It is important to be as detailed as possible. For new entities, there are often only one or two projects that have been planned. Those planned projects should be described in detail. The IRS will not be satisfied by a restatement of the purposes set forth in the certificate of incorporation.

(3) **Officers and Directors; Compensation (Part V)**: You must list the name, address and total compensation (or proposed compensation) for each officer and director, for each of the five highest compensated employees who will receive compensation of more than $50,000 per year and for each of the five highest independent contractors who will receive compensation of more than $50,000 a year.

Question 2 requests whether any of the officers, directors or trustees are related to each other through family or business relationships. If the organization is applying for public charity status, the IRS will frown upon a board that consists solely of related members. Although such is not expressly prohibited, the IRS is likely to require that the board be expanded to include independent parties.

Under question 2b, the entity must specify whether it has a business relationship with any of its officers, directors or trustees and under 2c, whether any of such officers, directors or trustees are related to any of the highest compensated employees or contractors.

Question 3 requires that you provide the qualifications for each of the officers, directors and trustees (whether or not compensated) and highly compensated employees and independent contractors, as well as their hours and duties. Question 3 also requires that you specify whether any of such persons are receiving compensation from any other organization (taxable or tax-exempt) that is related to the applicant through common control.

Question 4 asks whether compensation is approved in writing in advance of payment and whether compensation arrangements follow a conflict of interest policy and are based on compensation data concerning similar positions in similar nonprofits compiled by independent firms. Because the IRS is so focused on compensation issues, virtually all but the smallest organizations should be able to answer in the affirmative. It is easy to obtain independent data on compensation through reports compiled annually by the Council on Philanthropy and similar organizations. The Form 1023 instructions include a sample conflict of interest policy but the organization is free to adopt any form. It can also be included in the organization's by-laws.

Question 5 deals with the conflict of interest policy, which should be adopted by all organizations. The policy should provide that persons with a conflict of interest will not have any vote with respect to such transactions. The Form 1023 instructions include a sample conflict of interest policy but the organization is free to adopt any form. Such provisions can instead be included in the by-laws.

Question 6 requests, among other things, whether any individuals are compensated through non-fixed payments, including revenue-based payments. If an organization must compensate based on revenue, the very complex law on this field should be examined so as to ensure that no "private inurement" is involved.

Questions 8, 9 and 10 deal with transactions between the entity and its officers, directors and trustees or organizations controlled by such managers. Those transactions are absolutely prohibited in the case of a private foundation because they are deemed to be "self-dealing" even if they are market neutral. For example, a disqualified person could provide office space free to a private foundation but could not provide such space at a reduced rent. There are, however, certain exceptions for "reasonable" compensation for services, including investment advisory and similar services. With respect to public charities, all such transactions will be closely scrutinized. For example, a disqualified person could provide office space free to a private foundation but could not provide it at a discounted rent.

(4) **Specific Activities (Part VIII)**: The IRS has questions concerning specific activities. Questions 12 and 14 request whether the entity will be operating in foreign countries or making grants, loans or other distributions to foreign organizations. The federal tax laws allow for tax-exempt status if an organization is organized and operated in the United States but makes grants to foreign charities, provided that the U.S. entity is not simply serving as a conduit to the foreign entity. Thus, there are numerous "American Friends of" entities listed in the IRS Cumulative Bulletin (there are 151 in Delaware and over 500 in New York as of February 2007). In each of those cases, the IRS looks to the certificate of incorporation and by-laws of the U.S. charity to determine whether the U.S. charity exercises control over all funds and makes a determination in each case whether to transfer assets to the foreign entity. Further, the U.S. entity must monitor the foreign entity's usage of the funds and have procedures in place to both retrieve any mismanaged funds and cease to provide further funds, if the foreign grantee fails to report as to the use of the funds and/or uses the funds in an inappropriate fashion.

(5) **Past and Projected Financial Information (Part IX)**: This part requires both a balance sheet and an income and expenses statement. A new entity must show its projected revenues and expenses for the current year and for the subsequent two years. This part of the form is probably the most intimidating for the client, especially since the lawyers are usually unable to provide much guidance in terms of the actual numbers. Two points should be noted, however. First, The numbers need only be estimates (or maybe more properly characterized as "guestimates" since the IRS will not hold the company to them. In other words, use an optimistic guess as to what they hope the numbers will be. Second, only the applicable lines need to be completed. For instance, on the income and expense statement a simple organization that does not have paid employees and is working out of a home will only need to complete lines 1 (contributions), 14 (fundraising expenses), 22 (professional fees, especially accountants) and 23 (other expenses, *i.e.*, the basic costs of doing what they plan to do). Note the need to provide responses for the period described in Notice 1382Notice 1382 *(revised September 2009, available at http://www.irs.gov/pub/irs-pdf/n1382.paf))* instead of the periods as they appear on the form last revised June 2006): for groups in existence for less than five years, projected information for a total of three years if in existence less than one year or actual and projected information for a total of four years if in existence for one year or more; organizations in existence for five years or more will need to provide information for the most recent five years (this will require use of a separate statement since the Form 1023 includes only four columns). Years in existence refer to completed tax years.

(6) **Public Charity Status** (Part X). Notice 1382Notice 1382 tells the application not to complete line 6a on page 11 and not to sign the form under the heading "Consent Fixing Period of Limitations ...". For organizations in existence five or more years, only complete lines 6b and 7 on page 11.

(vii) Common errors: According to the IRS, 90% of the submissions since May 1, 2005 have been on the current form but approximately 30% of the filers have filed incomplete returns that were returned to the taxpayer. Two of the most common errors were failure to include proof of filing as to the certificate of incorporation, and signing

both lines under part X (page 11) of Form 1023, when the second line is reserved for signature by the IRS Director for exempt organizations.

(viii) IRS website: In addition to the very detailed instructions which the IRS supplies for completing the application, the IRS has, on its website (*http:// www.irs.gov/charities/index.html*), an "interactive life cycle" of a public charity. This helpful site will also link you to IRS forms and instructions. The IRS also has a site called "listserv," which if you subscribe, you will periodically receive emails from the IRS detailing what is new in exempt organizations.

(ix) Expected time for IRS review: Upon receipt, exemption applications accompanied by the required user fee are initially separated into three groups: (1) those that can be processed immediately based on information submitted, (2) those that need minor additional information to be resolved, and (3) those that require additional development. If an application falls in the first or second group (which covers about half of the applications), the applicant should receive either its determination letter or a request for additional information, via phone, fax, or letter, within approximately 60 days of the date the application was submitted. If the application falls within the third group, the applicant will be contacted once its application has been assigned to an EO specialist. Once the case is assigned, the length of time necessary for further review depends on the complexity of the issues, the need for more information, and the level of cooperation of the applicant. The average time for this second level of review is four months but in certain instances, such as applications for foreign grant-making organizations, the wait time can be up to a year due to the need to get comfort on antiterrorism issues, among other concerns.

The IRS does have a procedure allowing written requests for expedited processing. Expedited processing can be granted only where "compelling reasons" are provided. The IRS has said that this would include situations where (a) there is a specific grant pending where failure to secure the grant will have an adverse impact on the organization's ability to continue operating, (b) the new organization can demonstrate that it is a newly created organization providing disaster relief to victims of emergencies or (c) IRS errors have caused undue delays in issuing a determination letter. *See www.irs.gov/charities/articles/0,,id=139805,00.html for the IRS's Form 1023 FAQ #12.1, which states that 82% of requests are denied*, There is no special form for such request; it should be noted in a separate letter; if the claimed reason is disaster relief for a specific event, that should be written at the top of the application in hand "Disaster Relief, [Hurricane Katrina*]." For information about Hurricane Katrina, for instance, see http:// www.irs.gov/newsroom/article/0,,id=147281,00.html.*

(f) Tax on Unrelated Business Income

There are three prerequisites to the imposition on a charitable organization of the tax on unrelated business income: the activity must be a "trade or business," the trade or business must be regularly carried on and the trade or business must not be substantially related to the organization's exempt purposes.

Section 513 exempts the following activities from unrelated business or trade income: income from a business where substantially all the work is carried on by volunteers; a business carried on for the convenience of the charity, its students, its members, etc. (e.g., a cafeteria); a business where substantially all the merchandise is donated (e.g., a thrift shop); qualified convention and trade show activity; and certain services furnished by hospitals.

Also exempt from the imposition of the tax is passive income--income from rents, royalties, dividends, interest and annuities (except for passive income from a controlled organization and rents if more than 50% of the total rent is attributable to personal property or depends on the profits of the lessee).

On the basis of the royalty exclusion from UBIT, many nonprofits license commercial businesses to use their name, trade or service marks, copyrights, and mailing lists.

Another area of contention is whether a corporate sponsorship which involves advertising will be considered a trade or business. The IRS has issued regulations that provide that mere recognition of sponsorship payments will not be subject to tax so long as the effect is to identify the sponsor rather than to promote its products, services or facilities. Such acknowledgments would include: sponsor logos and slogans that do not contain qualitative or competitive descriptions of products, services or facilities; sponsor locations and telephone numbers; value-neutral descriptions of the sponsor's products or services, including displays of visual depictions; and sponsor brand or trade names and product or service listings.

(g) Other Section 501(c) Organizations.

To obtain IRS recognition of tax exempt status, most of these organizations file a Form 1024 with the IRS; it is a simpler form to complete than is the Form 1023 since the nonprofit is only eligible for tax exemption, whereas charitable organizations are also eligible to receive tax-deductible contributions.

(i) ***Section 501(c)(4) social welfare organizations***: Organizations operated exclusively for the promotion of social welfare, no part of the net earnings of which inure to the benefit of any private shareholder or individual, are classified as Section 501(c)(4) organizations. While many organizations which qualify for exemption under Section 501(c)(4) are charitable in nature and could qualify under Section 501(c)(3), they choose to qualify instead under Section 501(c)(4) since they engage in substantial lobbying and may be "action organizations." In some cases, the ability to lobby may be more important to an organization than the ability to obtain tax deductible contributions. Moreover, Section 501(c)(4) organizations may engage in political campaigning, so long as such is not the organization's principal activity.

Organizations that might qualify under either section include community block associations, and organizations with purposes such as advising purchasers of low-income housing, lending to businesses as an inducement to their locating in economically depressed areas, and so on.

(ii) ***Section 501(c)(6) nonprofit business organizations***: Qualification under this Section requires a not-for-profit corporation which has its purposes promotion of some common business interest, such as trade association, and not the operation of a business ordinarily carried on for profit, even if the business is conducted on a cooperative basis.

(iii) ***Section 501(c)(7) social and recreational clubs***: The Treasury Regulations note that this exemption extends primarily to clubs supported solely by membership fees, dues and assessments. Any other nonprofit purposes must be similar in nature. For example, a political club would not qualify.

(iv) ***Coordination of classification under Section 501(c) and "Type" of corporation under the New York Not-For-Profit Corporation Law:*** Type A corporations typically would qualify as social or recreational clubs under Section 501(c)(7). Some may qualify as business leagues or social welfare organizations. Most Type B corporations qualify under Section 501(c)(3). Indeed, the statutory language for the Type B corporation appears to have been drafted with this in mind. Type C corporations are complex. If a Type C corporation is organized and operated to carry on a business, it can qualify for tax-exemption even if it is profits are used for charitable, educational or other tax-exempt purposes. As to Type D corporations, the availability of a tax exemption is generally considered on a case-by-case basis.

(h) Annual Returns (Form 990) and Public Access to Reports

Exempt organizations are required to file annual information returns with the Internal Revenue Service. These information returns should be filed even if the organization has not yet received its ruling from the Service (the form includes a box to be checked if an exemption application has been submitted but not yet ruled on). The return is required to be filed by the fifteenth day of the fifth calendar month following the close of the taxable year (e.g., May 15 for those organizations who have selected the calendar year) unless an as-of-right three month extension (or a further for-cause-shown three month extension) has been obtained;

(i) ***Private Foundations.*** Private foundations are required to file Form 990-PF with the IRS each year, regardless of the assets held by the foundation or the gross receipts for the year. Private foundations are typically required to pay the excise tax on investment income on a quarter-annual basis. That payment is not made with the filing of the return; instead it is deposited with a bank.

(ii) ***Public Charities.*** Public charities are required to file either the basic Form 990, the short version Form 990-EZ for smaller entities or the "postcard size" Form 990-N for very small entities. For taxable years begun in 2007, only those with gross receipts of less than $100,000 and assets of less than $250,000 at the end of the year could use the Form 990-EZ and only those with less than $25,000 in gross receipts could use the Form 990-N.

The IRS issued an updated version of Form 990 which was first used in 2009 for taxable years beginning in 2008. *(For a detailed discussion of the new form, see a bulletin available on the Stroock firm website at <http:// www.stroock.com/sitecontent.cfm?contentID=58&itemID=719> http:// www.stroock.com/sitecontent.cfm?contentID=58&itemID-719)*. The new Form 990 consists of an 11-page, 11-part core form that is required to be completed by all organizations, and 16 schedules to be completed if applicable to the reporting nonprofit.

One major change in the redesigned Form 990 is the focus on corporate governance. The new form specifically asks whether the organization has the following written policies in place: conflict of interest, whistleblower, document retention and destruction, policies to ensure consistency in the operation of affiliates, policy regarding reimbursement of business, travel and entertainment expenses, compensation policy, audit policy and financial information disclosure policy. In addition, under the new Part XI, the IRS requires each organization to provide information about the composition and independence of its board. The redesign of Form 990 is a byproduct of the IRS' increased focus on the corporate governance of charitable organizations. IRS officials have repeatedly expressed their belief that the existence of an independent governing board, combined with well designed governance and management policies and procedures, increases the likelihood that an organization will comply with the tax laws.

In order to allow small exempt organizations time to adjust to the new form, transition rules were adopted. For filings for tax years starting in calendar 2008, organizations with gross receipts equal to or less than $1 million (up from $100,000) and total assets equaling or less than $2.5 million (up from $250,000) were able to use the simplified Form 990-EZ. For the 2009 tax year entities coild use the Form 990-EZ if gross receipts equal or were less than $500,000 and total assets equal or were less than $1.25 million. The new Form 990-EZ filing thresholds will then be set permanently at $200,000 of gross receipts and $500,000 in total assets beginning with filings for years starting in calendar 2010.

Prior to 2007, public charities with annual gross receipts of less than $25,000 were exempt from filing. Under legislation enacted in 2006, these organizations have been required since filings due in 2008 (*i.e.*, with respect to fiscal years that start after December 31, 2006), to notify the IRS, in electronic form on Form 990-N *(Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required To File Form 990 or 990-EZ)* the legal name and address of the entity and a principal officer and evidence of the basis for exemption from filing. Beginning with the 2010 tax year the IRS will increase the filing threshold for organizations allowed to use Form 990-N from $25,000 to $50,000.

Even if an organization is eligible to use a simpler form, it may file using the full Form 990. It may wish to use the full form because donors that follow the charity may be less receptive to charities that do not file the full forms and governance practices will no doubt be enhanced if the organization satisfies the full Form 990 requirements. If an organization determines that it can temporally use a simpler form, it should consider doing a “test run” (but not file) using the full form so that it can see where it needs to improve performance for the filing due in subsequent years, such as adopting governance policies.

A significant factor that many organizations may consider in deciding whether to file the full form, if such an option exists, is the cost related to filing such form, including accounting costs. It is expected that accounting and auditing firms will increase their fees due to enhanced reporting requirements. Additionally, more staff and board time will be required. Accordingly, the process of using the long form will be more time consuming and expensive.

If an organization is required to file an information return or annual electronic notice and fails to do so for three consecutive years, the organization will lose its tax-exempt status as of the filing due date of the third return. That means that it will have to reapply to have its tax-exempt status reinstated and pay the appropriate user fee. If the organization was exempt from filing, as is the case with certain government organization and churches and church-related entities, this three-year rule will not apply. See information on the IRS website at *http:// www.irs.gov/charities/article/0,,id=169250,00.html* regarding this procedure. Effective May 17, 2010, the exemptions for firms that did not file for three years will be revoked unless they properly filed an extension request for the last fiscal year before that date. While the IRS will begin revoking exemptions on May 17, it will wait until 2011 to send revocation notices. An IRS spokesman said “Ultimately, the revocation process will benefit the nonprofit sector by weeding out defunct organizations and nonprofits that are not meeting their reporting responsibilities. In the short run, however, it will cause hardship for some organizations.”

GuideStar estimates that 350,000 to 400,000 nonprofits are in danger of losing their exemptions. A large number of these organizations are smaller nonprofits that previously were not required to file an annual return because their gross revenues were $25,000 or less. These nonprofits now must file Form 990-N, which the IRS created in response to the Pension Protection Act. This action will result in a substantial reduction in the number of IRS-recognized nonprofits. While most of these are probably defunct, there will no doubt be some that remain active but failed to file. They will need to start the exemption application process over and they will lack IRS-recognition for the period between the lapse and their reinstatement.

The Form 990 must be filed electronically if the organization files at least 250 returns of any type with the IRS during the calendar year; other organizations are allowed to file electronically if they so desire. While some nonprofits have provided supplemental material with their Form 990s that is not required; such information cannot be filed if the form is filed electronically. The IRS also discourages such practice since it may result in inadvertent disclosure of confidential information.

Note that the IRS does not require that financials be audited but many state regulatory agencies, such as New York's Department of Law, do. Currently the threshold for auditing by the Department of Law is $250,000 in revenue (with a "review" required between $100,000 and $250,000), although these thresholds may be revised in years to come, possibly to conform to the Form 990-EZ thresholds. The Better Business Bureau Wise Giving Alliance also requires that charities have their financials audited if annual gross income exceeds $250,000. In 2009 Connecticut raised the threshold for auditing financials of registered soliciting charities from $200,000 to $500,000.

(iii) ***Other Organizations.*** Some organizations must report on other forms; these include Section 509(a)(3) supporting organizations, Section 527 (political) organizations required to file an annual exempt organization return, employee benefit trusts, black lung benefit trusts and certain religious and apostolic organizations. Certain governmental and church-affiliated organizations are not required to file any annual information returns.

(iv) ***Exempt Organization Business Income.*** If the nonprofit engages in unrelated business, it must file a separate return on Form 990-T. Note that since the enactment of the Pension Protection Act in 2006, all charities which file this return are required to make it publicly available for inspection or provide a copy upon written request, even if they are otherwise exempt from disclosing their Form 990 (such as is the case with churches [many of which never even filed with the IRS for exemption, since it was not required] and with organizations that have less than $25,000 in annual revenue, which currently do not have to file and in the future will only need to do a simple e-postcard filing). Failure to disclose can result in fines of $20 per day up to $10,000, with the penalty to be paid by the employee who refuses to disclose the information. If the return is posted on the Web, separate copies do not need to be provided to those who ask for them. For further information, see Notice 2007-45 at www.irs.gov/pub/irs-drop/n-07-45.pdf.

(v) ***Public Inspection; Availability on Guidestar***. The IRS will provide copies of filed Forms 990 (by filing a Form 4506-A) to anyone who asks. The IRS also provides copies to a company called Guidestar (*http://www.guidestar.org*) where they are made available to the public. Guidestar tries to get the filings input within two months after they are submitted to the IRS but if a filing does not appear within that timeframe the charity can request on a Form 4506-A that the IRS make the filing available to Guidestar or the charity can provide the information directly to Guidestar under the tab marked "Document Uploads" on the Guidestar.org website. [FN10] In addition, copies may often be obtained from state regulatory agencies (for instance, the Charities Bureau of the New York Department of Law makes the Forms 990 (and audited or reviewed financials if required to be filed) available on its website, *http://bartlett.oag.state.ny.us/Char_Forms/search_charities.jsp.*

Both public charities and private foundations must make the annual returns for the three most recent years available for inspection to any person which requests them, unless the form has been made available on the organization's website. Compliance with the request for a copy of the Form (or the organization's exemption application of Form 1023) must be made within 30 days, if the request is in writing, and immediately, if the request is in person. The organization may charge a reasonable fee to cover reproduction and mailing costs. Penalties are applicable for failure to allow for public inspection or to provide copies of the annual returns or application for exemption. Schedule B, which details information about contributions, should not be provided by any nonprofit other than a political

organization, in order to maintain appropriate donor confidence. Many nonprofits now post copies of their Form 990 and Form 1023 on their website.

(vi) ***Preparation of the Return***: The organization should retain an accountant to prepare and file the return unless the personnel at the firm are experienced in these matters; the outside auditor should also review the return as well as the underlying financials. Unless the accountant and contact person at the company working on the return are experienced in filing exempt organization returns, we recommend that an attorney review the return since there many legal issues are involved. The prior Form 990 consisted primarily of financial information and was therefore usually completed by the financial personnel of the nonprofit. The new form, however, is now, in the words of the IRS, "primarily a programs/activities/governance report rather than a financial report" and therefore the preparer will need to obtain input from the organization's program staff, managers, officers and directors (as well as legal counsel) in order to properly complete the form.

(vii) ***Penalties for Late Filing*.** A late filing of a required Form 990 or 990-EZ will result in the IRS assessing penalties; there is no penalty for late filing of a Form 990-N. If the nonprofit files using the wrong form, the IRS may also assess penalties as if it had not filed. If the nonprofit's gross receipts are less than $1,000,000 for its tax year and it does not have reasonable cause for filing late, the Internal Revenue Service will impose a penalty of $20 for each day the return is late, up to a maximum of $10,000 or 5 percent of the organization's gross receipts, whichever is less. The penalty increases to $100 per day, up to a maximum of $50,000, for an organization with gross receipts that exceed $1,000,000.

(i) Tax Deductibility of Contributions

One of the prime reasons that nonprofits seek tax exempt status is so donors can tax their contributions as deductions on their tax returns. Please note, however, that there are many IRS-imposed rules regarding procedures that need to be followed to facilitate such deductibility and to determine the limits of such deductibility.

(j) International Grant Making

If a nonprofit plans to make grants to foreign organizations, it needs to be mindful of requirements regarding such grantmaking. There are three primary concerns:

• The U.S. organizations should exercise "discretion and control" over the grant making process. Language regarding such discretion and control should be included in its by-laws or in a board-approved policy regarding foreign grantmaking procedures. It cannot be "mere conduit" for a contribution by a U.S. taxpayer desiring to obtain a U.S. tax deduction since contributions to overseas charities are not tax deductible. In other words, the projects which the organization funds should be those chosen by the U.S. organization, not the contributors to the U.S. organization. If the U.S. organization has approved multiple projects, the donors in the U.S. can select among those projects. But if a donor wants to donate funds for something else, the U.S. organization has to formally study and approve such project as one that it wishes to fund.

• Unless the U.S. organization is prepared to closely monitor how the funds are to be used by a grantee, the U.S. organization should only make grants to foreign organizations which would be characterized as public charities if they were located in the United States. This means that the foreign entity actually has to have an IRS determination letter (which is very rare) or that the foreign organization has to have provided to the U.S. organization an affidavit or legal opinion of foreign counsel to the effect that it is substantially equivalent to a U.S. public charity **and** the U.S. organization has to have been provided with and the U.S. organization has to have reviewed the legal formation documents of the overseas charity (*i.e.*, documents comparable to the certificate of incorporation and by-laws) and/or applicable foreign laws (both in English, which may entail significant expense) to make sure that the affidavit or opinion is correct and that the foreign organization's documents or governing law have IRS-appropriate language (including language that on dissolution assets go to another nonprofit and that there is no private inurement, etc.). The foreign organization will need to provide reports to the U.S. grantmaker at least once a year until the granted funds are fully expended indicating how the funds have been spent. If the foreign organization is not a recognized U.S. charity or the grantmaker has not reasonably determined that it is substantially equivalent to such a charity, the U.S. grantmaker will have to exercise a significant degree of oversight over how the money is used by the foreign organization (called "expenditure responsibility") and the money given to the foreign organization will need to be held in a segregated bank account or other fund until expended.

• It should adhere to U.S. guidelines regarding making sure that the funded charity is not on any U.S. or international terrorist lists.

If the organization is not making grants to foreign entities but is, instead, conducting its own operations in the foreign country, it will still need to be mindful of the issues related to antiterrorism and it will need to satisfy any local laws regarding operations in such country.

2. **State Corporate Tax Exemption**

The nonprofit should submit a Form CT-247 to the New York State Department of Taxation and Finance after the IRS exemption has been recognized in order to obtain an exemption from paying New York's franchise tax. Note that any unrelated business income that is subject to Federal tax is also subject to New York tax. *A copy of CT-247 is available at www.tax.state.ny.us/pdf/2005/fillin/corp/ct247_805_fill_in.pd*.

If the CT-247 is not submitted after the time of formation, it will need to be submitted at the time of any dissolution.

In California, the process of obtain franchise tax exemption was simplified in 2008. Now the nonprofit merely needs to provide the tax authorities with a copy of the IRS determination letter.

3. State Sales Tax Exemption

(a) New York

Exemptions from Paying Taxes on Purchases. The entity should apply for an *Exempt Organization Certificate* enabling it to avoid the payment of sales taxes on its purchases by submitting Form ST-119.2 (with a power of attorney on Form ST-119.4) to the New York State Department of Taxation and Finance. (*Form ST-119.2 is available at www.tax.state.ny.us/pdf/2008/fillin/st/st11_9_2_1108_fill_in.pdf*). Other states presumably have similar exemptions.

Note that IRS determination is not a prerequisite to this application, although it can simplify the application process. It is wise to submit this application before getting an IRS ruling if significant purchases are required before getting the IRS determination letter. The organization can also apply for a refund of taxes for up to three years after the taxes were paid by submitting the sales receipts along with an Application for Credit or Refund of State and Local Sales and Use Taxes on Form AU-11. After issuance of this certificate, the entity can give a copy to each its sellers attesting to the entity's sales tax exemption. Many sellers keep these certificates on file so they don't have to be submitted with each purchase.

Duty to Charge Taxes on Sales. The entity still has to charge sales tax on most of the property or services that it sells, such as gift shop sales, restaurant or other food sales, parking charges, etc. It has to register at least 20 days before it commences sales in the State with the Department of Taxation and Finance and obtain a *Certificate of Authority* (which can be done on-line at www.nys-permits.org or by filing a Form DTF-17, *Application to Register for a Sales Tax Certificate of Authority)* and file quarterly reports whether or not there were sales in the quarter.

Two sets of changes were enacted in 2008 regarding the sale of goods by nonprofits. Until 2008 sales of tangible personal property via mail order, telephone, the internet or other “remote” means, were exempt from sales tax but that exemption was eliminated effective September 1, 2008 if such sales are done with a degree of “regulatory, frequency and consistency.” Until 2008 no sales tax was due on the lease or rental or tangible personal property and the provision of certain utilities (e.g., power, telephone charges) and certain services to real property (e.g., to a tenant); these exemptions were also eliminated effective September 1, 2008.

Further refinements regarding sales considered to be made from an shop or store and sales via traditional and remote auctions of tangible property were adopted effective January 1, 2009. A traditional auction is where bidders are physically present in the room (and, if allowed, there can also be bidding over the phone or internet) and remote auctions are defined as auctions where no bidders or their representatives are present, whether conducted on the organizations' website or the website of another internet auction service. Each remote auction is defined as starting on a specific date and ending on another specific date (for example, listing ten items if the start and end dates are the same would be a single auction but listing three items with different start or end dates would mean that three auctions are held). If an organization hosts only two traditional or remote auctions per year, sales at such auctions will be exempt unless the organization also makes sales of similar items at a shop or store or the auction is held on the premise of a commercial auction house or other location where auction sales are traditionally held. If more than two auctions are held, the sales will be taxable (sales at all auction sales will be taxable if the organization scheduled or planned to hold more than two events that year but only the sales at events more than two will be taxable if the later auctions were not scheduled

or otherwise intended initially). In other words, auctions traditionally held at an annual event will be exempt but more than two eBay type auctions will trigger the need to collect sales taxes. Note that the taxes on auction sales only applies to tangible assets, so sales of vacation packages and similar items will not be taxable.

Standard New York exemptions for out-of-state sales, sales of items generally exempt from sales tax (periodicals, certain clothing and footwear, certain food products and certain drugs and medicines) and sales pursuant to an Exempt Organization Certificate or Resale Certificate will continue to apply, however. See Part KK-1 of Chapter 57 of the Laws of 2008. *For more information, see www.tax.state.ny.us/pdf/memos/sales/m08_5s.pdf and www.tax.state.ny.us/pdf/memos/sales/m08_15s.pdf*

(b) Delaware

Exemption from the Delaware corporate income tax is available for the following categories of corporations (see Delaware Code Ann. Tit. 30, section 1902(b)):

- Corporations organized for religious, charitable, scientific or education purposes whose net earnings do not inure to the benefit of any individual
- Fraternal benefit societies
- Nonprofit cemetery associations
- Nonprofit corporations organized for the prevention of curetly to children or animals
- Nonprofit business leagues, chambers of commerce, merchants associatons and boards of trade
- Fire companies
- Nonprofit civic leagues or organization
- Nonprofit recreational clubs

Note that nonprofits are not generally eligible for real property tax exemption in Delaware unless the property is held by a churt or religious society, college or school.

4. City Tax Exemptions

(a) Business Tax. If an entity is organized and operated exclusively for nonprofit purposes and does not issue stock, it is automatically exempt from the New York City General Corporations Tax and Unincorporated Business Tax. No application is required.

(b) Commercial Rent/Occupancy, etc. Entities organized and operated "exclusively" for religious, charitable, educational or prevention of cruelty to children or animal purposes are exempt from the New York City Commercial Rent/Occupancy Tax, the Annual Vault Charge and the Commercial Motor Vehicle Tax and the first three types of organizations are also exempt from the utility tax. No substantial party of the organization's activities may be attempting to influence legislation. Since the standards for granting these exemptions track the IRS exemption tests, it is usually best to wait until the IRS determination letter has been issued before applying. There is no standard form. Instead you send copies of the charter, bylaws, a current revenue and expense report, a balance sheet, the IRS letter, three years tax returns (if in existence that long) and an affidavit setting forth the New York type, the entity's purposes, a description of actual activities, the source and disposition of funds, a statement that no net income is credited to surplus or may inure to an individual and any other facts that may affect the application (including statements as to the activities conducted at the site and a description of any sublease or arrangement with other entities). This package is sent to the New York City Department of Finance in Brooklyn.

(c) Real Property Tax. Whether or not property is eligible for real property tax exemption is not based on the tests applicable to formation under the New York Not-for-Profit Corporation Law or to obtaining Internal Revenue Service recognition of tax exempt status; instead it is governed by the New York State Constitution and the Real Property Tax Law (RPTL) (especially sections 420-a and 420-b), and, for property in New York City, Section 11-246 of the New York City Administrative Code.

State Law. Property "used exclusively for religious, educational or charitable purposes" is exempt from real property taxes pursuant to Article. XVI, Section 1 of the New York State Constitution, and Section 420-a of the R-PTL sets out a slightly larger category of exemptions mandated by state law (for entities with purposes ***and*** activities that are "exclusively" religious, charitable, hospital, education, or moral or mental improvement of men, women or children. Sometimes specific property, such as Lincoln Center (RPTL Section 427) is granted tax exempt status by legislation.

Section 420-b allows local tax authorities to extend, if they wish, exemptions to other nonprofits. The New York City provision granting such discretionary exemption excludes entities whose purposes and activities are principally for the members (such as bar associations).

City Posture. New York City has had a love/hate relationship with nonprofits when it comes to city tax exemption, Since 1984 the City has taken a fairly friendly posture (whether that posture will continue in the current economic climate is open to question) but in the decade that preceded that the City was very aggressive in fighting nonprofits, in its attempt to stave off bankruptcy circa 1975-76, claiming that they did not fall within the strict confines of the rules. A full scale revocation of exemptions occurred circa 1980, requiring all previous holders to refile and prove their case. Almost every nonprofit had to go through administrative hearings and sometimes court battles to get their exemptions recognized.

Even though the City's attitude is more liberal than it was in the days of the fiscal crisis of the '70s, the burden of proving eligibility still rests on the entity and the City interprets the various eligible standards very narrowly. "Charitable" has been viewed in a more traditional sense -- relief of poverty -- rather than in the more expansive IRS sense. For instance, while the IRS will view "educational" very broadly in determining whether to recognize tax exempt status, the City has historically required the institution to be degree-granting to be educational. The two leading cases on the scope of the charitable/educational exemption related to the Association of the Bar of the City of New York and the Explorers Club, where the Court of Appeals upheld the City's denial of exempt status. *Association of the Bar of the City of New York v. Lewisohn*, 3123 N.E.2d 30 (NY 1974). The "religious" exemption applies to the churches, synagogues, etc. of "recognized religions" but not to more broadly religious uses. See *Swedenborg Foundation, Inc. v. Lewisohn*, 351 N.E. 2d 702 (NY 1976). The City examiners tend to look for organizations with strict religious beliefs, practices and services and established clergy, but we were successful in obtaining a hard-fought exemption for a less doctrinaire organization, the New York Theosophical Society. In the 1980 era revocation/rehearing push the City especially tried to revoke the exemptions of cultural institutions. The courts overturned the City's policy in *Symphony Space v. Tishelman*, 453 N.E. 2d 1094 (NY 1983), taking a more expansive view of what is educational, concluding that performing arts organizations satisfied the test. The City then backed off of its formal limited policy but remnants of that approach may still be found in the administration of the law.

The other crucial factors to bear in mind are that the organization must be organized "exclusively" for exempt purposes **and** the property in question must be used "exclusively" for such purposes. While the legislation uses the word "exclusively," that word has been interpreted to mean "almost exclusively." (The City view is not as generous as the view taken by the Internal Revenue Service that "exclusively" means "primarily."). In other words, only exempt activities can be conducted at the site. Vacant buildings are not being used for exempt purposes, unless the applicant can show a good faith effort to get the space ready for use.

Nonprofit tenants of a for-profit landlord (even those on a net lease paying real estate taxes) are not eligible for real property tax exemption. Any tenants of a nonprofit landlord have to meet the same organizational and use standards as the nonprofit in order for the property to be fully exempt. Furthermore, the eligible tenant cannot pay any rent in excess of "carrying, maintenance and depreciation charges." If you find your client in this situation, note the need to take care in preparing the rent provisions to either ensure compliance with the CMD standard or make the tenant liable for any resulting taxes. The activity of some nonprofits in renting out space for public events, whether by other nonprofits or by for-profit entities, may jeopardize their real estate tax exemption on the space (they may be able to argue that the use granted to the other organization is not a lease but is, instead, a license, which may not jeopardize the exempt status).

If a portion of the building is not being used for an exempt purpose, that portion will be taxable. Sometimes it is also possible to negotiate a partial exemption if there is a question as to whether a use is proper. For instance, we had a client which ran a religious-based organization that had two rectories; the City took the position that only one was necessary and to avoid protracted litigation, our client agreed to a partial exemption.

Application Procedure. The applications must be submitted based on the status of the property on January 5th (the tax status date). The use on that date governs the taxable status for the City's fiscal year, July 1- June 30. Historically, if a tax-exempt entity bought a parcel from a taxpaying owner, it could not get tax exempt status until at least the beginning of the next fiscal year and it must be in possession and using the building on the prior January 5th. Starting

in 2007 state law was changed so that tax-exempt entities can now obtain real property tax exemptions effective from the date of the acquisition of the property.

The applicant must submit a detailed application on a City-provided form. It is important to note that all questions must be answered and all exhibits provided before the City will consider the application. After submission, a representative of the Department of Finance will inspect the property. The Real Property Assessment Bureau then rules on the application. Appeals to the Tax Commission are possible if requested within 30 days of the receipt of the determination letter. Instead, or as a follow up to an unsuccessful Tax Commission appeal, a lawsuit as an Article 78 proceeding or as a motion for declaratory judgment can be brought. One virtue of the litigation route is that the court can rule on prior tax periods as well and grant refunds plus interest.

If exemption is granted, update filings have historically been required. Historically updates were done on an annual basis but starting with the 2007/2008 tax year the New York City Finance Department implemented an every-other-year renewal process. Each tax exempt property owner was to have received a communication from the city as to its renewal timetable. The renewal process uses a fairly simple form, again on a form provided by the City (it should mail them in November or December and the forms are due in January; if the property owner has not gotten a form by late December, it should obtain a copy from the City). In 2009, properties receiving Not-for-Profit Contemplated Use exemptions renewal applications must have been filed by January 30, 2009 but for properties receiving full or partial exemptions no renewal forms were required for the tax year beginning on July 1, 2009.

Applications are available at http:// www.nyc.gov/html/dof/html/property/property_tax_reduc_non_profit.shtml#forms.

The Department of Finance only has authority to grant exemptions for the current and immediately proceeding year. Cancellation of back taxes for more distant time periods requires a separate application for Cancellation of Back Taxes and Charges through the Comptroller's Office. If the organization is eligible, the process is fairly simple and takes about a year.

Every exempt owner will get quarterly tax bills but they should show zero tax. Similarly, tentative assessments should show the exempt value. These forms should be annually reviewed to ensure that they are correct (and that proper addresses appear on the forms).

Note that the City views each tax lot as a separate case. For every application, forms covering the entity (one for all properties) and the properties (one for each) will be required.

Are LLCs Eligible? For years, the New York Finance Department was emphatic that single-purpose / sole member limited liability companies, which are disregarded by federal and state tax law and are instead considered to be part of the sole owner, were not eligible for not-for-profit real property tax exemption. However, the Finance Department issued a letter ruling on June 12, 2002 and another letter ruling on November 21, 2007 saying that LLCs were eligible. The first entity was constructing a school where the lender required that the mortgage property be owned by such an LLC; the second entity provided affordable student housing financed with tax-exempt bonds and wished to limit exposure to liabilities though the use of a separate legal entity.

The first issue addressed by the rulings was whether an LLC was a "corporation or association" within the meaning of Real Property Tax Law Section 420-a; it was so held on the basis that trusts are similarly held to be associations.

The next issue was whether LLCs could be nonprofit. The Department noted that the New York law states that LLCs may be formed only for "business" purposes and the Practice Commentary states that "[al]though the LLCL does not expressly prohibit the formation of not-for-profit LLCs, the definition ... suggests that the drafters intended that LLCs form for pecuniary profit." The Department therefore required that the articles or organization and/or operating agreement state that there will be no pecuniary profit and that the LLC will operate for nonprofit purposes consistent with Section 420-a.

Other conditions which the Department imposed included that the sole member be qualified for exemption under Section 420-a, there is commonality between the management of the LLC and its single member (which is something you usually try to get away from, so as to avoid veil-piercing arguments), the property must be managed and maintained by the single-member, that rent not exceed "carrying, maintenance and depreciation charges" (as required by the RPTL), that the property revert to the single member or another exempt upon termination of the LLC (noting

that any transfer to a non-qualifying entity will result in a loss of exemption) and that the LLC and the member annually file an affidavit that there has been no change in ownership and the other conditions have been satisfied. It also required that the new LLC file a separate real property tax exemption application. For copies of these rulings, see FLR No. 024794-003 and FLR No. 0748373-021.

The section of the Finance Department website where these rulings are published states that these ruling are merely advisory. They are not legally binding and do not set precedent. To my knowledge, there never was a formal statement of policy issued regarding this issue. Also, the filing instructions and application make no reference to single purpose LLC situations. In fact, the filing instructions and application read the way they always have, with no discussion of any policy changes. The bottom-line is that this was originally a black and white issue and now seems to be grey. While it would be wise for a not-for-profit contemplating such use of an LLC to seek a prior ruling from Finance before entering into such an arrangement, the fact that there are now two letter rulings may give nonprofits more comfort on this point.

Annual Reports Regarding Income-Producing Property. Note a 2007 change regarding annual reports. Owners of income-producing properties that have an actual assessed value of more than $40,000 are required to file an annual real property income and expense statement by September 1st of each year. In the past, not-for-profits were exempt from this requirement. This policy changed in 2007, however. A not-for-profit that has rental income must now file an annual RPIE report, which has to be filed electronically. A separate filing is required for each tax lot. For further information as to how to file, see home2.nyc.gov/html/dof1itml/property/property_info_rpie.shtml-40k.

Real Property Exemptions Outside of New York. For a discussion on real estate tax exemptions nationwide, see Gerald A. Rosenberg, *Real Property Tax Exemptions at Risk*, Taxation of Exempts, September/October 2008, p.1.

(d) Water and Sewer. It may also be possible to obtain exemption for water and sever rents. The applicable statute is 18876 New York Laws, Chapter 696. There are 17 categories of exemption. Some organizations may only be partially exempt on certain properties (such as parsonages). About half of the New York City exempt properties also have water and sewer rent exemptions. The exemptions fully cover only a certain maximum usage and is partial above that. Application is made through the Water Register Office of the Department of Environmental Protection. The property must be in use. Applications are ruled on quickly and only start from the application date. Applications to the Comptroller's Office may be made for cancellation of prior period rents. No annual reports are required once the exemption is granted.

(e) Real Property Transfer Tax and Mortgage Recording Tax. In New York City, organizations organized or operated exclusively for religious, charitable or educational purposes or formed for the prevention of cruelty to children or animals are also exempt from the real property transfer tax, both as a seller and a buyer. (There is no comparable exemption for nonprofits outside of New York City, however.) See p.8 of the RPT form, “A transfer by or to an eligible tax exempt organization is exempt from the Real Property Transfer Tax. To be eligible, an organization must be operated exclusively for religious, charitable or educational purposes and must provide proof of the organization's tax exempt status.” The form goes on to say that the tax does not apply to “A deed, instrument or transaction by or to any corporation, fund or foundation, organized and operated exclusively for religious, charitable, or educational purposes, or for the prevention of cruelty to children or animals, and no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, provided, however, that nothing in this paragraph shall include an organization operated for the primary purpose of carrying on a trade or business for profit, whether or not all of its profits are payable to one or more organizations described in this paragraph.: No application is required. The parties merely note the exemption on the Real Property Transfer form. The title company representative may wish to see evidence of eligibility, such as the certificate of incorporation, IRS documents and/or an affidavit of the party. The local tax could be significant; the rates vary by price and property type: residential below $500,000 is 1%, and $500,000 and above is 1.425% (anything containing in excess of 3 units is not considered residential); commercial property below $500,000 is 1.425%, and $500,000 and above is 2.625%. Note that nonprofits are not exempt from the state tax, which is lower: $4 per $1000 of consideration.

Most nonprofits must pay the mortgage recording tax (the only exemption is for housing development fund corporations).

(f) Building Department. Nonprofits can also get exemption from the Building Department's charges for public assembly permit fees, elevator inspection fees, boiler inspection from filing fees and work permit fees. Applications to the Building Department are required and are quickly ruled on. Certain fees charged by the Department of Environmental Protection do not need to be paid by religious, charitable and educational organizations. Similarly, certain fire protection permit and inspection fees can be exempted, forms for which can be obtained from the Fire Department's Central Office, Bureau of Fire Prevention.

VI. STATE REPORTING OBLIGATIONS

Too often lawyers counseling nonprofits think that their formation responsibilities are over once the entity is incorporated and has obtained IRS recognition of its tax exempt status. That is not true for many nonprofits, especially charities. In most cases charities and some other forms of nonprofits (which may include IRS Section 501(c)(4) social welfare organizations) will need to register with the Department of Law if they have been formed under New York law, hold property or do business in New York or even solicit charitable contributions in New York. Many other states have certain registration requirements, especially related to charitable solicitations. We will from time to time refer to some of the provisions of California law on the topic.

The Charities Bureau of the New York Department of Law supervises many not-for-profit organizations and certain of their activities (not including, however, churches, church-related entities, hospitals, membership entities, historical societies or schools chartered by the Board of Regents and other nonprofits that are exempt from registration with the AG's office). According to its website it oversees about 50,000 charities. The Charities Bureau is headed by an Assistant Attorney General-in-Charge with a Section Chief handling many matters.

The AG's office requires registration by these charities under either or both of

- the Estates Powers and Trust Law ("EPTL") if they hold charitable assets in the state or
- the Executive Law if they solicit funds in the state.

Registration and annual reports are done of the same form for both types of registrations. *All of the AG's forms can be located on the web at http:// www.charitiesnys.comcharindex_html; helpful guides can be found at http://www.charitiesnys/.com/guides_advice_new.html.* Registration statements, annual reports and other filings (including copies of fund raiser contracts) are considered public documents available for inspection (unless some other statutory exemption from disclosure applies).

1. Regulation Regarding Administration of Charitable Assets

(a) Registration

All organizations formed under the N-PCL for charitable purposes [FN11] and all non-profit foreign corporations organized for charitable purposes "doing business" or "holding property" in New York must register with the Attorney General (Department of Law) under Section 8-1.4 of the Estates, Powers and Trust Law after having acquired assets used for charitable purposes unless exempt.

The "doing business" standard is most frequently encountered in the context of whether or not a foreign corporation (business or not-for-profit) must qualify to do conduct activities by a filing with the Secretary of State. We think the AG's standards are similar to the standards applicable to the Department of State filing but the AG may take a different position.

Exemptions. Exempt organizations include churches, church-related entities, hospitals, membership entities, educational institutions, museums, libraries and historical societies chartered by the Board of Regents and certain other nonprofits that are exempt from such registration. (See EPTL Section 8-1.4(b)). Although not mandatory, the AG's office now has a procedure for organizations to obtain confirmation of exemption under this law and the Executive Law. The details are set forth on the AG's website.

Timing. Such registration is due within six months after "any property held for charitable purposes, any income therefrom required to be applied to charitable purposes and/or any other income received ... required to be applied to charitable purposes" is received.

Forms/Method of Filing. You register using Form CHAR 410 All of the AG's registration and reporting forms, along with helpful explanatory material, is available on its website (*http://www.charitiesnys.com/registration_reporting_new.html*). While forms are currently only filable by mail, the AG's office is working to implement e-filing.

List of Filers. All nonprofits registered with the Department of Law are searchable on the AG's website (see http://bartlett.oag.state.ny.us/Char_ Forms/search_charities.jsp. The site lists the organization's federal EIN and its DoL registration number, fiscal year, website (if available), address and registration status and all recent filings with the Charities Bureau (including copies of IRS Forms 990 and copies of audited financial statements that have to be filed with the AG's office).

Note that it is illegal for a government agency to give a grant to a nonprofit which has not registered with the AG's office (if not exempt) or which is not current in its filings. In a public presentation in December 2005, the head of the Charities Bureau noted that it may be a breach of a director's fiduciary duty to allow an organization to become delinquent if that jeopardizes a grant.

Other States. Nine other states currently require similar registration (*source:* Marion R. Fremont-Smith, senior research fellow at the Hauser Center for Nonprofit Organizations). This includes registration to solicit charitable donations, discussed below.

(b) Annual Reports

Annual reports are required on Form CHAR 500 (previously known as CHAR 497) or CHAR 500-C (if affiliated entities are filing together) within six months after yearend (extensions can be obtained upon application) unless the organization had less than $25,000 in assets and/or cumulative gross receipts for the reporting period (it must then file a notice of exemption, however). Private foundations also have to file lists of securities owned. Copies of the federal annual information return on Form 990 (or 990-PF) must also be submitted.

2. Registration Regarding Charitable Solicitations

(a) Registration

Most all charitable organizations intending to solicit and receive charitable contributions "from persons in this state" must submit a Charities Registration Statement under Section 7A of the Executive Law (also found on Form CHAR 410) unless exempt. The AG's office at a public session in December 2006 confirmed that in their view, and the joint view of the Charleston Guidelines (Guidelines on Charitable Solicitations Using the Internet) issued by the National Association of State Charities Officers (NASCO) (see Nasconet.org), contributions generated by internet contacts are considered contributions triggering this requirement.

Exemptions. As with the EPTL, exempt organizations include churches, church-related entities, hospitals, membership entities, educational institutions, museums, libraries and historical societies chartered by the Board of Regents and certain other nonprofits but note that for the Executive Law exemption to apply in many instances (*e.g.*, schools, museums and libraries), the institution must file annual financials with another regulator (such as the Education Department) or be organizations (such as historical societies or other membership organizations) [FN12] that confine their solicitations to its members. *See Executive Law Article 7-A, Section 172.a.2*.

Dual Filing. Note that a dual filing can be made with the filing under the Estates, Powers and Trust Law.

Timing. While the filing under the EPTL can be made as late as six months after the entity acquires charitable assets (which is usually some time after its actual formation since donors are usually loathe to make charitable contributions until after the entity has its tax ruling from the IRS), registrations under the Executive Law must be made "prior to any solicitation" but in any event within before it has raised in excess of $25,000 per year (while the forms do not so state, I understand that the AG's office interprets this as being $25,000 raised from New Yorkers or in New York State) (if the organization passes the threshold level unintentionally, it has 30 days after to file) or if the entity uses professional fund raisers,

Disclosure Items. As discussed more fully below, such registration must include the names and addresses of all professional fund raisers, fund raising counsel and commercial co-venturers who "are acting" or "have agreed to act" for the corporation.

Amendments. If there are any material changes in the information included in the registration statement, an amendment form must be filed within 30 days thereafter (I suspect that this requirement is honored more in the breach since most lawyers probably only become active with their clients when annual filings are made, if then, once the organization is off-the-ground).

Substantive Requirements. Certain activities are prohibited under the charitable solicitation law, such as

- the making of material untrue statements or failure to disclose material facts in filings;

• engaging in fraudulent acts;
• using false or materially misleading advertising;
• failing to apply contributions to the specified purposes; and
• engaging the services of professional fund raisers or fund raising counsel (whether directly or through subcontracts) without complying with applicable provisions.

Other States. There is no single national registration for charitable solicitations. The requirements are on a state-by-state basis. 38 other states and the District of Columbia require some form of registration in order to solicit charitable contributions in such state above the applicable dollar threshold for such state (the states that do not require some form of registration are Delaware, Idaho, Indiana, Iowa, Montana, Nebraska, Nevada, South Dakota, Texas, Vermont and Wyoming). Some states require registration for just certain categories of solicitors (for example, in Texas people raising money for uniformed officers must register). There is a common application (see *http://www.multistatefiling.org/index.htm#what*) used by 36 of the 40 registration jurisdictions (Colorado, Florida and Oklahoma do not participate) but note that it tries to blend the requirements of all 36 filing states and is awkward to use if you only intend to solicit in a few states. In addition, there are riders for some of the states. If you only intend to solicit in New York (or New York initially), it is easier to start with the New York filing.

While most soliciting not-for-profit corporations should probably register in most, if not all, of the 40 states (if their campaigns are by mail, phone or internet to a broad base of potential donors and they aim to raise more than the applicable state threshold, such as $25,000 per year in that state), probably most only register in the state where they are chartered, based, have significant operations or regularly host events. It might also be wise to register in the states where board members or staff reside or work if they will be engaging in significant solicitations from their home or office. While there is a uniform registration form, the form must be separately filed in each jurisdiction with the filing fee and there is no uniform annual report form, which must also be filed separately in each jurisdiction.

Note also that certain written disclosures are required by the various states in connection with solicitations. You may have recalled receiving such disclosures on the backside of a solicitation form or on a separate sheet from national charitable organizations.

There are law firms that specialize in this type of work; in addition, the corporate service company CSC (and probably CT) also provide this service. As of 2006, the CSC fee for new state registrations in all jurisdictions was about $13,000 (with a similar charge for annual state reporting). While the law firms or corporate services companies that oversee these registrations will generally prepare the annual filings, each reporting organization must carefully review the filings for accuracy.

(b) Annual Reports

Annual reports on Form CHAR 500 are due by the 15th day of the fifth month following the end of the fiscal year from every registrant, unless an up to 180 day extension has been obtained (note: it must be sought and specifically granted since it is not automatic upon request like the first IRS extension).

Cancellation for Failure to File. Starting effective in 2006, the AG "shall" cancel the registration of companies which do not file annual reports on time; reregistration will be more costly than the initial registration (the fee is $150 instead of $25). Since the law also requires that notice be mailed at least 20 days before cancellation, it will be interesting to see if the notice will allow the entity to pay-up to avoid cancellation. Note also that the AG's office probably does not have the resources to mail such letters to all nonfilers; a November 17, 2003 *New York Times* article says that one in four charities currently do not file annual reports and "Mr. Josephson [the person then in charge of the Charities Bureau] said the office could not spare the number of employees that were needed to pull 12,000 files, and each of the 12,000 letters would have to be separately typed. Never mind the logistics of handling the responses." The article concludes, however, by noting that he has proposed hiring temporary workers on the grounds that the revenues from delinquents would cover the costs. As of early 2009, the then head of the Charities Bureau Jason Lilien indicated in a presentation to the Committee on Non-Profit Organizations of the City Bar Association that such cancellations have not yet started.

Audit and Review Requirements. The financial statements must be audited for every entity that receives revenue and support in excess of $250,000 and every entity "whose fund-raising functions are not carried on solely by persons who are unpaid for such services" and they must be "reviewed" if the revenue was at least $100,000 but not more

than $250,000. If the entity was registered but did not need to be, or if it did not receive any contributions that year, it has to file a form stating the nature of the exemption or that the entity did not receive any contributions, alternatively, it can deregister.

(c) Regulation of Fund Raising Professionals and Commercial Co-Ventures

New York has long required registration of fund raisers under the Executive Law and regulated the dealings between those people and the not-for-profits for which they work. The requirements included the need to have contracts with such persons set out in writing and filed with the AG. This has long been an area of great concern, since many fund raisers take inordinate percentages of the raised funds as their compensation. These laws regulate the actions of "professional fund raisers" (PFRs), "fund raising counsel" (FRCs) and "commercial co-venturers."

Note that the laws do not apply to corporations organized under the Religious Corporation Law and "other religious agencies and organizations, and charities, agencies, and organizations operated, supervised, or controlled by or in connection with a religious organization." Similarly, educational organizations solely soliciting students, alumni, faculty and trustees and their families and fraternal, patriotic, social, alumni, law enforcement support organizations and historical societies chartered by the Board of Regents when solicitation is confined to membership, as well as educational institutions or libraries that file annual financial reports with the regents of the university of the state of New York under the Education Law (or a similar agency in another state) are exempt. There are a few other exemptions set forth in the Executive Law or in the implementing regulations issued by the Department of Law (for instance, the regulations exempt hospitals, skilled nursing facilities and diagnostic/treatment centers).

For an AG-prepared guide on engaging PFRs or FRC, see http:// www.charitiesnys.com/pdfs/charities_raising_funds.pdf. An explanation of the registration requirements is available from the AG's office as Form CHAR009, available at http://www.charitiesnys.com/pdfs/char009.pdf). Copies of Article 7-A of the Executive Law are available at http:// www.charitiesnys.com/pdfs/statute_booklet.pdf and related regulations are available at http:// www.charitiesnys.com/pdfs/ProposedCharities-0000000Regulations-0000000March-icable provisions of Article 7-A are found in Sections 173 -175 and the applicable provisions of the regulations are found in Part 93).

There are separate provisions relating to the solicitation of funds for relief of specific individuals.

In the wake of the corporate governance scandals, even stricter rules regarding charitable solicitors were put into place in 2005. The proposals which were initially floated would have required all not-for-profits engaging charitable solicitors to get at least three bids before signing a contract and to require each director to review each bid before approving the agreement and to impose a three-fourths board approval requirement for contracts giving the entity only a small percentage of the contributions. These proposed requirements, however, were dropped after great protest, although they may be added in the future (*The Chronicle of Philanthropy*, May 1, 2003, p. 27).

The New York AG has attempted to crack down on solicitations that result in only a small portion of the raised funds being used for charitable purposes. The Department of Law issues an annual report *Pennies for Charity* of telemarketers practices; the report for 2006 indicated that solicitors keep on average more than two-thirds of the raised funds. The Better Business Bureau's Best Practices Standard says that no more than 35% of the funds raised can be kept by the fund raiser and I have been advised that the NY AG's benchmark is 30%. [FN13] States have tried to limit the percentage of funds that a professional fundraiser can keep but have, so far, been rebuffed in their efforts to do so on constitutional grounds.

Categories of Fund Raising Professionals and Co-Venturers:

- **Professional fund raisers** - persons who, for compensation, plan, manage, conduct, carry on or assist in solicitations (or employ people who do that), or actually solicit for the charity, or advertise that the purchase of goods, services, etc. will benefit a charitable organization (if not a commercial co-venturer).
- **Fund raising counsel** - persons who, for compensation, consult with the charity or plan, manage, advise or assist with respect to solicitations but do not have access to contributions or authority to pay related expenses and do not actually solicit. Grant writers and professional event planners are currently considered fund raising counsel although the Charities Bureau had announced in December 2006 that it proposed to issue an exemption for grant writers; as of May 2009 no formal proposed change had been made. (Under the statute, *bona fide* officers, employees or volunteers of the charity are not considered professional fund raisers or fund raising counsel; directors are not considered professional fund raisers but are not technically exempted from the fund raising counsel responsibilities.)

• A **commercial co-venturer** - persons who, regularly and primarily engaged in trade or commerce other than in connection with raising funds for charities who advertise that the purchase of goods, services, etc. will benefit a charity. This may be an unknowing trap for companies that want to say "a portion of your purchase price will be donated to XYZ charity," but there are no registration requirements and the substantive and reporting requirements are not strenuous.

Registration and Soliciting Requirements. The following rules apply:

• Professional fund raisers *(on Form CHAR013, available at http:// www.charitiesnys.com/pdfs/char013.pdf)* and fund raising counsel *(on Form CHAR014, available at http://www.charitiesnys.com/pdfs/char014.pdf)* must be registered with the AG. PFRs must be bonded for $10,000 (*on Form CHAR015, available at http:// www.charitiesnys.com/pdfs/char015.pdf)*. Registration is annual; the filing fee is $800. Professional solicitors in the employ of a professional fund raiser must also be registered on Form CHAR012 *(available at http:// www.charitiesnys.com/pdfs/char012.pdf*); registration is annual, with an $80 filing fee. Copies of a PFRs and FRC's registration statements and contracts that it has filed are available through the AG's Albany office or from the professional.

• Contracts with professional fund raisers, fund raising counsel and commercial co-venturers must be in writing. The contract must include the name, address and NYS registration number of each party; state clearly the beginning and ending dates of the contract; provide a clear description of the services to be performed and the financial terms; note the right of the charity to cancel the contract without cost, penalty or liability within 15 days after the PFR or FRC files the contract (or at any time if the contract is not filed); and have dated signatures. A copy of the agreement must be filed by the PFR or FRC within ten days after being entered into (on CHAR016, available at http:// www.oag.state.ny.us/bureaus/charities/pdfs/char016.pdf). Such contracts must be terminable by the charity with or without cause within 15 days after it has been filed (or at any time if not filed); no filing is required for contracts with co-venturers. Note that the AG's office will review the filings and delay effectiveness of registration until it is redone correctly. The AG's office has a form of rider (CHAR 016A, available at http:// www.charitiesnys.com/pdfs/ char016.pdf) that includes certain state-mandated language; while that language can appear in the text of the basic contract the AG's office will want to make sure that it is exactly as required; therefore it may be better to use the attachment instead of integrating the documents. The charity and the professional are required to keep copies of the contract for three years after the completion of its term.

• Each PFR and FRC must provide written confirmation to the charity that it is in compliance with the registration requirements.

• All soliciting material must use the charity's exact name as registered with the AG; accurately describe the charity and its activities and the purposes for which the solicitation is made; include language that the charity's most recent annual financial report is available from the charity or the AG's office; and include the name of the PFR and a statement that the PFR is being paid to solicit. Oral presentations must be reduced to writing and also filed with the AG; changes in oral presentations have to be filed within five days after the change.

• No services can be performed by the PFR or FRC [FN14]) until it has received an acknowledgement that the contract was filed from the AG's office or the contract has been on file for at least 15 days but if the AG raises questions within that 15 day period, no services can be performed until alleged deficiencies are addressed.

• All gross revenue received by the PFR has to be given to the charity or deposited in a bank account exclusively controlled by the charity within five days, without any deductions. Within 90 days after the termination of contracts with a PFR (or, if the contract goes beyond a year, at least annually), closing statements (or interim statements) have to be filed by such PFR with the AG on a form CHAR037 (*available at http://www.charitiesnys.com/pdfs/ char037.pdf*); such statements must disclose gross revenue, expenses and all funds paid to the fund raiser and to the charity.

• The PFR's or FRC's records must be available for audit by the charity.

• All advertising that a sale of goods, services, entertainment or any other thing of value will benefit a charitable organization must set forth the anticipated portion of the sales price, anticipated percentage of the gross proceeds, anticipated dollar amount per purchase, or other consideration or benefit the charitable organization is to receive except that advertising for sales by a charitable organization that has not used the services of a professional fund

raiser or commercial co-venturer in any way for the sale shall not be subject to such requirement. In other words, you cannot say "a portion of the purchase price will go to charity." Commercial co-venturers must provide to the charity within 90 days after the termination of a sales promotion an accounting stating the number of items sold, the dollar amount of each sale and the amount paid to the charity; if the effort is longer than a year, such report must be provided at least annually. A charitable organization which enters into a contract with a commercial co-venturer must file with the AG, on the date that its next financial report is due to be filed (a) a list of the names and addresses of all commercial co-venturers authorized by the charitable organization to use its name during the year covered by that financial report and, if known, during the year following the year covered by the financial report, (b) a statement of the financial terms and any conditions of each co-venture contract, and (c) a statement whether each commercial co-venturer has provided the charitable organization with the required accounting.

• The rules apply to both resident and non-resident fund raising entities and persons.

Enforcement. These rules are enforced by the AG, who can bring special proceedings seeking injunctions, cancellation of registrations, restitution, damages, costs, removal of directors or persons responsible for violations of law, dissolution of the entity or other proper relief. The AG can also assess civil penalties of not more than $1,000 per act or omission provided that prior notice and at least 30 days to cure has been given.

VII. SIGNIFICANT CHANGES

While New York has lessened the need for Attorney General or court approval upon the formation of a not-for-profit, such approval is required for certain fundamental changes in the nature of the entity, such as certain amendments of its formative documents, sales of certain assets, mergers or dissolution.

Note that the Charities Bureau adopted certain expedited procedures in 2009 to assist not-for-profit corporations and religious corporations that are in financial distress or are subject to foreclosure proceedings. These fast track procedures apply to proposed mergers, sales, *cy pres* applications and other matters that require court approval on notice to the Attorney General. To qualify for expedited review, an organization must demonstrate to the Attorney General's satisfaction that (1) there is an immediate threat to the financial viability of the organization or its programs, and (2) without expedited review, it is likely that the organization will discontinue a charitable program that provides a substantial benefit to the public; default on a mortgage or other secured financial obligation; incur a lien, attachment or other encumbrance on its property that will impair the organization's ability to carry out its charitable purposes; cease operations, dissolve or declare bankruptcy; or suffer other adverse consequences that are similar in nature and severity to the above. *For further information, see http:// www.charitiesnys.com/pdfs/expeditedreviewinstructions.pdf and the request form at http://www.charitiesnys.com/pdfs/expedited-review-0000000request-form.pdf.*

1. Amendment of Certificate of Incorporation

(a) ***Changes Not Requiring Amendment.*** Certain changes in the operation of the entity can either be effected by Board action or by amendment to the by-laws; these can be made without third party approvals.

(b) ***Changes Requiring Amendment***. Other changes, such as a change of name, purpose or power, must be effected by amending the certificate of incorporation. As with for-profit companies, changes in the charter can be effected by certificates of corrections (for typographical mistakes, see Section 105), certificates of change (for address or agent changes, see Section 803-A), or certificates of amendments or restated certificates of incorporation (see Section 803).

(c) ***Approvals Required***. Many changes of the certificate of incorporation require that you obtain state approvals.

(i) Changes in purposes or powers for type B and C companies (whether additions, deletions or modifications) must be approved by the Attorney General and a Justice of the Supreme Court for the county in which the entity has its primary office. See Section 804(a)(ii). When the statute refers to both levels of approvals, understand that it is really the AG approval that counts since the Supreme Court justice will usually rubber stamp it. But you will have to go through the process of submitting a petition to approve the amendment and some counties will require that you purchase an index number.

(ii) Any agency whose consent was required for the formation must also consent if the amendment adds, changes or eliminates a "purpose, power or provision the inclusion of which in a certificate of incorporation requires consent or approval" of a governmental body or officer **or** if the amendment changes the name of such corporation. See Section 804(a)(i). While you can easily determine if the change is of a "purpose" or a "power," there may be ambiguity regarding other "provisions the inclusion of which ... requires consent" and it may be necessary to coordinate with

the applicable regulatory agencies before filing the certificate of amendment to ascertain if agency consent will be required.

A primary concern of the Attorney General's office is to ensure that funds raised to carry out the old purpose are not diverted to a different purpose. If the restatement of purposes can be shown to merely be a better way to phase the initial purposes, you should have no problems. If, however, totally new purposes are being added, assurances will have to be given to prove that the previously-raised funds will not be used for the new purpose, at least without the approval of the donors. It is advisable to include along with the proposed certificate of amendment an affidavit of a knowledgeable company officer to the effect that "old" funds will be used for "old" purposes and "new" funds will be used for "new" purposes. The key consideration here is the intent of the donors: what would the donors want to do? This can be analogized to *cy pres* proceedings where you try to show to get approval to diverge from the restrictions in a bequest by showing that such restrictions can no longer practically be carried out and that, had the donor known that, here is what he would have done.

(d) ***Submission of changes to certificate and by-laws to the IRS and DOL.*** Changes in the charter, as well as changes in by-laws, must be sent to the IRS along with the next annual report and changes in purposes may trigger a review by the IRS as to continued tax-exempt status. The nonprofit may want to advise the IRS sooner, however, about name changes so that the new name is correctly reflected in the IRS records (especially the cumulative list of organizations that donors consult to confirm that their donations will be tax deductible).

If the organization is registered with the Department of Law, it will also need to be advised of any change of name by an Amended Registration Statement (CHAR410-A), which is due within 30 days after the change. A change in address does not require an amended registration statement but the change will need to be noted in the next annual report. Other changes should be noted in the annual filing.

2. Sale of All or Substantially All of the Assets and Mergers and Consolidations

(a) ***Board Approval***. The board of each organization as well as two-thirds of the members of the not-for-profit voting on the matter at a meeting at which a quorum is present, if the entity has members, must approve the sale of all or substantially all the assets of a nonprofit or its merger or consolidation with another corporation.

(b) ***AG and Court Approval.***. Approval of the Department of Law and Supreme Court is required for the sale of all or "substantially all" of the assets of Type B or C entities (see N-PCL Sections 510-511) and for the merger or consolidation of not-for-profits, or (less common) a for-profit and a non-for-profit, if one of the parties is a B or C (or the resulting consolidated entity will be a B or C) (see N-PCL Section 907). *The New York Attorney General's office has helpful guides on these topics (see http:// www.charitiesnys.com/pdfs/sales.pdf for the asset sale guide and http:// www.charitiesnys.com/pdfs/mergers.pdf for the merger guide)*.

Note that there is no numerical or other arithmetic test for what constitutes "substantially all" of the assets. The AG's office notes in its guide that the condition is triggered when the assets to be sold constitute "a large proportion of the corporation's total assets" or where the sale "may affect the ability of the corporation to carry out its purposes" regardless of the percentage of assets to be transferred. *See its comment at http:// www.charitiesnys.com/faqs_sales_new.html*: "There is no arithmetic test for determining how much is substantially all. We use a common sense approach. If the asset in question constitutes most of the corporation's assets, court approval should be obtained. Even if the asset is a small percentage of the corporation's total assets, if the transaction will affect the ability of the corporation to carry out its corporate purposes it is considered to be substantial and court approval should be obtained. If the asset is the corporation's main premises or a house of worship, court approval should be obtained. When in doubt, it is prudent to obtain court approval."

Mortgages do not generally need to obtain court approval as the sale of substantially all the assets but certain financing transactions (such as Industrial Development Authority bond financing transactions) require the lease or conveyance of property serving as collateral for the loan. If such property constitutes all or substantially all of the corporation's assets, court approval is required for the transfer or lease in connection with the mortgage. Religious corporations require court approval under RCL § 12 for mortgages of any of its real property, unless the mortgage is a purchase money mortgage. *See http://www.charitiesnys.com/faqs_sales_new.html.*

Venue is determined by the county in which the corporation's principal office is located and where it carries out its corporate purposes.

The court must find that

- the consideration and terms of the transaction are fair and reasonable to the corporation,
- that the purposes of the corporations and the interest of the members will be promoted by any merger and
- that the proceeds of any sale will be used for the corporation's purposes.

While the need for appraisals is not noted in the statute, the AG's office will insist on an independent appraisal (or possibly two appraisals if the transfer is not arms length or is to a director, employee or other person with some connection to the transferor) for the sale of assets; appraisals of real estate must usually be based on at least three comparables. This is true even when the transfer is to another charity and the cost of the appraisal will result in a reduction in the value of the assets to be transferred. Appraisals are not required in connection with sale of real estate by one solvent religious corporation to another solvent religious corporation.

There were two key cases on regarding the fairness of such sales. See *Manhattan Eye, Ear & Throat Hospital v. Spitzer* (N.Y. L. J, December 9, 1999 at p. 25 (Sup. Ct., N.Y. County) and *Rose Ocko Foundation, Inc. v. Lebovits* (259 A.D. 2nd, 685, 686 N.Y.S.2d 861, Second Department, 1999):

- The first case involved the proposed merger of Manhattan Eye, Ear & Throat Hospital with Memorial Sloan Kettering Cancer Center, where the AG opposed the merger and the court held that the statutory criteria were not met. The court enumerated factors to be considered in its decision: did the board exercise due diligence in deciding to sell, selecting the purchaser and negotiating the deal; were the procedures used in making its decision (including engagement of experts) fair; were conflicts of interest disclosed; and was the value to be received fair.
- In the second case, the not-for-profit contended that court approval was not required for the sale of its real estate because the property represented less than 80% of the value of the entity's total assets; the court held that approval was required, based on a review of legislative history, because the character of the corporation's activities would be fundamentally changed by such sale. The trial court further held that the standards for approval had not been satisfied. The Appellate Division upheld such determination, rejecting a percentage test for "substantiality, saying that qualitative factors were also important where the property in question was the entity's largest and most significant assets and its sale for inadequate consideration would hamper the ability of the entity to carry out its mission. (See William Josephson, "Guiding the Way Through Changes in Charities Law," *New York Law Journal*, September 18, 2000, p. 1).

(c) ***Tax Department Approval***. If the survivor is to be a non-New York corporation, the approval of the state Department of Taxation and Finance will be required. See N-PCL Sections 901-908.

3. Real Estate Transactions

(a) Non-Religious Corporations

While sales of general assets are subject to regulation only if the sale is of "substantially all" of the assets, separate procedures apply to *any* purchase, sale, mortgage or lease of real estate. See Section 509. While court approval is not generally required, no such transaction shall occur unless it has been approved by two-thirds of the "entire board" if the board size is less than 21 or by a majority of the "entire board" if the board is 21 or more. The "entire board" is generally considered to be the size of the board as if there were no vacancies. For instance, if the board size is 15 but there are five vacancies, all of the sitting directors have to approve the transaction.

This is a far more onerous requirement that mere majority approval of the directors in attendance at which a quorum (which can be as low as one-third of the entire board) is present, the general approval threshold for board action. While most boards act unanimously on routine transactions, they may have low quorum levels. Since the approval is specified as a majority or supermajority of the entire board, it is also difficult to have these decisions made by board committees. The statute does not distinguish between lessors and leasees.

I suspect that this requirement is often ignored unless the title company focuses on the issue. Note that real estate transactions are events that frequently trigger the need for legal opinions, meaning that legal counsel has to be especially mindful of this requirement. It may be an especially onerous requirement for nonprofits that routinely lease portions of the their property.

(b) Religious Corporations

There are separate requirements regarding sale of religious property under the Religious Corporation Law n(RCL). See Section 12, which generally requires "leave of the court" (and thus also AG approval) for any sale, mortgage (other than a purchase money mortgage) or lease for a term in excess of five years. The section has different provisions for certain denominations regarding the level of internal approval required. The Department of Law has published a booklet regarding quorum requirements for religious corporations in real property transactions. Note that these Religious Corporation Law requirements also apply to religious corporations formed under the N-PCL, not just to religious corporations formed under the RCL.

4. Dissolution

(a) General

As easy as it is now to form some not-for-profit corporations, it is excruciatingly difficult to "get rid of them." In the for-profit world (or for nonprofits in Delaware), formal dissolution is a relatively simple process (assuming that the creditors have been taken care of and you can file the final years tax return). You can also practically dissolve a for-profit entity "on the cheap" by failing to pay taxes for the proscribed period (two to three years) and then having the entity administratively dissolved - while that does not technically absolve the entity from its past tax liability, in a real world sense no one will be bothering to bring claims after that.

For not-for-profits, however, there are numerous hoops to be jumped. I suspect that a good number of the 50,000 New York not-for-profits shown on the AG's books are in fact defunct but just never bothered to jump these hoops. According to an explanation of the changes to the dissolution law prepared for the State Assembly in 2005, the Attorney General was then conducting a review of more than 12,000 nonprofits that were delinquent in filing their reports. Once an entity has ceased to be active, there are few people left who care to wrap it up right.

(b) Judicial vs. Non-Judicial Dissolution

Most dissolutions are "non-judicial." But that term is a misnomer, since it is still may be necessary to involve the court in the administrative process, although it is not the adversarial proceeding that a judicial dissolution would be. "Judicial" dissolutions involve legal proceedings brought to compel a dissolution. The judicial dissolution procedure must be used if the assets are not sufficient to discharge all liabilities (*i.e.*, the organization cannot pay its debts in the ordinary course of business).

(c) Asset vs. No/Low-Asset Dissolutions

There have historically been two dissolution tracks: **a one-stage process**, conducted primarily through the Department of Law but entailing one trip to the Supreme Court, **if the entity has absolutely no assets** at the time of the dissolution, and **a two-stage process** involving the Supreme Court and Department of Law at two stages, one related to the prior to distribution of assets and one after, **if the entity has any assets**. It was often recommended that if the assets that would be remaining would otherwise be very small, they should be fully dissipated by the time of the filing in order to use the "no asset" approach.

(d) Major Changes in 2006

In 2006 the N-PCL dissolution procedures were substantially revised in an attempt to simplify the process. I say "attempt" since, as will be discussed below, the process for nonprofits is still a disaster, especially for nonprofits with assets. Changes enacted by the legislature and signed by the governor in 2005 (Laws of 2005, Chapter 726, signed October 11, 2005) became effective on April 9, 2006. The new procure does the following things:

- Section 1002 was amended: (1) to allow the single-step no-asset approach to be also used in cases where a corporation has established a small reserve fund not to exceed $25,000 to be expended for "wind-up" expenses (such as legal and accounting costs) and its liabilities do not exceed $10,000 and (2) to provide special procedures for dissolution when there are fewer than three board members available to take such action (as may be the case with inactive organizations).
- Section 1003 was amended to eliminate the requirement for Supreme Court approval of certificates of dissolution (but not plans of dissolution and distribution of assets) for voluntary dissolutions, and instead the Attorney General will be authorized to approve certificates of dissolution under that section. Approvals from other state agencies, if previously required, are still required. While this sounds like a significant step, in truth the court approval process was always somewhat perfunctory, the real review occurring at the AG level.

• Section 1001(b) was amended to add Type D corporations to those which can use the no-asset procedure for dissolutions and to require that, in addition to stating that the no-asset dissolving corporation has no assets, a corporation pursuing a no asset dissolution must also state in its plan of dissolution that it has no liabilities.

• A new Section 1001(c) was added to set forth and clarify the required contents of a plan of dissolution for Types B, C and D corporations with assets.

• New Section 1002-a was added to require the corporation to carry out its plan of dissolution and distribution of assets before it files its certificate of dissolution with the Secretary of State and limits the period for winding-up the corporation's activities to 270 days, so that the Attorney General and other effected parties may be assured that the winding up period does not drag on and that any charitable assets can be devoted to appropriate charitable use. If there is good cause for delay, however, the Attorney General may extend such time.

• The new legislation also added a new Section 1414 which authorizes the dissolution by proclamation of the Secretary of State of a corporation formed pursuant to the N-PCL that has failed for a period of at least five years to file its annual report with the Attorney General pursuant to Section 8-1.4 of the Estates, Powers and Trusts Law and Article 7-A of the Executive Law. (Note, however, that organizations which never registered, even if they were required to register, are not subject to such dissolution procedure.)

The procedure to dissolve nonfilers is complicated, however. Prior to certifying a corporation for dissolution by the Secretary of State, the Attorney General must send a certified mail notice to such corporation during each of the prior two years. The Attorney General also must use "reasonable diligence" to identify a current address for such corporation and at least one certified mail notice must be sent within six months of the Attorney General's certification. The amendment requires that the names of the dissolved corporations be reserved by the Secretary of State for one year and permits a corporation, with the consent of the Attorney General, to be reinstated if it has filed all delinquent annual reports.

If any corporation dissolved by proclamation has assets at the time of dissolution, the Attorney General is authorized to act in accordance with Articles 10 and 11 of the NPCL with regard to such assets.

We should soon start to see some dissolutions pursuant to this procedure if the AG's office has carried through on the two year notice procedure.

Note that public cemetery corporations are excluded from the provisions of the simplified no-asset dissolutions and dissolutions by proclamation.

There is currently a large backlog of dissolution applications pending with the AG's office, both no- (or low-) asset dissolutions and asset dissolutions. Some of this is probably because people were holding off on dissolutions under the old rules and now view the procedure as being more favorable for dissolutions. But the backlog is also due to the fact that now much more material must be prepared or obtained earlier (such as material from the intended recipients of the organization's funds) for attachment to the plan for nonprofits with assets (see the list below under "Board Approval of Plan of Dissolution") and the new process has created more confusion.

We also understand that sometimes the AG's office overseeing dissolutions now encourages nonprofits to transfer assets of the organization to a distributee prior to dissolution (using the procedure noted above for transfers of all or substantially all of the assets) instead of making distributions in liquidation since they think the procedure for approval of such distributions works smoother than dissolution; whether this is so is questionable since the division that reviews such transfers can also tightly review the process (as noted above). Whether such transfer could take place without a payment by the transferee is unclear since the court must find that the consideration and terms of any sale transaction to be fair and reasonable to the corporation. The organization that uses such procedure, after such distribution, then can proceed to dissolution using the no or low asset procedures.

(e) Steps to Follow

The following is a brief summary of the steps that must be followed in any dissolution:

(i) Board Approval of Plan of Dissolution. In each approach, the board first adopts a "plan of dissolution and [if applicable] distribution of assets" (if it has no assets, that should be stated). The plan must now, under AG rules (not part of the new statute) include the following detailed information:

• a list of governmental consents that are required (see below);

• if the entity has assets, a description "with reasonable certainty" of such assets and their fair market values;

• a list "with reasonable certainty" of the total amount of debts and other liabilities incurred or estimated by the Corporation, including the total amount of any accounting and legal fees incurred or estimated in connection with the dissolution procedure (note that actual payments must not exceed any estimates, so estimate high);

• if it has assets, a description of to whom the assets are to be distributed and, for each distributee, the plan must have attached the following items:

• a certified copy of its certificate of incorporation (as amended);

• a certified copy of its by-laws;

• its letter of determination for the Internal Revenue Service;

• the financial reports it filed with the New York Department of Law for each of the last three years *[Query what is to be provided in the entity is exempt from such filings, as is the case with most religious and educational entities]*; and

• a sworn affidavit from its director and officer stating the purposes of the organization and that it is currently exempt from federal income tax.

This requirement for detailed distributee information can prove problematic. While technically the AG-s procedure requires that all the required submissions be made with the initial application, we understand that it will accept some of such information in installments if it is not available at the time of the initial submission.

(ii) ***Member Approval***. Approval by two-thirds of the members voting on the plan at a meeting at which a quorum is present is also required if the entity has members.

(iii) ***State Agency Consents***. If any state agency, etc. consented (or waived consent) to the formation of the company, its consent is required for its dissolution. A request to the New York Department of Law is not required even if its consent was required at formation (as it was in the past) since the additional procedures will address the AG's concerns. (The New York Department of Law has advised us (in January 2006) that it will still require consent for dissolutions if the agency in question initially waived consent). Copies of such approvals are attached to the plan.

(iv) ***Notice to Attorney General (if no/low assets)***. If the entity has no assets (or, as now, up to $25,000 in assets provided that such assets will be used in the dissolution process), a certified copy of the plan, along with the current certificate of incorporation, is given to the Attorney General within ten days after the plan has been "authorized" (which means that the plan was adopted by the board and, if necessary, members and all required agency consents, such as those from Education Department, have been obtained). (Note that all submissions to the AG under either procedure are to be sent to its office in the county in which the dissolving corporation is located; addresses can be found on the AG's website.) The AG's office will review the company's financial filings to confirm that it meats the "no asset" or "low asset" threshold so it may be necessary to file a current years financial report earlier than otherwise required.

(v) ***AG and Court Approval for Plan of Dissolution and Distribution of Assets (if assets)***. If the entity has assets, you must prepare a verified Petition for Order Approving Plan of Dissolution to the New York Supreme Court (in the county where the organization's main office is located) along with a form of order. These are sent with the necessary exhibits to the New York State Attorney General's office for review. If the AG approves, it will return the order with its signature. The AG's office will focus on the dissolving nonprofit's past three years of annual reports (doing at the end of the organization's life what it should have done while it was alive). The petition is then submitted to the court; it will be necessary to buy an index number and some districts may also require a Request for Judicial Intervention. The court reviews the papers to ensure that the requirements of the charter and applicable law are adhered to. No hearing is usually required if the AG approves.

(vi) ***Notice to Creditors***. There is an optional procedure to provide notice to all known creditors and to unknown creditors by publication. The procedure also applies to creditors with unliquidated or contingent claims. The notice must specify a date at least six months after publication by which claims need to be submitted. There is also a procedure for court resolution of disputed claims. Claims as to which a response has not been received from the creditors by the due date shall be barred unless the claim was in litigation, subject to the ability of a court to allow the claims against remaining assets for good cause shown. No notice of tax claims is allowed. Laborer's claims have preference after any valid liens. See Section 1107.

(vii) ***Distribution of Assets***. Within 270 days after the order is signed, the company must complete its liquidation, pay its liabilities, distribute its assets and windup its affairs. (Previously distribution of assets could occur after the

certificate of dissolution was filed.) There are procedures for the payment of unknown or unlocatable creditors and for obtaining extensions between 30 days and one year on the 270 day period for good cause shown.

(viii) ***Advising AG of Distribution***. The company advises the AG's office that it has carried out the plan and provides a final financial report showing a zero balance in assets and liabilities.

(ix) ***Certificate of Dissolution***. The corporation then prepares and signs a verified petition which it submits to the AG seeking approval of the certificate of dissolution. If the AG approves, it will endorse the original certificate and return it.

(x) ***State Tax Commission Consent/Filing With Department of State***. After the Attorney General consents to the certificate of dissolution, the consent of the State Tax Commission must then be obtained. To do this, send the certificate of dissolution along with a completed Application for Exemption From Corporate Franchise Taxes (CT-247), if not previously obtained, and the Department of State's filing fee for the certificate (currently $30). The tax department will then forward the certificate and filing fee to the Secretary of State's office. Alternatively, you can request the Tax Commission to return the approved certificate for filing yourself.

(xi) ***File with Department of State***. The certificate of dissolution is submitted to the Department of State, which provides a receipt.

(xii) ***Submit Filing Receipt to AG***. A copy of the Department of State receipt is sent to the AG's office

(xiii) ***File with IRS***. The company files its final report, along with copies of the certificate of dissolution and Department of State receipt, with the IRS.

(f) Comparison with Dissolution Procedures in Other States

It is interesting to contrast the procedures that must be followed in New York with those in Delaware and California. In Delaware there is no onerous requirement for any governmental agency clearances (see G.B.L. Sections 275 and 276).

In California, the Attorney General's review seems to be limited to the issue of whether the remaining assets are being transferred to carry out a purpose consistent with the organization's stated purposes. The only information that is required about the transferee is its name, address, and telephone number, an itemized list of assets to be distributed by type and value, the proposed date of distribution, any restrictions on the use of the assets and the proposed recipients charter or trust instrument, along with the dissolving corporations IRS Form 990 (or other financials) for the last three accounting periods, all of which are provided by letter. The proposed transferee has to have a similar purpose, a similar IRS exemption and be current in its California reporting.

(g) Judicial Dissolution

To start such a proceeding a verified petition would be submitted to the State Supreme Court by either

(a) the Attorney General if

(i) the corporation was formed through fraud or concealment of a material fact,

(ii) the corporation exceeded its authority or forfeited its charter or carried on business in a fraudulent or illegal manner or abused its powers contrary to public policy or

(iii) as otherwise allowed by the N-PCL or other laws,

(b) by a majority of the directors then in office or by a the members pursuant to a vote of a majority of the members if the assets are not sufficient to discharge the liabilities or dissolution would be beneficial to the members, or

(c) by 10% of the members or any director if

(i) the directors or members are deadlocked or

(ii) there is internal dissension between groups of members, or

(iii) certain directors or members have looted or wasted the assets, perpetuated the organization solely for personal benefit or otherwise acted in an illegal, oppressive or fraudulent matter or

(iv) the corporation is no longer able to carry out its purposes. It is interesting to note that creditors do not have a right to institute dissolution.

The Attorney General is a necessary party. The court's order to show cause will be published and copies will be served on the state tax commission and each creditor. The court will hold hearings as specified in the order to show cause and issue its decision. The court may appoint a receiver, who may be a director, officer or member of the corporation. The AG says that judicial dissolutions have to be used if the entity is insolvent, as an alternative to federal bankruptcy. These proceedings are rare. See Article 11 of the N-PCL.

The following steps would need to take place in connection with a dissolution for insolvency (other provisions may apply for other judicial dissolutions):

(i) ***Approval of Dissolution***. The directors would usually authorize the filing of a petition for involuntary dissolution but such meeting is not legally required since a majority of the directors can start the action by institution of a legal proceeding. (See *Application of Gail Kiddie Clothes, Inc.*, 56 N.Y.S.2d 117 (1945).

(ii) ***Petition for Dissolution***. A verified petition would be submitted to the State Supreme Court for New York County by a majority of the directors then in office. See N-PCL Sections 1102 and 1103.

(iii) ***Role of Attorney General***. The AG is a necessary party. That means that it has to receive all pleadings and can (and will) intervene in the case. See N-PCL Section 1102.

(iv) ***Order to Show Cause***. The court will issue an order requiring the nonprofit and others to show why the corporation should not be dissolved. The court will order the company to provide all relevant information, including assets and liabilities and names and addresses of creditors. The order to show cause will be published and copies will be served on the state tax commission and each creditor. See N-PCL Section 1104.

(v) ***Hearings***. The court will hold hearings as specified in the order to show cause and issue its decision.

(vi) ***Dissolution***. If the court agrees, it will issue an order dissolving the corporation. The clerk of court will then arrange to have the order filed with the Secretary of State and upon such filing the company will be dissolved. See N-PCL Section 1107.

(vii) ***Receiver.*** The court may appoint a receiver, who may be a director, officer or member of the corporation. See N-PCL Section 1111.

VIII. LIABILITY ISSUES

The most likely penalty for illegal actions or erroneous decisions by a trustee or officer of a nonprofit is the sanction of public embarrassment. (I sometimes call this the *New York Times* Rule -- always be mindful of how what you do will read if it is published on the front page of the *Times* or maybe better, the *New York Post*!) This will harm the individual and the institution and will often result in a reduction in the charity's public goodwill and reductions in contributions to the charity. If for no other reason that the loss of good name, those associated with a charity should always be mindful of the need to act in the interests of the charity and the greater good.

But in egregious instances, the trustees and officers of a nonprofit may found themselves facing greater legal liability, either in actions by the IRS, the state attorney general, the nonprofit's members or the nonprofit itself.

1. Attorney General's Supervisory Authority

The Attorney General has broad statutory authority to prosecute and defend legal actions to protect the interests of the State and the public (Executive Law § 63 *et seg.*) and broad statutory authority to "investigate transactions and relationships of trustees for the purpose of determining whether or not property held for charitable purposes has been and is being properly administered." EPTL § 8-1.4(i).

- The AG can issue and enforce subpoenas (EPTL § 8-1.4 (j), (k); Executive Law § 63(12) & 175.2(h); N-PCL § 112(b)(6)) and "may institute appropriate proceedings to secure compliance with ... section [8-1.4 of the EPTL] and to secure the proper administration of any trust, corporation, or other relationship to which this section applies" (EPTL § 8-1.4(m)).
- The AG can also institute a proceeding against a charitable organization that fails to apply "funds solicited from the public in a manner consistent with its charitable purposes or the solicitation for charitable purposes" (Executive Law § 175.2(e)).
- The Attorney General can initiate court action seeking the removal of trustees who authorize, or acquiesce in, inappropriate payments or other benefits to fellow trustees (EPTL 8-1.4(m) & (n)).
- Section 112 of the N-PCL enumerates the rights that the AG has to maintain actions or special proceedings involving not-for-profit corporations, allowing it, among other things, to stand in the shoes of members, directors and officers to enforce such persons' rights, but note that it cannot stand in the shoes of the corporation. For instance, the

willful failure of a corporation to file required state registrations and reports, including reports required by EPTL Section 8-1.4, constitutes a breach of the directors' duties to the corporation, giving rise to a direct or derivative right of action by the Attorney General, and may subject the corporation to judicial dissolution. See N-PCL Section 520.

• The Attorney General can also seek to surcharge individual trustees who have arguably squandered or wasted charitable assets, requesting a court to order one or more trustees to pay restitution to the charitable organization and thereby make it whole.

• Under the N-PCL § 720, the Attorney General may bring an action against directors and officers of a not-for-profit corporation for breach of fiduciary duties (see the discussion of those duties at section VIII below), including mismanagement and waste of corporate assets.

• N-PCL § 720(a)(2) & (3) authorize the Attorney General to bring an action to prevent or set aside an unlawful conveyance, assignment or transfer of corporate assets.

The AG also claims that it has certain common law authority to review the operation of nonprofits. As you know from reading the headlines, the New York AG can be fairly aggressive in seeking to enforce the rights of the members or the public at-large, as most recently highlighted in the action was brought (unsuccessfully) against the former head of the New York Stock Exchange, claiming that he received excessive compensation.

While many nonprofit entities (such as trade leagues, clubs, schools, religious entities, etc.) are freed from the duty to file annual reports with the AG's office, the Attorney General's office will continue to claim enforcement jurisdiction over them, either solely or in conjunction with other organizations such as the Education Department. If another state agency exercises primary jurisdiction, such as that exercised by the Education Department over education companies, the AG will usually defer to any action that the other agency desires to take.

2. Liabilities of Officers and Directors

(a) Fiduciary Duties

The Attorney General is the public officer with primary enforcement authority with respect to the management of charitable organizations and oversees the conduct of the organizations' directors and officers. The Attorney General's legal authority in this area stems directly from the Attorney General's role as the enforcer of the fiduciary duties of the officers and directors. These duties apply whether the particular organization is required to register or is exempt from registration. [FN15]

(i) The duty of care: The duty of care is the level of competence that each board member is expected to exercise. It is often described as the "care that an ordinarily prudent person would exercise in a like position and under similar circumstances." In other words, each board member owes the organization the duty to exercise reasonable care when he or she makes a decision as a steward of the organization. The common law duty of care requires that the trustees, directors and officers of charitable organizations be attentive to the organization's activities and finances and actively oversee the way in which its assets are managed. This includes attending and participating in meetings, reading and understanding financial documents, ensuring that funds are properly managed, asking questions and exercising sound judgment. New York has codified the standard for the duty of care in N-PCL § 717, which provides that directors and officers of not-for-profit corporations "shall discharge the duties of their respective positions in good faith and with the degree of diligence, care and skill which ordinarily prudent [persons] would exercise under similar circumstances in like positions." See also EPTL § 11-1.7, 11-2.2 & 11-2.3.

(ii) The duty of loyalty: The duty of loyalty is a standard of faithfulness -- each board member must give the entity his or her undivided allegiance when making decisions affecting the organization. This means that a board member can never use information obtained as a member for personal gain, but must act in the best interests of the organization. Private interests must not be placed above the charity's interests. The NPCL addresses certain aspects of this duty. For example, the N-PCL requires directors and officers to act in "good faith" (N-PCL § 717), contains an absolute prohibition against loans to directors and officers (N-PCL § 716) and contains restrictions on self-dealing transactions (NPCL § 406 & 715), as does EPTL § 8-1.8.

(iii) The duty of obedience: The duty of obedience requires each board member to be faithful to the organization's mission. He or she is not permitted to act in a way that is inconsistent with the central goals of the organization. A basis for this rule lies in the public's trust that the organization will manage donated funds to fulfill the organization's

mission. The common law duty of obedience includes the obligation of directors and officers to act within the organization's purposes and ensure that the corporation's mission is pursued. There is no explicit reference to the duty of obedience in the N-PCL. However, the duty may be inferred by the limitations imposed upon corporate activities as set forth in the purposes clause of the certificate of incorporation (N-PCL §§ 201, 202 & 402(a)(2)) and the directors' and officers' obligations as the corporate managers of the not-for-profit organization (N-PCL § 701 & 713). EPTL § 11-2.3(b)(3)(B) explicitly refers to the needs of a trust's beneficiaries.

Actions which directors should take to ensure that they comply with these duties include:

• Attend all board and committee meetings and functions, such as special events.
• Be informed about the organization's mission, services, policies, and programs.
• Review the agenda and supporting materials prior to board and committee meetings.
• Serve on committees or task forces and offer to take on special assignments.
• Make a personal financial contribution to the organization.
• Inform others about the organization.
• Suggest possible nominees to the board who can make significant contributions to the work of the board and the organization.
• Keep up-to-date on developments in the organization's field.
• Follow conflict-of-interest and confidentiality policies.
• Refrain from making special requests of the staff.
• Assist the board in carrying out its fiduciary responsibilities, such as reviewing the organization's annual financial statements. [FN16]

(b) Limitation of Liability to Third Parties for Volunteers

Section 720-a of the N-PCL, added in 1986, includes language limiting the exposure of directors and officers of charitable organizations serving without compensation (N.B: the person can receive reimbursement of actual expenses of attending meetings "or otherwise in the execution of such office") against third party claims unless the conduct constituted gross negligence or was intended to casue the resulting harm to the person asserting such liability. This provision does not limit claims by the Attorney General or by beneficiaries of trusts.

(c) Limitations of Liability to the Nonprofit and Other Directors

Under Delaware law, as under the New York law applicable to for-profit corporations, the certificate of incorporation can include a provision eliminating or limiting the personal liability of directors to the corporation or members unless the acts or omissions were in bad faith or involved intentional misconduct, a knowing violation of law or personal financial or other gain. Legislation was introduced in 2009 to add this provision to the N-PCL.

(d) Significant Cases Regarding Fiduciary Liability. Recent cases involving the exercise by the AG of its authority include the following:

(i) ***People v. Grasso***. Attorney General Eliot Spitzer brought a controversial suit against Richard Grasso, the former chairman of the New York Stock Exchange, seeking to reclaim a large portion of his $190 million pay package for his eight years as the Exchange's chairman (which pay equaled 99% of the Exchange's net income for the period, with his compensation one year exceeding four times the net income of the Exchange for that year) on the grounds that Grasso's pay was unreasonable under the state's nonprofit law and that the Exchange's governance procedures related to executive compensation were flawed. While the AG won important rulings at the trial level, decisions by the intermediate appellate court and the Court of Appeals (as discussed below) eventually lead Attorney General Cuomo to drop the case in 2008. Nevertheless, the case heightened public awareness of certain major issues and, notwithstanding the action to drop the case, many commentators believe that the decision did not undercut the AG's authority in more traditional public charity cases.

The AG won a major March 2006 victory at the trial level, in a summary judgment holding that Grasso must return as much as $100 million of his pay plus interest. *People ex rel. Spitzer v. Grasso*, 42 A.D.3d 126, 836 N.Y.S.2d 40, 2007 N.Y. Slip Op. 03990 (N.Y.A.D. 1 Dept. May 08, 2007) (NO. 8719, 401620/04). Key aspects of the trial court decision included the following:

• The trial court found that Grasso, as chairman and CEO of the Exchange, chose those who approved his compensation and he was in charge of the information provided to the board in connection with compensation decisions, such that the compensation committee and the full board was unaware of the full amount of compensation due to Grasso.

• The court also criticized the compensation committee for improper record keeping, failure to follow appropriate procedures, failure to disclose in the minutes full and considered consideration of compensation proposals, and disguising acceleration of about $60 million in benefits in an employment agreement without adequate attention.

• The court also held that a loan from a retirement plan to Grasso was a breach of fiduciary duty in direct violation of a statutory provision barring such loans.

• The court found that Grasso had a duty to keep the board fully informed on matters related to his compensation and that Grasso failed in such duty, finding that ignorance by the board as to the actual value of his compensation was not an adequate defense. The judge held that Grasso had violated all three of the fiduciary duties that a director holds - the duties of care, loyalty and obedience. He specifically found the payment of excessive compensation to be a violation of the duty of obedience, the authority for which was a duty noted on the AG's website inferred from various provisions of the N-PCL. The judge found that the AG had standing, not in a derivative fashion, but in a *parens patriae* role as a representative of the "investing community all of which rely on the integrity of the market."

The Appellate Division for the 1st Department in May 2007, however, on an appeal of Grasso's motion to dismiss, dismissed (by a 3-2 vote) four of six legal claims brought against Grasso, basically on standing grounds, finding that the claims which were not based on provisions of statutory law were not supportable, rejecting the AG's *parens patriae* doctrine. *People ex rel. Spitzer v. Grasso*, 12 Misc.3d 384, 816 N.Y.S.2d 863, 38 Employee Benefits Cas. 1221, 2006 N.Y. Slip Op. 26095 (N.Y.Sup. Mar 15, 2006) (No. 401620/04)

The appellate decision left in place the ability of the state to claim that Grasso (a) violated his fiduciary duty to the stock exchange under N-PCL Section 717 to discharge his duties "in good faith and with that degree of diligence, care and skill ... ordinary prudent men would exercise under similar circumstances in like positions," which can be enforced by the AG under N-PCL Section 720, and (b) was liable under N-PCL Section 720(a)(2) for making an unlawful conveyance of corporate assets "where the transferee knew the transfers were unlawful," (*i.e.*, compensation which was not reasonable since it was not "commensurate with services performed" pursuant to N-PCL Section 202(a)(12)), where the right of the AG to bring such claim is set forth in the statute. While the decision allows these two of the four claims to go to trial, the AG will need to prove that Grasso was aware that he knew that what he is claimed with doing was wrong. Still pending is an appeal by Grasso of the decision at trial granting the government partial summary judgment on the claim that Grasso breached his duty to the exchange.

The four claims that were dismissed:

• sought to force restitution of Grasso's benefits to the Exchange through the establishment of a constructive trust, claiming violation of the unreasonable compensation rules (the court held that this claim was the same as the allowable §202(a)(12) claim without having to prove the essential element that the recipient knew of the illegality of the distribution);

• declared his compensation was "unreasonable" under N-PCL §§ 202(a)(12) and 515(b) and therefore constituted unjust enrichment (the court held this claim to be similar to the prior claim which it dismissed);

• alleged that a majority of the board did not approve Grasso's compensation award under the Capital Accumulation Plan and Supplemental Executive Retirement Plan programs and, therefore, the compensation received as a result of these programs was voidable under §715(f) of New York's not-for-profit law (the court noted that while the employer could avoid the contract if the employee could not "establish affirmatively that the transaction was fair and reasonable." the AG had no specific enforcement powers related to any such potential claim), and

• argued that Grasso improperly received loans in violation of N-PCL §716 due to advance payment of certain lump sum benefits which he was not then entitled to (the court did not find any authority for the AG to bring action against the borrower, although the court noted that the AG could bring action against the directors who approved the loan, subject to their good faith defense, and also noted that that such provision may not be applicable due to a exception in § 1410(c)(2) allowing loans to employees of boards of trade if approved by the board).

The court did note the plenary authority granted by N-PCL § 112 to enforce the rights of members, directors or officers (but, in the case of Type A corporations, subject to court approval) and the right to bring certain enumerated claims under N-PCL §720(b), holding that the listing of such rights implies, under the maxim, *expressio unius est exclusio alterius* [the expression of one thing implies the exclusion of the other], that the AG does not have such right in other cases. The court also noted that while the statute gave the AG the power to enforce rights of members, directors or officers, it did not give the AG the right to enforce the rights of the corporation.

In response to the AG's claims that the four non-statutory causes of action reflect traditional common law powers, the court held that the AG "does not cite any authority supporting the proposition that the Attorney General enjoyed common-law authority to bring causes of action comparable to the four ... causes of action [in this case]." The appellate decision held that "in seeking to impose liability on Grasso without regard to either of the fault-based requirements of the legislative scheme, the complaint brings into sharp focus the fundamental problem with the Attorney General's position: its inconsistency with the principle of separation of powers." The court said that only the legislature could establish causes of action. The court noted that several of the claimed common law powers were even inconsistent with express statutory authority.

Noted corporate law commentator John Coffee is quoted as saying that the decision "is a bigger victory for defendants than most of us expected. Indeed, it may require a legislative response because it seemingly strips the New York Attorney General of most of his prior authority over not-for-profit corporations." Another commentator, James Fishman, a professor at Pace Law School and co-author of the leading treatise on New York nonprofit matters, *New York Nonprofit Law and Practice*, said that the "court is essentially saying what many critics of Spitzer have claimed, and that is that he stretched the power that he had."

The Appellate Division decision was upheld on an appeal to the Court of Appeals unanimously decided (2008 NY Slip Op. 057770,2008 NY Slip Op. 057770, June 25, 2008). This ruling upheld the dismissal of the four common law *parens patraie* claims, holding that the AG "crafted four causes of action with a lower burden of proof than that specified by the statute, overriding the fault-based scheme codified by the legislature and thus reaching beyond the bounds of the Attorney General's authority." As to the two remaining statutory claims, as to which the Appellate Division had not ruled, the court in dicta found such claims to be unwarranted. As to the first, that Grasso's salary did not meet the requirements of N-PCL Section 715(b) that transactions with interested parties be approved by the affirmative vote of a majority of the entire board, the court held that only the corporation, not the AG, has the power under to avoid the contract. On the second N-PCL-based claim, that certain advance payments constitute improper loans, the court found that the AG had the statutory authority to bring an action against directors who approve the loan in violation of N-PCL Section 716, such claim failed since the AG could not overcome a business judgment defense.

Following the Court of Appeals decision, the two statutory claims of the AG against Grasso (and one claim against another director) were dismissed by the Appellate Division on July 1 (*People v. Grasso*, 2008 NY Slip Op 05970; *http://www.courts.state.ny.us/reporter/3dseries/2008/2008_05970.htm by* a 3-1 court decision which turned on the NYSE's transformation into a for-profit corporation as part of its 2006 merger with Archipelago Holdings Inc. The court held that while the attorney general has the authority to police the amount of pay received by nonprofit executives, such authority did not extend to prosecuting such a suit in an effort to return money to a corporation that was now for-profit. Following such decision, the AG's office announced that it would not appeal the case.

For one point of view of the AG's enforcement power post-*Grasso*, see "Enforcement of Charities Laws in a Post-'Grasso' World" by Robert Pigott, *New York Law Journal*, August 4, 2008, *http:// www.law.com/jsp/ihc/PubArticleIHC.isv?id=1202423477760*. Pigott is a former bureau chief and section chief of the Attorney General's Charities Bureau and a member of the team in the Attorney General's Office that investigated and litigated the *Grasso* case; his views are flavored by that perspective. He holds that much of the difficulty of the case was that the nonprofit was not a charity. Had the company been a charity, its merger would have been subject to AG review, meaning that the mootness defense would not have been available. Furthermore, had the company been a charity it would have been subject to IRS scrutiny. Piggott also notes that never before had the AG's office asserted the now-overruled common law grounds for regulatory authority, relying more on the breach of fiduciary duty arguments. He also notes that charitable corporations are subject to the AG's regulatory authority under Section 8-1.4(m)

of the Estates, Powers and Trust Law (EPTL) giving the AG the authority to "institute appropriate proceedings ... to secure the proper administration of any trust, corporation or other relationship to which this section applies." He claims that this would allow claims for "no-fault" excessive compensation against officers or directors of charitable nonprofits. Refuting the dicta by the Court of Appeals to the effect that only the corporation can make a claim under N-PCL Section 715 to avoid contracts with interested parties may be correct as to Type A nonprofits, he states that directors (and members, if any) can derivatively pursue corporate claims and N-PCL Section 11(a)(7) gives the AG the standing to pursue claims of directors as to charitable types of organizations - Types B or C. He further notes that the claims by the AG under N-PCL Section 720, to bring an action against an officer or director of a nonprofit, were held by the Appellate Division to not be derivative (and therefore subject to defenses assertible against the corporation) and were instead in the AG's capacity as the state's chief law enforcement official.

For additional views to the effect that the AG still has great authority on compensation matters, see Ralph E. DeJong and Michael W. Peregrine, "Charities Should Heed New Rulings on CEO Pay," *The Chronicle of Philanthropy*, August 7, 2008, p. 25.

(ii) ***Claim Against Director for Failure to Disclose to the Board Compensation Arrangements for Richard Grasso***. In addition to the case that the AG has brought against former NYSE-head Richard Grasso, it has brought a case against the former chair of the Exchange's compensation committee, Kenneth Langone, seeking restitution of certain compensation under the NYSE's Capital Accumulation Plan that was not disclosed to the board at the time that compensation decisions were being made. In 2008 the Appellate Division, First Department affirmed the trial court's rejection of Mr. Langone's summary judgment motion, saying that the determination in question was a factual matter that needed to be heard at trial. See NYU, April 25, 2008, p. 1. This case was also dropped in 2008, as discussed above.

(iii) ***Removal of Adelphi University Trustees***. In February, 1997, the New York Regents removed 18 of the 19 trustees of Adelphi University for neglect of their fiduciary duties when they approved an excessive compensation package for President Peter Diamandopoulos. *Committee to Save Adelphi v. Diamandopoulos, decision of the Regents of the State University of New York* (February 10, 1997). In a subsequent proceeding brought by the Attorney General against the former trustees, the New York County Supreme Court held that the lawsuit stated claims for relief against defendants, including causes of action against Diamandopoulos for breach of fiduciary duty and claims against the other trustees for reimbursement of the legal fees spent by them on their defense before the Board of Regents. *Vacco v. Diamandopoulos*, Index No. 401253/97 (Sup. Ct. N.Y. County April 6, 1998) The court also denied the trustees' motion for advance indemnification.

(iv) ***United Way***. Beginning in 1992, the Attorney General began investigating news reports of the misappropriation and mismanagement of charitable funds at the United Way of America. When new management took over at United Way in 1995, the Attorney General and United Way entered into an Assurance of Discontinuance that required certain corporate governance reforms at the agency. Separately, the Attorney General sued two former United Way officers for alleged breach of fiduciary duty, seeking, *inter alia*, recovery of funds misappropriated from United Way. In July 1998, the court held that the Attorney General had standing to sue these officers for losses suffered by the not-for-profit entity as a result of their breaches of fiduciary duty and granted the Attorney General's motion for partial summary judgment on the issue of liability based on the two officers' criminal convictions. *Vacco v. Aramony*, N.Y.L.J., Aug. 7, 1998, p. 21 (Sup. Ct. N.Y. County July 13, 1998).

3. Liability for Payroll Taxes

While generally officers and directors of corporate entities are not liable for the debts of the organization, they can be held liable for certain payroll taxes. An employer holds unpaid payroll taxes as a trustee for the government. This includes the employee income tax withheld and the FICA withheld. It does not include the employer's FICA match and any other corporate tax liabilities.

Directors may be liable for the organization's nonpayment of payroll taxes as "responsible persons" under IRC Section 6672 for the tax plus a 100% penalty. Responsible persons can be persons who control disbursements (*e.g.*, a treasurer, executive director, etc.) and persons who participate in important management decisions who can influence those who control funds.

The IRS has sued board members if the board has approved expenditures knowing that trust fund taxes are unpaid. If a corporation is having cash flow problems the board should be active in assuring that such taxes are paid. A resigning officer or director would presumably remain liable for taxes that should have been paid prior to the resignation.

While Section 6672(e) sets forth an exception for nonprofit board members, there are three conditions: the director must be serving in an honorary capacity, the director must not participate in day-to-day operations and the director must not have actual knowledge of the failure. The inclusion of this express exception further shows that the IRS can view directors to be responsible persons. Note also that the exception does not apply if no other person can be held liable.

While Section 6672 creates civil liability (and therefore the burden of proof can be shifted to the individual to show that he is not a responsible person), potential criminal liability also exists for failure to deposit payroll taxes, although criminal charges would more likely be filed if there are other problems as well. For instance, the Fourth Circuit Court of Appeals affirmed a criminal conviction of an employee for failing to pay more than $4.5 million in payroll taxes withheld from the pay of employees of Logan General Hospital. A criminal conviction for failure to pay withholding taxes carries a maximum prison sentence of five years. Such criminal liability seems to be more appropriate where the responsible person was using the unpaid taxes for personal purposes.

Note that if payments are made to the IRS for employee payroll taxes, care should be taken to designate what the payment is for. If the employer does not so designate the payment, the IRS could apply the payment to taxes which are not trust fund taxes, *i.e.*, any corporate tax liabilities or payment of the employer's FICA match, leaving the responsible persons of the employer still liable for the trust fund taxes.

See "Nonprofit Boards Need to be Ever Vigilant When It Comes to Employment Taxes: Expect Increased IRS Scrutiny, by Charity Governance, available at http://charitygovernance.blogs.com/charity_governance/2006/05/charitable_ boar.html). See also Howard Godfrey, "Avoid the Payroll Tax Trap," Journal of Accountancy, *available at http://www.aicpa.org/pubs/jofa/nov2004/godfrey.htm) for more information about the IRS procedure*.

4. Bankruptcy and Liability of Nonprofits in the Zone of Insolvency

Nonprofits can voluntarily file for bankruptcy under the Federal Bankruptcy Code (either using Chapter 11 for reorganizations or Chapter 7 for liquidations). But they cannot be placed in involuntary bankruptcy by their creditors. See Section 303 of the Bankruptcy Act, which says that an involuntary case "may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced." A mouthful, for sure. But a nonprofit is not a moneyed, business or commercial corporation and therefore cannot be subject to an involuntary bankruptcy under the code.

At the time that a for-profit company is insolvent, the fiduciary duties of the directors shift from being owed to the shareholders to being owed to the creditors; when the company is in what is called "the zone of insolvency," such duties may be owed to both the shareholders and the creditors.

Since nonprofits without members don't have any group comparable to shareholders, that analogy does not hold. For charitable nonprofits, which are formed to benefit the broader public, their tax exempt status is dependent on their fulfilling a public mission and therefore it might be appropriate to say that the duty would seem to be still owed to the fulfillment of that mission. Certain commentators, however, say that upon insolvency creditors of nonprofits assume the same risk as creditors of for-profits and therefore the interests of the creditors should be paramount. As a result, such commentators state that the board must consider all constituencies of the nonprofit, including the creditors as well as the beneficiaries of the organization's charitable mission. *See Sherri Morissette, "Intensive Care: Directors' Duties in the Zone of Insolvency: The Quandary of the Nonprofit Corp.,"* American Bankruptcy Institute Journal, *March 2004, http://findarticles.com/p/articles/mi_qa5370/is_ 200403/ai_n21346190/print*.

In one case, regarding the Granada Hills (CA) Community Hospital, the trustees of a California hospital which eventually filed bankruptcy were sued on the theory that they should have filed bankruptcy sooner, thereby saving more of the bankruptcy estate for the benefit of creditors. While the trustees were eventually held not to be liable based on the business judgment rule since they would held to have acted in good faith and took steps that they felt were in the best interests of the hospital, the case has served as a warning shot. *See Karen Sandrick, "Judging Fiduciary Duty,"* Trustee Magazine, *April 2006, a copy of which is available at http://www.trusteemag.com/trusteemag_ app/jsp/articledisplay.jsp?dcrpath=TRUSTEEMAG/PubsNewsArticleGen/data/2006April/0604TRU_FEA_ CoverStory&domain=TRUSTEEMAG:*

"Beyond this, an argument could be made that trustees of an organization that is facing or is in the midst of bankruptcy may be subject to higher standards of fiduciary care. 'There's a real debate in the law, from my perspective, whether the duties do change in the circumstances of a bankruptcy,' Peregrine says. As soon as a corporation enters a period of insolvency, he explains, the directors owe duty partially, if not primarily, to corporate creditors, the thought being that when an organization is insolvent, the creditors become the business's owners. But while some court cases have concluded that this concept applies to directors of organizations in the not-for-profit world, others have not. 'If I were advising a client in that situation,' Peregrine says, 'I would say there's no clear guidance, so assume the worst, assume that you have a much higher standard in terms of your actions in overseeing a failing business organization because the creditors and their counsel will seek to hold you to higher standards.'"

5. Liability of Private Foundations and Managers

As referred to above in discussions of the differences between public charities and private foundations, private foundations are subject to certain limitations on their actions. These rules were imposed starting with the Tax Reform Act of 1969. Frequently proposals are made to apply these same restrictions to public charities but so far nothing has come of that. [FN17]

(a) Self Dealing

IRC Section 4941 prohibits many financial transactions between a private foundation and its "disqualified persons" (*i.e.*, its "insiders" -- officers, directors, trustees, key employees, substantial contributors (those who contribute at least $5,000 and the total amount that they have given exceeds two percent of the total contributions ever received by the foundation, determined as of the end of the tax year when the contribution is made), their family members, corporations, partnerships, trusts or estates in which any of the foregoing has more than 35 percent of the voting power, profits or beneficial interest, and any owner of more than 20 percent of a corporation, partnership or trust that is a substantial contributor) or with unrelated third parties if the transaction provides an indirect financial or economic benefit to a disqualified person

The prohibition covers

(a) sales, exchanges or leases of property;

(b) loans by or to the foundation;

(c) the provision of goods, services or facilities; and

(d) transfers of foundation assets.

Such flat prohibition applies even to transactions that meet all standards of fundamental fairness, even if the proposed arrangement (*e.g.*, substantially reduced rent) is demonstrably better than what can be obtained in the market place.

***Exceptions*.** There are a few exceptions to the definition of self-dealing:

• The disqualified person may give goods, services or facilities to the foundation without charge (e.g., free rent or interest-free loans).

• The disqualified person can be paid reasonable compensation for necessary reasonable personal services to the foundation. This would, for example, cover normal staff employees as well as providers of legal, accounting, investment, banking and brokerage services (the IRS limits personal services to only those services which have been clearly identified in IRS regulations or rulings)

• The foundation can provide transportation, meals and lodging (or reimbursement) to the disqualified person if the expenses are necessary reasonable.

• The foundation can provide goods or facilities to a disqualified person if the terms are no more favorable to the recipient than those on which those goods or services are made available to the general public.

• The disqualified person can receive "incidental and tenuous benefits" derived by a disqualified person from a private foundation's use of its income or assets, such as public recognition or goodwill.

• A private foundation can make a grant to a public charity on which a disqualified person is a director or officer (although such grant should be covered by a conflicts of interest policy).

• Certain transactions in connection with the liquidation, merger, redemption or recapitalization of corporate or partnership entities so long as the securities held by the foundation are subject to the same terms as securities held by others and payment is for no less than fair market value.

• Certain transactions during the administration of an estate.

Excise Tax Imposed. The IRS can impose substantial excise taxes on disqualified persons who engage in self-dealing transactions and on managers of the foundation. The first level of taxes on the disqualified person who engage in the self-dealing transaction with the private foundation is 10% of the amount involved (but the penalty may be imposed for each year until the act is corrected, which may result in a much greater tax liability) and a foundation manager who participated in a self-dealing transaction knowing that it was self-dealing (unless the participation was not willful and was due to reasonable cause) is subject to an excise tax of 5% of the amount involved (not to exceed $20,000 per act). If a self-dealing transaction is not "corrected" within the time allowed, the IRS may then impose a second level of taxes (at the rate of 200% of the amount involved on the disqualified person and 50% percent of the amount involved on a foundation manager -- but not to exceed $10,000); second tier taxes are rare.

Specific Situations. Examples of problematic expenditures include:

• Paying for spousal or family travel costs if the spouse does not independently performs necessary services on behalf of the foundation, the payment is treated as compensation for services to the board member or employee (reflected in a W-2 or 1099), and the total compensation paid to that individual is reasonable.

• Having a private foundation fulfill a legally binding charitable pledge made by a disqualified person.

• Having the foundation buy tickets to fundraising events if the tickets are then provided to disqualified persons or to third parties if a disqualified person thereby benefits unless attending the event furthers the foundation's managers duties for the foundation. This problem has created a major impact on private foundations buying tables at charity events. Note that the problem cannot be solved by having the foundation's disqualified person pay the portion of the ticket cost which is not considered a charitable contribution (*i.e.*, the "value" of the ticket).

• Use of a foundation credit card for personal expenses, even if the disqualified person promptly reimburses the foundation for the expenses since this transaction is considered to be a loan.

• Charging rent, even if at below-market rates.

For more information, see John Edie, Self-Dealing: A Concise Guide for foundation Board and Staff, *published by the Forum of Regional Association of Grantmakers, March 2008, available at http.//www.givingforum.org/s_ borum/ bin.asp?CID=5734&DID-6602&DOC=FILE.PDF*.

As noted above, these rules do not apply to public charities. At most, public charities are subject to certain conflict of interest provisions (see, N-PCL Section 715) or conflicts of interest policies, which generally only require disclosure and abstention. Delaware only requires that the transaction be fair to the corporation. Del. Gen. Corp. Law Section 144. The Model Nonprofit Corporation Act has an optional provision which says that 51% of the directors should be "financial disinterested" and the transaction has to be fair to the nonprofit. Revised Model Nonprofit Corporation Act, Section 8.13 (1988).

IRC Section 508(e) requires states to incorporate these self dealing and certain other private foundation excess tax rules into state law but, according to the former head of the New York Charities Bureau, there are no reported cases of state enforcement (although there is one unreported New York case brought by the Attorney General but the court said that the IRS would have to bring the enforcement action).

In the situation regarding investments by charities with Bernie Madoff, which became a *cause celebre* in 2009, one school invested in a Madoff investment although Mr. Madoff was a trustee of the school. If the school had been a private foundation, it would have fallen afoul of these rules.

(b) Excess Business Holdings Rules

Under I.R.C. Section 4943, holdings of a private foundation or a donor-advised fund in a "business enterprise," together with the holdings of persons who are disqualified persons with respect to that foundation or fund, may not exceed any of the following:

• 20% of the voting stock of an incorporated business

• 20% of the profits interest of a partnership or joint venture or the beneficial interest of a trust or similar entity

Ownership of unincorporated businesses that are not substantially related to the foundation's or fund's purposes is also prohibited.

A "business enterprise" is the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services. This does not generally apply to real property unless it is undeveloped and subdivided for sale. Specifically excluded from the definition are:

- Holdings that take the form of bonds or other debt instruments unless they are a disguised form of equity
- Income from dividends, interest, royalties and from the sale of capital assets
- Income from leases unless the income would be taxed as unrelated business income
- "Functionally-related" businesses and program-related investments
- Businesses that derive at least 95% of their income from passive sources (dividends, interest, rent, royalties, capital gains). This will have the effect of excluding gifts of interests in most family limited partnerships, and other types of holding company arrangements.

The Pension Protection Act of 2006 extended this rule to donor-advised funds. The rules applicable to existing holdings are complex; the funds have five years to divest holdings given to them after the enactment of the law (*e.g.*, closely held companies donated to the fund) that are above the permissible limit.

Excise Tax Imposed. If a private foundation violates the excess business holdings rules, there is a tax of 10% of the value of the excess business holdings. If this excess business holding amount is not transferred prior to the last day of the taxable year, the tax amount may be increased to 200% of the excess business holdings. IRC Sec. 4943(b).

(c) Jeopardizing Investments

Another issue that may come up in today's economy as it affects nonprofits is the liability of the managers of nonprofits for imprudent investment. An article in the *New York Times* (copy available at *http://www.nytimes.com/2009/02/12/business/12tax.html*) addressed the issue of possible tax fines for private foundations that invested heavily in the Madoff ventures. The article, though not giving the citation, was discussing IRC Section 4944 - the so-called "jeopardizing investments" rules. These rules apply to private foundations only, not to public charities.

Definition. Jeopardizing investments generally are investments that show a lack of reasonable business care and prudence in providing for the long-and short-term financial needs of the foundation in its carry out of its exempt function. No single factor determines a jeopardizing investment. The rules for determining whether an investment is "jeopardizing" are vague. According to an IRS website, no category of investments is treated as a jeopardizing investment *per se*, but careful scrutiny is applied to (i) trading in securities on margin, (ii) trading in commodity futures, (iii) investing in working interests in oil and gas wells, (iv) buying puts, calls, and straddles, (v) buying warrants, and (vi) selling short.

The determination is made on an investment-by-investment basis taking into account the foundation's portfolio as a whole. The foundation managers may take into account expected returns, risks of rising and falling prices, and the need for diversification within the investment portfolio. Whether an investment jeopardizes the foundation's exempt purposes is determined at the time the investment is made. If the investment was proper when made, it will not be considered a jeopardizing investment even if it later results in loss. The tax does not apply to investments received as a gift unless the transferor received any payment from the foundation.

The IRS rule is in addition to any other federal or state fiduciary duty obligation.

It is interesting to note that the rule nowhere requires diversification - the failure to diversity seems to have been the prime problem with many Madoff investors -- but it only cites diversification as a possible reason to make an investment.

Exemption for Program-Related Investments. Program-related investments are not considered as jeopardizing investments. To be a program-related investment,

(i) the primary purpose must be to accomplish one or more of the foundation's exempt purposes and significantly further the foundation's exempt activities,

(ii) production of income or appreciation of property must not be a significant purpose (one test of which is whether investors who engage in investments only for profit would be likely to make the investment on the same terms as the private foundation), and

(iii) influencing legislation or taking part in political campaigns on behalf of candidates cannot be a purpose.

The production of significant income or capital appreciation is not, absent other factors, conclusive evidence that a significant purpose is the production of income or the appreciation of property.

Excise Taxes Imposed on Foundation and Managers. Both the foundation and the individual foundation managers (*e.g.*, officers, directors/ trustee of the organization, or others having powers or responsibilities similar to those of an officer or director/ trustee) may become liable for taxes on jeopardizing investments.

An excise tax of 10% of the amount of the jeopardizing investment is imposed on the foundation for each tax year but the foundation can avoid liability if it can show that the jeopardizing investment was due to reasonable cause and not willful neglect, and that the jeopardizing investment was corrected within the correction period (which begins with the date of the investment and generally ends 90 days after a notice of deficiency for the additional tax is mailed). Such corrective steps will be very difficult when the investment has been "lost."

A separate excise tax of 10% of the amount involved is also imposed, on a joint and several basis, on any foundation managers who knowingly, willfully, and without reasonable cause participated in making the jeopardizing investment (but for each such investment such excise tax cannot exceed $10,000 for all managers for such investment). "Knowing" is defined as actual knowledge of sufficient facts, awareness that the circumstances may violate the federal tax law and negligence in attempting to understand the risks involved (the regulations state that "'knowing' does not mean 'having reason to know"' and managers can rely on advice of counsel expressed in a reasoned written legal opinion or written advice of appropriate investment counsel).

If a private foundation is liable for the initial tax and has not removed the investment from jeopardy within the taxable period (which begins on the date of the investment and ends on the earliest of (i) the date the investment is disposed of assuming the proceeds are not themselves jeopardizing investments, (ii) the date a notice of deficiency for the initial tax is mailed, or (iii) the date the initial tax is assessed), an additional excise tax of 25% of the amount involved will be imposed on the foundation and an additional excise tax of 10% of the amount involved will be imposed on all foundation managers who refuse to agree to all or part of the removal from jeopardy within the correction period (but such tax cannot exceed $20,000 for all managers for such investment). The additional tax will not be imposed if the investment is removed from jeopardy within the correction period.

Further Information. *For more information, see: http:// www.irs.gov/charities/foundations/article/0,,id=160678,00.html and http:// www.irs.gov/charities/foundations/article/0,,id-137787,00.html. See also 1988 EO CPE Text: K. Investments That Jeopardize Charitable Purposes, http:// ftp.irs.gov/pub/irs-tege/eotopick88.pdf [note that this was written in 1988 and some aspects are out of date) and Treas. Reg. § 53.4944, available at http://ecfr.gpoaccess.gov/cgi/t/text/text-iax?c=ecfr;sid-77a326aaee32fl490a94e2cll026c787;rgn=div8;view=text;node =2617.0.1.1.3.5.1.1; idno=26;cc=ecfr [note that the* regulations still reflect the 5% initial rate on both the foundation and the manager; the rate was increased to 10% pursuant to the Pension Protection Act of 2006].

(d) Taxable Expenditures

Under I.R.C. Section 4952, if a private foundation spends money on what is called a "taxable expenditure" it owes an excise tax. A taxable expenditure is an amount paid or incurred to:

- Carry on propaganda or otherwise attempt to influence legislation (commonly referred to as lobbying),
- Influence the outcome of any specific public election or carry on any voter registration drive, unless certain requirements are satisfied),
- Make a grant to an individual for travel, study, or other similar purposes, unless certain requirements are satisfied,
- Make a grant to an organization (other than an organization described in section 509(a)(1), (2), or (3) or an exempt operating foundation) unless the foundation exercises expenditure responsibility with respect to the grant, or
- Carry out any purpose other than a religious, charitable, scientific, literary, or educational purpose, the fostering of national or international amateur sports competition (with exceptions) or the prevention of cruelty to children or animals.

Excise Tax Rate. The initial tax imposed on the fund is 10% of the amount thereof and the tax imposed on any trustee knowing that it is a taxable expenditure is 2.5% percent of the amount thereof, unless such agreement is not willful and is due to reasonable cause. If the expenditure is not corrected within the taxable period, there imposed on the fund a tax of 100 of the amount of the expenditure and on the trustee a tax of 50 percent of the amount of the taxable expenditure.

IX. GOVERNANCE ISSUES

1. 33 Principles for Good Governance by the Panel on the Nonprofit Sector.

One good source of practical governance guidelines is the *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations* issued by the Panel on the Nonprofit Sector organized by Independent Sector in October 2007, *available at http://www.nonprofitpanel.org/*). [FN18]

The panel was initially formed to express the opinion of members of the nonprofit sector in response to certain study proposals made by the staff of U.S. Senate Finance Committee in 2004 regarding perceived nonprofit abuses. The panel issued reports to the committee and the nonprofit community in June 2005 and April 2006, offering over 150 recommendations for actions that Congress and the IRS could take to improve the laws regulating nonprofits, as well as educational and enforcement efforts to counter abuse.

Recognizing that many of the problems facing the nonprofit community would be better resolved by voluntary action at the entity level, the panel reviewed standards and principles of over 50 nonprofit self-regulation and accreditation entities and from that review proposed certain "Principles of Self-Regulation" for effective practice by charitable organizations. Two drafts of principles of self-regulation were issued (in January 2007 and in March 2007) and circulated for public comment. Since the initial proposals tended included certain onerous requirements (*e.g.*, board meetings shall be held at least three times per year; the organization should review its mission, organization documents, etc. at least once every three years; the board size shall be no less than five; etc.), the Panel recommended that all nonprofits "aspire to follow" these principles and that all "major organizations" (public charities with at least $1 million in annual revenues and private foundations with at least $25 million in assets) should implement these practices.

The final set of principles (recaptioned "Principles of Good Government and Ethical Practice") was issued in October 2007. The final recommendations are more flexible in nature than were the prior proposals (*e.g.*, eliminating a requirement for a minimum of meetings in favor of the requirement that the board of a charitable organization meet "regularly enough to conduct its business and fulfill its duties;" pushing out the minimum review period from three years to five years; and while recommending that boards be at least five members, noting that this may not be practical for "very small" organizations), instead of proposing separate responses by major organizations and other organizations, the committee now recommends that all charitable organizations conduct a thorough discussion of the complete set of principles and determine how the organization should apply each to its organization, recognizing that a board may conclude that certain principles do not apply to it. It also encourages each organization to develop a "transparent process for communicating how the organization has addressed the principles, including the reasons that any of the principles are not relevant."

In reviewing these principles, other sources of good practices might be considered. For instance, in February 2007 the IRS issued a preliminary staff discussion draft of "Good Governance Practices for 501(c)(3) Organizations." *A copy of the proposal and related discussions can be obtained at http:// www.irs.gov/charities/charitable/article/0,,id=167626,00.html*. In February 2008, [FN19] the IRS announced that it has withdrawn the discussion draft, noting that many of the provisions had been reflected in the new Form 990 that all nonprofits will need to start filing in 2009, the draft generally does not have the force of law. The Committee on Non-Profit Organizations of the City Bar Association issued in 2008 what it calls an Early Action Checklist for New and Smaller Charities.

As will be discussed more fully at Section IX.5, one major change in the redesigned Form 990 is the focus on corporate governance. The new form specifically asks whether the organization has the following written policies in place: conflict of interest, whistleblower, document retention and destruction, policies to ensure consistency in the operation of affiliates, policy regarding reimbursement of business, travel and entertainment expenses, compensation policy, audit policy and financial information disclosure policy. In addition, under the new Part XI, the IRS requires each organization to provide information about the composition and independence of its board. The redesign of Form 990 is a byproduct of the IRS' increased focus on the corporate governance of charitable organizations. IRS officials have repeatedly expressed their belief that the existence of an independent governing board, combined with well designed governance and management policies and procedures, increases the likelihood that an organization will comply with the tax laws.

The 33 principles, and the four categories in which they fall, are:

(a) Legal Compliance and Public Disclosure

1. A charitable organization must comply with all applicable federal laws and regulations, as well as applicable laws and regulations of the states and the local jurisdictions in which it is based or operates. If the organization conducts programs outside the United States, it must also abide by applicable international laws, regulations and conventions that are legally binding on the United States. *[similar to #1 of the January 2007 proposal]*

2. A charitable organization should have a formally adopted, written code of ethics with which all of its directors or trustees, staff and volunteers are familiar and to which they adhere. *[not in January 2007 proposal]*

3. A charitable organization should adopt and implement policies and procedures to ensure that all conflicts of interest, or the appearance thereof, within the organization and the board are appropriately managed through disclosure, recusal, or other means. *[similar to #3 of the January 2007 proposal]*

4. A charitable organization should establish and implement policies and procedures that enable individuals to come forward with information on illegal practices or violations of organizational policies. This "whistleblower" policy should specify that the organization will not retaliate against, and will protect the confidentially of, individuals who make good-faith reports. *[similar to #4 of the January 2007 proposal]*

5. A charitable organization should establish and implement policies and procedures to protect and preserve the organization's important documents and business records. *[similar to #5 of the January 2007 proposal]*

6. A charitable organization's board should ensure that the organization has adequate plans to protect its assets--its property, financial and human resources, programmatic content and material, and its integrity and reputation--against damage or loss. The board should review regularly the organization's need for general liability and directors' and officers' liability insurance, as well as take other actions necessary to mitigate risks. *[not in January 2007 proposal]*

7. A charitable organization should make information about its operations, including its governance, finances, programs, and activities, widely available to the public. Charitable organizations also should consider making information available on the methods they use to evaluate the outcomes of their work and sharing the results of those evaluations. *[similar to #6 of the January 2007 proposal]*

(b) Effective Governance

8. A charitable organization must have a governing body that is responsible for reviewing and approving the organization's mission and strategic direction, annual budget and key financial transactions, compensation practices and policies, and fiscal and governance policies. *[not in January 2007 proposal]* In other words, the board should not dwell on day-to-day matters but instead focus on "big picture" and high liability issues.

9. The board of a charitable organization should meet regularly enough to conduct its business and fulfill its duties. *[similar to #7 of the January 2007 proposal with minimum number of meeting eliminated]*

10. The board of a charitable organization should establish its own size and structure and review these periodically. The board should have enough members to allow for full deliberation and diversity of thinking on governance and other organizational matters. Except for very small organizations, this generally means that the board should have at least five members. *[similar to #5 of the January 2007 proposal but recognizing that very small organizations could have fewer directors]*

11. The board of a charitable organization should include members with the diverse background (including, but not limited to, ethnic, racial, and gender perspectives), experience, and organizational and financial skills necessary to advance the organization's mission. *[similar to #9 of the January 2007 proposal]*

12. A substantial majority of the board of a public charity, usually meaning at least two-thirds of the members, should be independent. Independent members should not: (1) be compensated by the organization as employees or independent contractors; (2) have their compensation determined by individuals who are compensated by the organization; (3) receive, directly or indirectly, material financial benefits from the organization except as a member of the charitable class served by the organization; or (4) be related to anyone described above (as a spouse, sibling, parent, or child) or reside with any person so described. *[similar to #10 of the January 2007 proposal but enlarged]*

13. The board should hire, oversee, and annually evaluate the performance of the chief executive officer of the organization, and should conduct such an evaluation prior to any change in that officer's compensation, unless there is a multi-year contract in force or the change consists solely of routine adjustments for inflation or cost of living. *[similar to #11 of the January 2007 proposal]*

14. The board of a charitable organization that has paid staff should ensure that the positions of chief staff officer, board chair, and board treasurer are held by separate individuals. Organizations without paid staff should ensure that the positions of board chair and treasurer are held by separate individuals. *[similar to #12 of the January 2007 proposal]*

15. The board should establish an effective, systematic process for educating and communicating with board members to ensure that they are aware of their legal and ethical responsibilities, are knowledgeable about the programs and activities of the organization, and can carry out their oversight functions effectively. *[similar to #13 of the January 2007 proposal]*

16. Board members should evaluate their performance as a group and as individuals no less frequently than every three years, and should have clear procedures for removing board members who are unable to fulfill their responsibilities. *[similar to #14 of the January 2007 proposal]*

17. The board should establish clear policies and procedures setting the length of terms and the number of consecutive terms a board member may serve. *[not in January 2007 proposal]*

18. The board should review organizational and governing instruments no less frequently than every five years. *[similar to #15 of the January 2007 proposal but three years changed to five]*

19. The board should establish and review regularly the organization's mission and goals and should evaluate, no less frequently than every five years, the organization's programs, goals and activities to be sure they advance its mission and make prudent use of its resources. *[similar to #16 of the January 2007 proposal but three years changed to five]*

20. Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. A charitable organization that provides compensation to its board members should use appropriate comparability data to determine the amount to be paid, document the decision and provide full disclosure to anyone, upon request, of the amount and rationale for the compensation. *[similar to #17 of the January 2007 proposal]*

(c) Strong Financial Oversight

21. A charitable organization must keep complete, current, and accurate financial records. Its board should receive and review timely reports of the organization's financial activities and should have a qualified, independent financial expert audit or review these statements annually in a manner appropriate to the organization's size and scale of operations. *[similar to #19 of the January 2007 proposal]*

22. The board of a charitable organization must institute policies and procedures to ensure that the organization (and, if applicable, its subsidiaries) manages and invests its funds responsibly, in accordance with all legal requirements. The full board should review and approve the organization's annual budget and should monitor actual performance against the budget. *[similar to #18 of the January 2007 proposal]*

23. A charitable organization should not provide loans (or the equivalent, such as loan guarantees, purchasing or transferring ownership of a residence or office, or relieving a debt or lease obligation) to directors, officers, or trustees. *[similar to #20 of the January 2007 proposal but expanded to include officers and language regarding homes]*

24. A charitable organization should spend a significant percentage of its annual budget on programs that pursue its mission. The budget should also provide sufficient resources for effective administration of the organization, and, if it solicits contributions, for appropriate fundraising activities. *[similar to #21 of the January 2007 proposal]*

25. A charitable organization should establish clear, written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of the organization, including types of expenses that can be paid for or reimbursed and the documentation required. Such policies should require that travel on behalf of the organization is to be undertaken in a cost-effective manner. *[similar to #22 of the January 2007 proposal]*

26. A charitable organization should neither pay for nor reimburse travel expenditures for spouses, dependents or others who are accompanying someone conducting business for the organization unless they, too, are conducting such business. *[not in January 2007 proposal]*

(d) Responsible Fundraising

27. Solicitation materials and other communications addressed to donors and the public must clearly identify the organization and be accurate and truthful. *[similar to #23 of the January 2007 proposal]*

28. Contributions must be used the purposes consistent with the donor's intent, whether as described in the relevant solicitation materials or as specifically directed by the donor. *[similar to #24 of the January 2007 proposal]*

29. A charitable organization must provide donors with specific acknowledgements of charitable contributions, in accordance with IRS requirements, as well as information to facilitate the donors' compliance with tax law requirements. *[similar to #25 of the January 2007 proposal]*

30. A charitable organization should adopt clear policies, based on its specific exempt purpose, to determine whether accepting a gift would compromise its ethics, financial circumstances, program focus or other interests. *[similar to #26 of the January 2007 proposal but prior version spoke of what is in the organization's "best interest"]*

31. A charitable organization should provide appropriate training and supervision of the people soliciting funds on its behalf to ensure that they understand their responsibilities and applicable federal, state and local laws, and do not employ techniques that are coercive, intimidating, or intended to harass potential donors. *[similar to #27 of the January 2007 proposal]*

32. A charitable organization should not compensate internal or external fundraisers based on a commission or a percentage of the amount raised. *[not in January 2007 proposal]*

33. A charitable organization should respect the privacy of individual donors and, except where disclosure is required by law, should not sell or otherwise make available the names and contact information of its donors without providing them an opportunity at least once a year to opt out of the use of their names. *[not in January 2007 proposal]*

2. Annual Reports to Members and Directors.

A provision of the N-PCL that is often overlooked in the operation of New York nonprofits is the requirement to give an annual report to the members at the annual membership meeting or to the directors at an annual directors meeting if there are no members. See Section 519. This report is basically a financial report and should not be confused with the voluntary written annual reports that a lot of nonprofits prepare and distribute to contributors and others more as a marketing tool. The financial report must be "verified" by the president and treasurer, a majority of the directors or an independent public or certified public accountant selected by the board.

The report must detail

(a) the assets and liabilities of the organization as of the end of the prior twelve months (which must have ended no more than six months prior to the meeting - note that this means the annual meeting must occur within six months of year end, although the provisions of the N-PCL specifically speaking of the annual meeting do not require such timing);

(b) the principal changes in assets and liabilities;

(c) the revenue or receipts, both unrestricted and restricted;

(d) the expenses or disbursements for both general and restricted purposes; and

(e) if the organization has members, the number of members together with a statement of the increase or decrease from the prior period, and a statement as to where the names and residence addresses can be found (note that many members of nonprofits, especially in these times of concern regarding privacy, may have only provided business addresses).

The report must be filed with the records of the corporation and a copy or abstract must be entered into the minutes of the meeting.

Note that there is no legal requirement to use Generally Accepted Accounting Principles in preparing such financials; the law is also silent on whether the financials should be prepared on a cash or an accrual basis.

Failure to provide this annual verification may subject the corporation to a court-ordered accounting. The law does not state what the legal or practical effect of verification is; could it be viewed as comparable to the certification that the principal executive and financial officers of public companies now have to provide under the Sarbanes-Oxley Act and could the officers be subject to suit or any liability if the verified financials are incorrect? Because of this uncertainty, organizations that have CPAs may wish to use the certification process instead of the verification procedure.

3. BoardSource's Ten Basic Responsibilities of Nonprofit Boards

The group BoardSource has published the following list of the basic responsibilities of nonprofit boards; *available at Source: http:// www.boardsource.org/Knowledge.asp?ID=3.368:*

1. Determine mission and purpose. It is the board's responsibility to create and review a statement of mission and purpose that articulates the organization's goals, means, and primary constituents served.

2. Select the chief executive. Boards must reach consensus on the chief executive's responsibilities and undertake a careful search to find the most qualified individual for the position.

3. Support and evaluate the chief executive. The board should ensure that the chief executive has the moral and professional support he or she needs to further the goals of the organization.

4. Ensure effective planning. Boards must actively participate in an overall planning process and assist in implementing and monitoring the plan's goals.

5. Monitor, and strengthen programs and services. The board's responsibility is to determine which programs are consistent with the organization's mission and monitor their effectiveness.

6. Ensure adequate financial resources. One of the board's foremost responsibilities is to secure adequate resources for the organization to fulfill its mission.

7. Protect assets and provide proper financial oversight. The board must assist in developing the annual budget and ensuring that proper financial controls are in place.

8. Build a competent board. All boards have a responsibility to articulate prerequisites for candidates, orient new members, and periodically and comprehensively evaluate their own performance.

9. Ensure legal and ethical integrity. The board is ultimately responsible for adherence to legal standards and ethical norms.

10. Enhance the organization's public standing. The board should clearly articulate the organization's mission, accomplishments, and goals to the public and garner support from the community.

4. Annual Publication.

The Internal Revenue Code used to require private foundations to publish by the due date of their annual information returns notices in local newspapers to the effect that the organization's annual return is available for inspection at its offices to anyone who so requests within 180 days of the notice. This requirement of the Code was eliminated in 1998 but New York amended the N-PCL in 2000 to make this a state law requirement for domestic private foundations. See N-PCL Section 406(b-1). As those of you who deal with limited liability corporations (which must publish notices of for several weeks at the time of formation or qualification in order to sue in New York) know, the New York newspaper publishing industry is very powerful and it did not wish to loose this source of revenue! The publication must be in the newspaper designated by the country clerk of the country in which the principal office of the foundation is located having general circulation in that county (if the county is over 1 million, such designation shall be as though such notice were a notice of judicial proceedings). Publication is to be made not later than the day prescribed by the IRS for filing such return (including IRS extensions). The notice shall state that the annual return of the foundation is available at its principle business office for inspection during regular business hours by any citizen who requiests it within 180 days after the date of such publication and shall state the address and telephone number of such office and the name of the principal manager.

5. Compensation Issues

(a) IRS Rules Regarding Excess Benefit Transactions; Requirements of New Form 990.

Section 4958 of the Internal Revenue Code imposes certain draconian excise taxes (sometimes called "intermediate sanctions") on "excess benefit transactions" between Section 501(c)(3) and (c)(4) entities and "disqualified persons." Congress created intermediate sanctions on July 30, 1996, as part of the Taxpayer Bill of Rights 2. Before then, the IRS had only two ways to respond to excess benefit transactions: (1) ignore the transgression or (2) revoke the nonprofit's tax-exempt status. On January 23, 2002, the Treasury Department issued temporary regulations relating to intermediate sanctions which became final in 2008 (see *Standards for Recognition of Tax-Exempt Status if Private Benefit Exists*, 73 Fed. Reg. 16519-16525 (March 28, 2008).

Excess benefit transactions are transactions where the value of the economic benefit provided by the nonprofit organization exceeds the value of the consideration received by that organization. (Note, however, that since the penalties imposed upon excess benefit transactions are so severe, and executive compensation is a "hot" issue for the IRS, it is wise to assume that compensation arrangements may be considered excess benefit transactions and therefore try to follow the rebuttable presumption procedure outlined below). Note that compensation is not limited to just the salary that an employee receives; it also includes bonuses, deferred compensation, employee benefits and other "perks." The whole compensation package has to be analyzed.

A disqualified person is any person who was, at any time during the five-year period ending on the date of the excess benefit transaction, in a position to exercise substantial influence over the affairs of the organization. A disqualified person also includes any family member of a person described in the preceding sentence or any entity in which at least 35 percent of the control or beneficial interest is held by such a person. (Note that these rules do not apply to private foundations, since they are subject to separate regulations.)

Note that these rules do not apply to fixed payments made by an organization to a disqualified persons pursuant to an initial contract, *i.e.*, a contract entered into before the person became a disqualified person. This is sometimes referred to as "the first bite rule." But note that this exemption only applies to fixed, not variable, payments and it does not apply to material changes to that contract. Fixed payments are set amounts or amounts determined by a fixed formula specified in the contract.

The taxes are imposed on both the disqualified person and, if applicable, the organization managers. Disqualified persons are liable for (i) an initial tax of 25 percent of the excess benefit and (ii) a tax of 200 percent of the excess benefit if that transaction is not corrected before the earlier of either the date a deficiency notice is mailed with respect to the 25 percent tax or the date the 25 percent tax is assessed.

A tax of 10 percent of the excess benefit must be paid by any organization manager who participates in an excess benefit transaction knowingly, willfully, and without reasonable cause. An organization manager is an officer, director, or trustee of the organization, or any individual having powers or responsibilities similar to those of an officer, director, or trustee. The tax that must be paid by participating organization managers for any one excess benefit transaction cannot exceed $10,000.

Rebuttable Presumptions

If, however, a procedure set forth in IRS regulations (Treas. Reg. § 53.4958-6) is followed when approving a transaction between a disqualified person and the organization (such as an employment agreement or property transfer), the disqualified person will get the benefit of a rebuttable presumption that the transaction was reasonable and the entity will be freed from the responsibility to obtain payment from the individual (or be subject to IRS sanctions). If the transaction is a compensation arrangement, a rebuttable presumption will be created that the compensation is reasonable; if the transaction is a transfer of property, a rebuttable presumption will be created that the transfer is at fair market value. This presumption shifts the burden of proving that the transaction was unreasonable (and thus subject to intermediate sanctions) to the IRS. All non-profit organizations should take advantage of the protection the safe harbor provisions offers if there is any risk that the transaction could be subject to attack by the IRS.

The procedure entails the following steps:

1. The decision about the transaction must be made in advance by the board (or an authorized board committee) composed entirely of individuals who do not have a conflict of interest with respect to the transaction and thus are truly "disinterested." Treas. Reg. § 53.4958-6(a)(1).

2. The Board or committee must have obtained and relied upon (as evidenced by minutes, etc.) appropriate comparability data in making its decision. These may include appraisals, other offers or, in the case of compensation decisions, documents showing compensation levels of persons working in similar positions in similar organizations (with similarities of size and geographic location being among the factors considered). The Board can also look to reliable third party surveys of compensation levels and expert studies. Treas. Reg. § 53.4958-6(a)(2). See P.L.R. 20024428 (June 21, 2002)P.L.R. 20024428 (June 21, 2002) (no rebuttable presumption created where minutes of meeting approving compensation failed to substantiate board reliance on compensation study and where compensation study was done after meeting). Organizations with less than $1 million a year in gross receipts need only rely on comparability data from three other organizations. Treas. Reg. § 53.4958-6(c)(2). The disqualified persons, or those for whom the transaction presents a conflict of interest, may meet with other members to answer questions but may not be present during the debate and voting on the transaction. Treas. Reg. § 53.4958-6(c)(1)(ii).

3. The board or committee must document the basis for its decision within 60 days of the action taken, or before their next meeting. The documentation must include: (a) terms of the transaction and the date approved, (b) the members of the board, or committee, who participated in the discussion and who voted on it, (c) the comparability data relied upon and how it was compiled and (4) the actions of any member of the board or committee having a conflict of interest with respect to the transaction. Treas. Reg. § 53.4958-6(a)(3),(c)(3).

For fixed payments, the presumption will exist if the above-noted steps are taken prior to entering into the contract, or granting the level of compensation absent a contract. For non-fixed payments, the presumption cannot arise until the exact amount of the payment is determined (or a fixed formula is specified) and the above-noted actions have been taken. If the authorized body approves an employment contract with a disqualified persons that includes a non-fixed payment (such as a discretionary bonus) up to a specified cap, the presumption will exist if the comparability data reviewed by the authorized body indicates that the maximum amount payable under both the fixed and the non-fixed components would not exceed the amount of reasonable compensation.

If the conditions of the rebuttable presumption are not fully met, it is generally considered advisable to meet as many of the conditions as can be reasonably met. If the conditions cannot be met, the organization and the manager against whom the IRS are seeking to impose the taxes can object but they would have the burden of proving the compensation to be reasonable.

Reporting to the IRS

Note that all new IRS applicants have to answer a question on the Form 1023 as to whether compensation decisions have been made in accordance with these requirements but such requirement does not apply to applicants who filed using the 1998 or earlier forms. Note, however, that the new Form 990 (released in 2008 for filing starting in 2009) asks whether the process for determining the compensation of the CEO, executive director or top management official and all other officers and "key employees" included review and approval by independent persons, review of comparability data and contemporaneous substantiation of the deliberation and decision (basically the same standard set forth in the "safe harbor")

(b) Officers of New York Corporations. Note that "salaries" of officers of New York corporations must be set by the Board of Directors, by action of "a majority of the entire board," if not done in or pursuant to the by-laws. A higher threshold can be set in the certificate of incorporation or by-laws. See N-PCL §715(f). Consideration should therefore be given to including a provision in the by-laws allowing the salary to be set by less than a majority of the "entire board" or by a compensation committee, or by other means, if desired. The statutory provision covers "salaries," it is not clear if it covers other forms of compensation (see the discussion in the dissent in *People ex rel. Spitzer v. Grasso*, 42 A.D.3d 126, 836 N.Y.S.2d 40, 2007 N.Y. Slip Op. 03990 (N.Y.A.D. 1 Dept. May 08, 2007) (No. 8719, 401620/04) as to whether pension benefits and deferred bonuses are subject to the same standard.

(c) CEO and CFO Salaries for California-Registered Nonprofits. All nonprofits that are required to register with the California Attorney General (see discussion at Section IX.6(a)) must go through a statutorily-required board or compensation committee review of the compensation (including benefits) of the President (or CE)) and treasurer (or CFO) to determine that the compensation is "just and reasonable." Such review is required when the officer is hired and when the compensation package is changed (unless the change is uniform for all employees). See a further discussion of California governance issues in Section IX.6(a).

(d) Director Compensation. It is clearly acceptable under state legal standards and federal tax rules to pay employees "reasonable compensation." What about payments to directors? Such payments are customary in the for-profit world; should they be similarly allowed for nonprofits?

While the norm among many nonprofits is to rely on volunteers, there is nothing in New York law which requires that directors been uncompensated for their time and efforts. *First*, with the growth of nonprofits (remember the first George Bush's "thousand points of light"?) it may be increasingly difficult to retain services. *Second*, the duties of directors will only grow more burdensome in the post-Sarbanes era. *Third*, some nonprofits are growing increasingly complex, necessitating a greater level of involvement by directors to "stay on top" of what is going on. *Lastly*, there is a growing level of risk being on boards.

Note, however, that most "good governance groups" look askance at director compensation. For instance, the *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations* issued by the Panel on the Nonprofit Sector organized by Independent Sector in October 2007 states that "Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. A charitable organization that provides compensation to its board members should use appropriate comparability data to determine the amount to be paid, document the decision and provide full disclosure to anyone, upon request, of the amount and rationale for the compensation."

While many nonprofits lack the financial wherewithal to consider compensation of directors, larger organizations can provide such compensation. Often, smaller well-funded organizations will establish such compensation. The issue then becomes what guidelines need to be adhered to.

Things to bear in mind in structuring such compensation include

• determining if state law allows such compensation (Section 202(a)(12) of the N-PCL specially allows a corporation to pay "reasonable compensation" to directors),

• determining how to fix such compensation without it being considered self-dealing (since the board is fixing its own compensation) (either by asking for member approval or appointing a special non-director committee or having management members - who are not compensated as directors per se - determine),

• the heightened possibility of AG intervention and possibly vetting the compensation proposal with the AG's office on a no-name basis,

• demonstrating reasonableness to address the private inurement and intermediate sanction concerns to avoid any loss of tax-exempt status, and

• determining if such payment will void any applicable state law which provides liability shields to directors as volunteers (for instance, the Illinois law shielding directors lapses for those earning more than $5,000 per year).

See "Director Compensation Plans for Nonprofits: Addressing the Key Legal Issues" by Michael Peregrine and Ralph DeJong in the October 2000 issue of *The Exempt Organization Tax Review*.

6. Governance Policies, including Codes of Ethics; Policies on Conflicts of Interest; Whistle Blower Policies; Document Retention/Destruction Policies; Privacy Policies

(a) Requirements of New Form 990

The issue of governance has become a hot topic for the nonprofit world following numerous scandals (and the Enron and other scandals in the for-profit world which led to the passage of the Sarbanes-Oxley Act). The new Form 990 adopted in 2008 (for filings in 2009 and thereafter) has brought this issue to a head by including numerous provisions related to nonprofit governance, including

• how and by whom the organization is governed, the number of board members who could vote, and which of the board members are independent (the IRS has set out its definitions of independence; if an organization believes that its board members are independent even if they are not so regarded under the IRS's definition, the organization may provide such explanation in Schedule O);

• family or business relationships between or among governing and managing officials (note that family relationships does not include domestic partnerships; it is limited to spouse, ancestors, siblings and descendents and such descendants' spouses);

• changes to governing documents;

• information regarding potential misuse of assets;

• whether the organization has members, etc. and whether decisions of the governing body are subject to their approval;

• whether minutes of board and committee meetings are kept on a contemporaneous basis (within 60 days of the meeting or prior to the next meeting, whichever is later);

• whether the Form 990 is provided to the full board (not merely to an audit, finance or executive committee) for review prior to filing, along with a description (on Schedule O) of the processes that the nonprofit uses to review the Form 990 (in the past many nonprofits have found that the accountants or other parties preparing the 990 did not produce a draft suitable for circulation until immediately prior to the extended due date, when the chance for a further extension is not easily available; now, with this disclosure requirement, greater efforts need to be undertaken to ensure that something is available for board distribution on a timely basis even if the accountants are still "tweaking" the return to be filed);

• its governance and management policies and practices, including whether the organization has adopted written policies regarding

• conflicts of interest (and whether annual disclosure by affected parties of interests that could give rise to conflicts is required and whether compliance is regularly and consistently monitored and enforced - with a description of how such monitoring and enforcement is done),

• whistleblowers,
• document retention and destruction, and
• joint ventures (if applicable);
• whether the process for determining the compensation of the CEO, executive director or top management official and all other officers and "key employees" included review and approval by independent persons, review of comparability data and contemporaneous substantiation of the deliberation and decision) *(discussed above)*.
• how the organization makes certain important information available to its constituents, including a list of states where it is required to file the Form 990 and how it makes available to the public its Form 990 and Form 1023 *(Application for Recognition of Exemption)*, and key governing documents, conflicts of interest policy and financial statements (copies of which some organizations now post on their website); and
• if the company's financial statements were audited, whether it has an audit committee (phrased as a committee that assumes responsibility for oversight of the audit, review, or compilation of its financial statements and selection of an independent accountant). Note that Form 990 uses the term "selection;" the audit committees for most nonprofits, however, do not select the auditor or accountant but instead make recommendations to the full board regarding such selection. (Note that this requirement is not set forth in the governance section of the core Form 990 - Part VI, where you might logically expect to see it, but rather in Part XI regarding financial statements.)

These disclosures relate to a certain point in time in the tax year (or the end of the tax year), not the time of filing. Accordingly, the answers regarding adoption of policies must be made based on the policies in place at the end of the fiscal year, not as adopted between such date and the filing date. If policies were not adopted as of the year-end date, but were adopted subsequently, the IRS has said that the organization may explain in Schedule 0 that it adopted such policies after the end of the tax year and before filing the Form.

If the nonprofit monitors and enforces a conflicts of interest policy or if it follows the compensation procedures noted above, it must provide a description of such practices. If the nonprofit does not have any of the policies or compensation practices, it need not explain why but presumably further explanations could be provided if desired.

While some of these policies and procedures may be "overkill" for smaller charities, it may be prudent to adopt them nevertheless so that the charity looks better to its prospective donors and the IRS. In any case, all organizations should have at a minimum a conflicts of interest policy.

It may also be prudent to prepare and circulate questionnaires to members of the organization's governing board members, officers and key employees (which could include recertification of receipt of and compliance with the conflict of interest and other policies), along the lines of "D&O questionnaires" long used for public companies, in order to satisfy the requirement that the nonprofit undertake "reasonable efforts" to provide the necessary information.

(b) Codes of Ethics

The highly publicized business scandals of the past several years have led many commercial and not-for-profit enterprises to craft codes of ethics for their organizations and thus to set forth formally, and as succinctly as possible, those basic values that each entity believes is appropriate for itself and its employees. There is a school of thought that a code of ethics is not necessary, that there are other controls in a business environment that will help the entity to "do the right thing." Others see the task of writing a code of ethics as a job with no end, as there are any number of marketplace circumstances in which the organization might take a moral position. Is the code intended to address each one, with all its permutations? A 2007 IRS preliminary staff discussion draft of "Good Governance Practices for 501(c)(3) Organizations" (available at http://www.irs.gov/charities/charitable/article/0,, id=167626,00.html) recommends that the board "should consider adopting and regularly evaluating" a code of ethics. The IRS has, however, proceeded no farther with codes of ethics, while it has through the Form 990 that came into effect in 2009 asks questions that effectively require nonprofits to adopt conflicts of interest policies, document retention/distribution policies, whistle blower policies and compensation policies.

Obviously, such a code is not an easy undertaking, and it is likely that the authors in those not-for-profit entities that take up the challenge will find various areas of agreement and disagreement. And, while there may be conceptual overlaps, it is also important not to confuse a code of ethics with other documents that an entity might produce, such as a mission statement or a strategic plan of action (both of which are worthy projects for a not-for-profit entity).

While ethics policies are generally regarding as good, at this time we do not generally recommend that a nonprofit adopt a conflicts of interest policy unless there is a specific issue that needs to be addressed, the organization has certain constituencies that would be served by adoption of such a policy or the organization has encountered previous problems that could be resolved by adoption of such an ethics policy. It is more important to first address the need for specific policies called for by the Form 990 or other needs of the organization.

(c) Conflict of Interest Policies

It is a tenet of sound governance that the governing board be aware of any actual or potential conflict-of-interest for its members, or for key employees, in their dealings with the organization. Accordingly, it is imperative that all nonprofits have a formal conflict-of interests policy, to be followed by periodic reports by board members and management officials of any relationships or transactions with the not-for-profit they serve that might provide preferential treatment for them or for the organizations that employ them. New organizations seeking IRS determination of tax-exempt status are required to answer the question of whether they have conflict-of-interest policies (the strong inference being that the should) and the IRS has promulgated a model form.

At a minimum a conflicts policy will require disclosure before the board takes action on any action where a conflict may arise and that any conflicted board members absent themselves from at least part of the discussion and the voting on the issue.

There are two schools of thought on whether the policy should merely require disclosure of conflicts as they arise or whether there should in addition be some periodic certification process where board members provide notice of all potential conflicts. The Form 990 asks whether the conflicts of interest policy includes an annual disclosure process and periodic monitoring. Although the prototype policy proposed by the IRS as part of its current Application for Recognition of Exemption includes such annual disclosure process, many nonprofits did not include that provision (relying instead on disclosure when the need arises, on the theory that it was not advisable to adopt a policy that would not be followed) or, if they did, have failed to follow the required procedure on an annual basis. The new annual Form 990 question may serve as an impetus for adoption of such a procedure and for diligent monitoring of compliance.

The IRS form of conflicts policy, and many other forms in existence, focus on conflicts between the nonprofit and the people it does business with, *i.e.*, economic relations with its vendors, etc. This is intended to address the serious issue of favoritism to board members, etc. where a contract may be given to an insider when a better deal (cost or service wise) might be obtained from a third party). But with nonprofits there is another form of conflict that may arise - one where board members have competing interests since they are also active with other similarly-situated nonprofits (or even other nonprofits in other fields since the board member may undertake greater fundraising efforts for one company than for another). Here the issue is the need to address the duty of loyalty to both entities. A well-drafted conflicts policy will also address this concern through disclosure. If a grant-making organization makes grants to other organizations that have some affiliation with the members of the board or management of the grant making organization, it would be prudent to adopt an affiliated grants policy

(d) Whistle Blower Policies

Another policy which a large nonprofit organization should consider is a whistleblower policy, to encourage lower level staff to point out financial and other problems without fear of retaliation from superiors. Whistleblower policies are mandatory for certain organizations receiving major funding from the U.S. government, such as health care companies. See the Deficit Reduction Act of 2005 (effective January 1, 2007). The 2007 IRS preliminary staff discussion draft of "Good Governance Practices for 501(c)(3) Organizations" recommended that the board "should adopt an effective policy for handling employee complaints" and the Form 990 now requires disclosure of whether such a policy exists. The adoption of a whistleblowers policy is one of the 33 recommendations of the Panel on the Nonprofit Sector. Such policies obviously make no sense in a "mom and pop" or board-run nonprofit but should be adopted once a nonprofit obtains a significant number of employees, especially when they are working in a chain of command structure.

Section 1107 of the Sarbanes-Oxley Act of 2002 ("SOX"), which in most part only apply to certain public companies, makes it a crime to retaliate against whistle blowers. This provision is not limited by the Act's terms to publicly-traded companies and it therefore applies to nonprofits. It is a felony to retaliate against an individual for providing law enforcement authorities with truthful information relating to the commission, or possible commission, of any federal

offense. Violations of this section are punishable by fines or imprisonment up to ten years. New York Labor Law Sections 740 and 215 also include certain whistleblower protections (for reporting dangers to public health and safety and violations of various labor laws).

The Sarbanes-Oxley Act does not require nonprofit organizations to adopt a written whistle blower policy, which it does require of the effected public companies. While there are some who oppose such policies on the theory that it will only heighten the likelihood that a disgruntled employee will use it as a pretext for a illegal discharge action, such policies have been considered to be good preventative measures to avoid potential liability and as a matter of good governance.

Issues to be considered include:

• ***The scope of reportable events***. Whistleblower policies under SOX only need to cover accounting and auditing misdeeds. Many policies adopted by nonprofits have been expanded to cover all misdeeds that may get the nonprofit in trouble.

• ***Who the policy should cover***. Consideration should also be given as to whether the complaint procedure should also apply to persons who are not employees, such as volunteers or board members, since those persons are also likely to learn of problems that should be disclosed. While they cannot be fired from a paid employment position, they may feel intimidated for social reasons and thereby unwilling to step forward.

• ***To whom complaints should be made***. The most appropriate body would be an audit committee but many nonprofits do not have such a committee. It is probably best to designate one specific person (by name or title) with alternates who can be used if the person complained about is that person or that person is not available. Many public companies, and some larger nonprofits, hire an outside service, which will guarantee anonymity.

• ***Who should oversee dispute examination and resolution.*** Generally the board should have some key role to play in the process so that it learns of all complaints. The person to whom complaints are made should routinely report to the board when a complaint is made (maintaining confidentiality).

• ***What protections should be granted the complainer.*** At a minimum, the policy must enunciate that the nonprofit will abide by all the strictures against discharge or other penalties as required by applicable law (*e.g.*, SOX and the New York Labor Law).

(e) Document Retention/Destruction

Following in the wake of the Enron scandals, when certain key documents were destroyed by the accounting firm, issues regarding document destruction have been of great concern to regulatory authorities. Section 802 of the Sarbanes-Oxley Act of 2002 imposes criminal penalties for knowingly altering, destroying, concealing, or falsifying any record or document "with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States, any case filed under Title 11 [bankruptcy cases], or in relation to or contemplation of any such matter or case." This statute is in addition to previously existing statutes generally prohibiting obstruction of justice. This section is only one of two of the Sarbanes-Oxley Act that applies to non-public companies, including nonprofits (the other is certain protections for whistle-blowers). This provision applies as early as when a company has reason to believe that a federal investigation of its records is being contemplated regarding "any matter" within the jurisdiction of such federal agency.

Section 1102 of Sarbanes-Oxley makes it a crime to knowingly intimidate, threaten, or corruptly persuade another person--or attempt to do so--with the intent to cause or induce any person to alter, destroy, mutilate, or conceal an object for the purpose of impairing the object's integrity or availability for use in an official proceeding. An official proceeding is defined as a proceeding before a court, Congress, or a federal agency. Violations of the Sarbanes-Oxley document destruction provision are punishable by fines or imprisonment up to 20 years.

Document retention and destruction policies have to focus on two separate concerns. One concern is institutional and the other is legal. From an institutional standpoint, to keep every document forever is not practical. First, having too many documents clutters up an organization's records storage, making it difficult to find what is truly important. But sometimes if documents are prematurely discarded important institutional history may be discarded. So from an institutional perspective the policy will need to balance off such competing needs.

From a legal standpoint, the concern is that documents not be discarded too soon if there is any potentiality that the documents will be helpful in defending the organization from legal liability. There is also a competing factor: once a legal investigation is known to be contemplated, destruction of arguably relevant documents may generate criminal liability or give rise to presumptions that are harmful to the organization.

Accordingly, even before the IRS included a question on the Form 990 regarding existence of such policies, it was thought wise for all organizations, including nonprofits, to adopt document-destruction policies and procedures, that include:

• Adoption of a written policy outlining how long each category of document should be maintained. While certain laws exist, and some common practices have evolved, about how long documents should be retained, the policy needs to be customized for each different organization to take into account the types of documents that it will need for its business. Determinations of periods for retention need to reflect both legal limits and business needs. Unfortunately, there are no hard-and-fast rules for determining a minimum holding period. Sources of legally advisable time periods include statutory requirements, requirements under contracts with government agencies and others. Although federal and state laws may provide guidance in some cases, common sense is often the best guide.

• Tax law sets forth certain periods of time in which the IRS can make claims for past taxes. Accordingly, documents that may be relevant on tax issues should be held for at least the IRS period. But if there are controversial or aggressive positions by an organization that may have to be supported or defended in future years, the period for warehousing documents may be longer than for those years when the entity is just doing "business as usual." Moreover, for documents supporting a tax/information return, as a general rule, the retention period begins on the filing date of the return or its due date (with extensions), whichever is later. Note that tax authorities may claim at any time that they never received a tax return and therefore the statutory period of limitations for that run has not yet started; unless the organization has evidence that the return was in fact received (such as return receipts), there can be no assurance that the standard statutory period of limitations has run.

• Under the federal Fair Labor Standards Act, the employer has the burden to present evidence of the hours worked by employees. Accordingly, If adequate records are not maintained, an employee may be able to successfully seek payment for hours that were not in fact worked.

• It is also important to remember that retention periods for important documents should begin at the end of the fiscal year during which the document was created, not from the date on the document itself. For tax documents, the clock shouldn't start until the end of the year of filing.

• It is sufficient to save a single copy of documents (although certain key documents, such as annual information filings on Forms 990 and audited financials, might be save both in the records for the year in question and in a compendium of such filings for all years) and drafts need not be retained.

• Any policy should address, if relevant, the need to be mindful of whether different periods should apply to different modes of document retention, including paper copies, e-mail, computer records or backup records. Emailed and other electronic documents pose a special challenge because they may reside in multiple locations, many of which are beyond the control of the organization. Care therefore may need to be taken in the first instance, to make sure that inappropriate documents are not disseminated.

• All document destruction should be promptly suspended when a risk of a government investigation arises. Senior management should issue written instructions to stop any destruction as soon as it learns of or has suspicion of any such investigation. Similar standards would also apply in the case of a private lawsuit, since the destruction of documents could lead to a claim by the other party that important evidence favorable to it was destroyed. Failure to preserve documents can result in court sanctions, including exclusion of evidence or an instruction by the judge that the destroyed documents would have been damaging to the party that destroyed them. Care should also be taken in those circumstances to not alter metadata (data in electronic files that documents the origin of electronic data, such as when a file was created or revised and who accessed the document. If an e-mail account could be relevant in a lawsuit, create a mirror image of the account which is then no longer accessed.

• The following might be a starting point:

• Bank statements and reconciliations (including canceled checks) -7 years

• Accounts receivable and payable ledgers - 7 years

• Cash receipts and disbursements journals - 7 years

• Payroll journals - 10 years

• General ledger and year-end journal entries - indefinite retention

• Real property records - indefinite retention

• Records of gifts received - indefinite retention (especially regarding gifts of personal property since it will be necessary to document any deed restrictions or to show the lack of such restrictions)

• Financial statements, annual reports and tax returns - indefinite retention

• Incorporation records, by-laws and minute books - indefinite retention

• Contracts - life of contract plus at least six years (indefinite retention would be appropriate for agreements that might be useful either to show the history of the organization or for use as forms for later deals)

(f) Other Policies

Other policies that a nonprofit may need, depending on the activities that it engages in or its staffing situation, include policies on the following issues:

• Compensation (to satisfy the safe harbor tests noted above);

• Other employee related policies, including policies on credit card usage; gift acceptance; nepotism; sexual harassment; and travel;

• Handicap access (especially appropriate for historic sites);

• Investment and endowment; or

• Privacy (relating to the use of the names of members or supporters. These policies go into issues related to the ability to sell membership lists or share such lists with other like-minded organizations).

(g) General Considerations

One cautionary note with the adoption of policies - they are only as good as their implementation. If the organization adopts a policy it needs to monitor compliance with the policy and periodically assess whether the policy needs to be changed. It is worse to have a policy and not follow it than it is not to have a policy. I would avoid requiring review on a set schedule since many organizations will not adhere to such a schedule but review should be done every three to five years or more frequently if appropriate. Implementation includes training of staff on a regular basis, not just if legal problems are anticipated.

7. Minutes and Resolutions

The meetings of all boards and executive committees should be documented with contemporaneous minutes. There is an art to preparing minutes so that they are not too brief or, conversely, too detailed. The minutes are an historic record that is easily discoverable, so care should be taken to ensure that the minutes are factually correct but do not include material that was intended to be kept confidential. It is clear that minutes are not intended to be a transcript of the meeting (you do not need to include who said what, unless an attendee specifically requests that his or her comments be reflected in the meeting). If a tape is made to assist the preparer of the minutes, the board should have a policy on whether such tapes should be destroyed after the minutes are approved.

The minutes should reflect the time and place of the meeting (including both start and stop times), where the meeting occurred (or that it was a telephonic meeting), what directors attended (and whether they attended by phone) and officers in attendance, who else attended (usually indicated to be "invited"). The minutes should note all topics discussed and all decisions reached (or, with respect to topics of major discussion, that no action was taken at the meeting). Usually the names of the speakers on any topic and what they said do not need to be recorded, unless there is a special presentation (such as comments by legal counsel or invited experts).

With respect to major decisions, it may be appropriate to provide more detail, such as reasons for and against a specific decision, in order to show that the topic was thoroughly discussed and analyzed before a decision was reached. At one time legal counsel would recommend a minimalist approach to minute-taking, on the grounds that the more that was said in the minutes the more issues might surface that could create future times. Now, however, when issues can easily be raised as to whether a topic was appropriately discussed, it is more common to have fuller discussions in the minutes.

Actions can be reflected as formal resolutions (*i.e.*, RESOLVED, that") or just in the text of the minutes (e.g., "after discussion, upon motion duly made and seconded, it was decided to ....") or some variation between these two approaches,

depending on the circumstances. Formal resolutions are appropriate if the company is going to have to provide a certified copy of the board action to a counterparty. Otherwise, more informal documentation may be adequate.

The minutes should be prepared in time for approval at the next board meeting; if the meeting is held within less than 60 days of the date of the minuted meeting, the IRS considers the minutes to have been prepared on a contemporaneous basis if done within 60 days of the meeting. The minutes should be circulated to the board members in advance of the next meeting so that the directors can read them in advance and approve them at the following meeting. The secretary of the meeting should then sign the approved minutes. Some organizations ask that all directors sign the minutes to indicate approval (if they attended the meeting) or consent (if they did not); while such approach is good, it is cumbersome and most corporations do not bother to obtain such signatures.

8. Accounting and Related Considerations

(a) Auditing

(i) Required Audits

The IRS does not require that financials be audited. If the nonprofit receives significant federal government funding (*i.e.*, over $500,000 in any year), however, it must have to do what is called an OMB Circular A-133 compliance audit (sometimes also called a "single audit" (as in all government agencies using the same procedure). *See http://en.wikipedia.org/wiki/OMB_A-133_ Compliance_Supplement* and *http://en.wikipedia.org/wiki/Single_Audit*.

State agencies often require audited financials when revenue or assets hit certain thresholds. For instance, the New York Charities Bureau requires that financials be audited if the annual revenue exceeds $250,000 and it requires that they be reviewed (a lesser degree of professional accountant investigation) if revenue is at least $ 100,000 in any year. Such audited or reviewed financials are public documents since they are included with the annual filings with the Charities Bureau.

Under the California Nonprofit Integrity Act of 2004 (incorporated in Government Code Section 12580-12599.7, nonprofits with gross revenue of $2 million or more (excluding government grants if the granting agency requires an audit or accounting) that are required to register and file reports with the California Attorney General (*i.e.*, nonprofits that hold property in California, conduct business in California *or solicit funds* in California) must prepare GAAP financials, conduct an audit by an auditor who meets auditor independence standards meeting with the standards of the Comptroller General of the U.S. (the "Yellow Book") and make it publicly available within at least nine months after the fiscal year end. (While the statute applies to foreign corporations "doing business or holding property" in California, the Attorney General has taken the position that this includes nonprofits that have only registered to solicit charitable funds in the state. As of early 2009, however, we are not aware of any enforcement action being taken by the AG against out-of-state non-qualified entities. A good argument may be made that substantive internal governance provisions (such as approval procedures for salaries and committee composition, but not necessarily the need for audits) should not apply to out-of-state companies since general practice is to look to the law of the state of formation for such matters. Note that the act does not apply to any religious, cemetery, educational, hospital or health care service plan corporations.

Auditors are not allowed to donate their services. They can, however, quote reduced rates. If an accountant serves on the board of directors the firm he or she works for could not audit the financials, although they could provide other financial services such as general counseling or preparation of tax returns.

(ii) *Required Audit Committees*.

Federal and New York law does not require a nonprofit to establish an audit committee, although legislation proposed by the New York Attorney General circa 2003-2005 would have required such committee unless the full board assumed the audit committee function.

Under the California Nonprofit Integrity Act of 2004, nonprofits that are required to conduct an audit (see (i) above) must have an audit committee. Such committee cannot include staff members, the president, CEO, treasurer or CFO of the organization (although the AG's website indicates that this applies only to persons holding such offices who are compensated, not to board members who are officers). The committee can be as small as one person. California law allows nondirectors to serve on such committee (but New York law would not).

The responsibilities of a well run audit committee include the following:

• Interviewing auditor candidates (which should probably be done on a periodic basis, *e.g.*, at least every five years) and engaging the auditor or making recommendations to the full board regarding the auditor to engage;

• Participating in the negotiation of the auditor's compensation;

• Determining whether the auditor's services should be terminated (or so recommending to the full board);

• Considering the auditor's independence (if it also provides other services for the nonprofit, such as tax preparation or advising services);

• Authorizing the engagement of the auditor for nonaudit services.

• Working with the auditor to oversee the planning for and the conduct of the audit;

• Review of the financial statements, the audit report and the auditor's management letter (a report regarding deficiencies and material weaknesses, if any) and recommend to the board whether to accept such audit report;

• Review and revision (with staff input) of the nonprofit's internal controls over financial reporting, and other similar controls and procedures, with the auditor (such controls are required for OMB Circular A-133 audits and they would have been required under legislation proposed by the New York Attorney General circa 2003-2005);

• Oversight of the accounting function at the nonprofit, including staffing, qualifications and "tone at the top;"

• Consideration and adoption of appropriate policies, and monitoring of compliance with such policies, such as whistleblower policies and ethics policies.

Ideally, these tasks should be set forth in an audit committee charter which the full board would adopt.

(b) Valuation of Donated Service

The value of donated services of a type that a nonprofit would otherwise have to purchase need to be accounted for as both revenue and expenses on a nonprofit's income statement prepared in accordance with generally accepted accounting principles. Accordingly, as the providers of donated services we may be asked to provide the value of our services. In providing that number from the time records for the nonprofit's fiscal year, it is best if separate numbers can be provided for the portion of our services that related to the nonprofit's program, administration and fund raising are separately broken out. From the standpoint of agencies that rate nonprofits, it is best for the nonprofit to expend a smaller sum on administration and fund raising than on program. If there is no allocation, the auditors will probably treat all the costs as administration, which will increase the proportion allocated to the less desirable sector. While much of what lawyers do is more in the nature of general administration, sometimes the work relates to the nonprofit's programs (e.g., reviewing or negotiating contracts pertaining to such provided services).

The value of donated services can also sometimes be counted for purpose of any "match" that a nonprofit has to raise in order to receive government or other matching funds.

Donated services for this purpose, however, only applies to classic professional services, not to general counseling on matters of mutual interest or service on the board of directors, etc.

(c) Endowment Funds

Many larger, and some smaller, nonprofits are lucky enough to have endowment funds - monies that are invested to generate income or appreciation that can be used in yearly operations. The beauty of an endowment fund is that an organization (or designated programs) can "live off the income" if the fund is large enough

But in today's troubled economic environment many nonprofits find that their endowments are "underwater" -- meaning that the current principal amount in the endowment is less than the historic dollar value (*i.e.*, the amount contributed to the endowment by the original donor). Under the law currently in effect in New York, Florida, New Jersey and 28 other states that currently are governed by the Uniform Management of Institutional Funds Act (UMIFA), the charities can no longer take distributions of appreciation from such endowments. While they may still be able to use on a current basis any interest, dividends, royalties and rents generated by endowment property, the inability to use appreciation has placed them in a precarious financial situation. Under states that have adopted the newer Uniform Prudent Management of Institutional Funds Act (UPMIFA) (which includes California and Connecticut), however, the trustees have greater flexibility in using the principal in the endowment funds for current needs. The provisions of UMIFA (and what preceded UMIFA) and UPMIFA will be discussed below.

What is an Endowment Fund. First we need a word of clarification. Many organizations have "endowments" that are not truly endowments. A true endowment is a gift which a donor designates in a written instrument to be not wholly expendable by the organization on a current basis. This contrasts with funds which the nonprofit otherwise has available

to it (for instance, proceeds from unusual sales) on which the board has imposed certain spending restrictions. The later fund, while sometimes referred to by the nonprofit as an endowment, is really a "board restricted fund" and the board can, at any time, lift such restrictions. Board restricted funds are not subject to the limitations that are discussed below and therefore are not as problematic as are endowments. The board, as part of the budget process determines what funds can be spent and can therefore easily revise any such board-imposed restrictions if it so desires. While temporarily restricted by board action, for accounting purposes such board-restricted funds are considered as unrestricted.

Old Standards Allowed Distribution of Income Only. Historically, endowment funds were allowed only to use "income" for current purposes and under trust accounting rules, which most nonprofits assumed applied, that meant that they could only use the dividends, interest, rent or royalties received for day-to-day operations; any increase in the value of investments (stocks, bonds, etc.) could not be touched. When such assets were sold they had to be rolled over into other forms of investments. Additionally, each investment had to meet the applicable investment standard - in other words, risk was analyzed on an asset-by-asset basis, rather than by looking at the entire portfolio. Furthermore, trust law did not allow delegation of investment authority.

Changes in 1970s; UMIFA. In the 1970s it was realized that many funds were investing solely for income, instead of growth (*i.e.*, capital appreciation) so as to generate the necessary significant income for current operations. The funds were less likely to invest in stocks which might grow in value since the appreciation could only be used to increase the principle of the endowment. In the market conditions that existed in that and subsequent periods (at least up to the time of the current market collapse), many stocks that were increasing in value were not dividend-paying but rather used what might otherwise be paid as dividends to grow the business. Endowments needing to generate current income were therefore practically precluded from investing in such stocks.

Accordingly, many states adopted what is called the Uniform Management of Institutional Funds Act ("UMIFA"). UMIFA was first approved by the National Commissioners on Uniform State Laws ("NCUSL") in 1972. 47 states and the District of Columbia adopted UMIFA. It was adopted in New York as part of the Not-for-Profit Corporation Law ("N-PCL")(Sections 102, 512, 514, and 522).

UMIFA allowed the prudence of investment to be determined by looking at the entire portfolio, allowed endowments to invest in any type of assets, allowed the pooling of endowment funds and allowed the nonprofit to delegate management to professional investment advisors, so long as the charity in each case exercised ordinary business care and was prudent in making its choices. This is sometimes called "total return investing."

Under UMIFA the board is able to spend on a current basis, in addition to classic income, any realized appreciation in the endowment fund (*i.e.*, gain on the sale of securities) and any unrealized appreciation with respect to readily marketable assets so long as the board determines that such expenditure is prudent, after considering the charity's purposes, provided that no such expenditures of appreciation cause the fund to go below the "historic dollar value" of the fund (*i.e.*, the original principal, unadjusted for inflation). Whether or not there has been appreciation is viewed, at least in New York State, on a fund-by-fund, not an aggregate, basis (see *Advice for Not-For-Profit Corporations on the Appropriation of Endowment Fund Appreciation* -- the "Endowment Memo -- published by the Charities Bureau of the New York Attorney General's Office, available at http:// www.charitiesnys.com/pdfs/Endowment-Guide.pdf).

Donors can, of course, approve other spending arrangements, being only limited by the limits of their creativity and the willingness of the donee organization to live with any such restrictions (note that more and more donee organizations are not willing to accept unusual donor restrictions). For instance, the instrument may allow the board to spend according to a "spending rate policy" adopted by the board that specifies the percentage to be appropriated for spending in that year.

In New York, and maybe other states, the process of appropriation of endowment appreciation has to be done at the board level instead of the staff level. The Treasurer of each nonprofit is required under Sections 513(b) and 519(a)(2) of the N-PCL to make an annual report to the Board of Directors concerning the administration and use of the assets in each endowment fund held for specific purposes and the income from such assets. The board, after reviewing such report and other relevant information, should deliberate and vote on whether and to what extent to appropriate endowment appreciation for expenditure and document such decisions in board minutes. See the Endowment Memo.

Further Changes; UPMIFA. While UMIFA was a vast improvement over the old rule, times and the needs of charities have changed since 1972. In 2006 the NCUSL approved a revised approach, the Uniform Prudent

Management of Institutional Funds Act ("UPMIFA"). UPMIFA updates the prudence standard applicable to management and investment of charitable funds, revises the rules governing expenditures and includes provisions governing the release and modification of existing restrictions.

Prudence Standard. The prudence standard in UPMIFA states that managers must act "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." UPMIFA then sets forth an articulated prudence standard (which is more detailed than that found in UMIFA), requiring a review of seven criteria:

(1) duration and preservation of endowment principal,
(2) the purposes of the institution and the endowment funds,
(3) general economic conditions,
(4) effects of inflation or deflation,
(5) the expected total return from income and appreciation,
(6) other resources of the institution, and
(7) the investment policy of the institution.

As under UMIFA, funds can be pooled. UPMIFA states that a charity must diversify its investments unless "special circumstances" otherwise dictate. New investments received by the organization must be reviewed promptly to determine if they conform to the charity's investment strategy and fund objectives.

No Need to Maintain Historic Dollar Value. The biggest change in UPMIFA concerns the ability to spend endowment funds. Under UPMIFA the charity is not obliged to maintain the historic dollar value of the fund (unless contractually so obligated by the terms of the original gift) and the charity can spend the amount which it deems prudent after considering the donor's intent (*i.e.*, whether the endowment should continue permanently even if that would mean a reduction in current income or whether the donor would wish to see the institution or the funded program continue as before), the purpose of the fund and relevant current economic factors. This more flexible approach allows nonprofits to "dip into" the endowment principal if a good need arises. Changing the emphasis from historic dollar value (*i.e.*, the amount of dollars originally given), the act assumes that the charity will preserve the purchasing power of the principal absent unusual circumstances (in other words, the principal of the endowment should grow to cover inflation). It encourages charities to adopt what is called a "spending rate" policy that would recognize short-term changes in the value of the fund. Again, the charity must follow the donor's intent if so expressed in the gift instrument, a letter accompanying a gift or a solicitation by the charity; accordingly donors could impose caps (*e.g.*, an annual limit on expenditures of 4% of the amount of the endowed fund). If the grant instrument restricts spending to "income" only, however, the charity can use the UPMIFA standards. The UPMIFA standard would apply to all grant instruments, even those that predate adoption of UPMIFA, unless contrary grant language is clear.

Optional Provisions. UPMIFA includes several optional provisions that states may adopt. One gives the Attorney General 60 days to review the actions of all charities with endowments that aggregate less than $2 million if the value would thereby drop below the historic dollar value. A second optional provision creates a rebuttable presumption of imprudence if spending exceeds more than 7% of the endowment in any one year (valuation determined on the basis of a three year rolling average).

Release of Restrictions. UPMIIFA also changes the rules regarding obtaining consent to the release of restrictions. Under UMIFA the charity can seek court approval if the donor does not consent, without any regard to *cy pres* standards. (Under *cy pres* procedures, a charity can seek to have restrictions lifted if the restrictions are impossible of performance or illegal, with more practical restrictions being substituted for the now-superceded restrictions.) The UPMIFA procedure tracks more closely the *cy pres* standards, allowing the lifting of restrictions if they are impracticable or wasteful or impair the management or investment of funded or if, because of circumstances not anticipated by the donor, the modifications will further the purpose of the fund, with all changes needing to be consistent with the donor's probable intent.

One other change will assist smaller charities - if the fund is both old (*i.e.*, at least 20 years old) and small (*i.e.*, no more than $25,000), the restriction can be lifted solely upon approval by the attorney general (or if there has been no action by the AG after 60 days following notice) instead of needing to obtain court approval. No notice is required to the donor in the case of any *cy pres*-like proceedings, although such notice is probably politically appropriate.

Approval Status. As of March 3, 2009, UPMIFA had been approved in 29 states (including California and Connecticut) and introduced in 15 more (including New Jersey). It has not yet been introduced in New York or Florida; a bill has been drafted by counsel for the Commission on Independent Colleges and Universities (CICU) but has not yet introduced in New York - it is expected that a full push will be made in New York after input from the Attorney General's office is obtained.

Underwater Endowments. The flexibility inherent in UPMIFA has become doubly necessary in the wake of the market collapse of 2008-2008, where many nonprofits find their endowment funds "underwater." For instance, some universities find themselves in situations where they cannot honor pay the salaries of contracted-for endowed professorships since the fund's principal is no longer adequate to generate sufficient income. This problem is especially critical to younger nonprofits where the endowments have not had time to adequately grow over the historic dollar value; older endowments may have existed for a long time under the pre-UMIFA rules where the corpus of the endowment grew through stock appreciation and such excess was not subsequently depleted.

The New York's Attorney General's Endowment Memo says that a charity may still appropriate classic income (*i.e.*, dividends, interest, rents and royalties) if an endowment fund is underwater but appropriation and expenditures of capital appreciation is precluded unless the net appreciation was appropriated for spending by the governing board before the principal of the fund went below the historic dollar value. If the fund went underwater due to spending pursuant to an spending-rate policy "or otherwise," the AG says that the charity has a duty to restore to the fund any appropriation of net appreciation that occurred when the fund was below historic dollar value and any appropriation of net appreciation that caused the fund to decrease below historic dollar value. The AG's position paper seemingly does not require restoration of funds lost due to market declines or due to distribution of classic income. The Endowment Memo states that failure to restore the fund may subject directors and officers for liability of breach of their fiduciary duties under N-PCL Section 717.

Further Information. For more information about UPMIFA, see http:// www.upmifa.org/DesktopDefault.aspx. The full text is available at http:// www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf. For a comparison to current New York law, see http://upmifa.org/states/NY - Comparison.doc. For a comparison to current New Jersey law, see http:// upmifa.org/states/NJ- -Comparison.doc. For other states see http:// www.upmifa.org/DesktopDefault.aspx?tabindex=3&tabid=70.

(d) Accounting Policies, Procedures and Controls

Policies and Procedures Manual. The charity should have an accounting policies and procedures manual. An Accounting Policies and Procedures Manual prepared by John Wiley from its book *Model Policies and Procedures for Not-for-Profit Organizations* is now available without charge on the web. It can be downloaded at www.wiley.com/legacy/compbooks/mcmillan.

A comprehensive manual is a fundamental component of an effective accounting and financial-reporting system. Lack of formal procedures may result in increased risks of errors and loss or misuse of assets, inconsistent treatment of transactions and lack of comparability of financial information. A comprehensive manual offers employees a clear picture of corporate controls, accounting procedures and practices, provides the charity with a source of information that will not be lost if key personnel leave, and will be helpful in training new employees.

The manual should include but not be limited to the following:

- Clearly outlined job descriptions;
- Flowcharts and narratives of the accounting system and procedures, including document-flow from the inception of a transaction to completion;
- A description of the level of authority required for approving transactions;
- Examples of documents and records used in each segment of the accounting system;
- A summary and description of accounting policies, especially for accruals and other areas requiring judgment, and related-party transactions;
- A description of reports prepared;
- A description of capitalization policies:
- A summary of procedures for preparing standard journal entries for recurring monthly transactions; and
- The current chart of accounts, including detailed explanations of account content.

Segregation of Duties. There should be a segregation of duties between the person responsible for receiving donations, updating receivable records (such as a finance director) and making deposits into the charity's bank account and the person responsible for preparing accounts payable documents, processing disbursements, and preparing bank reconciliations (such as a bookkeeper or controller). Procedures should be implemented to have the fundraising department prepare a list of donations received daily, when the mail is opened, and that this list should be reconciled to the daily bank deposit.

Documentation. The development department should obtain the proper documentation and support for all pledges and contributions, to increase controls over contributions. Additionally, procedures should be implement to establish a pledges receivable aging report and reconcile amounts recorded in the general ledger and in the development department's records on a monthly basis.

Fidelity Bonds. In general, internal controls are designed to safeguard assets and to help prevent losses from employee error or dishonesty. However, the cost of maintaining internal controls which preclude all such losses would be prohibitive. Accordingly, insurance, such as fidelity bonds, may be a practical solution, relating inexpensive supplement to internal controls. The following types of coverage are available:

- Scheduled bond - used where employer needs to cover only certain named employees;
- Blanket bond - covers all employees, including automatic coverage for new employees; and
- Position bond - covers specific positions rather than certain named employees.

9. Emergency Preparedness Plan

An emergency preparedness plan should prepare an organization, within reasonable cost/benefit constraints, to deal with any event that could interrupt its activities, disrupt or destroy its record-keeping systems and subsequently affect adversely its ability to conduct its operations.

The most common sources of operational disruptions are the more readily conceivable: hardware and software failures; fires, floods and other natural disasters; and, unhappily, sabotage by current or former employees or by outsiders. Likewise, the most common emergency plan for many not-for-profit entities is to “back up” computerized financial and operational data periodically and (sometimes) to sore it off the organization's premises. However, business interruption can result from such diverse events as unsafe buildings, broken water mains, power failures, accidents involving heavy machinery, threats made by telephone or letter, and public demonstrations by political groups. Although off-site data storage is an important control for information technology, there may be a need for other types of safeguards.

The following issues might be considered:

- Are there specific officers or employees who have been designated to take specific actions in the event of an emergency?
- If a problem arises, who will notify those who benefit from the charity's mission as well as call key supporters, bankers, attorneys, vendors, etc.?
- What will be the source of immediate working capital if it must shut down for some period of time?
- What provision will be made for alternative employee working space, if its premises are closed?
- Is insurance coverage adequate?

X. CERTAIN OPERATIONAL ISSUES

1. EIN and State ERN.

In order to open a bank account, make employment tax payments, file an application for recognition of tax exempt status with the IRS, etc. it is necessary to first obtain an employer identification number (EIN). For information about applying on-line, see www.irs.gov/businesses/small/article/0,,id=98350,00.html. The corporation will also need to obtain a New York Employer Registration Number (ERN) for reporting unemployment insurance, withholding and wage data; you can download Form NYS-100 at www.tax.state.ny.us.

2. Bank Accounts.

The Board should either approve each bank account (the preferred approach from a financial control standpoint) or authorize designated officers to open up accounts (less desirable but sometimes required if many accounts will be necessary or if personnel with authority to sign change frequently; if such procedure is used, the board will need to be diligent to obtain reports from management and have other controls in place) and designate who has authority to transact business

in such accounts (while one signature is acceptable for small amounts or routine payments -- *e.g.*, payroll, two signatures should be required for larger payments). No signatory should ever pre-sign a check.

3. Payroll Arrangements.

If the new nonprofit has a compensated staff, it will need to determine whether individuals performing services for it are employees or independent contractors. *For information about the distinction, see IRS Rev. Ruling 87-41, available at http://employerbook.hypermart.net/RR87-41.htm or http://www.medlawplus.com/legalforms/instruct/revrul87-41.htm*.

It will need to establish a system for preparing and filing annual Form W-2s for employees and 1099s on behalf of independent contractors paid $600 or more in a calendar year (and filing IRS Form 1096 correlating to 1099 information, and Form W-3, Transmittal of Wage and Tax Statements, covering W-2 data). IRS forms are available at www.irs.gov. The employer must obtain from each employees within three days of employment a completed Form I-9, Employment Eligibility Verification, to be kept with the employee's records for up to three years (the forms are not filed with the U.S. government). See www.uscis.gov.

The payroll system (manual or automated) must satisfy (a) withholding requirements (federal, state & city); (b) requirements for payment of funds withheld (federal, state & city); and (c) reporting requirements for funds withheld (federal, state & city). The filing frequency is based on the size of your payroll. A reputable payroll service provider can provide this service and should assume the liability for failure to pay withholdings.

As discussed above under Liability, while generally officers and directors of corporate entities are not liable for the debts of the organization, they can be held liable for certain payroll taxes.

4. Unemployment Insurance Coverage.

The new nonprofit needs to obtain unemployment insurance for its employees. Payments are based on gross payroll and are remitted quarterly to the NYS Unemployment Insurance Division. Nonprofits are exempt from Federal Unemployment Tax. *Information about the NYS Unemployment Insurance division is at www.labor.state.ny.us/ui/ui_index.shtm*.

5. Short Term Disability and Workers Compensation Coverage.

New York State law requires most employers to provide short term disability and workers' compensation coverage to employees. Many organizations obtain these coverages through the New York State Insurance Fund, although there are alternatives. Information about the State Insurance Fund is at www.nysif.com. The following employees do not need to be covered by workers compensation (but they can be voluntarily covered):

- Paid clergy and members of religious orders -- to be exempt the clergy and members of religious orders must be performing only religious duties.
- Members of supervised amateur athletic activities operated on a nonprofit basis provided that such members are not otherwise engaged or employed by any person, firm, or corporation participating in such athletic activity.
- Paid individuals engaged in a teaching capacity in or for a religious, charitable or educational institution (as determined under Section 501(c)(3) under the Internal Revenue Code) but the teachers must only be performing teaching duties.
- Paid individuals engaged in a non-manual capacity in or for a religious, charitable or educational institution - note that manual labor includes but is not limited to such tasks as filing; carrying materials such as pamphlets, binders, or books; cleaning such as dusting or vacuuming; playing musical instruments; moving furniture; shoveling snow; mowing lawns; and construction of any sort.
- Persons receiving charitable aid from a religious or charitable institution who perform work in return for such aid and who are not under any express contract of hire, and certain persons receiving rehabilitation services in a sheltered workshop.

See http:// www.wcb.state.ny.us/content/main/onthejob/CoverageSituations/nonprofit.jsp

A not-for-profit entity that is not compensating individuals (including executive officers) for their services is not required to obtain a workers' compensation insurance policy. For this purpose compensation includes stipends, room and board, and other “perks” that have monetary value but money used solely to offset expenses incurred while performing activities for the nonprofit are not counted as stipends. If a nonprofit has a workers' compensation insurance policy, its uncompensated executive officers are exempt (i.e., not covered), as long as that nonprofit has elected to exclude those individuals from coverage (by filing Form C-105.52). All compensated executive officers of a not-for-profit that is not classified as religious,

charitable or educational (Section 501(c)(3) under the IRS tax code) must be covered by a workers' compensation insurance policy.

The Workers Compensation Board will frequently send letters to companies, including nonprofits, that do not appear to have adequate coverage imposing Draconian penalties (e.g., a $20,000 fine), even when the nonprofit is exempt or has attempted to obtain coverage in a timely fashion but, due to bureaucratic difficulties, such coverage was not effected promptly. The Board is frequently willing to waive or reduce the penalties, but prompt attention needs to be paid to the matter (and detailed records should be kept with respect to attempts to file).

6. Other Insurance.

The nonprofit should also obtain necessary business insurance coverage, including, if applicable, general liability, property, professional responsibility, sexual abuse, automobile insurance (if it owns vehicles) and non-owned auto liability (if it uses nonowned vehicles). It should use an insurance broker for this. It should also consider obtaining directors and officers liability insurance. *See Directors and Officers Liability Insurance: Do All Nonprofit Organizations Need Directors and Officers Liability Insurance? at www.npccny.org/info/oi2.htm for guidance*.

7. Tension Between Board and Staff.

When you are working with start-up nonprofits, the board will often effectively "run the show," with board members taking on individual staff and executive positions. When the entity grows to the point were professional staff is hired, there will often be a tension between the board and the newly-hired staff, with the boards wishing to have a greater level of day-to-day involvement than staff is comfortable with. This is one of those issues that must be addressed in the nonprofit maturation process and board members will have to learn how to "back off" but not surrender their supervisory duties. Directors and staff will have to learn how the board should be kept informed, set policy and oversee operations, but not make routine operating decisions.

8. Raffles, Sweepstakes and Gaming.

A lot of charities conduct raffles and sweepstakes as fund raisers, either alone or in conjunction with other events such as annual benefits.

(a) Registration of Raffles

New York and certain other states require prior registration of raffles, which are defined as "games of chance in which a participant pays money in return for a ticket or other receipt and in which a prize is awarded on the basis of a winning number or numbers, color or colors, or symbol or symbols designated on the ticket or receipt, determined by chance as the result of a drawing from among those tickets or receipts previously sold." *See General Municipal Law Section 186.3-b. See also http://www.racing.state.ny.us/charitable/faqs_ raffle.htm and http://www.oag.state.ny.us/bureaus/charities2/pdfs/raffles.pdf*.

The New York Games of Chance Law, which is codified in the General Municipal Law, is administered by the Racing and Wagering Board. It specifically allows certain nonprofits to register to conduct raffles. The process is two-fold: the organization must obtain an identification number from the New York State Racing and Wagering Board and then it must obtain a license from the local municipality (although, if the net proceeds from raffles by such organization are less than $30,000 per calendar year, the organization may submit a verified statement on a Form VS-1 to that effect and thus be exempt from obtaining a license). There is no fee to obtain the identification number; there is a $25 fee for the local license.

The General Municipal Law sets forth the specific purposes of the organization which must be dominant purposes in order to be eligible. These include organizations formed for charitable, educational, fraternal, service, veterans or volunteer firefighter purposes. The organization must have been formed under New York law *(query: does that violate the interstate commerce clause?)*, been in existence for at least three years before applying, and it must be located in a locality that allows games of chance. It must devote at least 75% of its activities to programs other than conducting games of chance. If the proceeds exceed $30,000 it must maintain a separate account for raffle proceeds.

If licensed (or exempt) the organization can sell raffle tickets in the municipality where it is registered and any other municipalities in the county where such municipality is located or in any other contiguous county but only if those municipalities have passed a games of chance local law. Such raffles are legal in New York City; licenses are obtained from the Department of Consumer Affairs. There are numerous restrictions related to the raffle: only *bona fide* members of the organization can conduct the raffle, rentals for locations cannot include a percentage of proceeds,

the entire net proceeds must be exclusively devoted to the lawful purpose of the organization, no single prize may exceed the value of $50,000 (except that an organization may raffle off a single prize with a value of up to $100,000 if its application so notes), tickets may not be sold earlier than 180 days prior to the event, the winner may not be required to be present at the event, the raffles may only be held on the premises of the organization or a licensed lessor (*i.e.*, they could not be held at a hotel in conjunction with a fund raiser), every winner must be determined and every prize awarded and delivered within the same day the drawing is held and alcohol, real estate, security bonds, stock or evidences of debt cannot be awarded.

Within 30 days after the raffle, the organization must provide a full accounting to the licensing agency, which states: the number of tickets printed, sold, returned or retained as unsold, the fair market value of each prize awarded, the amount of gross receipts from the raffle, and the name and address of each person to whom an expense has been paid. If proceeds are less than $30,000 per year, a short form VX-2 verification may be used instead of the accounting. A copy of the sworn report must also be filed with the organization's annual report to the Attorney General.

New York and New Jersey, and probably other states, allow what is called a 50/50 raffle, where half of the money goes to the charity and half to those who have bought tickets, with the ability to restrict participation to actual contributors.

For California's provisions, see Penal Code Section 320.5, which generally exempts charitable raffles from the prohibitions of the code where at least 90% of the gross receipts are used for charitable purposes, the charity has been qualified to do business in California for at least a year and is exempt from taxation under state code sections and the charity is registered annually with the Department of Justice.

(b) Alternative Procedure

If an organization does not comply with the registration provisions, it should take care to ensure that the ability to participate in such activities is open to anyone who asks, whether or not they have made a contribution or bought a ticket, since otherwise the activity would be considered gambling. Note that some states also have “sweepstakes” laws which may require prior registration, announcement of winners and other procedural requirements.

(c) Tax Issues

Note that payments for raffles or sweepstakes are not charitable contributions (on the theory that you are getting something equivalent in value to what was paid) and appropriate disclosure of that fact should be made in any sales effort.

(d) Poker

The recent craze for Texas Hold 'Em and other forms of competitive and on-line poker has given rise to cases regarding nonprofits plans to host poker competitions. Proposals to legalize such charity poker events have been enacted in California, [FN20] Michigan, New Hampshire [FN21] and Oregon. [FN22] They were also introduced in Maine New York, Minnesota and Texas. For information about how gambling activities are treated by the IRS, see IRS Publication 3079. Note especially that purchases of raffle tickets and other gambling expenditures such as buy-ins to poker events should not be considered tax-deductible contributions by supporters, since the chance of winning is seen by the IRS as a *quid pro quo* equal in value to the price of the ticket. The IRS may also treat the nonprofit's income from gambling activities as taxable unrelated business income.

(e) IRS Disclosure

Schedule G of the new Form 990 requires reporting by organizations that reported certain amounts of professional fundraising expenses, revenue from special events, and revenue from gaming activities. The information required includes the types of fundraising activities (mail, email, phone, in-person, solicitation of government or non-government grants and events); whether there were written or oral agreements with fundraisers and the ten highest paid individual or entity fundraisers pursuant to such agreements if they are to receive at least $5,000; the states in which the organization is registered to solicit funds or been notified that it is exempt from registration and where it is registered to conduct gaming activities; information for each fundraising event or gaming activity raising more than $15,000 (including for each such event and for all events the gross revenue, cash prizes, non-cash prizes, facility costs and other direct expenses and, on an aggregate basis for all such events, the total direct expenses and net income).

9. Lobbying Rules

There are two aspects to nonprofit lobbying: (a) whether lobbying is allowable for nonprofits and, to the extent allowable, what filings need to be made by the nonprofits and (b) what registrations are required in order to engage in lobbying, whether at the federal, state or New York City level.

For the first aspect, see the tax discussion above. These issues regarding lobbying are unique to nonprofits. *For a helpful guide to the federal tax aspects of nonprofit lobbying, especially making the Section 501(h) election, see http:// www.afi.org/assets/resources/resources2/Worry-Free-Lobbying-for-Nonprofits.pdf*

The issues regarding registration are generally the same for nonprofits as for other entities engaging in lobbying activities, although lobbying aspects of the seeking of government grants may be unique to nonprofits.

10. 527 Organizations

Section 527 organizations, also referred to as "political organizations," electronically file a Form 8871 (unless they have to file with the Federal Election Commission -- see below). *For instructions on how to do that, see IRS Publication 4216 regarding political organizations (527) available at http:// www.irs.gov/pub/irs-pdf/p4216.pdf discussing procedure to file Form 8871, Political Organization Notice of Section 527 Status, and Form 8872, Political Organization Report of Contributions and Expenditures (if required)*.

According to Rev. Rul. 2003-49 (May 19, 2003), *available at http:// www.irs.gov/pub/irs-drop/rr-03-49.pdf Q/A 9*, Form 8871 must be filed "within 24 hours after the date on which the organization was established." If there is any material change, it must file an amended Form 8871 within 30 days and the it must file a final Form 8871 within 30 days of termination of its existence. According to Q/A 20, if the Form 8871 is not filed on a timely basis exempt function income (including contributions received, membership dues, political fundraising receipts, etc, normally tax exempt) from the date of the filing is due until the filing is made is taxable. The tax is determined by multiplying the income by the highest federal tax rate.

While a political organization is generally exempt from federal income taxes, there are certain categories of income (including certain investment income) on which it must pay taxes. The political organization needs to file a Form 990 if its receipts exceed $25,000 per year ($100,000 if it qualifies as a qualified state or local political organization, basically entities that file similar reports at the state level - see the Form 8871 instructions). It also may need to file a Form 1120-POL if it has investment income.

If the organization is required to report as a political committee under the Federal Election Campaign Act to the Federal Election Commission, it does not have to file the Form 8871, 8872 and 990 but it may be required to file the Form 1120-POL. For further information, see the FEC website, http:// www.fec.gov/sitemap.shtml.

An entity is required to make publically available its Forms 8871, 8872 and 990 (excepting lists of contributors) but it does not need to make available its 1120-POL. Copies of Forms 8871 and 8872 are available on the IRS website.

11. Reduced Postal Rates. *A summary of these requirements is available at http://www.irs.gov/pub/irs-news/fs-02-13.pdf*.

Eight categories of nonprofits are eligible to obtain reduced postal rates. *See US Postal Service Publication 417, available at pe.usps.com*. The eligible organizations are nonprofits that are religions, educational, scientific, philanthropic (charitable), agricultural, labor, veterans and fraternal. Qualified political committees can also get reduced mailing rates.

The nonprofit or political committee applies for reduced rate mailing privileges at each post officer where it plans to do its mailings by filing PS Form 3624. The nonprofit must also provide copies of its formative papers, evidence of nonprofit status (*e.g.*, IRS determination letter or financial statement from an independent auditor), list of activities for the past 12 months, financial statement showing the qualifying activity and other documents off operations which could include bulletins, brochures, membership solicitation material, annual reports, and meeting minutes.

The local post office will review the application and then send it to a national office in New York. The review process normally takes about two weeks. Refunds of fees paid for "standard rates" (but not first class rates) during the period between application and granting of reduced rate privileges are possible.

Once a nonprofit is authorized to mail at one post office it can apply for similar rights at other post offices by filing a PS form 3623.

The nonprofit must make at least one mailing at the Nonprofit Standard Mail rates during a two year period or the authorization will be revoked automatically.

There are certain content-based limitations on the nonprofit rate. Nonprofit prices are not permitted for mailing promotional material for credit cards, and promotional material for insurance policies, and travel arrangements is restricted.

Nonprofit rates, however, may not be worth it. Among other things, the postal service requires that the nonprofit do certain tasks before the mailings are made that it would not otherwise have to do. Sometimes commercial bulk rates may not be that much more. Some nonprofits also report that nonprofit mailings take more time to arrive, meaning you have to mail earlier.

12. Anti-Terrorism Rules

In the era after 9/11, the federal government has become more concerned with charities being used as funnels to aid terrorist organizations. Accordingly, charities now have to take special steps to make sure that they are not inadvertently assisting terrorists. These steps are most burdensome for organizations that make international grants, have overseas employees or otherwise engage in international transactions.

(a) Executive Order

Executive Order 13224, issued September 23, 2001 *(available at http:// www.fas.ors/irp/offdocs/eo/eo-13224.htm)*, prohibits all persons, including non-profit entities, from contributing funds to or receiving services from terrorists, and does not include a safe harbor for unknowing acts. This requirement has the force of law.

(b) Treasury Department

Following the issuance of EO 13224, the U.S. Department of the Treasury published its *Anti-Terrorist Financing Guidelines: Voluntary Best Practices For U.S.-Based Charities* ("Best Practices Guidelines"). These guidelines were revised on September 29, 2006. *A copy is available at http:// www.treas.gov/offices/enforcement/key-issues/protecting/docs/guidelines_ charities.pdf* Unlike the President's executive order, these guidelines are not manditory but, because they establish certain strongly recommended procedures to be followed, the guidelines have generated controversy since the U.S. Treasury Department has the authority under the USA Patriot Act to freeze or seize assets of charities and failure to follow these guidelines may be viewed adversely by the Treasury Department.

The Department of the Treasury, together with DOJ, also issued *The 2003 National Money Laundering Strategy*, (the "Strategy") That publication calls for increased oversight to identify and shut down those charities with ties to terrorist organizations and to keep terrorist financiers from using legitimate but unwitting charities for inappropriate purposes. The Strategy also advocates improved efforts on the part of the Federal Government in sharing information with the private sector.

Note also that the Best Practices Guidelines apply to all U.S. charities, not just those making foreign grants. Part III of the guidelines sets forth a general "good governance" roadmap that charities may wish to review in determining governance practices. The topics addressed include governance instruments, independent oversight and key employees. Part IV addresses financial accountability and transparency, with provisions regarding budgets, CFO/CAOs, audits, solicitation of funds, and receipt and disbursement of funds. Part V discussed programmatic verification, including ability of grantee to accomplish its goals, the need for written agreements, periodic reporting and ongoing monitoring, the need to take reasonable steps to avoid funding terrorist groups (including routine on-site audits) and the requirement to correct misuse of resources.

Part VI addresses anti-terrorism best practices, including information gathering procedures and vetting of its employees and grantees. This guideline includes review of the Department of the Treasury's Office of Foreign Assets Control's Specially Designated Nationals List (available at http:// www.ustreas.gov/offices/enforcement/ofac/sdn/), which identifies entities designated by the U.S. Government as Foreign Terrorist Organizations or as supporters of terrorism or other activities that are inimical to U.S. national security and foreign policy interests. The Best Practices Guidelines also note that the charities should be aware of similar lists maintained by other nations and international agencies such as the United Nations and also encourages that the charity check the Terrorist Exclusion List maintained by the Department of State in consultation with the Department of Justice (DOJ), which is comprised of individuals and organizations found to commit or support terrorist activities and is used primarily for the purpose of excluding aliens associated with entities on the list from entering the United States.

(c) US AID

The United States Agency for International Development, a government agency that depends on nongovernmental organizations to carry out its mission, requires a certification from both U.S. and foreign nongovernmental organizations to the effect that the organization does not provide material support to any individual or entity that

appears on the OFAC SDN, the United Nations list, or other specified lists before the organization can receive a grant or cooperative agreement.

(d) Office of Combined Federal Campaign Operations

Nonprofits that wish to participate in the Federal government's Combined Federal Campaign for payroll deductions of charitable gifts (like United Way), must sign the following certification:

"I certify that, as of the date on which this application is being submitted to the CFC, the organization named in this application does not knowingly employ individuals or contribute funds to entities or persons on either the Department of Treasury's Office of Foreign Assets Control Specially Designated Nationals List or the Terrorist Exclusion List. Should any change in circumstances pertaining to this certification occur at any time, the organization will notify OPM's Office of CFC Operations immediately."

Under the rules as originally issued, the organization is required check at least once a year two terrorist watch lists to ensure that their full and part time employees and donees are not on the list. It does not have to review the list regarding volunteers or businesses from which the organization purchases goods or services. The lists are the Treasury Department's Specially Designated Nationals List (which is over 170 pages) and the State Department's Terrorist Exclusion List (which lists about 60 terrorist groups).

You may be aware that the Executive Director of the American Civil Liberties Union originally agreed to these requirements but, after his board became aware and noted that it was in fact protesting these types of requirements, the organization ceased its participation in the federal campaign because of the perceived abuses which this procedure requires. In late 2005 the Combined Federal Campaign dropped its requirement that organizations participating in the campaign check to see if their employees' names are on government lists of terror suspects (see, Stephanie Strom, *Requirement on Watch Lists is Dropped*, New York Times, November 10, 2005, p. A22).

(e) The Lists; Further Information

The lists are:

• U.S. Treasury Department's Specially Designated Nationals List *(available at http://www.ustreas.gov/offices/enforcement/ofac/sdn/)*

• the U.S. State Department's Terrorist Exclusion List *(available at http:// www.publicsafety.ohio.gov/links/terrorist_exclusion_list.pdf)* and

• the United Nations Security Council Resolution 1267 list *(available at http://www.un.org/sc/committees/1267/consolist.shtm)l*

Note that the links in the OCFCO guidelines, *which are available at http://www.opm.gov/cfc/opmmemos/2004/2004-12.asp*, do not work any more

ATTACHMENTS

A. Resources for Formation and Operation of New York Not-for-Profit Corporations
B. Sample Forms:
1. New York Certificate of Incorporation
2. Delaware Certificate of Incorporation
3. New York by-laws
4. Delaware by-laws
5. Prototype conflicts of interest policy
6. Prototype whistleblower policy
7. Prototype document destruction/retention policy

RESOURCES FOR FORMATION AND OPERATION OF NEW YORK NOT-FOR-PROFIT CORPORATIONS

IMPORTANT ADDRESSES AND TELEPHONE NUMBERS [FN23]

Internal Revenue Service

Internal Revenue Service [note that this address differs from that on the Form 1023; it was changed effective January 2009 -- see http://www.irs.gov/pub/irs-pdf/f1023.pdf]

P.O. Box 12192
Covington, KY 41012-0192
or
201 West Rivercenter Blvd.
Covington, KY 41011
Attn: Extracting Stop 312
(Express Mail or other delivery service)

To get *Exempt Organization Update*, a free frequent email from the IRS, subscribe at https://service.govdelivery.com/service/subscribe.html?code=USIRS_ 16

For technical and procedural questions concerning charities and other non-profit organizations (including the status of Form 1023 filings), call the IRS Tax Exempt and Government Entities Customer Account Services at (877) 829-5500 (toll-free number) or write to: Internal Revenue Service, Exempt Organizations Determinations, P.O. Box 2508, Cincinnati, OH 45201

For questions about employment taxes to the Business and Specialty Tax Line at (800) 829-4933 (toll-free).

New York State Department of State

Division of Corporations, State Records and Uniform Commercial Code
New York State Department of State
41 State Street
Albany, New York 12231
www.dos.state.ny.us/corp
Attn: David S. Carroll, Assistant Counsel (518-473-2278; fax: 518-474-5173)
Corporations -- General Information: (518) 473-2492 (ask for business document specialist supervisor)
Fax: 518-474-1418 (for filing certificates) 518-473-1654 (for name reservation)
Fees: For basic filing = $75 (check, MO or credit card -- must include credit card authorization form)
For expedited filing, must so mark on exterior of package (fee = $25 for 24 hour; $75 for same day and $150 for two-hour service)
For certified copy = $10
For amendment = $30
For applications of authority = $135
State Records: (518) 474-4770
Uniform Commercial Code: (518) 474-4763
http://www.dos.state.ny.us/corp/corpwww.html
Division of Corporations and State Records

1-900-835-2677	for information concerning specific corporation, if search of the corporate records is necessary (e.g., to find out if Certificate has been filed). There is a fee for the use of this number.
(518) 473-2492	to speak to a specific person or obtain general information

or

(for hand deliveries of special handling requests)
123 William St. -- 19th Floor
New York, New York 10038
(212) 587-5740

New York Department of Law ***(for registrations under the EPTL and Executive Law; approval of business leagues and other corporate changes)***

For Charities Registration:

New York State Department of Law
120 Broadway, 3d floor
New York, New York 10271
Charities.Bureau@oag.state.ny.us
www.oag.state.ny.us/charities/charities.html (212) 341-2400 -- General
(212) 341-2070 -- Record Room Attn: (212-416-8490)
Jason Lilien, Assistant Attorney General, Bureau Chief of the Charities Bureau
Karin Kunstler Goldman, Section Chief for External Relations, Public Education and Administration (karin.goldman@oag.state.ny.us)
Maria Simpson, Assistant Attorney General, Investigations
Daryl Eason (for Certificates of Incorporation) (x2870)
Toula Hanish, Senior Legal Assistant; (for dissolutions) (212.416.8416; fax: 212.416.8393; toula.hanisch@oag.state.ny.us)
Laura Werner (406-1210)
Paula German (212-416-6404) or Barbara Zuckerman (for Certificates of Amendment and Asset Sales) (212-416-8415)
Mylan Denerstein is the Executive Deputy Attorney General in charge of the Social
Justice section, in which the Charities Bureau resides
Note that approvals for mergers, assets sales and dissolutions frequently have to be processed through the AG's local office. Check the AG's website for information on such transactions.

For Fund Raising Professionals Registration:
Registration Section -- Fund Raising Professionals
New York State Department of Law
The Capitol
Albany, NY 12224
518-486-9797
Charities.Fundraising@oag.state.ny.us

For Approval of Certificates of Incorporation for Business Leagues, etc.:
New York State Office of the Attorney General
Antitrust Bureau
120 Broadway, 26th Floor
New York, NY 10271
Phone: (212) 416-8262
Fax: (212) 416-6015
Email: antitrust@oag.state.ny.us

For Freedom on Information Law (FOIL request on Form CHAR 007)
New York State Attorney General
Charities Bureau
Attn: FOIL Officer
120 Broadway, 3rd floor
New York, NY 10271
or by email to Charities.FOIL@oag.state.ny.us

New York State Education Department ***(for consent to incorporation under N-PCL Section 404(d) and (w))***
New York Education Department
Office of Counsel
New York State Education Building
89 Washington Avenue, Room 148
Albany, New York 12234
(518) 474-8966
fax: 518-474-4188
www.nysed.gov

http://www.counsel.nysed.gov
http://www.counsel.nysed.gov/consents.html
legal@mail.nysed.gov
Attn.: Susan A. Naccarato, Senior Attorney
Richard L. Nabozay, Senior Attorney
Anne Marie Koschnick, (518-473-8296) (main contact for consents)
Debbie (for status of submitted consent request) (518-474-1527)
Tom Hogan (for elementary and secondary schools)
Mr. David W. Palmquist, Head
Chartering Program, New York State Museum
Room 3097, Cultural Education Center
New York State Education Department
The University of the State of New York
Albany, NY 12230518-473-3131
Fax: 518-473-8496
dpalmqui@mail.nysed.gov
www.nysm.nysed.gov/charter/

New York State Office of Children and Family Services ***(for consent to incorporation under N-PCL Section 404(b))***
Office of Children and Family Services
52 Washington Street, Room 133, North Building
Rensselaer, NY 12144
(518) 474-3333 or 474-9752
www.ocfs.state.ny.us
Attn.: John R. Canino, Senior Attorney (518-486-6378)
Charles Carson (518-474-7112)

Note: the statute currently says consent must come from the Department of Social Services but, in practice, that consent now comes from the Office of Children and Family Services. If needed, the address of the Department of Social Services is:

Department of Social Services
Counsel's Office
40 North Pearl Street
Albany, NY 12243
(518) 474-9502
Attn.: Linda Hunt (518-474-9777)

Legislation was introduced to amend Section 404(b) to formalize this procedure (A.4623, introduced February 11, 2005), but it was not passed. We are advised that an uncodified provision in a budget bill was approved that eliminated the need for this consent. The legislation would also do away with the need for consent for incorporation of day care centers (but not the need for substantive licensing after incorporation). It would also formalize an informal practice requiring that the consent for adult care facilities be provided by the commissioner of health instead.

New York State Public Health Council and Department of Health ***(for consent to incorporation under N-PCL Section 404(p) and (t))***
New York State Department of Health
Division of Legal Affairs
Empire State Plaza, Room 2482
Albany, NY 12237-0026
Tel: 518-473-3233
www.health.state.ny.us
Attn: Paul Stavis (or Karen Westervelt, Executive Secretary or
Donald Perens, Jr., Office of Counsel or Suzanne Sullivan 518-474-7553)

New York State Office of Mental Retardation & Developmental Disabilities ***(for consent to incorporation under N-PCL Section 404(q) requiring licensing by such department or solicitation of funds for such purpose)***

Office of Mental Retardation & Developmental Disabilities
Office of Counsel
44 Holland Avenue, 3rd Floor
Albany, NY 12229
(518) 474-7700
Attn.: Nancy Roth
www.omr.state.ny.us

New York State Office of Mental Health ***(for consent to incorporation under N-PCL Section 404(q) requiring licensing by such department or solicitation of funds for such purpose)***

New York State Office of Mental Health
Bureau of Inspection and Certification
44 Holland Avenue
Albany, NY 12229
518-474-5570
www.omh.state.ny.us

New York State Office of Alcoholism and Substance Abuse Services ***(for consent to incorporation under N-PCL Section 404(u) or (v)***

Office of Alcoholism and Substance Abuse Services
Bureau of Certification
1450 Western Avenue
Albany, NY 12203-3526
(518) 457-4384
www.oasas.state.ny.us

New York State Office of Temporary & Disability Assistance

Counsel's Office
40 North Pearl Street
Albany, New York 12243-0001
(518) 474-9502
Attn.: Mr. Ron Speier

New York State Department of Labor Standards

State Office Building Campus, Room 185A
Albany, New York 12201
or
345 Hudson Street
New York, New York 10014
(212) 352-6981 (Employer Information Calls Only)

New York State Worker's Compensation Board

District Office
180 Livingston Street
Brooklyn, New York 11248
(718) 802-6600 (on the job injuries)

New York State Insurance Fund

199 Church Street
New York, New York 10007
(212) 962-8900

New York State Department of Taxation and Finance

Exempt Organizations Unit (for ST-119.2)
New York State Tax Department
Building #8, W.A. Harriman Campus
Albany, NY 12227-0125
Tel: 518-457-2782
or
New York State Corporation Tax (for CT-247)
Building 9, Room 350
W.A. Harriman Campus
Albany, NY 12227
or
Processing Unit (for CT-13)
P.O. Box 1909
Albany, NY 12201
or
New York State Income Tax Bureau (for IT-21045; IT-2101)
Box 229
Albany, NY 12201
or
80 Maiden Lane
New York, New York 11236
(212) 383-1352 -- General Information

New York State Racing and Wagering Board ***(for raffle identification numbers)***
1 Watervliet Avenue Extension, Suite 2
Albany, NY 12206-1668

New York City Department of Finance
Property Division
Exemption Unit
Room 909, Municipal Building
New York, New York 10007
(212) 669-2700

Borough Offices:

Manhattan:	Room 920 Municipal Building New York, New York 10007 (212) 669-4892
Brooklyn:	Room 200 Brooklyn Municipal Building Brooklyn, New York 11201 (718) 935-9500
Queens:	14406 94th Avenue Jamaica, New York 11435

(718) 298-7000

Staten Island: 350 St. Marks Place
Staten Island, New York 10301
(718) 390-5295/6

New York City Tax Commission
One Centre Street
Room 936
New York, New York 10007
(212) 669-4410

New York City Office of the Comptroller
Bureau of Law & Adjustment
Real Property Division
2 Lafayette Street -- 2nd Floor, Room 206
New York, New York 10007
(212) 442-0012

New York City Department of Environmental Protection
Bureau of Air Resources Records
59-17 Junction Blvd., 9th Floor
Corona, New York 11368
(718) 595-3855
Exemptions (Borough Offices):
Bronx: 1932 Arthur Avenue
Bronx, New York 10457
(718) 579-6975
Brooklyn: 248 Duffield Street
Brooklyn, New York 11201
(718) 480-8017
Queens: 96-05 Horace Harding Expressway, 13th Floor
Corona, New York 11368-5107
(718) 595-6650
Staten Island: 60 Bay Street, 6th Floor
Staten Island, New York 10301
(718) 876-6805

New York City Department of Buildings
Attn: Central Billing
60 Hudson Street -- 14th Floor
New York, New York 10013
(212) 312-8206 -- General
(212) 312-8159 -- Billing Offices

New York City Department of Consumer Affairs ***(for NYC raffle licenses)***
42 Broadway
New York, NY
212-487-4161

[FN1]. With the assistance of Etta Brandman of Stroock & Stroock & Lavan, LLP

[FN2]. Copilevitz and Canter, *Fund Raising and Non-Profit Report*, August 2008.

[FN3]. Another type of newly-evolving entity is called the **L3C or L3C**. It is a low-profit LLC [and called such in some states] structured to more easily attract program-related investments (PRIs -- see discussion below in this footnote) by private foundations. They are organized for a business purpose but must significantly further the accomplishment of one or more charitable or educational purposes. They are not tax-exempt since they can have equity owners and generate a profit. An L3C can have different classes of investors--such as individuals, government agencies, nonprofits, and for-profits--with foundations taking the most risk. The L3C's investment structure would be designed to bring new pools of funds such as pension and endowment investments to bear on problems normally treatable only by nonprofit dollars. It can tier the interests -- for-profit investors who need a higher return, people looking to support socially-beneficial enterprises willing to settle for a modest return, and charitable investors willing to take a minuimal return.

By being a defined entity organized under state laws, the thinking is that L3Cs would usually reduce legal fees and organizational costs associated with PRIs. Its financial structure would allow the creation of a saleable product by the financial industry. The appearance of L3C in the entity name should help the entity attract PRIs. Whether they have worked in practice remains to be seen. The L3C structure represents the collaboration of a multitude of individuals and organizations, including Americans for Community Redevelopment, the Council on Foundations, the Kauffman Foundation, and Caplin & Drysdale, among others. It was devised by Robert Lang, CEO of the Mary Elizabeth and Gordon B. Mannweiler Foundation, with help from Marcus Owens at Caplin & Drysdale (the former head of the Exempt Organization section at the IRS). Vermont was the first state to enact legislation on the topic (enacted April 30, 2008) *[for a list of existing VT companies, see http://cgi2.sec.state.vt.us/cgi-shl/nhayer.exe]*. Illinois, Michigan, North Dakota, Wyoming, and Utah have all followed suit, as has the Indian Crow nation. Legislation has also been introduced in Arkansas, Maine.

Missouri, Montana, North Carolina, Oregon, Tennessee and Wyoming. Under the Vermont legislation the L3Cs files the same paperwork that it would file to form a regular LLC -- the only difference is that it must significantly further the accomplishment of one or more charitable or educational purposes and would not have otherwise been formed but for the relationship to such purposes. While no significant purpose can be the production of income or the appreciation of property, the fact that it produces significant income or appreciation is not, in the absence of other factors, conclusive evidence that it has a significant purpose of producing such income or appreciation. The company name must include the L3C indicator. If the company loses its charitable/educational purpose, it reverts to being a regular LLC and it must change its name to lose the indicator. The organizational form has been amended to include the L3C designation. It appears that a regular LLC can not later elect L3C status.

See the following for more information: http:// www.sec.state.vt.us/corps/dobiz/llc/llc_3c.htm; http:// www.communitywealth.com/Newsletter/August-2007/L3C.html; http://www, americansforcommunitydevelopment.org/; http:// philanthropy.com/news/conference/7858/new-legal-status-for-socially-oriented-business-gains-ground; http:// philanthropy.com/news/updates/index.php?id=4133.

Other topics that may be relevant are **program-related investments (PRSs)** and **mission-related investments (MRIs)**. PRIs are investments by a philanthropic organization in a for-profit venture with the goal of achieving a goal espoused by the philanthropy -- whether or not the investment creates a financial return for the philanthropy is irrelevant so long as the investment serves the philanthropy's philanthropic mission. The IRS has stringent rules that must be satisfied for PRIs in order for them to satisfy the minimum 5% payout requirement for private foundations. A PRI can be a loan, loan guarantee, equity purchase, or other investment that will further the foundation's philanthropic purposes; the Ford Foundation is famous for making them; *for more information, see http://foundationcenter.org/getstarted/faqs/html/pri.html*. Although the Internal Revenue Code allows all private foundations to make program related investments, PRIs are underutilized because of the bureaucratic hurdles and significant costs associated with obtaining "sign-off from the IRS in the form of a private letter ruling (PLR). PRIs that are structured as loans must charge a rate of interest less than commercial rates.

MRIs are investments made by philanthropic entities in the pursuit of both financial and social returns. In mission related investing the foundation proactively seeks investment opportunities that produce a blend of financial returns and social impact that are in line with the philanthropy's mission. It focuses on investment of financial assets. They still seek to get a market rate of return, but maybe not the maximum rate that could be obtained from an investment made solely on the basis of maximum return. Such investments do not qualify for the 5% payout requirement; groups which do MRIs view the 5% payout obligation as a minimum, not a maximum. *See http://www.community-wealth.org/_ pdfs/news/recent-articles/04-08/article-swack08.pdf (a*

short article about the Heron Fund, one of the first foundations that focused on MRIs) and http:// www.rockpa.org/pdfs/mri.pdf (a longer guide by Rockefeller Philanthropy Advisors discussing policy and implementation issues, including case studies). See also http://www.fsg-impact.org/app/content/ideas/item/545 regarding mission investment intermediaries.

[FN4]. See the discussion below (V.4(c)), however, regarding rulings by the NYS Finance Department allowing a single member LLC owned by a nonprofit to obtain a real property tax exemption, and thereby sanctioning the use of an LLC for non-business purposes. While historically "business" was construed to mean "for profit," there is a movement in some states to get away from such limited meaning. For instance, commencing in 2004 the California Corporations Code Section 17002, which allows LLCs to engage in any lawful business activity, was expanded to clarify that a business purpose can be found whether or not the company's actions are for profit, thereby allowing California nonprofits to use the LLC form. The entity must otherwise meet the requirements of the California Revenue and Tax Code Section 23701. In 2008 Ohio passed legislation (HB 160) that clarifies that nonprofits can be in LLC form and that single member LLCs with a sole nonprofit member shall be treated "as part of the same legal entity as its nonprofit member." For Missouri, see wiki.answers.com?Q/Can_an_LLC_be_a_Nonprofit. For an article encouraging legislative reform to allow nonprofits to operate in LLC form, see Christopher M. Riser, "Nonprofit LLCs: Time for a New Experiment, available at www.mayer-riser.com/Articles/nonprofit/npnc.htm.

[FN5]. Fiscal sponsors are non-profit organizations that offer their legal and tax-exempt status to other groups (including unincorporated associations and corporations that don't yet have a federal recognition of exempt status) that are engaged in activities related to the sponsor's mission. The sponsor provides various levels of services for which it charges a fee, typically a percentage of funds raised. Services can included payroll (*i.e.*, becoming the employer of record for the sponsored group's employees), employee benefits, office space, publicity, fundraising assistance, and training services. Donors make their tax-deductible contributions to the sponsor, which then distributes such fund to the sponsored entity for the sponsor-approved purpose. *A guide to fiscal sponsorship can be found at http:// foundationcenter.org/getstarted/tutorials/fiscal/*.

[FN6]. If there is an immediate need to make a donation and you don't want to form the donee outside of New York, alternatively the donor can give funds to an donor-advised fund (which is a charity, generally established by financial management companies such as mutual funds, which will accept contributions and only make distributions as recommended by the donors) with the right to later "request" that such organization give the money to a newly-formed or already-existing entity; such funds will usually accede to the request if the recipient is a tax exempt although they may be less willing to give to private foundations. Note also that the IRS and Congress has focused on abuses by donor-advised funds and there may soon be more federal restrictions on their use.

You may also be able to give the money to a community trust which will usually use it for the purposes requested by the donor, assuming those purposes are consistent with the trust's mission. It may also be possible to form a "bare bones" New York nonprofit that is not doing things that require New York consents and later change the certificate of incorporation to add those purposes but this procedure will require Attorney General and Supreme Court approval of the amendment to the certificate of incorporation, which approval would not be required at the time of initial formation.

[FN7]. Note, however, that many education corporations have provisional charters that have expired. While sometimes the provisional charter will be extended, often the department just leaves the lapsed provisional charter in place. This situation arises because the department does not have adequate staff to do the inspections that are required to issue an absolute charter.

[FN8]. "No corporation having the power to solicit contributions for charitable purposes may solicit contributions for any prupsoe for which approval of such solicitation is required under the provisions of section four hundred four of this chapter unless the certificate specifically makes provision for such solicitation and the required written approval is endorsed on or annexed to such certificate or unless the corporation is among those referred to in section one hundred sevent two-a of the executive law." Whew!

[FN9]. Statistics are from a November 2008 letter from Ms. Lerner to Dear Colleagues, quoted in *Statement of William Josephson [the former head of the New York Charities Bureau] to the Committee on Finance, United States Senate, March 17, 2009*, available at http:// finance.senate.gov/hearings/testimony/2009test/031709wjtest.pdf

[FN10]. Starting in 2009 Guidestar allows nonprofits to post additional information about themselves. This includes information about background, funding, board information, revenues and expenses, annual reports, funding and volunteer needs, requests for in-kind contributions and various staffing information.

Another site that reports on charities is Charity Navigator. It rates nonprofits that solicit the public for support. Rated organizations must have over $500,000 in annual public support (generally excluding those that rely on government grants or fees for services) and have filed at least four years of Forms 990. It then divides potential candidates by types of charities (health, international, human services, etc.) and by geographic region to obtain a representative pool and focus on those that receive the largest amount of total support from individuals, corporations, foundations and government. Its rating focus on various how responsibly it functions day-to-day as well as how well positioned ti is to sustain its programs over time, generating a numbers-based rating system (zero to four stars) of the financial health of over 5000 charities. *See http://www.charitynavigator.org/.*

[FN11]. The AG's regulations applicable this law and the charitable solicitations law discussed below (NYCRR, Title 13, Chapter V, Part 90.3) define charitable organizations as “any benevolent, philanthropic, patriotic, or eleemosynary ... entity .... that intends to solicit or solicits contributions from New York State residents.” It is not clear whether “contributions” includes non-deductible contributions such as might be given to a (c)(4) social welfare organization.

[FN12]. Note that museums are exempt even if they solicit the general public so long as they are chartered by and report to the Education Department but historical societies must limit their solicitations to members in order to be exempt. It may therefore be advantageous to be chartered as a museum, although that may have its own drawbacks.

[FN13]. These percentages are different that the organizations' targets for total fundraising costs. For instance, the Better Business Bureau says the nonprofits should spend at least 50% of annual revenue on program costs; the American Institute of Philanthropy put the figure at 60% of expenses and the United Way of the National Capital Area sais 80%. Program costs exclude fundraising costs and general administration. See Frequently Asked Questions, National Center for Charitable Statistics, at http:// nccsdataweb.urban.org/tablewiz/tw_bmf.php.

[FN14]. Note that the language in the state (Section 172 of the Executive Law) regarding FRC is unclear. It says “No services shall be performed under such a contract until the professional fund-raiser shall have received an acknowledgement from the attorney general of the receipt of a copy of such contract or such contract shall have been on file with the attorney general for at least fifteen days, whichever is shorter. Provided, however, that no services shall be performed pursuant to such contract if, within fifteen days of filing, the attorney general has notified the professional fund raiser or fund raising counsel and the charitable organization of any deficiencies in the contract and/or the registration and filing under this article.” Since the first part of the provision speaks of “professional fund-raisers,” the implication is that this does not apply to fund raising counsel but note that the term is used with a hyphen between “fund” and “raiser” instead of as two words; the use in hyphen form elsewhere in the statute seems to apply to both PFRs and FRC whereas the use without a hyphen is used solely for PFRs; furthermore, the following proviso specifically includes FRCs. So the better reading is that the 15 day delay applies to both PFRs and FRC.

[FN15]. This discussion of the various fiduciary duties is based on a 2003 article on the NY AG's website captioned “The Regulatory Role of the Attorney General's Charities Bureau” as well as Bruce R. Hopkins, *Legal Responsibilities of Nonprofit Boards* (BoardSource 2003), a summary of which is available at http://www.boardsource.org/Knowledge,asp?ID=3.364

[FN16]. See BoardSource: http://www.boardsource.org/Knowledge.asp?ID=3.369

[FN17]. See, *e.g., Statement of William Josephson [the former head of the New York Charities Bureau] to the Committee on Finance, United States Senate, March 17, 2009*, available at http:// finance.senate.gov/hearings/testimony/2009test/031709wjtest.pdf

[FN18]. You will find three versions of the principles at the website: (a) the basic 38 page version which includes each principle with general overview followed by the text of each principle plus a short elaboration of that principle; (b) a 4 page summary version that includes merely the text of each principle and (c) a 136 page “reference edition” that includes, in addition to the

overview and principles, a longer elaboration of each principle (including legal analysis) plus various studies of self-regulatory systems, issues and models. This memorandum tracks the summary version.

[FN19]. See *EO Update*, February 27, 2008, Issue No. 2008-3, as posted on the Life Cycle of a Public Charity website, http://www.irs.gov/charities/article/0,,id=178221,00.html

[FN20]. Beginning January 1, 2007, California allows eligible nonprofit organizations that have been in existence for at least three years and register with the Division of Gambling Control to hold "charity poker night" fundraisers under specified circumstances. See http://ag.ca.gov/gambling/charitable.php

[FN21]. or New Hampshire, see http://66.116.121.28/poker-law/article/4204/home-poker-and-the-law-in-america

[FN22]. For Oregon rules, see http://onthefelttournaments.com/cgi-bin/page_ display.cgi?page_nav_name=legaINvW

[FN23]. This listing was last updated in January 2009 but there are, no doubt, many listings that have probably changed from what appears here, both before and since that date. Individuals indicated as being in charge of various functions may also have changed but the names indicated may be helpful in trying to find the currently appropriate person.

OTHER RESOURCES

• BOOKS

1. American Bar Association, Committee on Nonprofit Corporations. Guidebook for Directors of Nonprofit Corporations, Second Edition. 2002

2. American Bar Association, Committee on Nonprofit Corporations and American Society of Corporate Secretaries. Nonprofit Governance and Management. 2002

3. American Bar Association, Committee on Nonprofit Corporations and American Society of Corporate Secretaries. Nonprofit Resources: A Companion to Nonprofit Governance. 2002

4. Bjorklund, Victoria, Fishman, James J. and Kurtz, Daniel L. New York Nonprofit Law and Practice: With Tax Analysis, Second Edition. Matthew Bender, 2007 annually updated

5. Bromberger, Allen, et. al. Getting Organized, Fifth Edition. Lawyers Alliance for New York, 1999 [This is the best hands-on book for formation of a New York not-for-profit; it also goes into the tax exemption process in a simple but thorough fashion]

6. Community Resource Exchange, From Vision to Reality: A Guide for Launching a Successful Nonprofit Organization. Available at http:// crenyc.com/resources/resources_publications.php

7. Delany, Sean and Schechter Manley, Linda. Mergers and Strategic Alliances for New York Not-for-Profit Corporation. Lawyers Alliance for New York.

8. Edie, John A. and Nober, Jane C. Beyond Our Borders - A Guide to Making Grants Outside the U.S., Third Edition. Council on Foundations, 2002

9. Futter, Victor (editor). Nonprofit Governance and Management. American Bar Association: Section of Business Law.

10. Futter, Victor (editor). Nonprofit Resources: A Companion to Nonprofit Governance. American Bar Association: Section of Business Law.

11. Hill, Frances. Taxation of Exempt Organization. Warren Gorham & Lamont.

12. Hopkins, Bruce. The Law of Tax-Exempt Organizations. Eighth Edition. 2003. John Wiley & Sons

13. Hopkins, Bruce. The First Legal Answer Book for Fund-Raisers. John Wiley & Sons

14. Hopkins, Bruce. The Second Legal Answer Book for Fund-Raisers. John Wiley & Sons

15. Hopkins, Bruce. The Law of Fundraising. Third Edition. John Wiley & Sons, 2002 (with cumulative supplement)

16. Hopkins, Bruce. Private Foundations: Tax Law and Compliance. John Wiley & Sons.

17. Hopkins, Bruce. 650 Most Essential Nonprofit Law Questions Answered. John Wiley & Sons

18. Hopkins, Bruce and D. Benson Tesdahl. Intermediate Sanctions: Curbing Nonprofit Abuse. John Wiley & Sons, 1997

19. Kurtz, Daniel L. Board Liability: Guide for Nonprofit Directors. Mover Bell (this is "ancient" by law book standards)

20. Lawyers Alliance for New York. Advising Community Development and Nonprofit Organizations. Lawyers Alliance for New York.

21. Oleck, Howard Leoner and Stewart, Martha E. Nonprofit Corporations, Organization and Associations. Prentice Hall (it may be out of date)

22. Overton, George and Frey, Jeannine (Editors). Guidebook for Directors of Nonprofit Corporation. American Bar Association.

23. Prunty, Bert (editor). White on New York Corporations (Vols. 6-8), LexisNexis Matthew Bender.

24. Raish, David. Compensation and Benefits for Key Employees of Tax-Exempt Organizations. Little Brown.

25. Stewart, Sue Stern, Schumacher, John L., Martin, Patrick D. and Fox, Richard L. Charitable Giving and Solicitation. Warren, Gorham & Lamont (a loose-leaf service)

26. Weithorn, Stanley (chair). The New York Not-for-Profit Corporation: Its Creation, Maintenance and Termination, New York, PLI, 1975. While dated, it has helpful information regarding obtaining state agency consents.

• PERIODICALS AND SERVICES

1. *CCH Exempt Organizations Reporter* (full text of all state nonprofit corporation laws and laws governing charitable solicitations)

2. *Exempt Organization Tax Review*. Published by Tax Analysts. (this publication is indispensible)

3. *The Non-Profit Counsel; The Law of Tax-Exempt Organizations Monthly*. Published by John Wiley & Sons.

4. *Chronicle of Philanthropy* (this is very helpful). See http:// philanthropy.com/subscribe or 800-728-2819. To get *Philanthropy Today*, a free daily email from *Chronicle of Philanthropy*, subscribe at https:// philanthropy.com/services/email_lists?minimal=y.

• ORGANIZATIONS AND WEBSITES

1. Alliance for Justice, http://www.afj.org/for-nonprofits-foundations/resources-and-publications/about-advocacy-lobbying.html for information regarding how nonprofits can lobby

2. Alliance for Nonprofit Governance. *www.angonline.org*

3. Alliance for Nonprofit Management, *www.allianceonline.org*

4. Alliance of Nonprofit Mailers, */www.nonprofitmailers.org/* (1211 Connecticut Ave. N.W., Ste 610, Washington, DC 20036-270 Tel: 202/462-5132)

5. American Association of Museums, 1575 Eye Street NW, Suite 400, Washington DC 20005; 202/289-1818; fax: 202/289-6578; http://www.aam-us.org/

6. American Institute of Certified Public Accountants. *www.aicpa.org*

7. American Insttitute of Philanthropy; *www.charitywatch.org*

8. Association of Fundraising Professionals, *http://www.afpnet.org/index.cfm* (1101 King Street, Suite 700, Alexandria, VA; 703-684-0410; Fax: 703-684-0540)

9. Association of Small Foundations, Bethesda, MD

10. Better Business Bureau. *www.newyork.bbb.org. -- see also Better Business Bureau - New York Philanthropic Advisory Service, 257 Park Avenue South, New York, NY 10010, 212-358-2873, www.newyork.bbb.org AND Philanthropic Advisory Service Council of Better Business Bureaus; 4200 Wilson Boulevard, Suite 800, Arlington, VA 22203-1804, 703-276-0100, www.give.org*

11. Board Café *http://www4.compasspoint.org/p.asp?WebPage_ID=652*

12. Board Source, *http://www.boardsource.org*

13. Boardnet*USA*, *www.boardnetusa.org*

14. Center for Non-Profit Corporations [for New Jersey corporations], 1501 Livingston Avenue, North Brunswick, New Jersey 08902, Phone: 732/227-0800, Fax: 732/227-0087, Web: http://www.njnonprofits.org (home page); E-mail: center @njnonprofits.orghttp://www.njnonprofits.org/index2.html

15. Charity Naivigator; (rating agency), *www.charitynavigator.org*

16. Chronicle of Philanthropy, *http://philanthropy.com*

17. Community Resource Exchange, 90 Washington Street, 27th Floor, New York, NY 10006; (212) 344-0195, *www.crenyc.org*, 212-894-3395 (management consulting for nonprofit organizations; financial consulting services and may help with employment and payroll issues)

18. CompassPoint -- electronic newsletter for nonprofit board members. *www.compasspoint.org.*

19. Council of Community Services of New York. *www.ccsnys.org, 272 Broadway, Albany, New York 12204; Phone: 518.434.9194 or 800.515.5012; Fax: 518.434.0392 OR Metro New York Initiatives, 305 7th Avenue @ 27th, 11th Floor, New York, NY 10001; Phone: 917-522-8304*

20. Council on Foundations, *www.cof.org*

21. Economic Research Institute (prepares compensation reports). *http:// www.salaryexpert.com/index.cfm?FuseAction=PCSReports.Main&ItemID=20&trkid=514-243* or *www.eri-nonprofit-salaries.com*

22. Foundation Center, 79 Fifth Avenue, New York, NY 10003; (212) 620-4230 and 800-424-9836; *www.fdncenter.org or foundationcenter.org* (has a fundraising library which includes comprehensive information on funding sources; its list of funding sources is also available on the website)

23. Governance Matters; 6 East 39th Street, Suite 602, New York, NY 10016; 212-447-1236; f 212-447-0925; www.governancematters.org// www.governancematters.org/. *(effective May 1, 2009 Governance Matters was slated to merge with Volunteer Consulting Group; Governance Matters provides research, workshops, education and online resources in the area of nonprofit governance)*

24. GuideStar; *http://www.guidestar.org* (contains a database of information from the 990s of over 700,000 nonprofits). See http:// www.guidestar.org/DisplayArticle.do?forYear=2007 [update for current year] for a helpful list of articles about various nonprofit issues.

25. Hauser Center for Nonprofit Organizations at Harvard, *www.ksg.Harvard.edu/hauser* [named after Stroock partner Rita Hauser and her husband] (The Hauser Center for Nonprofit Organizations, John F. Kennedy School of Government, Harvard University, 79 John F. Kennedy Street, Cambridge, MA 02138; tel: (617) 496-5675; fax: (617) 495-0996; e-mail: hauser_center @harvard.edu)

26. Independent Sector, 1828 L Street, Suite 1200 N.W., Washington, D.C. 20036; (202) 223-8100; *http:// www.independentsector.org* (a national umbrella group providing information and advocacy on issues affecting nonprofit organizations)

27. Internal Revenue Service:

(a) Tax Information for Charities & Other Non-Profits: *http:// www.irs.gov/charities/index.html* and *http:// www.stayexempt.org/* [five on-line training courses on tax issues, including keeping tax exempt status, unrelated business, employment issues, Form 990 and required disclosures (each ranging from 30 to 60 minutes)]

(b) IRS Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986 (http:// www.irs.gov/charities/article/0,,id=96136,00.html)*

28. International Center for Not-for-Profit Law, *www.icnl.org*

29. International Executive Service Corps, *www.iesc.or*

30. Internet Nonprofit Center *http://www.nonprofits.org/library/gov/urs/*

31. Lawyers Alliance for New York, 171 Madison Avenue (at 33rd Street), 6th floor, New York, NY 10016; 212-219-1800; Fax: 212-941-7458; info @lawyersalliance.org; *www.lany.org*

32. Mid-Atlantic Association of Museums, 2300 N Street, NW, Suite 710, Washington, DC 20037; Phone: (202) 452-8040; Fax: (202) 833-3636; E-mail: director@midatlanticmuseums.org

33. Minnesota Council on Nonprofits. *www.mncn.org/inforcentral.html* [note: not just for Minnesota organizations]

34. Museum Association of New York, 265 River Street, Troy, New York 12180; T: 518.273.3400; F: 518.273.3416; E: Info@MANYonline.org; W:MANYonline.org

35. National Association of State Charity Officials *http://www.nasconet.org; 518-486-9797*

36. National Center for Charitable Statistics, *http:// nccsdataweb.urban.org/FAQ/index.php?category=31*

37. National Council of Nonprofit Associations, 1900 L Street, NW, Suite 605, Washington, DC 20036-5024, (202) 467-6262 Fax: (202) 467-6261, *ncna@ncna.org. www.ncna.org (publishes annual survey of state laws regarding regulation of charitable solicitations as well as a summary of recent state legislative activity).*

38. National Network of Fiscal Sponsors, *http://www.tidescenter.org/strategies-resources/national-network-of-fiscal-sponsors/index.html*

39. New York Attorney General's Office, New York State Department of Law, 120 Broadway, 3d floor, New York, New York 10271, (212) 341-2400 -- General; (212) 341-2070 -- Record Room; *www.oag.state.ny.us/charities/charities.html*

40. New York City Bar Justice Center. http:// www.nycbar.org/citybarjusticecenter?city-bar-public-service-network.

41. New York City Lobbying Bureau (NYC lobbying registration); *www.cityclerk.nyc.gov.*

42. New York Council of NonProfits -- 1000 nonprofits statewide. *www.nycon.org*

43. New York Lawyers for the Public Interest (civil rights focus), 151 West 30th Street, 11th Floor, New York, New York 10001-4007; phone: 212-244-4664; fax: 212-244-4570; TDD: 212-244-3692; http://www.nylpi.org/about_contact.html

44. New York Nonprofit Press (a monthly paper and daily email; focuses on human service nonprofits). editor@nynp.biz OR publisher@nynp.biz OR 888-933-NYNP

45. New York State Commission on Public Integrity (oversees NYS lobbying registration); www.nyintegrity.org/faq.lrr.html.

46. New York State Council on the Arts, 175 Varick Street New York, NY 10014; Tel: (800) 510-0021; Tel: (212) 627-4455; TDD 1-800-895-9838; Fax (212) 620-5911; http://www.nysca.org/public/home.cfm New York State Society of CPAs. *www.nysscpa.org* operates a program called CPAs on Board. For information see http://www.nysscpa.org/cpasonboards/main.hrm. Note that nonprofits that wish to obtain the board services of a CPA need to register with the Council of Community Services of New York State, Inc. (CCSNYS) (http://www.ccsnys.org/) or the Nonprofit Coordinating Committee of New York, Inc. (NPCC) (see its Financial Expertise Initiative at http://www.npccny.org/FEI.htm).

47. Nonprofit Board Crisis -- a blog by Mike Burns available at http:// nonprofitboardcrisis.typepad.com/mbblog/.

48. Nonprofit Connection, *www.nonprofltconnection.org*, One Hansen Place, Room 2504, Brooklyn, NY 11243718-230-3200 financial consulting services and may help with employment and payroll issues)

49. Nonprofit Coordinating Committee of New York, Inc., 1350 Broadway, Suite 1801, New York, NY 10018; 212-502-4191; *http://www.npccny.org*, publishes *New York Nonprofits*, a monthly newsletter and an annual salary survey [NOTE: much of its material is available to members only; dues are based on the operating budget for nonprofits and range from $25 to $1,000; corporations can join for $1,000 and individuals for $100]

50. NonProfit Gateway, *http://www.nonprofit.gov*

51. Nonprofit Genie, *http://www.genie.org* [note: California oriented]

52. Nonprofit Help Desk, *http://www.nphd.org/menul.htm* (a nonprofit technology assistance provider, with programs in financial matters. It is an activity of Jewish Community Council of Greater Coney Island)

53. Nonprofit Quarterly, Lincoln Plaza • 89 South Street • Boston, MA 02111-2670 • tel: 617.523.6565 • fax: 617.523.2070

54. Philanthropy New York, http://www.philanthropynewyork.org/s_ nyrag/index.asp (formerly known as New York Regional Association of Grantmakers, *www.nyrag.org; name changed in 2009)*

55. Pro Bono Partnership, *www.probonopartnership.org*

56. Support Center for Nonprofit Management, 305 Seventh Avenue, 11th fl, New York, NY 10001-6008; Office: 212-924-6744 (attn.: John D. Vogelsang, Associate Director, ext 308; Fax: 212-924-9544; Wireless: 347-400-3908; jv @supportctr.org), *www.suportctr.org*

57. Support Center of New York, 305 Seventh Avenue, 11th Floor, New York, NY 10001 (212) 924-6744 (Information and referrals regarding financial management and accounting for nonprofit organizations)

58. U.S. International Granimaking, *www.usig.org*

59. Unified Registration Statement *http://www.multistatefiling.org* (also gives links to state registration offices)

60. United States International Grantmaking, a project of the Council on Foundations, *www.isig.org.*

61. Urban Institute. *www.urban.org*

62. Volunteer Consulting Group, 6 East 39th Street, Suite 602, New York, NY 10016; 212-447-1236; fax: 212-447-0925; boardinfo@vcg.org; *www.vcg.org or www.boardnetUSA.org (effective May 1, Governance Matters was merged into this group). It provides customized consulting, recruiting and training to nonprofit boards and helps nonprofits recruit board members online; Governance Matters provides research, workshops, education and online resources in the area of nonprofit governance*

63. Volunteer Lawyers for the Arts, 1 East 53rd Street, 6th Floor, New York, NY 10022; (212) 319-2787; *http://www.vlany.org*

64. Volunteers of Legal Service (works to increase the availability of pro bono civil legal services to New York City's poor), 54 Greene Street, New York, New York 10013; Phone: (212) 966-4400; Fax: (212) 219-8943; E-Mail: info @volsprobono.org; Website: www.volsprobono.org

SAMPLE FORMS

PROTOTYPE NEW YORK CERTIFICATE OF INCORPORATION

CERTIFICATE OF INCORPORATION
OF
[___]

(Under Section 402 of the Not-for-Profit Corporation Law of the State of New York)

The undersigned, being a natural person of at least eighteen years of age and acting as the incorporator of the corporation hereby being formed under the Not-for-Profit Corporation Law of the State of New York, certifies that:

FIRST: The name of the corporation is _____ (the "Corporation").

SECOND: The Corporation is a corporation as defined in subparagraph (a)(5) of Section 102 of the Not-for-Profit Corporation Law ("N-PCL") and is a Type [B] corporation under Section 201(b) of the N-PCL, [The lawful public or quasi-public objective which its purposes will achieve is _____.] ***[REQUIRED ONLY FOR TYPE C CORPORATIONS: THE SECRETARY OF STATE VIEWS "C" CORPORATIONS TO BE THOSE THAT MIGHT NORMALLY BE A BUSINESS CORPORATION EXCEPT THAT THEY ARE RUN FOR NONPROFIT PURPOSES. C CORPORATIONS MUST HAVE MEMBERS; MEMBERS ARE OPTIONAL FOR B CORPORATIONS.]***

THIRD: The purposes for which the Corporation is formed are ***[TRACK THE LANGUAGE OF THE RELEVANT PROVISION OF SECTION 201(b) OF THE N-PCL; IF TYPES, INCLUDE WHICHEVER OF THE FOLLOWING ARE APPROPRIATE AND CONFORM WITH ARTICLE FIFTH:*** charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals] in nature and, more particularly, _____ [FN1a] and to conduct any and all other activities as shall from time to time be found appropriate in connection with the foregoing purposes and as are lawful for not-for-profit corporations. [In furtherance of these charitable purposes, the Corporation may: **[LIST SPECIFIC PLANNED ACTIVITIES]** [FN2a] [and apply from time to time the principal of any property which it may hold and the income therefrom exclusively for charitable, educational, literary or cultural purposes by such agencies and means as shall, from time to time, be found appropriate, including by contributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended or corresponding provisions of any subsequent federal tax laws (the "Code") and the regulations thereunder as they now exist or as they may hereafter be amended] ***[THE BRACKETED LANGUAGE SHOULD BE INCLUDED IN THIS PURPOSE PARAGRAPH IF THE ORGANIZATION IS FORMED TO MAKE GRANTS. OTHERWISE IT SHOULD APPEAR IN PARAGRAPH FIFTH AS A POWER. IN ANY CASE, IT SHOULD ONLY APPEAR IN ONE PARA GRAPH]***

FOURTH: Nothing herein shall authorize the Corporation, directly or indirectly, to engage in or include among its purposes any of the activities mentioned in N-PCL Sections 404(b) through (w) [without the consents required by Sections 404(b) through (w) [FN3a] or perform or engage in any act or practice prohibited by the General Business Law §340 or other antimonopoly or antitrust statutes of the State of New York. ***[NOTE: IF THERE IS ANYTHING THAT THE CORPORATION INTENDS TO DO THAT LOOKS LIKE IT MIGHT FALL WITHIN ONE OF THOSE AREAS EVEN THOUGH THAT IS NOT SOMETHING THE ENTITY PLANS TO DO, IT MAY BE ADVISEABLE TO ADD LANGUAGE SPECIFICALLY CONFIRMING THAT IT DOES NOT INTEND TO DO THAT TYPE OF ACTIVITY. [FN4a]]***

FIFTH: In furtherance of the foregoing purposes, the Corporation shall have all of the powers conferred upon or permitted to corporations organized under the N-PCL [(including without limitation Section 202 of the N-PCL) [FN5a] as well as the power to:

(a) solicit, take and hold any bequest, devise or gift or purchase, lease, or otherwise acquire any property, whether real or personal, without limitation as to value; [FN6a]

(b) hold, maintain, use, convey, sell or otherwise dispose of such property and invest, reinvest, administer, collect and receive the income and profits thereof, and expend the principal thereof and income therefrom in any manner as may be permitted by

law and as, in the judgment of the Board of **[Directors] [Trustees]**, will best promote the purposes for which the Corporation is organized;

(c) [apply from time to time the principal thereof and the income therefrom exclusively for ***[TRACK THE GENERAL PURPOSES NOTED IN ARTICLE THIRD SUCH AS:*** "charitable, educational, religious, scientific, literary or cultural] purposes by such agencies and means as shall, from time to time, be found appropriate therefor, including by contributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986, as the same may be amended from time to time (the "Code"), and the regulations thereunder as they now exist or as they may hereafter be amended] [***SEE COMMENT IN PARAGRAH THIRD AND REMOVE FROM THIS PARAGRAPH IF APPROPRIATE]***; and

(d) do any and all lawful acts and things which may be necessary, useful, suitable or proper for the furtherance, accomplishment or attainment of any or all of the purposes of the Corporation. [FN7a]

SIXTH: [FN8a] (a) Notwithstanding any other provision contained in this certificate, no substantial part of the activities of the Corporation will be the carrying on of propaganda or otherwise attempting to influence legislation (except to the extent permitted by the Code whether pursuant to an election under Section 501(h) of the Code, or the corresponding provisions of any subsequent Federal tax laws, during any fiscal year or years in which the Corporation has chosen to utilize the benefits authorized by that statutory provision, or otherwise) and no part of its activities will entail the participation or intervention in any political campaign by any means, including the publication or distribution of statements on behalf of, or in opposition to, any candidate for public office, nor will the Corporation engage in any activity which would, in the opinion of the **[directors] [trustees],** jeopardize an exemption from Federal income taxation under Section 501(c)(3) of the Code or the corresponding provisions of any subsequent Federal tax laws and the regulations promulgated thereunder as they now exist or as they may hereafter be amended.

(b) The Corporation is not formed for pecuniary profit or for financial gain and no part of the assets, income or profits of the Corporation shall be distributed to or inure to the benefit of any member, **[trustee,] [director]** or officer of the Corporation or any private individual (except that reasonable compensation may be paid for services rendered to or for the Corporation), and no member, trustee, director or officer of the Corporation or any private individual shall be entitled to share in the distribution of any of the corporate assets on dissolution of the Corporation.

(c) In the event of dissolution, all of the remaining assets and property of the Corporation shall after payment of necessary expenses thereof be distributed as the Board of **[Directors] [Trustees]** determines to another organization or organizations exempt under Section 501(c)(3) of the Code, or the corresponding provisions of any subsequent Federal tax laws, or to the Federal government or a state or local government for a public purpose, subject to any requisite approvals and/or jurisdiction of the Supreme Court of the State of New York and any other applicable state agencies.

(d) In any taxable year in which the Corporation is a private foundation as described in Section 509(a) of the Code or the corresponding provisions of any subsequent Federal tax laws, the Corporation shall distribute its income for said period at such time and manner as not to subject it to tax under Section 4942 of the Code or the corresponding provisions of any subsequent Federal tax laws; and the Corporation shall not (i) engage in any act of self-dealing as defined in Section 4941(d) of the Code, (ii) retain any excess business holdings as defined in Section 4943(c) of the Code, (iii) make any investments in such manner as to subject the Corporation to tax under Section 4944 of the Code, or (iv) make any taxable expenditures as defined in Section 4945(d) of the Code, or any corresponding provisions of any subsequent Federal tax law.

(e) Notwithstanding any other provision contained herein, the Corporation is organized exclusively for one or more exempt purposes specified in Section 501(c)(3) of the Code, and shall not carry on any activities not permitted to be carried on by a corporation exempt from Federal income taxation under Section 501(c)(3) of the Code and the regulations promulgated thereunder as they now exist or as they may hereafter be amended, or the corresponding provisions of any subsequent Federal tax laws.

SEVENTH: The office of the Corporation is to be located in the County of **[New York]**, State of **[New York]**.

EIGHTH: The name and address of each of the initial **[directors] [trustees]** of the Corporation are as follows:

Name	Address

[LIST -- need at least three]

The initial **[directors] [trustees]** of the Corporation shall hold office until the first annual meeting of the **[[directors] [trustees] [members]** of the Corporation. After the formation of the Corporation the number of **[directors] [trustees]** shall be determined in accordance with the By-Laws, but shall not be less than three. [FN9a]

NINTH: The duration of the Corporation is to be perpetual.

TENTH: The Secretary of State is hereby designated as agent of the Corporation upon whom process against it may be served. The post office address to which the Secretary shall mail a copy of any process against the Corporation served upon him is:

[NAME AND ADDRESS OF FIRM]

Attention: _____ [FN10a]

ELEVENTH: [CERTAIN CORPORATIONS LISTED IN ARTICLE 14 OF THE N-PCL ARE REQUIRED TO INCLUDE ADDITIONAL STATEMENTS]

[THIS FOLLOWING ARE OPTIONAL PROVISIONS]:

[Designation of a registered agent]

[Any provision, not inconsistent with the N-PCL or any other statute of the state, which provision is (1) for the regulation of the internal affairs of the corporation, including types or classes of membership and the distribution of assets on dissolution or final liquidation, or (2) required by any governmental body or officer or other person or body as a condition for giving the consent or approval required for the filing of such certificate of incorporation, such as. "The Corporation shall have] [as its members _____, _____ and _____] [members who shall be divided into such classes, if any, with such designations, characteristics, rights and limitations upon such members as shall be set forth in the Corporation's by-laws or, if such by-laws so allow, a resolution adopted by the Board of Directors.] [The Corporation shall not have any members.] [Contributors to the Corporation, however, may be denominated members but shall have only such privileges as may be specified by the Board from time-to-time." [FN11a]

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Incorporation and affirms that the statements made herein are true under the penalties of perjury this _____ day of _____, 20 ___.

_____
Incorporator
Name: _____
Address: _____

_____
_____

[FN1a]. For a grant making organization: "and include (without limitation) making contributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986 and the regulations thereunder as they now exist or as they may hereafter be amended."

[FN2a]. According to the Department of State's website, see http:// www.dos.state.ny.us/corp/nfpguide.htm, the purpose or purposes "must clearly and fully describe the activities of the corporation." According to the Department of State you should not use the words "including but not limited to" when describing the purpose; you should not state vague and general purposes and you should not state the routine activities and powers the corporation will carry out in furtherance of its purposes (e.g., owning property). The activities should be different that the purposes, focusing more on specific types of transactions instead of goals.

[FN3a]. This language has long appeared in our forms but, starting in late 2006, some examiners in the Department of State's office have objected to it. Since any such consents would need to be included with the filing, there should be no problem deleting it.

[FN4a]. Possible disclaimers for education related companies would include the following, found on the Board of Education website (http:// www.counsel.nysed.gov/forms/ques.html#3):

a. Nothing herein shall authorize the corporation to operate or maintain a library, museum or historical society or to own or hold collections [as such term is defined by the New York State Education Department"]. ***[Whether it is legally supportable for***

the Education Department to require that this limitation be phrased this way might be called into question. The Education Department rules [see http://www.counsel.nysed.gov/pamphlet9/nycrr327.htm] discuss regulation of historical societies with collections and libraries and museums; if you are not a historical society, library or museum, the fact that you have a collection should not be relevant But the Education Department may not agree with this analysis. The Education Department has the following definitions: "Collection means one or more original tangible objects, artifacts, records or specimens, including art generated by video, computer or similar means of projection and display, that have intrinsic historical, artistic, cultural, scientific, natural history or other value that share tike characteristics or a common base of association and are accessioned; for purposes of this section, historic structures owned by an institution shall be considered as part of a collection when so designated by the institution." "Accession means: (a) adding an object to an institution's collection or (b) the act of recording/processing an addition to an institution's collection." "Institution means a museum or historical society with collections formed by the Board of Regents or otherwise incorporated as an education corporation under the laws of the State of New York." The additional words in brackets clarify that "collections" should not be defined using a generic definition.]

b. Nothing herein shall authorize the corporation to operate or maintain a charter school, a nursery school, an elementary school or a secondary school.

c. Nothing herein shall authorize the corporation to operate or maintain a college or university or to grant degrees or credit leading to a degree.

d. Nothing herein shall authorize the corporation to engage in the practice of any profession, or to use a professional title of any profession, required to be licensed by Title VIII of the Education Law.

e. Nothing herein shall authorize the corporation to provide professional training in the profession of ***[NOTE THAT THE FORM ON THE WEBSITE DOES NOT HAVE ANY OTHER WORDS BUT OBVIOUSLY SOMETHING IS MISSING HERE; I WOULD SUGGEST JUST COMPRESSING THE TWO PHRASES INTO "ANY PROFESSION REQUIRED..."]*** or any other profession required to be licensed by Title VIII of the Education Law.

f. Nothing herein shall authorize the corporation to own, operate or maintain an FCC licensed public or private educational television and/or non-commercial educational radio station or cable communications facility.

g. Nothing herein shall authorize the corporation to use the term certified athletic trainer in connection with the services of the corporation.

h. Nothing herein shall authorize the corporation to use the terms certified dietitian, certified dietician or certified nutritionist in connection with the services of the corporation.

i. The corporation, or any person in the corporation, claiming to be engaged in the practice of massage or massage therapy shall not in any manner describe, advertise, or place any advertisement for services as defined in section seventy-eight hundred one of this article unless such services are performed by a person licensed or authorized pursuant to this chapter.

j. Nothing herein shall authorize the corporation to use the terms "psychology, psychologist, psychological, or certified social worker, licensed master social worker, licensed clinical social worker, licensed marriage and family therapist, licensed mental health counselor, licensed psychoanalyst, or licensed creative arts therapist in connection with the services of the corporation.

k. The corporation will restrict the provision of counseling services to instruction, advice, support, encouragement or information to individuals, families, and relational groups, provided that this shall not include the diagnosis or treatment of mental, emotional, nervous, or behavioral disorders.

l. Any referral made to an individual licensed under Title VIII of the Education Law for the performance of professional services under such Title shall be made on a non-fee basis.

[FN5a]. This language has long appeared in our forms but, starting in late 2006, some examiners in the Department of State's office have objected to it. Since such powers are in the N-PCL, there should be no objection removing the language. The purpose of the language is more to educate the reader as to the provision of the N-PCL where most corporate powers are enumerated.

[FN6a]. The language regarding charitable solicitations is added pursuant to Section 115 of the N-PC, which states: "No corporation having the power to solicit contributions for charitable purposes may solicit contributions for any purpose for which approval of such solicitation is required under the provisions of section four hundred four of this chapter unless the certificate

specifically makes provision for such solicitation and the required written approval is endorsed on or annexed to such certificate or unless the corporation is among those referred to in section one hundred seventy-two-a of the executive law."

[FN7a]. For private foundation, if appropriate, add: "Notwithstanding the foregoing, nothing herein contained shall permit the Corporation to solicit gifts or contributions from the public."

[FN8a]. This information is required in order to obtain an IRS determination that the entity is charitable.

[FN9a]. The names of the initial directors are optional for Type D corporations.

[FN10a]. Unless the attention party is a partner, consider saying "Managing Clerk" and making sure the Managing Clerk knows who should get the papers.

[FN11a]. Note that until late 2007 it was customary to include a provision allowing board and committee telephonic meetings; in 2007 the law was changed to allow such meetings unless precluded in the charter or by-laws.

CERTIFICATE OF INCORPORATION
OF
[___]

(Under Section 402 of the Not-for-Profit Corporation Law of the State of New York)

[[NAME AND ADDRESS OF FIRM]] [FN1b]

PROTOTYPE DELAWARE CERTIFICATE OF INCORPORATION

CERTIFICATE OF INCORPORATION
OF
____, INC.
(A nonprofit corporation formed under the General Corporation Law of the State of Delaware)

The undersigned, being a natural person and acting as the incorporator of the nonstock nonprofit corporation hereby being formed under the provisions and subject to the requirements of the laws of the State of Delaware (particularly Chapter 1, Title 8 of the Delaware Code and the acts amendatory thereof and supplemental thereto, and known, identified and referred to as the "General Corporation Law"), hereby certifies that:

FIRST: The name of this corporation (hereinafter called the "Corporation") is _____, Inc.

SECOND: The address of the Corporation's registered office in the State of Delaware is *[Corporation Trust Center, 1209 Orange Street, Wilmington, County of New Castle and the name of its registered agent at such address is The Corporation Trust Company]* ***OR*** *[2711 Centerville Road, Suite 400, Wilmington, DE 19808, County of New Castle and the name of its registered agent at such address is Corporation Service Company]*.

THIRD: ThE Corporation shall be a nonprofit corporation. The Corporation is formed, organized and operated exclusively for the charitable and educational purposes of _____, including, among others, _____ and other activities similar or related to the foregoing, and to apply from time to time the principal of any property which it may hold and the income therefrom exclusively for *[charitable, religious, scientific, literary, cultural or educational]* ***[DELETE ANY THAT ARE NOT CORRECT]*** purposes by such agencies and means as shall, from time to time, be found appropriate therefor, including by contributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended or corresponding provisions of any subsequent federal tax laws (the "Code") and the regulations thereunder as they now exist or as they may hereafter be amended.

The Corporation is empowered to take and hold by bequest, devise, gift, purchase, lease or otherwise any property real or personal, without limitations as to value, insofar as the same may be held by a non-profit corporation organized under the General Corporation Law; to hold, maintain, use, convey, sell or dispose of such property and to invest, reinvest, administer, collect and receive the income and profits thereof, and expend the principal thereof and income therefrom in any manner as may be permitted by law and as, in the judgment of the Board of Directors, will best promote the purposes for which the Corporation is organized; to have in furtherance of these purposes, all of the powers conferred upon or permitted to non-profit corporations

organized under the General Corporation Law; and to do any and all lawful acts and things which may be necessary, useful, suitable or proper for the furtherance, accomplishment or attainment of any or all of the purposes of the Corporation.

The Corporation shall have the authority to exercise all of the powers conferred upon corporations organized not for profit and without authority to issue capital stock under the provisions of the General Corporation Law, provided that the exercise of any such powers shall be in furtherance of any one or more of the exempt purposes of the Corporation.

FOURTH: Notwithstanding any other provision in this certificate, no substantial part of the activities of the Corporation will be the carrying on of propaganda, or otherwise attempting to influence legislation, and no part of its activities will entail the participation or intervention in any political campaign by any means, including the publication or distribution of statements on behalf of any candidate for public office, nor will the Corporation engage in any activity which would, in the opinion of the directors, jeopardize an exemption from Federal income taxation under Section 501(c)(3) of the Code and the regulations promulgated thereunder as they now exist or as they may hereafter be amended.

No part of the net earnings of the Corporation shall inure to the benefit of any member, trustee, director, or officer of the Corporation, or any private individual (except that reasonable compensation may be paid for services rendered to or for the Corporation), and no member, trustee, director or officer of the Corporation or any private individual shall be entitled to share in the distribution of any of the corporate assets on dissolution of the Corporation.

In the event of dissolution, all of the remaining assets and property of the Corporation shall after payment of necessary expenses thereof be distributed as the Board of Directors determines to another organization or organizations exempt under Section 501(c)(3) of the Code or to the Federal government, or state or local government for a public purpose, subject to any requisite approval and/or jurisdiction of the courts of the State of Delaware.

In any taxable year in which the Corporation is a private foundation as described in Section 509(a) of the Code, the Corporation shall distribute its income for said period at such time and manner as not to subject it to tax under Section 4942 of the Code; and the Corporation shall not (a) engage in any act of self-dealing as defined in Section 4941(d) of the Code, (b) retain any excess business holdings as defined in Section 4943(c) of the Code, (c) make any investments in such manner as to subject the Corporation to tax under Section 4944 of the Code, or (d) make any taxable expenditures as defined in Section 4945(a) of the Code or corresponding provisions of any subsequent Federal tax law.

Notwithstanding any other provision of this Certificate of Incorporation, the Corporation is organized exclusively for one or more exempt purposes specified in Section 501(c)(3) of the Code, and shall not carry on any activities not permitted to be carried on by a Corporation exempt from Federal income taxation under Section 501(c)(3) of the Code and the regulations promulgated thereunder as they now exist or as they may hereafter be amended.

FIFTH: The Corporation is not to have authority to issue capital stock.

SIXTH: The name and mailing address of the incorporator are as follows:

_____
_____
_____

SEVENTH: **[OPTIONAL]** The name and mailing address of each of the initial directors of the Corporation are as follow:

NAME	MAILING ADDRESS

EIGHTH: The duration of the Corporation is to be perpetual.

NINTH: For the management of the business and for the conduct of the affairs of the Corporation, and for the creation, definition, limitation, and regulation of the powers of the Corporation and of its governing body, **[NOTE THAT SECTION 102 ALLOWS THE CERTIFICATE OF INCORPORATION TO INCLUDE PROVISIONS THAT CREATE, DEFINE, LIMIT OR REGULATE THE POWERS OF THE CORPORATION, ITS DIRECTORS OR MEMBERS]** it is hereby provided:

(a) The power to adopt, amend, or repeal the bylaws of the Corporation may be exercised by the Board of Directors of the Corporation. **[NOTE ALSO PARAGRAPH (E) WHICH GIVES THE SAME RIGHT TO THE MEMBERS, IF THERE ARE ANY. WHILE IT IS OK TO GIVE THE SAME POWER TO BOTH GROUPS (ESPECIALLY SINCE IT MAY**

BE EASIER TO MAKE AMENDMENTS AT THE DIRECTOR LEVEL), EACH ENTITY SHOULD CONSIDER WHETHER SUCH RIGHT SHOULD BE LIMITED TO ONE GROUP. IF ONLY THE MEMBERS HAVE THE RIGHT, IT MAY BE CUMBERSOME TO AMEND THE BY-LAWS]

(b) The activities and affairs of the Corporation shall be managed by or under the direction of its governing body, which in this certificate of incorporation is referred to as a Board of Directors.

(c) The number of directors constituting the initial whole Board of Directors shall be [the number specified in Paragraph SEVENTH. Thereafter, the number of directors constituting the whole Board shall be] fixed from time to time in the manner prescribed in the bylaws. The phrase "whole Board" shall be deemed to mean the total number of directors which the Corporation would have if there were no vacancy or vacancies.

(d) A director shall have such qualifications as may be prescribed in the bylaws. The members of the initial Board of Directors *[have been named in this certificate of incorporation] [shall be named by the incorporator]*. Thereafter, each successive Board of Directors shall be elected by [the members] [as set forth in the bylaws] **[THE BOARD CAN BE SELF PERPETUATING IF THE CERTIFICATE OF INCORPORATION SO SAYS -- SEE SECTIONS 102(b) OF THE GENERAL CORPORATION LAW]** [of the Corporation; *provided, however*, that, in the interim between annual or special elections by such directors, the directors in office, though less than a quorum, may fill any newly created directorship and any vacancy, including a vacancy which results from the removal of any director or directors]. Except as may otherwise be provided under the provisions of the General Corporation Law, any or all of the directors may be removed for or without cause by action of a majority of the members [or by action of a a majority of the whole Board]].

(e) The bylaws shall provide for the conditions of membership in the Corporation. **[ONE MAJOR AMBIGUITY UNDER DELAWARE LAW IS WHETHER YOU NEED TO HAVE MEMBERS. THE DELAWARE GENERAL CORPORATION LAW IS SILENT ON WHETHER THERE HAVE TO BE MEMBERS BUT IT DOES STATE THAT APPROACH WOULD BE TO STATE THAT THOSE PERSONS WHO ARE THE DIRECTORS FROM TIME-TO-TIME SHALL BE THE ONLY MEMBERS; THIS PROCEDURE USED TO BE USED IN NEW YORK WHEN NONPROFITS THE CONDITIONS OF MEMBERSHIP MUST BE STATED IN THE CERTIFICATE OF INCORPORATION OR BY-LAWS. IN THE PAST THE DELAWARE DIVISION OF CORPORATIONS TOOK THE POSITION THAT MEMBERS WERE REQUIRED, BUT SINCE 2001 IT HAS CHANGED THAT POSITION, NOW ALLOWING ORGANIZATIONS TO FILE CERTIFICATES THAT STATE THAT CONDITIONS OF MEMBERSHIP SHALL BE AS STATED IN THE BY-LAWS AND THEN STATE IN THE BY-LAWS THAT THE ORGANIZATION SHALL HAVE NO MEMBERS. AN ALTERNATIVE HAD TO BE FORMED UNDER THE MEMBERSHIP CORPORATION LAW.] [THE FOLLOWING SHOULD BE INDLUDED ONLY IF THERE ARE TO BE MEMBERS:]** [The Corporation shall have one or more classes of members. Each member shall be entitled [to vote in the election of directors of the Corporation], [to vote for the adoption, amendment, or repeal of the bylaws pursuant to the provisions of the General Corporation Law,] [to approve amendments to the Corporation's certificate of incorporation by a vote of a majority of the members present in person or by proxy at a meeting at which a quorum is present] **[UNDER SECTION 242, SUCH RIGHT EXISTS ONLY IF SPECIFIED IN THE CERTIFICATE OF INCORPORATION; UNDER SECTIONS 255, 271 AND 276 THE MEMBERS WHO HAVE THE RIGHT TO ELECT THE DIRECTORS (IF ANY) DO HAVE A RIGHT TO VOTE ON MERGERS, SALES OF ASSETS AND DISSOLUTIONS]** and to vote in such other proceedings as the General Corporation Law shall confer voting power on members entitled to vote in the election of directors of the Corporation. A member shall be entitled to one vote in all proceedings in which a member is entitled as of right to vote under any of the provisions of the General Corporation Law and in all proceedings in which a member is entitled to vote under any provisions of this certificate of incorporation and of the bylaws. ***[UNLESS OTHER WISE SPECIFIED IN THE CERTIFICATE OF INCORPORATION, EACH MEMBER IS ENTITLED TO ONE VOTE. SEE SECTION 215 OF THE GCL REGARDING MEMBERS MEETINGS.]*** Except as may be otherwise provided by the General Corporation Law or the bylaws, [a majority][20%] of the members, or the sole member if there be only one, shall constitute a quorum at any meeting of members, and, except in the election of directors, a majority of the votes cast, a quorum being present, shall be the act of such member or members. In the election of directors, at which voting need not be by ballot, a plurality of the votes cast shall elect.] [The voting members shall have the right to vote to approve any merger or consolidation of the Corporation under Section 255, the sale or all or substantially all the assets of the Corporation under Section 271 or the dissolution of the Corporation under

Section 276 of the General Corporation Law notwithstanding that such members do not have the right to vote for election of members of the Board of Directors.]

(f) [Meetings of the members shall be held at such place within or without the State of Delaware as may be designated by or in the manner provided in the bylaws. Except as the General Corporation Law or as this certificate of incorporation may otherwise provide, the bylaws of the Corporation shall or may provide, as the case may be, for the record date, time, call, lapse of period of time after notice, actual or constructive notice of meetings of said members or of actual or constructive waiver of notice thereof, the authority to vote, consent, or dissent in person or by proxy representation and the duration of any proxy, and the conduct of meetings, including provisions for the adjournment thereof.] **[OMIT IF THERE ARE NOT TO BE MEMBERS]**

(g) To the fullest extent that the General Corporation Law, as it exists on the date hereof or as it may hereafter be amended, permits the limitation or elimination of the liability of directors, no director of this Corporation shall be personally liable for monetary damages for breach of fiduciary duty as a director.

(h) The Corporation shall, to the fullest extent permitted by Section 145 of the General Corporation Law, as the same may be amended and supplemented, or by any successor thereto, indemnify any and all persons whom it shall have power to indemnify under said section from and against any and all of the expenses, liabilities or other matters referred to in or covered by said section. [The Corporation shall advance expenses to the fullest extent permitted by said section.] Such right to indemnification [and advancement of expenses] shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person. The indemnification and advancement of expenses provided for herein shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any By-Law, agreement, vote of [members or] disinterested directors or otherwise.

TENTH: From time to time, and in furtherance of the purposes for which the Corporation is being organized, any of the provisions of this certificate of incorporation may be amended, altered, or repealed, and other provisions authorized by the laws of the State of Delaware at the time in force may be added or inserted in the manner and at the time prescribed by said laws, and all rights at any time conferred upon the members of the Corporation by this certificate of incorporation are granted subject to the provisions of this Article TENTH.

THE UNDERSIGNED, the sole incorporator named above, for the purpose of forming a Corporation pursuant to Chapter 1 of Title 8 of The Delaware Code, does make this certificate, hereby declaring and certifying that this is **his/her** act and deed and the facts herein stated are true, and accordingly have hereunto set **his/her** hands this _____ day of _____, 20 ___.

_____

_____

[Name]

[FN1b]. Section 150.1 of the New York Codes, Rules and Regulations requires that a certificate of incorporation include a backer that provides the name and address of the submitter. Though not set forth in the NYCRR, the fax and telephone numbers and email address of the submitter could also be included but note that the backer becomes a permanent state record and therefore sensitive information should not be included.

PROTOTYPE NEW YORK BY-LAWS

ADOPTED: ___ / ___ / ___

[LAST] AMENDED: ___ / ___ / ___

[OR LIST EACH DATE OF AMENDMENT]

BY-LAWS [FN1c] OF

_____

(A NEW YORK NOT-FOR-PROFIT CORPORATION) (THE "CORPORATION")

[ARTICLE I

Members [FN2c]

Section 1.1. Determination of Members. The Corporation shall have one class of members which shall consist of the persons who from time to time constitute the members of the Board of Directors. The right or interest of a member shall terminate upon such person no longer being a director of the Corporation.

Section 1.2. Annual Meeting of Members. The annual meetings of the members shall be held at such times (but within six months of the end of the Corporation's fiscal year) and places as the Board of Directors may from time to time determine *[in conjunction with the annual meeting of the directors but action to be taken as members shall be taken separately from action to be taken as directors]*. **[SOME COMPANIES MAY WANT TO FIX THE DATE OR MONTH OF THE ANNUAL MEETING IN THE BYLAWS; IN THAT CASE IT IS WISE TO ADDITIONALLY GIVE THE BOARD FLEXIBILITY TO SET THE DATE OTHERWISE]** Special meetings of the members, which may be held in conjunction with or separate from meetings of the Board, may be called by the President or the Secretary and shall be called upon request of one-third of the members. Notice of meetings shall be as set forth in Section 2.11 (with all references therein to "directors" being deemed references to "members." The Board of Directors shall present at each annual meeting of members its report, which shall set forth the statements and shall be verified or certified in the manner prescribed by Section 519 of the Not-for-Profit Corporation Law. Such report shall be filed with the records of the Corporation and either a copy or an abstract thereof entered in the minutes of the proceedings of such annual meeting of members.

Section 1.3. Location of Meetings. Annual meetings and special meetings shall be held at such place, within or without the State of New York, as the Board of Directors or the President may from time to time fix. Whenever the directors or the President shall fail to fix such place, or whenever members entitled to call or convene a special meeting shall convene the same, the meeting shall be held at the principal office of the Corporation.

Section 1.4. Proxies. A member may authorize another person or persons to act for him or her at a meeting or by written consent if so authorized by a written proxy, a copy of which shall be provided to the Corporation. Each proxy must be in writing and signed by the member or by his or her attorney-in-fact and electronic and facsimile signatures shall be permitted. No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the member executing it, except as otherwise provided by the General Corporation Law.

Section 1.5. Quorum. Except as herein otherwise provided or required by the General Corporation Law, *[one-half]* of the members entitled to vote, present in person or by proxy shall constitute a quorum at a meeting of members for the transaction of any business. A majority of the members present may adjourn the meeting despite the absence of a quorum. At such adjourned meeting, at which a quorum shall be present, any business may be transacted which might have been transacted at the meeting as originally notified.

Section 1.6. Voting. Each member shall be entitled to one vote. In the election of directors, a plurality of the votes cast shall be required for election. Any other action shall be authorized by a majority of the votes cast, except where the Not-for-Profit Corporation Law prescribes a different proportion of votes, provided that such majority of the affirmative votes cast shall be at least equal to a quorum.

Section 1.7. Action Without a Meeting. Whenever members are required or permitted to take any action by vote, such action may be taken without a meeting on written consent, setting forth the action so taken, signed by all the members entitled to vote.]

ARTICLE I

[NOTE NEED TO RENUMBER AS ARTICLE II (AND RENUMBER SECTIONS AS 2.XXX) IF MEMBERS PROVISION REMAINS]

Directors

Section 1.1. Board of Directors. The affairs of the Corporation shall be managed by its Board of Directors, [FN3c] which shall have all the powers permitted by law unless expressly limited by these By-Laws. As used in these By-Laws, "entire Board of Directors" means the total number of directors that the Corporation would have if there were no vacancies.

Section 1.2. Number of Directors. The number of directors shall be [_____. The number of directors may be increased or decreased from time to time by amendment to these By-Laws, except that the number of directors shall not be less than three] [as set by the Board of Directors from time to time, but no less than three nor more than-- [FN4c]]. No decrease in the number of directors shall shorten the term of any incumbent director. [FN5c]

Section 1.3. Election and Term of Office. The Board of Directors shall initially consist of the directors listed in the Certificate of Incorporation, who shall serve until the election of directors at the first annual meeting has taken place. Directors shall be elected at the annual meeting of the Board of Directors by *[plurality vote] [vote of a majority of the directors present at the time of the vote, if a quorum is present]* and may succeed themselves in office. Thereafter, the term of office of each director shall be until the close of the next succeeding annual meeting of the Board of Directors [FN6c] and until his or her successor shall have been elected and qualified, or until his or her earlier death, resignation or removal. Vacancies occurring on the Board of Directors for any reason, including newly-created directorships, may be filled by the vote of a majority of the directors then in office, whether or not a quorum. A director elected to fill a vacancy caused by resignation, death, or removal shall be elected to hold office for the unexpired term of his or her predecessor.

Section 1.4. Resignation; Removal.

(a) A director may resign at any time by giving written notice to the Board of Directors, the President or the Secretary. Unless otherwise specified in the notice, the resignation shall take effect upon receipt by the Board of Directors or such officer and acceptance of the resignation shall not be necessary to make it effective. *[If any director shall be absent from [three] consecutive regular meetings of the Board of Directors without an excuse, the Board of Directors may decide to consider such absence as a resignation, and such resignation shall take effect at the time of such decision.]* ***[AN ALTERNATIVE PROVISION WOULD BE TO MAKE SUCH RESIGNATION AUTOMATIC. ANOTHER ALTERNATIVE WOULD BE TO HAVE LANGUAGE TO THE EFFECT THAT NONATTENDANCE (HOWEVER DEFINED) COULD BE CONSIDERED "CAUSE"]***

(b) Any director may be removed, with cause, by an affirmative vote of a majority of the entire Board of Directors [FN7c] *[provided that such possible removal was noted in the notice of such meeting]. [Any director may be removed with or without cause by an affirmative vote of a majority of the members present at a meeting at which a quorum is present or by unanimous written consent of the members.]*

Section 1.5. Meetings.

(a) Annual Meeting; Annual Report. *[The annual meeting of the Board of Directors for the election of the officers of the Association, and for the transaction of such other business as properly may come before it, shall be held at the place at which the annual meeting of the members of the Association shall be held, and shall be held immediately following such meeting. [IF THE CORPORATION HAS MEMBERS]* [The annual meetings of the Board of Directors for the election of the directors and officers of the Association, and for the transaction of such other business as properly may come before it, shall be held at such times (but within six months of the end of the Corporation's fiscal year) ***[THIS TIME FRAME IS NOTED SINCE THE REQUIRED ANNUAL REPORT MUST INCLUDE 12-MONTH FINANCIALS THAT ARE NOT OLDER THAN SIX MONTHS]*** and places as the Board of Directors may from time to time determine.] ***[SOME COMPANIES MAY WANT TO FIX THE DATE OR MONTH OF THE ANNUAL MEETING IN THE BY LAWS; IN THAT CASE IT IS WISE TO ADDITIONALLY GIVE THE BOARD FLEXIBILITY TO SET THE DATE OTHERWISE]*** [The President and Treasurer shall present at each annual meeting their report, which shall [set forth the statements and shall be verified or certified in the manner prescribed by Section 519 of the Not-for-profit Corporation Law] [show in appropriate detail the following:

(1) The assets and liabilities, including the trust funds, of the Corporation as of the end of a twelve month fiscal period terminating not more than six months prior to said meeting.

(2) The principal changes in assets and liabilities, including trust funds, during said fiscal period.

(3) The revenue or receipts of the Corporation, both unrestricted and restricted to particular purposes during said fiscal period.

(4) The expenses or disbursements of the Corporation, for both general and restricted purposes, during said fiscal period.]

Such report shall be filed with the records of the Corporation and either a copy or an abstract thereof entered in the minutes of the proceedings of such annual meeting of members.] ***[ELIMINATE IF THE COMPANY HAS MEMBERS, SINCE THE REPORT IS GIVEN AT THE MEMBERS MEETING].***

(b) Regular Meetings The Board of Directors from time to time may provide by resolution for the holding of such regular meetings as it may determine upon and may fix the time and place of such meetings.

(c) Special Meetings. Special meetings of the Board of Directors may be held at any time and place upon call of the President or any director upon written demand of not less than one fifth of the entire Board of Directors.

Section 1.6. Quorum of Directors; Attendance by Telephone. The presence of a *[majority] [one third] [one third or, to the extent that the number of directors is more than 15, five members plus one additional member for each ten directors (or fraction thereof) over 15]* of the entire Board of Directors shall constitute a quorum for the transaction of business at any meeting of the directors. Participation by one or more directors by means of a conference telephone or similar communications equipment allowing all persons participating in the Board or committee meeting to hear each other at the same time shall constitute presence at such meeting. ***[NOTE THAT UNTIL 2007 THE PROVISION REGARDING TELEPHONIC ATTENDANCE HAD TO APPEAR IN THE CHARTER OR BY-LAWS TO BE EFFECTIVE; NOW THE N-PCL PRESUMES THAT SUCH TELEPHONIC MEETINGS ARE ALLOWED UNLESS THE BY-LAWS OR CHARTER STATES OTHERWISE]***

Section 1.7. Adjourned Meetings. A majority of the Board of Directors present at a meeting, whether or not a quorum is present, may adjourn such meeting to another time and place. Notice of the time and place of such adjourned meeting shall be given to directors who were not present at the time of such adjournment.

Section 1.8. Action of the Board of Directors. The vote of a majority of the directors present at the time of the vote, if a quorum is present, shall be the act of the Board of Directors, unless the question or action is one upon which a different vote is required by express provision of statute, the Certificate of Incorporation or these By-Laws. Each director shall have one vote.

Section 1.9. Action by Written Consent of Directors. Any action required or permitted to be taken at any meeting of the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board of Directors or the committee consent in writing to the adoption of a resolution authorizing such action. Such resolution and written consents thereto shall be filed with the minutes of proceedings of the Board of Directors or the committee.

Section 1.10. Compensation. The Board of Directors may authorize reimbursement of expenses incurred by directors in the performance of their duties [and payment of a fee for attendance at meetings]. Nothing herein contained shall be construed to preclude any director from serving the Corporation in any other capacity and receiving compensation therefor.

Section 1.11. Notice. Notice of the time and place and, to the extent required by law or these By-Laws, the purpose of every meeting of the Board of Directors [other than the annual meeting following the annual meeting of the members and regular meetings] shall be given by the Secretary by mailing (effective *[three days] [72 hours]* after posting), by Express Mailing or sending by overnight courier (effective upon the day and hour of promised delivery), or by *[telecopying] [emailing,]* delivering or *[telephoning]* (effective immediately) the same to the usual address *[or telephone or telecopier number or email address]* of such director as it appears on the books of the Corporation [(with respect to notice by telephone, fax or email, limited to those directors who have agreed in writing to accept notice such way)] at least ___ *[days] [hours]* before such meeting (in the case of notice by telephone, confirmed in writing before the meeting). ***[NOTE: SOME COMPANIES LIMIT EMAIL OR FAX NOTICE ONLY TO THOSE DIRECTORS WHO AGREE IN WRITING TO RECEIVE NOTICE SUCH WAY]*** Such notice shall be deemed to be given when (a) the director or his or her assistant or secretary is reached by telephone or personal delivery, or (b) if telegrammed, time the telegram is sent, [or] (c) if mailed, when the notice is deposited in the United States mail with postage thereon prepaid, addressed to the drector's residence or, if the director has filed with the Secretary of the Corporation a written request that notices be mailed to some other address, then addressed to such other address[, or (d) if emailed, when sent if no notice of rejection is received or (e) if telefaxed, when sent if electronic confirmation of receipt is received]. Notice of any meeting need not be given, however, to any director who submits a signed waiver of notice, before or after the meeting, or who attends the meeting without protesting the lack of notice. Notices do not need to be given for regular meetings of the Board [and the annual meetings of the Board following the annual meeting of the members].

Section 1.12 Chairman. At all meetings of the Board of Directors, the *[Chairman of the Board] [President]* shall preside. In the _____'s absence, the _____ may appoint a Chairman *pro tem*, or if the _____ fails to do so the directors shall appoint one of their own members to preside.

ARTICLE II

Committees

Section 2.1. Creation.

(a) The Board of Directors, by resolution adopted by a majority of the entire board, from time to time may designate from among its members such standing committees, each consisting of three or more directors, as the business of the Corporation may require, and delegate such authority to such committees as the Board of Directors may deem appropriate [as allowed by

Section 712 of the Not-for-Profit Corporation Law] [provided that no such committee of the Board shall have authority as to (i) submitting to members any action requiring members' approval under the N-PCL, (ii) filling vacancies in the Board or any committees, (iii) fixing compensation of the Directors for serving on the Board or on any committee, (iv) amending or repealing these By-Laws or adopting new By-Laws, (v) amending or repealing any Board resolution which by its terms shall not be so amendable or repealable, or (iv) conducting any other activities expressly prohibited by law] or other applicable law. **[*YOU CAN NAME SOME OF THOSE COMMITTEE, SUCH AS THE EXECUTIVE COMMITTEE IN THE BY-LAWS, IF DESIRED: "The Board shall have the following standing committees and may, by resolution adopted by a majority of the entire Board, establish other standing committees.]*** [FN8c]

(b) In addition, the Board of Directors may create such special committees of the board as it may deem desirable, the members of which shall be appointed [by the board] [by the Chairman / President [with the consent of the Board of Directors]] from among its members. [***THE N-PCL STRICTLY REGULATES THE PROCESS OF APPOINTING MEMBERS OF STANDING COMMITTEES BUT GIVES THE CORPORATION MORE FLEXIBILITY REGARDING SPECIAL COMMITTEES; UNLESS THE BY-LAWS USE ANOTHER METHOD, MEMBERS OF SPECIAL COMMITTEES ARE CHOSEN BY THE CHAIRMAN WITH THE CONSENT OF THE BOARD]*** Any special committees shall have only the powers specifically delegated to them by the Board of Directors and in no case shall have powers which are not authorized for standing committees.

(c) [Persons who are not directors may be named as adjunct members of standing and special committees with the right to attend and speak at meetings but such adjunct members shall not have any voting rights or be counted for quorum purposes.]

(d) Committees of the Corporation, if any, may be established by the Board of Directors and the members thereof (who do not need to be directors) elected in the same manner as officers of the Corporation.

Section 2.2. Procedure. Each member of a committee shall be serve at the pleasure of the Board of Directors or, if appointed by the [Chairman], at the pleasure of the [Chairman]. The Board of Directors may appoint alternate members of any standing committee to act as substitutes for any absent member at meetings of such committee. ***[THE N-PCL SPECIFICALLY ALLOWS ALTERNATES FOR STANDING COMMITTEES AND IS SILENT ON THE OTHER COMMITTEES]*** If there shall be a vacancy in any committee, such vacancy may be filled by the Board of Directors or, if such committee member was appointed by the [Chairman], by the [Chairman] [subject to approval by the Board]. *[Unless otherwise chosen by the Board of Directors at the time of the appointment of members, the chair of each committee shall be selected by the [Chairman of the Board].]* Except as otherwise provided by these By-Laws or by the Board of Directors, each committee shall determine its own rules of procedure *[and elect its own chairman]*. ***[NOTE THAT SOME COMPANIES MAY WISH TO HAVE THE COMMITTEE CHAIRS SELECTED BY THE PRESIDENT OR THE BOARD]*** A majority of the membership of a committee of the Board shall constitute a quorum for the transaction of business by such committee unless otherwise established pursuant to committee rules of procedure. Any executive committee shall keep minutes of its meetings and each other committee shall keep records of its proceedings or prepare reports and promptly submit the same from time to time to the Board of Directors.

ARTICLE III

Officers

Section 3.1. Officers, Election and Term. The officers of the Corporation shall be a [Chairman of the Board], President, a Secretary, a Treasurer and such other officers as the Board of Directors may elect. Unless otherwise provided in the resolution of election or appointment of such officer or such officer's successor, each officer shall continue in office until the close of the annual meeting of the Board of Directors next following his or her election and until his or her successor shall have been duly elected and qualified or until his or her death, resignation or removal. Any officer may resign at any time by giving written notice to the President or the Secretary. Unless otherwise specified in the notice, the resignation shall take effect upon receipt thereof and acceptance of the resignation shall not be necessary to make it effective. Any officer may be removed by the Board of Directors with or without cause.

Section 3.2. Powers and Duties. [The agents and officers of the Corporation shall each have such powers and perform such duties in the management of the affairs, property and business of the Corporation, subject to the control of the Board of Directors, as generally pertain to their respective offices, as well as such additional powers and duties as may be authorized from time to

time by the Board of Directors.] OR [The powers and duties of the officers of the Corporation in the management of the affairs, property and business shall, subject to the control of the Board of Directors, be as follows: [FN9c]

- CHAIRMAN. The Chairman of the Board of Directors shall preside at all meetings of the Board of Directors. If no President is elected, or if elected, in the President's absence or inability to act, the Chairman shall have the same powers and duties of the President of the Corporation. ***[NOTE THAT MOST NONPROFITS HAVE EITHER A CHAIRMAN OR A PRESIDENT, NOT BOTH. ACCORDINGLY, THE DUTIES OF THE TWO OFFICES CAN BE INTERCHANGABLE. MANY NONPROFITS PREFER TO THE USE THE TERM "CHAIR" INSTEAD OF "CHAIRMAN;" IN ANY CASE, MAKE SURE THAT ALL REFERENCES IN THESE BY-LAWS ARE THE SAME]***

- PRESIDENT. The President shall have general supervision of the affairs of the Corporation. He or she shall *[coordinate with the Executive Director on the general affairs of the Corporation and]* keep the Board of Directors fully informed, and shall freely consult with them concerning the activities of the Corporation. He or she shall have the power to sign alone, unless the Board of Directors shall specifically require an additional signature, in the name of the Corporation all contracts or other documents authorized either generally or specifically by the Board of Directors; unless otherwise limited by the Board, the Board may also grant such signing authority to other officers or agents of the Corporation. He or she shall be a member *ex-officio* of all committees of the Board of Directors, and, if he or she be a director, shall have the right to vote on all such committees unless otherwise precluded by action of the Board of Directors. He or she shall perform such other duties as shall from time to time be assigned to him or her by the Board of Directors and shall perform such other duties as are necessarily incident to the office of the President.

- VICE PRESIDENTS. The Vice Presidents shall have such powers and duties as may be assigned to them by the Board of Directors. In the absence of the President, the Vice Presidents, in the order designated by the Board of Directors, shall in general perform the duties of the President.

- SECRETARY. The Secretary shall act as secretary of all meetings of the Board of Directors at which he or she is present and shall keep or cause to be kept minutes of all meetings of the members, Board of Directors and any executive committee in books proper for that purpose. He or she shall attend to the giving and serving of all notices of the Corporation. He or she shall perform all the duties customarily incident to the office of the Secretary, subject to the control of the Board of Directors, and shall perform such other duties as shall from time to time be assigned to him or her by the Board of Directors. The Secretary shall be the keeper of the Corporation's seal if there be one.

- ASSISTANT SECRETARIES. The Assistant Secretaries shall perform the duties of the Secretary in his or her absence or at his or her request, and shall perform such other duties as shall from time to time be assigned to them by the Board of Directors.

- TREASURER. The Treasurer shall have the custody of all funds and securities of the Corporation which may come into his or her hands. He or she shall keep or cause to be kept full and accurate accounts of receipts and disbursements of the Corporation and shall deposit or cause to be deposited all monies and other valuable effects of the Corporation in the name and to the credit of the Corporation in such banks or depositories as the Board of Directors may designate. Whenever required by the Board of Directors, he or she shall render a statement of his or her account. He or she shall at all reasonable times exhibit his or her books and accounts to any officer or director of the corporation and shall perform all duties incident to the position of the Treasurer subject to the control of the Board of Directors and shall, when required, give such security for the faithful performance of his or her duties as the Board of Directors may determine.

- ASSISTANT TREASURERS. The Assistant Treasurers shall perform the duties of the Treasurer in his or her absence or at his or her request, and shall perform such other duties as shall from time to time be assigned to them by the Board of Directors.]

Section 3.3. Other Agents. The Board of Directors may appoint from time to time such agents as it shall deem appropriate, each of whom shall hold office at the pleasure of the Board of Directors, and shall have such authority and perform such duties and shall receive such reasonable compensation, if any, as the Board of Directors may from time to time determine.

Section 3.4. Compensation. The Corporation may pay its officers, agents and employees compensation commensurate with their services, and reimbursement for expenses incurred in the performance of their duties. The amount of salary paid to [each officer] [the President] shall be fixed by action of the Board of Directors or, if such exists, the Executive Committee.

[IF THE ORGANIZATION HAS AN EXECUTIVE DIRECTOR, CONSIDER INCLUDING A SEPARATE SECTION REGARDING SUCH POSITION OR HAVING SUCH PERSON ADDED AS AN OFFICER, WITH A PARAGRAPH DESCRIBING THE PERSON'S DUTIES.]

[ARTICLE IV

Executive Director [FN10c]

[There shall be][The Board may authorize the engagement of] an Executive Director of the Corporation, who may, but he need not, be a director or officer or member of the Association. The last three sentences of Section [3.1] of these By-Laws shall apply by analogy to the Executive Director. The Executive Director shall [be the chief operating office, shall] have general control of the work of the Corporation subject to the direction of the Board of Directors, and shall report to the Board of Directors at each meeting. The Executive Director, along with the President, shall have the authority, in the name and on behalf of the Corporation, to executive all agreements, contracts, checks, mortgages, drafts, notes or other obligations, instruments and documents of the Corporation, authorized either generally or specifically by the Board. The Executive Director shall present an annual report to the annual meeting of [members] [directors] of the Corporation concerning the work of the Corporation for the year preceding such meeting.]

ARTICLE IV

Indemnification

Alternative A (simple)

The Corporation shall indemnify each director and officer (or, if deceased, his or her personal representatives), and the Corporation [may] [shall] [NOTE ISSUE] advance his or her expenses, in the manner and to the full extent authorized or permitted under the Not-for-Profit Corporation Law of the State of New York, and, except as restricted by law, the Corporation may provide additional indemnification pursuant to agreement, action of the Board of Directors, provision of these By-Laws or otherwise. [The right to be indemnified [or to the advancement or reimbursement of expenses] pursuant to these By-Laws is a contract right pursuant to which the person entitled thereto may bring suit as if the provisions hereof or of any such resolution were set forth in a separate written contract between the Corporation and such person, and shall continue to exist after any rescission or restrictive modification hereof or of any such resolution with respect to events occurring prior thereto. [FN11c]

Alternative B (more complex)

Section 4.1. Indemnification of directors and Officers. Except to the extent expressly prohibited by the New York Not-For-Profit Corporation Law:

(a) The Corporation shall promptly indemnify each person who is a present or former director or officer of the Corporation or member of a committee established pursuant Article II (or such person's executor, administrator or personal representative) who was or is made, or is threatened to be made, a party to any action or proceeding, whether civil or criminal (including without limitation any action brought by or in the right of the Corporation), or who is a subject of a government investigation, by reason of the fact that such person (or such person's testator or intestate) (i) is or was a director, officer or committee member or (ii) in the case of a present or former director or officer, serves or served, at the request of the Corporation, as a trustee, director or officer of any other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise in any capacity, against any and all liabilities, losses, judgments, fines (including excise taxes assessed with respect to an employee benefit plan pursuant to applicable law), amounts paid in settlement and expenses (including attorneys' fees, reasonably incurred) in connection with such action or proceeding, or any appeal therein, or government investigation, except where a judgment or other final adjudication adverse to such person establishes that his or her acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated, or that he or she personally gained in fact a financial profit or other advantage to which he or she was not legally entitled.

(b) The Corporation shall advance or promptly reimburse upon request of a person referred to in Section 4.1(a) all expenses, including attorneys' fees, reasonably incurred by such person in connection with any action, proceeding or government investigation of the kind referred to in Section 4.1(a) in advance of the final disposition thereof, subject to, should the Board of Directors so require, receipt of a written undertaking by or on behalf of such person to repay such amounts if such person is ultimately found not to be entitled to indemnification under this Article IV or otherwise or, where indemnification is granted,

to the extent the expenses so advanced or reimbursed exceed the amount to which such person is ultimately determined to be entitled, provided that such person shall cooperate in good faith with any request of the Corporation that common counsel be used by parties to any action, proceeding or government investigation who are similarly situated unless to do so would be inappropriate because of actual or potential differing interests between such parties.

Section 4.2. Additional Indemnification. The Corporation, by a resolution of its Board of Directors or the Executive Committee thereof or an agreement approved by the Board of Directors or Executive Committee, may, to the fullest extent permitted by applicable law, indemnify and advance or reimburse expenses to any person, including a person entitled to indemnification pursuant to Section 4.1 and employees and agents of the Corporation, including, without being limited to, indemnification of the same scope, to the same effect and granting the same rights as the indemnification of directors and officers provided by this Article IV.

Section 4.3. Interpretation. A person for whom indemnification or the advancement or reimbursement of expenses is provided for under Section 4.1 (or by a resolution authorized pursuant to Section 4.2 specifically acknowledging the provisions of this Article IV) may elect to have the provisions of this Article interpreted on the basis of the applicable law in effect either (i) at the time of the occurrence of the event or events giving rise to the action, proceeding or government investigation, to the extent permitted by law, or (ii) at the time indemnification or advancement or reimbursement of expenses is provided or sought.

Section 4.4. Contract Right.

(a) The right to be indemnified or to the advancement or reimbursement of expenses pursuant to Section 4.1, or a resolution authorized pursuant to Section 2 specifically acknowledging the provisions of this Article IV, (i) is a contract right pursuant to which the person entitled thereto may bring suit as if the provisions hereof or of any such resolution were set forth in a separate written contract between the Corporation and such person, and (ii) shall continue to exist after any rescission or restrictive modification hereof or of any such resolution with respect to events occurring prior thereto.

(b) If a request to be indemnified or for the advancement or reimbursement of expenses pursuant to Section 4.1, or a resolution or agreement authorized by Section 4.2 specifically acknowledging the provisions of this Article IV, is not paid in full by the Corporation within 30 days after a written claim for such advancement or reimbursement has been received by either the President or Secretary of the Corporation and the claimant thereafter brings suit against the Corporation to recover the unpaid amount of the claim which is successful in whole or in part, the Corporation shall be obligated to pay the claimant the expenses, including reasonable attorneys' fees, of prosecuting such claim, if such claim is successful in whole or in part. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending a civil or criminal action or proceeding in advance of the final disposition thereof where the required undertaking has been tendered to the Corporation) that the claimant has not met the standards of conduct which make it permissible under Section 4.1 for the Corporation or the applicable resolution or agreement authorized under Section 4.2 to indemnify the claimant for the amount claimed, but the burden of proving such defense shall be on the Corporation. Neither the failure of the Corporation (including its Board of Directors or independent legal counsel) prior to the commencement of such action to have made a determination that indemnification of the claimant is proper in the circumstances because he or she, or his or her testator or intestate, has met the applicable standard of conduct set forth in Section 4.1, nor an actual determination by the Corporation (including its Board of Directors or independent legal counsel) that the claimant, or his or her testator or intestate, has not met such applicable standard of conduct, shall be a defense to such action or create a presumption that he or she, or his or her testator or intestate, has not met such applicable standard of conduct.

Section 4.5. Additional Rights; Definitions.

(a) The indemnification or advancement or reimbursement of expenses granted pursuant to or provided by the provisions of this Article IV shall be in addition to and shall not be exclusive of any other rights to indemnification and advancement or reimbursement of expenses to which such person may otherwise be entitled by law, Certificate or Incorporation, By-Law, insurance policy, contract or otherwise.

(b) For purposes of this Article IV, the following terms shall have the following meanings: (i) “the Corporation” shall include any legal successor to the Corporation, including any corporation or other entity which acquires all or substantially all of the assets of the Corporation in one or more transactions, (ii) “person” shall include the personal representative, testator or intestate of a person, (iii) “officer of the Corporation” shall include persons who are elected by the Board of Directors as officers and persons who are appointed by such Board as officers and (iv) service “at the request of the Corporation” shall

include serving any corporation or other entity which may be specified by resolution of the Board or its Executive Committee, any corporation, partnership, joint venture, trust or other enterprise of which fifty percent or more of the voting power or economic interest is held, directly or indirectly, by the Corporation or any employee benefit plan of the Corporation.

Section 4.6. Modification. If any provision of this Article IV is determined to be unenforceable in whole or in part, such provision shall be modified so as to be enforceable, to the maximum extent allowed by law, and as so modified be enforced to the fullest extent permissible, it being the intent of this Article to provide indemnification to all persons eligible hereunder to the fullest extent permitted under law.

Section 4.7. Insurance. To the extent permitted by the New York Not-For-Profit Corporation Law, the Corporation may purchase and maintain insurance, at its expense, to indemnify (i) the Corporation against any obligation which it incurs as a result of these By-Laws or any indemnification resolution, (ii) its directors, officers, employees and agents in instances in which they must or may be indemnified by the Corporation pursuant to these By-Laws or any indemnification resolution and (iii) its directors, officers, employees and agents in instances in which, for any reason, they are not, or may not be, indemnified by the Corporation.

ARTICLE V [FN12c]

Conflict of Interest

No director shall be an officer, director, trustee, owner (either as a sole proprietor or partner), shareholder or member with a five percent or greater interest in all outstanding voting or equity interests, employee or agent of any company or business venture (or any affiliate thereof) which has entered, or might reasonably in the future enter, into a relationship or a transaction with the Corporation unless the director shall have disclosed such relationship to the Board of Directors, by written disclosure to the President, promptly upon learning of the relationship between the Corporation and such other company or venture. At such time as any matter comes before the Board in such a way as to give rise to a conflict of interest, the affected director shall make known the potential conflict and, after answering any questions posed by the other directors, shall withdraw from the meeting for so long as the matter shall continue under discussion and shall abstain from all voting with respect to such matter *(provided, however*, that such director may execute a written consent to such action if unanimity is required for such action to be authorized or vote for such action if the proposed action has received approval by a majority of the directors not subject to such conflict and under the Not-for-Profit Corporation Law or these By-Laws such person's vote is required in order for the proposed action to be approved). The affected director may be counted to establish a quorum for a meeting at which an action in which such director has an interest is being considered. [FN13c]

ARTICLE VI

Amendments

Except as otherwise required by Section 709 of the N-PCL or other provisions of applicable law, [FN14c] these By-Laws may be amended, added to or repealed by the [members or by the] Board of Directors, by the vote of a majority of the entire Board of Directors *[provided written notice of the proposal to amend and a copy of the proposed amendment shall have been given to each* member or director, as applicable *at least [10] days prior to such meeting in accordance with the notice procedure set forth in Section 1.11][; provided, however,] [except] that no prior notice shall be required to increase or decrease the size of the Board of Directors [by up to ... positions] in connection with the election of new directors or acceptance of resignations or other events leading to the departure of directors]* ***[THE EXCEPTION ALLOWING CHANGES IN THE SIZE OF THE BOARD WITHOUT PRIOR NOTICE IS DONE TO MAKE IT EASIER TO CHANGE THE NUMBER OF DIRECTORS - SINCE ANY SUCH CHANGE MUST BE DONE BY AMENDMENT OF THE BY-LAWS UNLESS THE BOARD CAN CHANGE SIZE DUE TO MEMBER-APPROVED BY-LAW PROVISIONS ALLOWING SUCH ACTION SOME COMPANIES, HOWEVER, MAY WISH TO PUT LIMITS ON THE NUMBER OF DIRECTORS BY WHICH THE BY-LAWS CAN BE CHANGED TO A VOID ANY RISK OF "PACKING" THE BOARD WITHOUT ADEQUATE PRIOR NOTICE.].***

Note: some by-laws include provisions regarding conflicts of interest. Those provisions can also be set forth in a separate conflicts policy.

[FN1c]. This term appears in corporate literature with or without a hyphen and with only the initial "B" capitalized or with both the "B" and "L" capitalized. This draft uses the double capital + hyphen approach. Whatever style is used, however, the document should be internally consistent.

[FN2c]. Drop this paragraph if there are no members. The membership provisions of this version have the directors as the only members. This approach works for corporations which must have members, such as Type A, C and D corporations, where you do not want "true" members. It also works if the board wants to have the flexibility to change its size without having to amend the by-laws (see the director size provision in the next article). If you have "true" members, the membership provisions should meet the needs of the entity, such as the following provisions:

1. MEMBERS. There shall be only one class of members. The persons signing the Certificate of Incorporation as the incorporators of the Corporation shall be the first members of the Corporation. A majority of those persons who at any time constitute the membership of the Corporation may, from time to time, fix the number of members of the Corporation. Additional members may be elected by the existing members from time to time at any annual meeting of members or at any special meeting of members called for election of members. Each member shall be at least 18 years of age. A member need not be a citizen of the United States or a resident of the State of New York. Except as may herein otherwise be provided, membership shall be terminated by the death, resignation or removal of a member or by the dissolution or liquidation of the Corporation, and any right or interest of a member shall terminate upon the happening of any such event.

2. RECORD DATE FOR MEMBERS. For the purpose of determining the members entitled to notice of or to vote at any meeting of members or any adjournment thereof, or to express consent to or dissent from any proposal without a meeting, or for the purpose of any other action, the Board of directors may fix, in advance, a date as the record date for any such determination of members. Such record date shall not be more than fifty days nor less than ten days before the date of such meeting. If no record date is fixed, the record date for the determination of members entitled to vote at a meeting of members shall be at the close of business on the day next preceding the day on which notice is given, or, if no notice is given, the day on which the meeting is held. When a determination of members of record entitled to notice of or to vote at any meeting of members has been made as provided in this paragraph, such determination shall apply to any adjournment thereof, unless the Board of directors fixes a new record date under this paragraph for the adjourned meeting.

3c. MEMBERSHIP MEETINGS.

(a) TIME. The annual meeting shall be held on the date fixed, from time to time, by the Board of directors or the Chairman of the Board or the President within six months of the end of the Corporation's fiscal year [THIS IS CURRENTLY A REQUIREMENT UNDER SECTION 519 OF THE N-PCL SINCE FINANCIALS NO OLDER THAN SIX MONTHS HAVE TO BE PRESENTED TO THE ANNUAL MEETING]. A special meeting shall be held on the date fixed by the Board of directors or the Chairman of the Board or the President except when the Not-for-Profit Corporation Law confers upon members the right to fix the date.

(b) PLACE. Annual meetings and special meetings shall be held at such place, within or without the State of New York, as the Board of directors or the Chairman of the Board or the President may from time to time fix. Whenever the directors, the Chairman of the Board or the President shall fail to fix such place, or whenever members entitled to call or convene a special meeting shall convene the same, the meeting shall be held at the office of the Corporation in the State of New York.

(c) CALL. Annual meetings may be called by the Board of directors or the Chairman of the Board or the President or by any other officer instructed by the Board of directors to call the meeting. Special meetings may be called in like manner except when the directors are required by the Not-for-Profit Corporation Law to call a meeting, or except when the members are entitled by said law to demand the call of a meeting.

(d) NOTICE OR ACTUAL OR CONSTRUCTIVE WAIVER OF NOTICE. Written notice of all meetings shall be given, stating the place, date and hour of the meeting, and, unless it is an annual meeting, indicate that it is being issued by or at the direction of the person or persons calling the meeting. The notice of an annual meeting shall state that the meeting is called for the election of directors and for the transaction of other business which may properly come before the meeting. The notice of a special meeting shall in all instances state the purpose or purposes for which the meeting is called, and, at any such meeting, only such business may be transacted which is related to the purpose or purposes set forth in the notice. A copy of the notice of any meeting shall be given to each member at his or her address as it appears on the record of members or, if he or she shall have filed with the Secretary of the Corporation a written request that notices be mailed to some other

address, then directed to him or her at such other address. The notice shall be given personally or by first class mail not less than ten or more than fifty days before the date of the meeting. Notice by mail shall be deemed to be given when deposited, with postage thereon prepaid, in a post office or official depository under the exclusive care and custody of the United States Postal Service. If a meeting is adjourned to another time or place and if any announcement of the adjourned time or place is made at such meeting, it shall not be necessary to give notice of the adjourned meeting unless the Board of directors, after adjournment, fixes a new record date for the adjourned meeting. Notice of a meeting and/or of the lapse of any prescribed period of time need not be given to any member who submits a signed waiver of notice and/or of the lapse of any prescribed period of time before or after the meeting. The attendance of a member at a meeting without protesting prior to the conclusion of the meeting the lack of notice of such meeting shall constitute a waiver of notice by such member.

(e) MEMBERS' LIST OR RECORD AND CHALLENGE. A list or record of members as of the record date, certified by the Secretary or other officer responsible for its preparation, shall be produced at any meeting of members upon the request therefor of any member who has given written notice to the Corporation that such request will be made at least ten days prior to such meeting. If the right to vote at any meeting is challenged, the person presiding thereat shall require such list or record of members to be produced as evidence of the right of the persons challenged to vote at such meeting, and all persons who appear from such list or record to be members entitled to vote thereat may vote at such meeting.

(f) ANNUAL REPORT OF DIRECTORS. The Board of Directors shall present at each annual meeting of members its report, which shall [set forth the statements and shall be verified or certified in the manner prescribed by Section 519 of the Not-for-Profit Corporation Law] [show in appropriate detail the following:

(g) (1) The assets and liabilities, including the trust funds, of the Corporation as of the end of a twelve month fiscal period terminating not more than six months prior to said meeting.

(h) (2) The principal changes in assets and liabilities, including trust funds, during said fiscal period.

(i) (3) The revenue or receipts of the Corporation, both unrestricted and restricted to particular purposes during said fiscal period.

(j) (4) The expenses or disbursements of the Corporation, for both general and restricted purposes, during said fiscal period.]

(k) Such report shall be filed with the records of the Corporation and either a copy or an abstract thereof entered in the minutes of the proceedings of such annual meeting of members.

(l) CONDUCT OF MEETING. Meetings of the members shall be presided over by one of the following officers in the order of seniority and if present and acting-- the Chairman of the Board, the President, a Vice President, or, if none of the foregoing is in office and present and acting, by a chairman to be chosen by the members. The Secretary of the Corporation, or in his or her absence, an Assistant Secretary, shall act as secretary of every meeting, but if neither the Secretary nor an Assistant Secretary is present the Chairman of the meeting shall appoint a secretary of the meeting.

(m) PROXY REPRESENTATION. Every member entitled to vote at a meeting of members or to express consent or dissent without a meeting may authorize another person or persons to act for him or her by proxy. Each proxy must be in writing and signed by the member or by his or her attorney-in-fact and electronic and facsimile signatures shall be permitted. No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the member executing it, except as otherwise provided by the Not-for-Profit Corporation Law.

(n) QUORUM. Except for a special election of directors pursuant to section 604 of the Not-for-Profit Corporation Law, and except as herein otherwise provided, one-half of the members entitled to vote, present in person or by proxy shall constitute a quorum at a meeting of members for the transaction of any business. A majority of the members present may adjourn the meeting despite the absence of a quorum. At such adjourned meeting, at which a quorum shall be present, any business may be transacted which might have been transacted at the meeting as originally notified.

(o) VOTING. Each membership shall entitle the holder thereof to one vote. In the election of directors, a plurality of the votes cast shall be required for election. Any other action, including the election of members, shall be authorized by a majority of the votes cast except where the Not-for-Profit Corporation Law prescribes a different proportion of votes; provided that the said majority of the affirmative votes cast shall be at least equal to a quorum.

4. MEMBERSHIP ACTION WITHOUT MEETINGS. Whenever members are required or permitted to take any action by vote, such action may be taken without a meeting on written consent, setting forth the action so taken, signed by all the members entitled to vote.

[FN3c]. Directors can alternatively be called "Trustees."

[FN4c]. Note that Section 702 of the N-PCL says that the number of directors can be adjusted by action of the members or directors only if the corporation has members and such specific provision of the by-laws allowing such has been approved by members. Absent members, Section 702 says the number of directors must be "fixed" by the by-laws. If this is an issue, the organization could have members consisting of those persons who are from time to time elected as directors as a way of making an end-run around this provision. It would also enable removal without cause, which can only be done by members. If the organization does not have members, then the number of directors must be stated in the by-laws and the by-laws must be amended if the number is to be changed.

[FN5c]. IF YOU WANT TO HAVE A CLASSIFIED BOARD: The directors shall be divided into [three] classes, the members of each class to be elected by the directors of the Corporation to serve for terms of [three] years or such lesser period as may be specified at the time of election The duration of terms shall be so scheduled that the number of seats to be filled shall, so far as practicable, be equal in each succeeding year but the fact that classes are not equal in size shall in no way affect the validity of the constitution of the Board of directors or of a director's election.

[FN6c]. Sometimes you see the provision stated as "at the close of the election of directors at the next annual meeting" but that formulation can create a musical chairs situation. If, however, the organization wants to have the "new crew" on hand at the meeting, such formulation would work.

[FN7c]. Note that the N-PCL, Section 706, allows removal by regular vote of the board provided that there is a quorum of not less than a majority of the directors present; if this provision is preferred, change the language to read "when there is a quorum of not less than a majority of the entire Board present at the meeting of the Board at which such action is taken." That provision implies that the board may not remove directors without cause, although members could if the by-laws so said.

[FN8c]. Here are some committee descriptions:

Executive Committee. The Executive Committee shall consist of the officers of the Corporation and such other members as the Board may elect. Except as otherwise provided by law and in these By-Laws, the Executive Committee may exercise all the powers of the Board and shall act in its stead between meetings of the Board of Directors. The Executive Committee shall periodically review staff, salary scale and structure, the personnel manual, pension plans and insurance policies. The Executive Committee shall report its actions to the full Board of Directors at the next meeting of the Board of Directors.

Finance Committee. The Finance Committee shall be responsible for the preservation and enhancement of assets; shall prepare an annual budget for the Corporation, subject to Board approval; shall supervise investments and advise on matters of financial policy, fund raising and expenditures; and shall annually review the Corporation's directors' and officers' indemnification insurance and make certain it is in force. [ADD AUDIT COMMITTEE FUNCTIONS]

Nominating/Governance Committee. The Nominating/Governance Committee shall nominate directors and officers of the Corporation, shall establish the members of the various classes of the Board of Directors as set forth in Section; and shall have the following additional functions: orientation and education of Board members; assessment of performance of Board members; recruitment of new Board members; responsibility for Board development and accountability; and periodic review and, if appropriate, recommendation of revisions of the Corporation's Certificate of Incorporation, By-Laws [and Board Manual].

Development Committee. The Development Committee shall be responsible for fundraising approaches to foundations, annual giving and benefits and other projects which generate income, as well as supervise subcommittees for benefits. In addition, the Committee shall be responsible for the cultivation of donors, supporters and potential Board members.

Marketing/Public Relations Committee. The Marketing/Public Relations Committee shall oversee the publicity and public relations efforts of the Corporation and anything else that has to do with promoting the Corporation.

[FN9c]. Alternatives:

President: Powers and Duties. The President shall preside at all meetings of the Board of Directors and Executive Committee. The President shall have general supervision over the affairs of the Corporation, shall keep the Board of Directors informed about the significant activities of the Corporation and shall appoint the chairmen of the standing committees. The President shall be an ex officio voting member of all committees. The President shall assign to all other officers and committee chairs such duties as may be necessary in addition to those specifically prescribed by the By-Laws. He or she shall perform all the duties which pertain to the office of President and shall perform such other duties as from time to time may be assigned by the Board of Directors.

Vice Presidents: Powers and Duties. The Executive Vice President shall exercise the functions of the President during the absence or disability of the President. In the absence or disability of both the President and Executive Vice President, the other Vice Presidents (in the order of seniority, based on their first date and time of election or, if elected at the same time, in the order of listing in the minutes for the meeting at which such election was held) shall exercise the functions of the President. Each Vice President shall have such powers and discharge such duties as may be assigned from time to time by the President or, in the event of the absence of the President, by the Board of Directors.

Treasurer: Powers and Duties. The Treasurer shall keep or cause to be kept full and accurate accounts of receipts and disbursements of the Corporation, and shall deposit or cause to be deposited all moneys, evidences of indebtedness and other valuable documents of the Corporation in the name and to the credit of the Corporation in such banks or depositories as the Board of Directors may designate. At the Annual Meeting and whenever else required by the Board of Directors, he or she shall render a statement of the Corporation's accounts. He or she shall at all reasonable times exhibit the Corporation's books and accounts to any officer or Director of the Corporation, and shall perform all duties incident to the position of Treasurer, subject to the control of the Board of Directors, and shall when required, give such security for the faithful performance of his or her duties as the Board of Directors may determine.

Assistant Treasurers: Powers and Duties. Each Assistant Treasurers shall have all the powers and shall perform all the duties of the Treasurer in case of absence or disability of the Treasurer.

Secretary: Powers and Duties. The Secretary shall be responsible for the giving and serving of all notices of the Corporation and the recording all minutes of the meetings of the Board of Directors and Executive Committee. He or she shall have charge of the corporate seal and shall perform such other duties as pertain to the office of Secretary.

Assistant Secretaries: Powers and Duties. Each Assistant Secretaries shall have all the powers and shall perform all the duties of the Secretary in case of the absence or disability of the Secretary.

[FN10c]. E.G.: ARTICLE VII. EXECUTIVE DIRECTOR. The Board may appoint an Executive Director, who shall serve in such position at the discretion of the Board. The responsibilities of such Executive Director shall be set by the Board at the time that such Executive Director is hired and may be modified from time to time in the discretion of the Board, subject, however, to any contractual undertakings between the Corporation and the Executive Director. Subject to any contrary or different responsibilities and authority which may be specified by the Board or set forth in any agreement between the Corporation and the Executive Director, the Executive Director shall:

(a) be in charge of the operations, business, and property of the Foundation and maintain oversight of all of its activities;

(b) be responsible for implementing the policies established by the Board;

(c) provide liaison between the Board and the personnel of the Foundation (both paid and volunteer);

(d) report (in writing and/or in person) at each meeting of the Board and the Executive Committee at each on the activities of the Foundation;

(e) organize the administrative functions of the personnel of the Foundation and be responsible, within guidelines established by the Board, for selecting, hiring, controlling and discharging personnel and developing and maintaining personnel policies and practices;

(f) represent to the Foundation to the public and the professional communities; and

(g) perform any other duty within the express or implied terms of the Executive Director's duties under these By-Laws and any employment agreement that may be necessary for the best interest of the Foundation.

[FN11c]. Appropriate language could also be put in the charter. See Alternative B for long-form indemnification provisions which includes more pro-director language. Other more neutral alternative language would include the following:

"Any person made, or threatened to be made, a party to any action or proceeding, whether civil or criminal, by reason of the fact that such person or such person's testator or intestate, was a director or officer of the Foundation*, or serves or served any other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise in any capacity at the request of the Foundation, shall be indemnified by the Foundation, and the Foundation [may][shall] [NOTE ISSUE] advance such person's related expenses, to the full extent permitted by the New York Not-for-Profit Corporation Law. The Board of directors shall have the power to adopt resolutions or to enter into agreements providing for additional indemnification in such cases as the Board of directors shall decide, provided that such additional indemnification may not be made to or on behalf of any director or officer if a judgment or other final adjudication adverse to the director or officer establishes that his or her acts were committed in bad faith or were the result of active and deliberative dishonesty and were material to the cause of action, or that he or she personally gained in fact a financial profit or other advantage to which he or she was not legally entitled. The Foundation* shall have the power to purchase and maintain insurance to indemnify the Foundation and its directors and officers to the full extent such indemnification is permitted by law."

[FN12c]. This could alternatively appear in a separate policy. See page 19 *et. seq.* for standalone conflicts policies that could be used, either independently or as part of the by-laws.

[FN13c]. **AN ALTERNATIVE:**

ARTICLE V

CONFLICT OF INTEREST

Section 5.1. Notice of Conflicts. Each director and officer, within 30 days after his or her initial election to the Board or to such office [and annually thereafter] (or, if such relationship did not exist at such time, promptly upon learning of such relationship), shall disclose to the Board of directors, by written disclosure to the President and the Secretary, a list of all businesses or other organizations of which he is an officer, director, director, owner (either as a sole proprietor or partner), shareholder with a five percent or greater interest in all outstanding voting or equity interests, employee or agent with which the Corporation or any affiliate has entered, or might reasonably in the future enter into, a relationship or a transaction in which the director or officer may have conflicting interests [(including, without limitation, (receiving a grant from) / (making any grant to) the Corporation)] [EXPAND TO INCLUDE OTHER TYPES OF CONFLICTS]. The President shall become familiar with the statements of all directors and officers in order to guide his or her conduct should a conflict arise. The Vice President shall become familiar with the statement filed by the President. If any director or officer fails to submit a proper disclosure statement, the Secretary shall notify the full Board at its next meeting.

Section 5.2. Conflict Situations. At such time as any matter comes before the Board in such a way as to possibly give rise to a conflict of interest, the affected director shall make known the potential conflict, whether disclosed by his or her written statement or not, and after answering any questions that might be asked him, shall withdraw from the meeting for so long as the matter shall continue under discussion. Should the matter be brought to a vote, the affected director shall not vote on it, [*provided, however*, that such director may execute a written consent to such action to be authorized if the matter would otherwise have been approved by the percentage of directors appropriate to approve such matter at a meeting of the directors]. If the affected director fails to withdraw voluntarily, the Chairman of the Board shall require that the affected director remove himself from the room during both the discussion and the vote on the matter. If the conflict of interest affects the Chairman, the Vice Chairman shall require that the Chairman shall remove himself or herself in the same manner, and for the duration of discussion and action on the matter the Vice Chairman shall preside.

Section 5.3. Quorum. [If the matter is an item of business for which a special meeting of the Board was called, the affected director shall not be counted to establish a quorum for such meeting, nor shall or she participate in the deliberations or vote on the matter. A quorum for such a special meeting shall be a majority of the non-affected directors notwithstanding that the number of non-affected directors may not represent a majority of the full Board so long as the number of non-affected directors is at least one-third of the directors fixed in Section ..... of these Bylaws.] or [The affected director may be counted to establish a quorum for a meeting at which an action in which such director has an interest is being considered.] or [If the number of directors on the Board who can vote on a matter involving an actual or potential conflict of interest is less than the number required for a quorum, the Board shall refer the matter to a committee of the Board with a sufficient number of directors who can vote on the matter to constitute a quorum. The committee's action on the matter shall be binding on the Board and the Corporation.]

Section 5.4 Determinations. The Board or committee acting on a matter involving an actual or potential conflict of interest shall make a reasonable effort to establish and document the fairness of the transaction or arrangement (the scope of such effort being determined by the size and circumstances of the transaction or arrangement), and shall indicate in the minutes of the meeting: (a) the names of any directors and officers who might have a direct or indirect financial or other interest in the matter and the nature of their interest, (b) whether any interested director participated in the discussion of the merits of or the vote on the matter, (c) a summary of the terms and merits of the transaction or arrangement, and (d) a record of the vote on the matter.

Section 5.5 Exemptions. A director's membership on the Board of directors or on a committee of, or a director's status as an employee, officer or agent of _____ or any of its affiliates, shall not, in and of itself, constitute a conflict of interest, nor is disclosure of such membership necessary.

[FN14c]. This provision requires approval by two-thirds of the entire board to impose (or eliminate) higher quorum or voting requirements than otherwise set by law.

PROTOTYPE DELAWARE BY-LAWS

BY-LAWS

OF

_____

(a Delaware nonprofit corporation)

ARTICLE I

LOCATION

The principal office of the Corporation shall be located in ***[any county of the City of New York, New York][where determined from time to time by the Board of Directors].*** The Corporation may also have such offices at such other places as the Board of Directors may from time to time determine. The registered office and registered agent of the Corporation in Delaware shall be as selected by the Board of Directors from time to time.

ARTICLE II

MEMBERS [FN1d]

2.1 Determination of Members. The Corporation shall have one class of members which shall consist of the persons who from time to time are elected as members of the Board of Directors. The right or interest of a member shall terminate upon such person no longer being a director of the Corporation, or dissolution or liquidation of the Corporation.

2.2 Annual Meeting of Members. The annual meeting of the members of the Corporation shall be held in conjunction with the annual meeting of the directors but action to be taken as members shall be taken separately from action to be taken as directors. Special meetings of the members, which may be held in conjunction with or separate from meetings of the Board, may be called by the President or the Secretary and shall be called upon request of one-third of the members. Notice of meetings shall be as set forth in Section 5(c) of Article III.

2.3 Location of Meetings. Annual meetings and special meetings shall be held at such place, within or without the State of Delaware, as the Board of Directors or the President may from time to time fix. Whenever the directors or the President shall fail to fix such place, or whenever members entitled to call or convene a special meeting shall convene the same, the meeting shall be held at the principal office of the Corporation.

2.4 Proxies. A member may authorize another person or persons to act for him or her at a meeting or by written consent if so authorized by a written proxy, a copy of which shall be provided to the Corporation. Every proxy must be signed by the member or his or her attorney-in-fact. No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the member executing it, except as otherwise provided by the General Corporation Law.

2.5 Quorum. Except as herein otherwise provided or required by the General Corporation Law, one-half of the members entitled to vote, present in person or by proxy shall constitute a quorum at a meeting of members for the transaction of any business. A majority of the members present may adjourn the meeting despite the absence of a quorum. At such adjourned meeting, at which a quorum shall be present, any business may be transacted which might have been transacted at the meeting as originally notified. Section 9 of Article III sets forth provisions regarding attendance.

2.6 Voting. Each member shall be entitled to one vote. In the election of directors, a plurality of the votes cast shall be required for election. Any other action shall be authorized by a majority of the votes cast, except where the General Corporation Law prescribes a different proportion of votes, provided that such majority of the affirmative votes cast shall be at least equal to a quorum.

2.7 Action Without a Meeting. Whenever members are required or permitted to take any action by vote, such action may be taken without a meeting on written consent, setting forth the action so taken, signed by ***[all the members entitled to vote] [such portion of the members as are authorized to take such action by a vote].***

ARTICLE III

BOARD OF DIRECTORS

3.1 Management: Number of Directors. The Corporation shall be managed by a Board of Directors (the "Board"). Each director shall be at least 18 years of age. The initial Board of Directors shall be ***[three]*** [CAN BE AS LOW AS ONE BUT FOR IRS AND GOVERNANCE PURPOSES IT IS BETTER TO HAVE MORE] persons. The number of directors may be increased or decreased by a vote of a majority of the entire Board or by action of the members *[but shall never be less than* ***[three]*** *or more than* ***[21]*** *directors]*. No decrease shall shorten the term of any director then in office. The use of the phrase "entire Board" herein refers to the total number of directors which the Corporation would have if there were no vacancies.

3.2 Composition. The first Board of Directors shall consist of those persons ***[elected by the Incorporators][named in the Certificate of Incorporation]*** and they shall hold office until their successors have been duly elected and qualified. Directors who are elected at an annual meeting of members and directors who are elected in the interim to fill vacancies, shall hold office until the next annual meeting of members and until their successors have been duly elected and qualified. In the interim between annual meetings of members, vacancies caused by Board expansion, resignation, death or removal may be filled by the vote of the directors then in office. Directors may succeed themselves in office.

3.3 Removal; Resignation. Any or all of the directors may be removed with cause or without cause by a vote of a majority of the members of the Corporation. A director may resign at any time by giving written notice to the Board or to an officer of the Corporation. Unless otherwise specified in the notice, the resignation shall take effect upon receipt thereof by the Board or such officer. Acceptance of such resignation shall not be necessary to make it effective.

3.4 Compensation. Directors shall receive no compensation for their services. Nothing herein shall be construed to preclude any director from serving the Corporation in any other capacity ***[(other than the [Artistic][Executive] [Administrative] Director)]*** and receiving compensation for that activity.

3.5 Meetings. (a) The directors shall hold an annual meeting on the ***[e.g., third Tuesday of May]*** or at such other time as shall be determined by the Board. The annual meeting shall be held at such a place, whether within or outside the State of Delaware and at such time as the Board shall determine, or, at the discretion of the Board.

(b) The President may call additional meetings as the occasion warrants. The President must call a meeting of the Board within 30 days if requested in writing by at least one-third of the directors. Special meetings also may be called by one-third of the directors then in office.

(c) Notice of all meetings stating the time and place of the meeting, shall be given to each director either personally, or by telephone, telegram or ordinary mail, and, as to those directors who so agree, facsimile or electronic mail, at least ***[three]*** days before the date on which said meeting is to convene. At any meeting at which all of the directors are present, notice of the time, place and purposes thereof shall be deemed waived. Notice of any meeting may be waived in writing, either before, during or after any meeting.

3.6 Quorum. Except to the extent otherwise set forth in these By-Law or in the Certificate of Incorporation of the Corporation, one-third of the directors then in office shall constitute a quorum. Where vacancies on the Board prevent a quorum from being present, a majority of the directors then in office shall constitute a quorum. In either case, if a quorum is not present, a majority

of those present may adjourn the meeting from time to time without further notice. Except as otherwise provided herein, a majority of such quorum may decide any question properly brought before the Board at such meeting.

3.7 Voting. Except as otherwise provided by the General Corporation Law and except as in these By-Laws otherwise provided, the vote of a majority of the directors present at the time of the vote, if a quorum is present at such time, shall be the act of the Board.

3.8 Action Without a Meeting. Any action permitted to be taken at a meeting of the Board (or committee thereof) may be taken without a meeting if each of the directors then in office (or each of the members of a committee thereof) consents thereto in writing. Such writing or writings shall be submitted to the Secretary and shall be filed with the minutes of proceedings of the Board or committee thereof.

3.9 Attendance. Directors shall be considered present at a meeting of the Board or other committee and members shall be considered present at a meeting of the members if the participation in such meeting is through conference, telephone or similar device so long as such device permits each person in the meeting to hear the others and to be heard by all the others.

3.10 Chair. Except as otherwise provided herein, the President of the Corporation shall serve as chair of any meeting of the Board. The Vice Presidents, if any, in order of seniority by tenure or as otherwise determined by the Board, shall serve as chair in the President's absence. If the President is not in attendance and there is no Vice President in attendance, the attending directors shall elect a chair of the meeting.

3.11 Committees. Whenever the Board shall consist of more than three persons, the Board may designate from their number an executive committee or other standing committees, including without limitation, a nominating committee. Such committees shall have such authority as the Board may delegate, except to the extent prohibited by law. In addition, the Board may establish special committees for any lawful purpose, which may have such powers as the Board may lawfully delegate. Members of such special committees shall be appointed by the Board.

ARTICLE IV

OFFICERS

4.1 Positions. The officers of the Corporation shall be the President, *[at least one Vice President,]* a Secretary, a Treasurer and such other officers as the Board may determine. ***[The President must be a director, but no other officer must serve as a director.]***

4.2 Tenure. Each officer shall continue in office until the close of the annual meeting of the Board next following his or her election and until his or her successor shall have been duly elected and qualified or until his or her death, resignation or removal. Any officer may resign at any time by giving written notice to the President or the Secretary. Unless otherwise specified in the notice, the resignation shall take effect upon receipt thereof and acceptance of the resignation shall not be necessary to make it effective. The Board may remove any officer with or without cause at any time.

4.3 Agents. The Board may appoint from time to time such agents as it shall deem appropriate, each of whom shall hold office at the pleasure of the Board, and shall have such authority and perform such duties and shall receive such reasonable compensation, if any, as the Board may from time to time determine.

4.4 Powers and Duties. The agents and officers of the Corporation shall each have such powers and perform such duties in the management of the affairs, property and business of the Corporation, subject to the control of the Board, as generally pertain to their respective offices, as well as such additional powers and duties as may be authorized from time to time by the Board. In addition, the President, Vice President, if any, and Treasurer shall have the specific authority, when duly authorized by the Board, to sign and execute all contracts in the name of the Corporation and sign checks, drafts, notes and orders for the payment of money.

4.5 Engagement of [Artistic][Executive][Administrative] Director and Others. The Board may contract with a firm or an individual to serve as the Corporation's [Artistic][Executive][Administrative]Director, and may contract with a firm or hire staff to assist with the work of the Corporation. The Board may also engage the services of legal and accounting professionals as needed.

4.6 Compensation. The Corporation may pay its officers, agents and employees compensation commensurate with their services, and reimbursement for expenses incurred in the performance of their duties. The amount of salary paid to each officer shall be fixed by action of - the Board or, if such exists, the Executive Committee.

ARTICLE V

LIABILITY, INDEMNIFICATION AND INSURANCE

5.1 Mandatory Indemnification. The Corporation shall indemnify any person who was or is a party, or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that he or she is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, manager, member, officer, employee or agent of another corporation, partnership, joint venture, limited liability company, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, if such person acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe their conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of *nolo contendere* or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner such person reasonably believed to be in, or not opposed to, the best interests of the Corporation, or, with respect to any criminal action or proceeding, that the person had reasonable cause to believe that his or her conduct was unlawful.

5.2 Optional Indemnification. The Corporation shall have the power to indemnify any person who was or is a party, or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor by reason of the fact that such person is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit, if such person acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, the best interests of the Corporation, provided that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation, unless, and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability, but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses as the Court of Chancery or such other court shall deem proper.

5.3 Mandatory Reimbursement. To the extent that a present or former director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in the defense of any action, suit or proceeding referred to in Sections 1 and 22 of this Article, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.

5.4 Procedure. Any indemnification under Sections 1 and 22) of this Article (unless ordered by a court) shall be made by the Corporation only as authorized in the specific case upon a determination that indemnification of the present or former director, officer, employee or agent is proper in the circumstances because he or she has met the applicable standard of conduct set forth in Sections 1 and 22 of this Article. Such determination shall be made with respect to a person who is a director or officer at the time of such determination (i) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (ii) by a committee of such directors designated by a majority vote of such directors, even though less than a quorum is not obtainable, or (iii) if thee are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (iv) by the members entitled to vote, if any.

5.5 ***[Optional]*** Advancement of Expenses. Expenses (including attorney's fees) incurred in defending a civil, criminal, administrative or investigative action, suit or proceeding ***[may][shall to the fullest extent allowed by law]*** be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the current or former director or officer to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the Corporation as authorized in this Article V.

5.6 Nonexclusivity. The indemnification provided by this Article V shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any agreement, vote of disinterested directors, or otherwise, both as to action in their official capacity and as to action in another capacity while holding such office, and shall continue as to a

person who has ceased to be a director, officer, employee or agent, and shall inure to the benefit of the heirs, executors and administrators of such a person.

5.7 Insurance. The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or who is or was serving at the request of the Corporation as a director, officer, manager, member, employee or agent of another corporation, partnership, limited liability company, joint venture, trust or other enterprise, against any liability asserted against such person and incurred by such person in any such capacity, or arising out of their status as such, whether or not the Corporation would have the power to indemnify such person against such liability under the provisions of this Article.

5.8 Report to Board. If the Corporation has paid indemnity or has advanced expenses under this Article to a director, officer, employee or agent, the Corporation shall report the indemnification or advance in writing to the directors entitled to vote with or before the notice of the next meeting of the Board.

5.9 Interpretation. A person for whom indemnification or the advancement or reimbursement of expenses is provided for under this Article V may elect to have the provisions of this Article interpreted on the basis of the applicable law in effect either (i) at the time of the occurrence of the event or events giving rise to the action, proceeding or government investigation, to the extent permitted by law, or (ii) at the time indemnification or advancement or reimbursement of expenses is provided or sought.

5.10 Contract Right.

(a) The right to be indemnified or to the advancement or reimbursement of expenses pursuant to this Article V, (i) is a contract right pursuant to which the person entitled thereto may bring suit as if the provisions hereof or of any such resolution were set forth in a separate written contract between the Corporation and such person, and (ii) shall continue to exist after any rescission or restrictive modification hereof or of any such resolution with respect to events occurring prior thereto.

(b) If a request to be indemnified or for the advancement or reimbursement of expenses pursuant to this Article V is not paid in full by the Corporation within 30 days after a written claim for such advancement or reimbursement has been received by either the President or Secretary of the Corporation and the claimant thereafter brings suit against the Corporation to recover the unpaid amount of the claim which is successful in whole or in part, the Corporation shall be obligated to pay the claimant the expenses, including reasonable attorneys' fees, of prosecuting such claim, if such claim is successful in whole or in part. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending a civil or criminal action or proceeding in advance of the final disposition thereof where the required undertaking has been tendered to the Corporation) that the claimant has not met the standards of conduct which make it permissible under this Article V to indemnify the claimant for the amount claimed, but the burden of proving such defense shall be on the Corporation. Neither the failure of the Corporation (including its Board of Directors or independent legal counsel) prior to the commencement of such action to have made a determination that indemnification of the claimant is proper in the circumstances because he or she, or his or her testator or intestate, has met the applicable standard of conduct set forth in this Article V, nor an actual determination by the Corporation (including its Board of Directors or independent legal counsel) that the claimant, or his or her testator or intestate, has not met such applicable standard of conduct, shall be a defense to such action or create a presumption that he or she, or his or her testator or intestate, has not met such applicable standard of conduct.

ARTICLE VI

CONFLICTS OF INTEREST

6.1 Required Disclosure. An officer or director shall disclose to the Board whether any proposed transaction or arrangement pending or to be brought before the Board or any committee of the Board involves or may involve a personal profit, gain or other financial benefit to that officer or director or any other officer or director, either direct or indirect through any family member, related business or nonprofit organization or investment (a “Conflict of Interest Matter”). The Board shall (a) identify any Conflict of Interest Matter, and (b) identify any director who may receive any personal profit, gain or other financial benefit therefrom, either direct or indirect through any family member, related business or nonprofit organization or investment (an “Interested Director”).

6.2 Departure During Discussion. An Interested Director shall leave the meeting room during and refrain from participating in the discussion of the merits of the Conflict of Interest Matter, and shall not vote on such matter.

6.3 Referral to Committee. If the number of directors on the Board who can vote on a Conflict of Interest Matter is less than the number required for a quorum, the Board shall refer the Conflict of Interest Matter to a committee with a sufficient number of directors who can vote on the Conflict of Interest Matter to constitute a quorum. The Committee's action on the Conflict of Interest Matter shall be binding on the Board and the Corporation.

6.4 Procedure. The Board or committee acting on a Conflict of Interest Matter shall make a reasonable effort to establish and document the fairness of the transaction or arrangement (the scope of such effort being determined by the size and circumstances of the transaction or arrangement), and shall indicate in the minutes of the meeting: (a) the names of any directors and officers who might have a personal financial interest directly or indirectly in the Conflict of Interest Matter and the nature of their interest, (b) whether any Interested Director participated in the discussion of the merits of or the vote on the Conflict of Interest Matter, (c) a summary of the terms and merits of the transaction or arrangement, and (d) a record of the vote thereon.

ARTICLE VII

MISCELLANEOUS

7.1 Books and Records. The Corporation shall keep at the principal office of the Corporation, complete and correct records and books of account, and shall keep minutes of the proceedings of the members, the Board, or any committee appointed by the Board, as well as a list or record containing the names and address of all members.

7.2 Seal. The corporate seal shall be in such form as the Board shall from time to time prescribe.

7.3 Fiscal Year. The fiscal year of the Corporation shall be January 1 through December 31 unless otherwise determined by the Board.

7.4 Amendment. All By-Laws of the Corporation shall be subject to alteration or repeal, and new by-laws may be made, by a majority vote of the directors or members, at a special meeting called for such purpose provided that notice of the proposed alternation, repeal or new by-laws shall have been provided at least ***[14]*** days in advance of such meeting.

[FN1d]. One major ambiguity under Delaware law is whether you need to have members. The Delaware General Corporation Law is unclear on whether there must be members. The statute is silent on whether there have to be members but it does state that the conditions of membership must be stated in the certificate of incorporation or by-laws. In the past the Delaware Division of Corporations took the position that members were required, but since 2001 it has changed that position, now allowing organizations to file certificates that state that conditions of membership shall be as stated in the by-laws and then state in the by-laws that the organization shall have no members. If this approach is desired, say here: "The Corporation shall have no members."

PROTOTYPE CONFLICTS OF INTEREST POLICY

This form, unlike the IRS form included in the instructions to Form 1023, covers nonfinancial relationships with other parties. This policy requires annual certifications; if an organization is unable to follow such a process, it may wish to drop the certification requirement. Note, however, that organizations that have to file the full Form 990 are required to indicate whether they have a conflicts policy which requires certification. Policies for private foundations should include additional language, primarily related to prohibited and permissible transactions between a private foundation and its disqualified persons, which can be found in the prototype proposed by the IRS in the Form 1023.

This prototype policy is provided with the understanding that Stroock & Stroock & Lavan LLP is not rendering legal, accounting, or other professional advice or service. Professional advice on specific issues should be sought from an accountant, lawyer, or other professional.

Adopted: ___ / ___ / ___

[NAME OF CHARITY]

CONFLICTS OF INTEREST POLICY

ARTICLE I

Purpose

The purpose of this conflicts of interest policy is to protect the interest of [NAME OF CHARITY] (the "Company" or "AAA")) when it is contemplating entering into a transaction or arrangement that might benefit the private financial [or nonfinancial interest] of an officer, director or [staff member] [key employee] **[THE IRS FORM 990 ASKS IF KEY EMPLOYEES ARE SUBJECT TO ANNUAL DISCLOSURE; IF A COMPANY WANTS TO MAKE THE POLICY APPLICABLE TO ALL EMPLOYEES, THEN THE ANNUAL CERTIFICATION -- WHICH IS THE MOST CUMBERSOME PART OF THE POLICY -- COULD BE LIMITED TO DIRECTORS, OFFICERS AND KEY EMPLOYEES]** of the Company. This policy is intended to supplement but not replace any applicable state and federal laws governing conflicts of interest applicable to nonprofit and charitable organizations.

AAA desires to obtain the services, as directors, officers and [staff members] [key employees] of AAA, of many individuals who have knowledge, contacts or interests in fields of relevance to AAA. It is to be expected that many of these people will therefore on occasion have business or personal interests which may give rise to conflicts of interest. Under relevant state law, conflicts of interest involving an interested person are not inherently illegal, nor are they to be regarded as a reflection upon the integrity of the individual involved. In fact, the failure to consider activities that might give rise to a conflict of interest may mean that the Company could not engage in activities that could be highly beneficial to it.

While the appearance of a conflict is often times as important as the reality, it is the manner in which the conflicted individual and the officers and Board of Directors of the Foundation deal with a disclosed conflict that determines the propriety of the underlying transaction. Therefore, the crucial steps in this Conflicts of Interest Policy are disclosure, discussion and decisions by disinterested directors on the basis of what is in the best interests of the Foundation.

ARTICLE II

Definitions

["Close personal friend. This term can not be defined with precision. Each person subject to this policy needs to determine for himself or herself whether another person is a close personal friend for purposes of this policy.]

"Director." [IF THE ORGANIZATION USES THE TERM TRUSTEES INSTEAD, CHANGE ALL APPLICABLE REFERENCES]. A voting member of the organization's governing body.

"Family members." An individual's spouse [(or domestic partner)], ancestors [(including parents and step-parents and grandparents)], siblings (whether whole or half blood [or by adoption]), [descendents (including] children, grandchildren, and great grandchildren [whether natural or adopted]) and spouses [(or domestic partners)] of [ancestors,] siblings and descendents, and great grandchildren[, in-laws (including father-, mother-, brother- or sister-in-law) and any person with whom an interested person shares living quarters under circumstances that closely resemble a marital or familial relationship or who is financially dependent upon the interested person]. [FN1e]

"Financial interest." A person has a financial interest in a person, entity or organization with which the Company has or proposes to have a transaction or arrangement if the person (or to such person's knowledge any family member [or close personal friend]):

(a) has, directly or indirectly, through business, investment, family or close friendship, an ownership or investment interest in such person, entity or organization; provided, however, that for public companies the person must own or control 5% or more of any voting security (including any securities that may be acquired by such person upon the exercise of options or other derivative securities), or

(b) has legal or de facto power to control the election of a majority of directors, or has legal or de facto power to exercise a controlling influence over the management or policies, of such person, entity or organization, or

(c) has a current or potential compensation arrangement with such person, entity or organization that will be affected by a transaction with the Company. Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

"Interested person." Any director, officer, [staff member], [key employee [FN2e] or any member of a committee with governing board delegated powers, who has a direct or indirect financial interest [or a material nonfinancial interest,] **[THIS POLICY ALSO APPLIES TO NONFINANCIAL INTERESTS WHEREAS THE PROTOTYPE IRS POLICY ONLY**

APPLIES TO FINANCIAL INTERESTS. SOME NONPROFITS MAY NOT WISH TO HAVE THE CONFLICT POLICY APPLY TO NONFINANCIAL INTERESTS] as defined below, in another person, entity or organization is an interested person. [HOSPITAL INSERT FROM THE IRS FORM POLICY - FOR HOSPITALS THAT COMPLETE SCHEDULE C TO FORM 1023 - If a person is an interested person with respect to any entity in the health care system of which the Organization is a party, he or she is an interested person which respect to all entities in the health care system.]

"Key employee." Any employee of AAA (other than an officer, director or trustee) who (i) receives reportable compensation from AAA and all related organizations in excess of $150,000 for the calendar year ending with or AAA's tax year; (ii) either (a) has responsibilities, powers or influence over the organization as a whole that are similar to those of officers, directors or trustees, (b) manages a discrete segment or activity of the organization that represents 10% or more of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole, **or** (c) has or shares authority to control or determine 10% or more of the organization's capital expenditures, operating budget, or compensation for employees **and** (iii) is one of the 20 employees with the highest reportable compensation from the organization and related organizations for the calendar year ending with or within the organization's tax year. [FN3e] [Whether or not such persons fall within the test described above, "key employee" also includes any executive director, chief executive officer, chief administrative officer and chief financial officer, or anyone filling such functions, and anyone else with major executive or decision making authority so designated by the [President, Executive Director or] the Board of Directors.] **[BRACKETED WORDS ARE OPTIONAL]**

["Material nonfmancial interest." A person has directly or indirectly a material nonfinancial interest in a person, entity or organization if the person (or to such person's knowledge any family member [or close personal friend]) is

(a) a director, officer, executor, administrator, trustee, beneficiary, or controlling partner of, or otherwise serves in a fiduciary capacity or holds a substantial beneficial interest in,

(b) a substantial contributor (i.e., an individual who directly or through affiliated corporations or foundations makes a gift or pledge of [$100,000] or more at any one time or cumulatively within a five year period prior to the occurrence of the conflict either in cash, appreciated securities, other assets or in land, easement, or bargain-sale value) to,

(c) an employee of or volunteer for, or

(d) a person who owes a fiduciary duty to

such other person, entity or organization (i) with which the Company has entered or may enter into a material transaction or arrangement, (ii) which has goals similar to those of the Company in terms of its program or (iii) with respect to which the Company may be in direct competition for unique funding (such as grants) which interest is not a financial interest. AAA does recognize, however, that many of its directors or officers may be active in other charitable organizations. It shall not be considered a conflict of interest for anyone to engage in general fund raising for another charitable organization unless such other charity has a similar mission to AAA. The Company also recognizes that there may be many indirect forms of interest that a person or his or her family members may have that may, under a very literal reading of this definition, be considered a "nonfinancial interest" but such interest is tenuous. This definition, and the resulting reporting required by this policy, is intended to cover material interests. For example, if a Board member arranges for volunteers from his or her corporation to do volunteer work for the Company, knowing that the firm will include that volunteer opportunity in its marketing materials and thereby benefit the company (and perhaps the Board member's standing in the company), that possible interest would not need to be disclosed. Another example is low level employment at a company with which the Company has a customer or vender relationship where the compensation of the individual is not directly affected by such relationship.]

"Officer." A person elected or appointed to manage the organization's daily operations, such as a president, vice president, secretary or treasurer, as determined by reference to the organization's organizing document, bylaws or resolutions of its governing body or otherwise so designated consistent with state law and, in addition (if not otherwise officers) the top management official, defined as the person who has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration or operation of the organization, and the top financial official, defined as the person who has ultimate responsibility for managing the organization's finances. If two persons share such responsibility, both shall be deemed officers.

"Person, entity or organization." A person, entity or organization shall include natural persons, corporations, partnerships, limited liability companies, trusts, estates, joint ventures, unincorporated affiliations of any kind, government agencies, public boards and commissions and not-for-profit organizations or other entities or organizations.

"Related organization." Any organization that has one or more of the following relationships with the organization:

1) Parent--an organization that controls another organization,
2) Subsidiary--an organization controlled by another organization,
3) Brother/Sister--an organization controlled by the same person(s) that control the organization, or
4) Supporting/Supported--an organization that is (or claims to be) at any time during the organization's tax year (i) a supporting organization of the organization within the meaning of Section 509(a)(3) of the Internal Revenue Code ("IRC"), if the organization is a supported organization within the meaning of Section 509(f)(3) of the IRC, or (ii) a supported organization, if the organization is a supporting organization.

"Staff member." An employee of the Company or any independent contractor or volunteer performing services customarily performed by an employee of a company. **[ALTERNATIVELY THE TERM "EMPLOYEE" COULD BE USED IN PLACE OF "STAFF MEMBER," WHICH WOULD LIMIT THE POLICY TO EMPLOYEES ONLY]**

"Transaction or arrangement." A transaction or arrangement includes agreements, understandings, transactions, arrangements, programs or other activities with other persons, entities or organizations and shall include (a) making or receiving grants, (b) hiring or engagement and firing of staff, consultants, vendors or service providers (including auditors, attorneys, investment advisors and similar professionals), (c) leasing or purchasing real estate (or interests therein), equipment or other property, (d) investment activities, and (e) activities related to publicity.

ARTICLE III

Procedures

3.1 **Duty to Disclose**

In connection with any actual or possible conflict of interest between the Company and any interested person, the interested person must disclose to the Company's Compliance Officer the existence of any financial interest or material nonfinancial interest promptly upon becoming aware of such conflict or possible conflict [(such as at the time the interested person first became associated with the Company or acquired such financial interest or material non-financial interest or pursuant to any periodic inquiry from or certification to the Company)].

Any director who is the subject of such conflict shall disclose all material facts regarding any transaction or arrangement under consideration to the Compliance Officer, who shall disclose such information (if the director does not) to the directors and members of committees with governing board-delegated powers prior to such board or committee meetings considering the proposed transaction or arrangement if not previously disclosed. The Compliance Officer of the Company shall be responsible for ascertaining conflicts with officers and [staff members][key employees] who are not members of the Company's governing board.

The name of the person who holds the position of Compliance Officer from time to time shall be set forth at the end of this policy. If the interested person is the Compliance Officer, disclosure shall be made to the Company's _____.

3.2 Determining Whether a Conflict of Interest Exists

After the interested party has disclosed his or her interest and all other material facts, and after any discussion with the interested person (including allowing the Board to ask questions of the interested person), the interested person, if in attendance, shall leave the governing board or committee meeting while the determination of whether a conflict of interest exists is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists. [If, however, an interested person has only a material nonfinancial interest, such person shall not be required to leave the meeting during the consideration of whether there is a conflict of interest and during the discussion of, and the vote on, the transaction or arrangement unless so requested by the chairperson of the governing board or committee or a majority of the others in attendance.] If the governing board or committee determines that the interested person has a conflict of interest on the matter to be acted upon, such interested person shall not vote on such matter [; *provided, however*, that such person may execute a written consent to such action to be authorized if the matter would otherwise have been approved by the percentage of directors appropriate to approve such matter at a meeting of the directors. [FN4e]]

3.3 **Procedures for Addressing the Conflict of Financial Interest**

If the governing board or committee determines that there is a conflict of interest, the persons with a financial interest shall not return to the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest. The chairperson of the governing board or committee may, if determined to be appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement where the interested person has a financial interest; after exercising due diligence, the governing board or committee shall determine whether the Company can obtain with reasonable efforts in an appropriate timeframe a more advantageous transaction or arrangement from a person not associated with the interested person or a better arrangement from the person or entity associated with an interested person.

If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the governing board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Company's best interest, for its own benefit, and fair and reasonable. In conformity with the above determination, it shall make its decision as to whether to enter into the transaction or arrangement.

3.4 Violations of the Conflicts of Interest Policy

If the governing board or committee has reasonable cause to believe an interested person has failed to disclose actual or possible conflicts of interest, it shall inform such person of the basis for such belief and afford such person an opportunity to explain the alleged failure to disclose. If, after hearing such person's response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member has failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

ARTICLE IV

Records of Proceedings

The minutes of the governing board and all committees with board-delegated powers shall contain:

(a) The names of the persons who disclosed or otherwise were found to have a financial [or material nonfinancial] interest in connection with an actual or possible conflict of interest, the nature of the financial [or material nonfinancial] interest, any action taken to determine whether a conflict of interest was present, and the governing board's or committee's decision as to whether a conflict of interest in fact existed.

(b) The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the general content of the discussion, including any alternatives to the proposed transaction or arrangement, any determination as to whether a transaction or arrangement is in the Company's best interest, for its own benefit and fair and reasonable, and any determination as to whether or not to enter into the transaction or arrangement, and a record of any votes taken in connection with the proceedings.

ARTICLE V

Compensation

A voting member of the governing board who receives compensation, directly or indirectly, from the Company for services (or who has a family member who receives such compensation) is precluded from voting on matters pertaining to that member's (or such family member's) compensation.

A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation (or who has a family member who receives such compensation), directly or indirectly, from the Company for services is precluded from voting on matters pertaining to that member's (or such family member's) compensation.

No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Company, either individually or collectively, is prohibited from providing information to any committee regarding compensation.

[HOSPITAL INSERT -- FOR HISPITALS THAT COMPLETE SCHEDULE C TO FORM 1023 -- Physicians who receive compensation from the Organization, whether directly or indirectly or as employees or independent contractors, are precluded from membership on any committee whose jurisdiction includes compensation matters. No physician, either individually or collectively, is prohibited from providing information to any committee regarding physician compensation.]

ARTICLE VI

General

Interested persons should not accept favors or gifts of consequence from current and/or potential grantees, vendors, service providers or others in a position to influence the Company or benefit from transactions or arrangements with the Company. Trivial gifts in the nature of mementos need not be returned nor a friendly dinner invitation declined if it will cause unnecessary offense. A rule of reason should prevail, but a rule of reason that pays full attention to appearances as well as to actualities.

This policy cannot describe all potential conflicts of interest, and its application may be uncertain at times. Interested persons should exercise the highest standards of ethical judgment and err on the side of caution.

If there are any questions, the individual concerned should consult with the Company's Compliance Officer

ARTICLE VII

Exemptions

An interested person's membership on the Board of Directors or on a committee of the Board, or a person's status as a staff member, officer or agent of _____ **[LIST ANY AFFILIATED ENTITY IF SO DESIRED]** or any of its affiliates, shall not, in and of itself, constitute a conflict of interest, nor is disclosure of such membership necessary.]

ARTICLE VIII

Statements from Interested Persons

Each director, officer and [staff member] [key employee] shall promptly after the time that this Conflicts of Interest Policy is adopted or, if later, when such person assumes such position, **and at least annually thereafter (such as in connection with the annual audit, at the annual meeting of the Board or shortly thereafter),** sign a statement substantially as set forth in the attached form of certification or such other certification form as shall from time to time be adopted by the Board of Directors.

ARTICLE IX

[Periodic Reviews

To ensure that the Company operates in a manner consistent with charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

(a) Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm's length bargaining[, and]

(b) Whether partnerships, joint ventures, and arrangements with management organizations conform to the Company's written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes and do not result in inurement, impermissible private benefit or in an excess benefit transaction.

When conducting the periodic reviews as provided for in this Article, the Organization may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.] ***[THIS PROVISION IS FROM THE PROTOTYPE CONFLICTS POLICY INCLUDED AS APPENDIX A TO THE INSTRUCTIONS TO FORM 1023. THE PROVISION REALLY ADDRESSES EXCESS BENEFIT, NOT CONFLICT, ISSUES. WHILE THE PERIODIC REVIEW CALLED FOR IS ADVISEABLE, IT IS NOT WISE TO INCLUDE IT IF THE ORGANIZATION CANNOT BE SURE THAT IT WILL DO THE PERIODIC REVIEW REQUIRED]***

****

Name and Contact Information for Compliance Officer (last updated ___ / ___ / ___):

[FN1e]. Note that bracketed language goes beyond the requirements of the IRS Form 990.

[FN2e]. The IRS sample conflicts of interest policy set forth as Appendix A to the instructions for Form 1023 Application for Recognition of Exemption (available at http://www.irs.gov/pub/irs-pdf/il023.pdf, pp. 25-26), does not apply to employees (or key employees); it also only applies to "principle officers." The IRS Form 990, adopted in 2008, however, has a question (Q. 12b) as to whether the nonprofit has a conflict policy which asks if its officers [not limited to "principle officers"], directors and "key employees" are required to disclose annually interests that could give rise to conflicts. Accordingly, the policy should be applicable to key employees. Whether or not the nonprofit wishes to extend the policy to all employees is up to the nonprofit. If the policy applies to all employees, references to "key employees" can be dropped.

[FN3e]. This language (and the definition of officers and directors) comes from the instructions to Part VIII, Section A of Form 990, p. 21.

[FN4e]. Note the need to review the by-laws to see if any adjustment may be necessary. The following language might be considered: "[If the matter is an item of business for which a special meeting of the Board was called, the affected Director shall not be counted to establish a quorum for such meeting, nor shall or she participate in the deliberations or vote on the matter. A quorum for such a special meeting shall be a majority of the non-affected Directors notwithstanding that the number of non-affected Directors may not represent a majority of the full Board so long as the number of non-affected Directors is at least one-third of the Directors fixed in Section of these Bylaws.] or [The affected Director may be counted to establish a quorum for a meeting at which an action in which such Director has an interest is being considered.] or [If the number of Directors on the Board who can vote on a matter involving an actual or potential conflict of interest is less than the number required for a quorum, the Board shall refer the matter to a committee of the Board with a sufficient number of directors who can vote on the matter to constitute a quorum. The committee's action on the matter shall be binding on the Board and the Corporation.]"
Form of Annual Certification

200 ___ / 200 ___ AAA

ANNUAL DISCLOSURE FORM

Note: if additional space is needed to provide answers, use the reverse or riders.

A. Conflicts of Interest Disclosures. I have described below any relationships, positions or circumstances in which I am involved that I believe would constitute a financial interest [FN1f] [or material nonfinancial interest [FN2f]], as those terms are defined in the Conflicts of Interest Policy of AAA, in a person, entity or organization with which the Company has or proposes to have a transaction or arrangement including

(1) Persons, entities or organizations [FN3f] in which I or a family member [FN4f] or close personal friend [FN5f] have a financial interest.

My Name or Name of Family Member [or Close Personal Friend]	Name of Person, Entity or Organization	Position Held

(2) [Other persons, entities or organization in which I or a family member have a nonfinancial interest, including a relationship such as director, trustee, officer, committee member, employee, consultant, key staff member, advisor, major donor, volunteer.

My Name or Name of Family Member	Name of Person, Entity or Organization	Position Held

If I believe that my involvement with one or more of these other entities will present a conflicts for fundraising or otherwise acting on the behalf of the Corporation, I have stated below how and why and indicated what steps, if any, I am prepared to take to minimize any such conflict.

Whether or not I see a conflict with the other organization, the following named organizations are aware of my involvement with the Corporation:

(3) Family members of mine employed or retained by the Company:

(4) Any other relevant information:

B. Certifications. I hereby acknowledge that I:

(1) have received, read and understand the Conflicts of Interest Policy of AAA (the Policy,"

(2) agree to comply with the Policy,

(3) understand the Company is charitable and in order to maintain any federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes,

(4) shall not use my position, or the knowledge gained from my position to further my own financial interests or to derive personal financial advantage, and may not obtain for me, my relatives (including but not limited to family members], or my friends a material financial interest of any kind from my association with the Company,

(5) have a duty to place the interest of the Company foremost in any dealings with the Company decision-making and have a continuing responsibility to comply with the requirements of this policy,

(6) shall not conduct personal business with the Company and any of its affiliates, without prior disclosure and approval,

(7) will report an interest in any proposed transaction [FN6f] with the Company in the form of a significant personal financial or nonfinancial interest in the transaction or in any organization involved in the transaction, or in holding a position as trustee, director, or officer in any such organization, and will make full disclosure of such interest in writing before any discussion or negotiation of such transaction,

(8) will recognize a potential conflict of interest with respect to any matter coming before the Board or committee and shall not have a right to be present for discussion of or vote on resolutions in connection with the matter,

(9) shall exercise care not to disclose confidential information acquired in connection with such status or information, the disclosure of which may harm the interest of the Company or would result in personal profit or advantage for my, my family members or my friends, and

(10) understand that any activity that I engage in related to the Company that may cause problems for the Company, seeming or real, shall be disclosed to the Company prior to such action occurring.

_____ _____

PRINT NAME SIGNATURE

_____

DATE

[FN1f]. **"Financial interest."** A person has a financial interest in a person, entity or organization with which the Company has or proposes to have a transaction or arrangement if the person (or to such person's knowledge any family member [or close personal friend]):

(a) has, directly or indirectly, through business, investment, family or close friendship, an ownership or investment interest in such person, entity or organization; *provided, however*, that for public companies the person must own or control 5% or more of any voting security (including any securities that may be acquired by such person upon the exercise of options or other derivative securities), or

(b) has legal or *de facto* power to control the election of a majority of directors, or has legal or *de facto* power to exercise a controlling influence over the management or policies, of such person, entity or organization, or

(c) has a current or potential compensation arrangement with such person, entity or organization that will be affected by a transaction with the Company. Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

[FN2f]. "**[**"**Nonfinancial interest."** A person has directly or indirectly a material nonfinancial interest in a person, entity or organization if the person (or to such person's knowledge any family member [or close personal friend]) is

(a) a director, officer, executor, administrator, trustee, beneficiary, or controlling partner of, or otherwise serves in a fiduciary capacity or holds a substantial beneficial interest in,

(b) a substantial contributor (*i.e.*, an individual who directly or through affiliated corporations or foundations makes a gift or pledge of [$100,000] or more at any one time or cumulatively within a five year period prior to the occurrence of the conflict either in cash, appreciated securities, other assets or in land, easement, or bargain-sale value) to,

(c) a volunteer for, or

(d) a person who owes a fiduciary duty to

such other person, entity or organization (i) with which the Company has entered or may enter into a material transaction or arrangement, (ii) which has goals similar to those of the Company in terms of its program or (iii) with respect to which the Company may be in direct competition for unique funding (such as grants) which interest is not a financial interest. AAA does recognize, however, that many of its directors or officers may be active in other charitable organizations. It shall not be considered a conflict of interest for anyone to engage in general fund raising for another charitable organization unless such other charity has a similar mission to AAA. The Company also recognizes that there may be many indirect forms of interest that a person or his or her family members may have that may, under a very literal reading of this definition, be considered a "nonfinancial interest" but such interest is tenuous. This definition, and the resulting reporting required by this policy, is intended to cover material interests. For example, if a Board member arranges for volunteers from his or her corporation to do volunteer work for the Company, knowing that the firm will include that volunteer opportunity in its marketing materials and thereby benefit the company (and perhaps the Board member's standing in the company), that possible interest would not need to be disclosed. Another example is low level employment at a company with which the Company has a customer or vender relationship where the compensation of the individual is not directly affected by such relationship.]

[FN3f]. A person, entity or organization shall include natural persons, corporations, partnerships, limited liability companies, trusts, estates, joint ventures, unincorporated affiliations of any kind, government agencies, public boards and commissions and not-for-profit organizations or other entities or organizations.

[FN4f]. The family of an interested person shall include such person's spouse (or domestic partner), ancestors, siblings, descendents, spouses (or domestic partners) of ancestors, siblings and descendents, in-laws and any person with whom an interested person shares living quarters under circumstances that closely resemble a marital or familial relationship or who is financially dependent upon the interested person.

[FN5f]. This term can not be defined with precision. Each person subject to this policy needs to determine for himself or herself whether another person is a close personal friend for purposes of this policy.

[FN6f]. A transaction or arrangement includes agreements, understandings, transactions, arrangements, programs or other activities with other persons, entities or organizations and shall include (a) making or receiving grants, (b) hiring or engagement and firing of staff, consultants, vendors or service providers (including auditors, attorneys, investment advisors and similar professionals), (c) leasing or purchasing real estate (or interests therein), equipment or other property, (d) investment activities, (e) activities related to publicity and (f) other activities.

PROTOTYPE WHISTLEBLOWER POLICIES
ADOPTED: ___ / ___ / 20 ___

(LONGER VERSION)

AAAA, INC.

WHISTLEBLOWER POLICY

General

AAAA, Inc. (the "Company" or "AAA")) requires that its directors, officers, employees, contractors and volunteers] ("Associates") abide by all laws and regulations applicable to the Company and observe high standards of business and personal ethics in the conduct of their duties and responsibilities. To help ensure that the Company complies with its legal requirements and appropriate standards of financial reporting and acts in an ethical manner, the Board of Directors of the Company has adopted this Whistleblower Policy (the "Policy"), including procedures for the reporting and investigation of illegal or unethical conduct in connection with the Company's finances or other aspects of its operations.

Reporting Responsibility

If an Associate becomes aware (or has a reasonable good faith belief) that the Company's finances, internal controls, auditing function, accounting systems, or governance policies are compromised or threatened, or has a good faith concern regarding the legality or propriety of any action contemplated to be taken or taken by the Company or another Company Associate, or a good faith belief that action needs to be taken for the Company to be in compliance with laws, policies or ethical standards, such Associate should immediately report his or her concern pursuant to this Policy.

Examples of matters which should be reported include the following, which is not an all-inclusive list:

- Supplying false or misleading information on the Company's financial documents, including the tax return (Form 990) or filings with state agencies,
- Providing false information to or withholding material information from the Company's auditors,
- Violations of the Company's policies, including its [Code of Ethics and Conduct and its] Conflicts of Interest Policy,
- Self-dealing, private inurement and private benefit (*i.e.*, Company assets being used for personal gain or benefit),
- Payment for services or goods that are not rendered or delivered,
- Fraud, theft or embezzlement,
- Bribery or kickbacks,
- Violations of laws or regulations,
- Regulatory, compliance, or ethics-related issues, concerns or violations or
- Planning, facilitating or concealing any of the above.

No Retaliation

The Policy is intended to encourage and enable Associates to raise their serious concerns within the Company prior to seeking outside resolution. No Associate who in good faith (whether or not the such allegations are proven to be mistaken) reports a concern pursuant to this Policy, or who cooperates with an investigation of a complaint (whether by the Company or its agents or by any law enforcement officials, government or regulatory agency or the Company's auditors), shall suffer harassment, retaliation or adverse employment consequence. Notwithstanding the prior sentence, the Company reserves the right to take appropriate disciplinary action, including termination or removal from office, when the Company concludes that such action is warranted. An Associate who retaliates against someone who has reported a concern in good faith or who is cooperating in any investigation is subject to discipline up to and including termination of employment or other services. All acts against complainants or other participants should be reported immediately to the Company's Compliance Officer.

Acting In Good Faith

Anyone filing a complaint concerning a violation or suspected violation of the Code must be acting in good faith and have reasonable grounds for believing the information disclosed indicates a violation of the Code. An individual who deliberately or maliciously provides false information may be subject to disciplinary action (up to and including termination).

Reporting Violations

Reports may be submitted in writing or verbally, but the reports should contain enough information to substantiate the concern and allow an appropriate investigation to begin. In many cases, a supervisor is in the best position to address an area of concern. However, if the complaint relates to such supervisor, an Associate is not comfortable speaking with such supervisor or the Associate is not satisfied with such supervisor's response, the Associate should raise the concern with the Company's Compliance Officer.

Supervisors or others who receive complaints are required to promptly report concerns to the Company's Compliance Officer, who has specific and exclusive responsibility to investigate all reported violations. If the concern relates to the Compliance Officer, however, communications regarding the concern may instead be raised with another member of the Board of Directors, who shall have all the authority and duties set forth in this Policy as given to the Compliance Officer.

Compliance Officer

The Company's Compliance Officer is responsible for investigating and proposing resolutions for all reported complaints and allegations concerning violations of the Code. The Compliance Officer has direct access to the Board of Directors and is required to report to the Board at least annually on compliance activity. Unless another person is otherwise designated by the Board and so named below, the Company's Compliance Officer is the chair of the Board or, if existing, the chair of the Audit Committee.

Confidentiality

Violations or suspected violations may be submitted on a confidential basis by the complainant or may be submitted anonymously. AH reports will be received and acted upon in confidence to the maximum extent practicable given legal requirements and the need to gather facts, conduct an effective investigation, and take necessary corrective action.

Handling of Reported Violations

The Compliance Officer will promptly notify the sender, when known, acknowledging receipt of the reported violation or suspected violation. All reports will be promptly investigated.

Generally the Compliance Officer (or other person acting with the authority of the Compliance Officer) will promptly report, after initial investigation, all complaints to the chair of the Board and to any appropriate Board committee, such as the Audit or Executive Committee, prior to the next regularly scheduled meeting (unless such meeting occurs within ... days following receipt of such complaint and the Compliance Officer believes that more time is necessary to initially investigate the matter before reporting on it, in which case the report shall be made at the next succeeding meeting). Reports will include a copy

of the complaint, its date, nature and source (unless the complainant has requested confidentiality and/or anonymity), how it was communicated, whether the Compliance Officer regards the complaint as credible, and proposals to address it. The chair of such committee will promptly report the complaint to the full committee (or if there is no appropriate committee, the chair of the Board will report the complaint to the full Board), except that the complaint will not be shared with an individual who is the subject of the complaint. All credible allegations will be followed up promptly, with further investigation conducted if needed to resolve disputed facts.

The committee to which any complaint has been reported will inform the Board if any complaint is confirmed, or if the committee otherwise believes that the Board should be made aware of the situation. The committee will have ultimate authority over the treatment of any complaints reported to it, subject to the Board's oversight.

The committee or, in the case of complaints reported to the full Board, the Board will ensure that records of all complaints are maintained in accordance with the Company's document retention policy.

Following investigation, the Company will take appropriate remedial and disciplinary action as it deems justified by the circumstances, including possibly terminating employment, board membership or volunteer status, seeking restitution, removal from office, or criminal prosecution.

The Compliance Officer shall report to the full Board of Directors at least annually on compliance matters.

###

Name and Contact Information for Compliance Officer (last updated ___ / ___ / ___):
Name: _____
Address: _____

_____
Phone: _____
Fax: _____
Email: _____

(SHORTER VERSION)

AAAA, INC.

WHISTLEBLOWER PROTECTION POLICY

General

_____, Inc. (“AAAA”) requires its directors, officers and employees to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. As employees and representatives of AAAA, we must practice honesty and integrity in fulfilling our responsibilities and comply with all applicable laws and regulations. Accordingly, the Board of Directors has adopted this Whistleblower Protection Policy to ensure that issues regarding ethical and legal compliance are adequately addressed.

Reporting Responsibility

All directors, officers and employees are required to report any and all violations or suspected violations of business and personal ethical standards and/or applicable legal requirements in accordance with this Whistleblower Protection Policy. The matters which should be reported under this policy include suspected fraud, theft, embezzlement, accounting or auditing irregularities, bribery, kickbacks and misuse of AAAA assets or personnel.

This policy is not a vehicle for reporting violations of AAAA's applicable human resources policies, problems with co-workers or managers, or for reporting issues related to alleged employment discrimination or sexual or any other form of unlawful harassment, all of which should be dealt with in accordance with the applicable provisions of the AAAA Personnel Manual.

No Retaliation

No director, officer or employee who in good faith reports a violation shall suffer harassment, retaliation or adverse employment consequences resulting from such report. An employee who retaliates against someone who has reported a violation in good faith is subject to discipline up to and including termination of employment. Managers must ensure that these procedures are available and known to all employees and that all employees have easy access to the mechanism for making reports. This Whistleblower Protection Policy is intended to encourage and enable employees and others to raise serious concerns within AAAA prior to seeking resolution outside AAAA.

Reporting Procedures

An employee who suspects wrongdoing by a colleague or colleagues should first reach out to his or her supervisor or, if the issue involves such supervisor (or the employee is not comfortable discussing the matter with the supervisor), such suspected wrongdoing may be reported to another co-worker with managerial duties to address the matter directly. If the matter cannot be resolved at this level, the employee should contact either his or her Program Director or the AAAA Executive Director.

Any complaints of wrongdoing regarding the Executive Director or Chief Financial Officer also shall be reported directly to the Chair of the Finance and Audit Committee.

Any Program Director who learns of any suspected wrongdoing covered by this Whistleblower Protection Policy (other than a complaint of wrongdoing regarding the Executive Director or Chief Financial Officer), either directly or through a report from a subordinate or other individual, must advise the Executive Director of such suspected wrongdoing. The Program Director shall also keep the Executive Director informed of any steps taken to resolve the complaint.

Any complaints of wrongdoing received by an officer or director of AAAA shall be reported directly to the Chair of the Audit Committee, who may decide to refer such complaints to the Executive Director for investigation and resolution.

The Executive Director shall immediately report any whistleblower complaints both to the Chair of the Board and the Chair of the Audit Committee, shall report on how such complaints are being handled, and shall subsequently report when and how each complaint is resolved. The Chair of the Audit Committee may decide that any such complaint should be investigated and resolved by the Audit Committee rather than by management. In addition, the Audit Committee shall investigate and resolve any complaints of wrongdoing by the Executive Director or Chief Financial Officer.

The Chair of the Audit Committee shall report to the full Board of Directors at least annually on any whistleblower complaints that have been received, and how those complaints were resolved.

Accounting and Auditing Matters

The Audit Committee shall address all reported concerns or complaints regarding corporate accounting practices, internal controls or auditing brought to its attention. The Chair of the Audit Committee shall immediately notify the full Audit Committee of any such complaint and work with the Committee until the matter is resolved.

Acting in Good Faith

Anyone filing a complaint concerning a violation or suspected violation of the ethical and legal standards noted above must act in good faith and have reasonable grounds for believing the information disclosed may indicate a violation of such standards. Any allegations that prove not to be substantiated and which prove to have been made maliciously or knowingly to be false will be viewed as a serious disciplinary offense.

Confidentiality

Violations or suspected violations may be submitted on a confidential basis by the complainant or submitted anonymously. Reports of violations or suspected violations will be kept confidential to the extent possible, consistent with the need to conduct an adequate investigation.

These prototype policies are provided with the understanding that Stroock & Stroock & Lavan LLP is not rendering legal, accounting, or other professional advice or service. Professional advice on specific issues should be sought from an accountant, lawyer, or other professional.

PROTOTYPE DOCUMENT RETENTION/DESTRUCTION POLICY

ADOPTED: ___ / ___ / 20 ___

THE CLIENT NEEDS TO REVIEW THE RETENSION SCHEDULES AT THE END OF THE POLICY TO SEE WHAT OTHER INFORMATION MAY BE NECESSARY FOR THAT ORGANIZATION. THE CLIENT SHOULD ALSO REVIEW THIS LIST WITH ITS AUDITORS. IF THE STAFF HAS NOT BEEN ABLE TO SIGN-OFF ON THE TIMETABLE BEFORE ADOPTION OF THE POLICY, THEN THE BOARD MIGHT WISH TO ADOPT THE FOREPART OF THE POLICY (WHICH FOCUSES ON MATTERS OF PUBLIC CONCERN REGARDING DOCUMENT DESTRUCTION, ETC.) NOW AND DIRECT STAFF TO COME BACK WITH APPROPRIATE RETENSION SCHEDULES WITHIN A DEFINED PERIOD.

AAAA, Inc.

Records Retention and Destruction Policy

Introduction

Adherence to sound record retention and destruction practices and procedures has become a vital aspect of business. The failure to adequately retain appropriate records increases the risk that companies and personnel will face serious legal problems as well as negative publicity.. Similarly, keeping such records longer than appropriate can also create problems. Accordingly, _____ (the "Company" or "AAA") expects all of its personnel to exercise reasonable efforts to uphold the standards set forth in this Records Retention and Destruction Policy (the "Policy").

Record Retention Schedules; Obligation to Suspend Destruction

The record retention schedules *[contained in][adopted pursuant to]* this Policy *[shall]* reflect general obligations existing under applicable law and Company policies. **However, in the event of any actual or threatened litigation or an investigation involving the Company, or when there is a series risk of litigation or an investigation, management personnel must suspend the destruction of any documents relevant to. or that may be requested in, such litigation or investigation.** In addition to certain sanctions under *[federal law][the federal Sarbanes-Oxley Act of 2002 (including fines or imprisonment up to 20 years)]*, failure to preserve documents can result in court sanctions, including exclusion of evidence or an instruction by the judge that the destroyed documents would have been damaging to the party that destroyed them. Therefore, when in doubt, records--both in hard copy and electronic form-- should be retained until the Company determines that destruction will not hinder any pending or potential litigation, proceeding or investigation.

Importance of Electronic Record Retention and Retrieval Procedures

The Policy applies to both written and electronic records. Electronic records should be preserved through reliable means, such as backup tapes or comparable technology, for such periods as are set forth in this Policy. Electronic communication should generally be treated the same as historically traditional paper communications and documents with respect to record retention policies.

In the event of actual or threatened litigation or an investigation, or when there is a series risk for litigation or an investigation, Company personnel with access to electronic records are required to suspend any automatic electronic records destruction functions that might result in the destruction of any documents relevant to, or that may be requested in, such litigation or investigation. Electronic records must be held in accessible form for proper production pursuant to a legal proceeding or investigation. Care should also be taken in those circumstances to not alter metadata (data in electronic files that documents the origin of electronic data, such as when a file was created or revised and who accessed the document). If an e-mail account could be relevant in a lawsuit, a mirror image of the account should be created and then the original account should be no longer accessed.

Note that once an electronic communication is created and sent, it continues to exist on both the sender's and recipient's computers and servers due to backup mechanisms. Since such documents can not be easily destroyed after creation, care should be taken in deciding whether to send such documents as electronic communications.

Effect of Noncompliance With Company Record Retention Policy

Failure to comply with this Policy may lead to individual legal liability for Company personnel, as well as disciplinary action by the Company, up to and including termination of employment.

Record Retention Schedule and Recommended Manner of Retention and Destruction

[Retention schedules for records held by the Company and its affiliates, as recommendations on how such records should be maintained, are set forth below.]

OR

[Since the various records of the Company that exist are of many types, and vary significantly with respect to the various operations of the Company, this policy requires that appropriate staff of the Company, under the guidance of the Executive Director, prepare retention schedules indicating minimum periods of time for retention of such classes of documents. By _____, the Executive Director shall provide the Board of Directors with a written retention schedule detailing such holding periods, which such schedule shall then become a part of this Policy.]

The time periods in the record retention schedule are minimum commitments that may be adjusted as Company management deems necessary or pursuant to suspension conditions described in this Policy. Executive staff, with the concurrence of the Executive Director, may revise any minimum holding periods from time to time, in which case a revised schedule shall be provided by the Executive Director to the Board and the retention schedule shall be deemed amended. The Executive Director shall report annually to the Board as to whether there have been any changes in the retention schedules or whether there should be any changes in this Policy.

In addition to legal reasons to keep or discard Company documents, care should also be given to retaining documents that may be important for historic reasons. It may be necessary or appropriate to consult older documents from time to time in connection with reconstruction of the past history of the organization or its projects; for that reason, staff may reasonable determine that it is appropriate to retain certain documents of possible historic relevance for periods longer than otherwise may be thought to be appropriate under the mechanical time periods set forth in this Policy.

Care should be exercised in determining how to destroy documents that are to be no longer kept. If there is any sensitivity to such documents, they should be shredded or otherwise destroyed in a way that they will not become accessible. Nonsensitive documents can be recycled through other appropriate means.

****

If anyone is aware of any pending or anticipated legal proceedings or investigations that may mandate preservation of documents or records, has a question about whether a record should be retained due to pending or anticipated legal proceedings or investigations, or has general questions about the Policy, please contact (___ - ___ - ___).

Description of Record(s)	**Recommended Manner of Recordkeeping**	**Disposition** [1]
I. Organizational Records:		
Incorporation documents including articles of incorporation, bylaws, and related documents	Store in corporate record book such as the minute book, under the appropriate tab	Permanent

Tax-exemption documents including application for tax exemption (IRS Form 1023), IRS determination letter, corresponding state documents and any related documents (see below for annual filings)	Store in corporate record book such as the minute book, under the appropriate tab	Permanent. Federal law requires copies of these documents to be held at organization's headquarters office. These records must be made available for public inspection upon request
Meeting/board documents including agendas, minutes and related documents	Store signed minutes (with only those other documents referenced as attached) in minute book book; all other meeting material should be stored in a file (one file per meeting).	Permanent. Care should be taken to include only necessary information in these documents

II. Key Financial Records:

Year-end audited financial statement	With financial records	Permanent
Treasurer's reports, periodic other than year-end	With financial records	Three years. Store w/ financial records. Consider whether to destroy after three years.
Bank statements, canceled checks, check registers, investment statements, and related documents	With financial records	Seven years. Store w/ financial records. Destroy after seven years. See also separate listing below.
Annual information returns (IRS Forms 990) and state filings (NY CHAR 500 and similar reports filed elsewhere) [2]	Federal law requires that the three most recent years federal returns (and the Form 1023) be kept in the organization's headquarters office and be made available for public inspection upon request	Permanent. Consider posting copies of the Form 1023 and Form 990 (excluding contributor data) on the organization's website or with GuideStar.

	(excluding contributor data). Copies of state filings shall also be kept.	
III. Grant Information:		
Grant inquiries (not granted)	General grant making files	7 years
Grant recipient information, including names, addresses	Separate files for each grantee and each grant. Include application, grant agreement, equivalency affidavit and other supporting material and periodic reports as required by grant application. Prepare a separate list of grant recipients which should include names, addresses, when grant paid, amount and purpose	Permanent.
IV. Other Information (manner of retention to be determined as appropriate[3]):		
Collections Records	Permanent (including records regarding deaccessioned property)	
Construction Documents	Permanent	
Contracts and Leases	So long as active plus 7 years (or longer if it may have historic value or be a basis for another transaction later)	
Correspondence (general)	3 years (or longer if it may have historic value)	
Correspondence (legal / important)	Permanent	
Email	Just like correspondence	
Employee - Applications (current employees)	So long as person is employed and 7 years after	

Employee - Applications (other)	3 years
Employee - Assignments and Garnishments	7 years
Employee - Benefit Plan Documents	7 years
Employee - Payroll Records	7 years
Employee - Payroll Reports (federal, state or local) [4]	7 years
Employee - Personnel Records (after termination)	7 years
Employee - Personnel Records (current)	Permanent
Employee - Retirement & Pension Records	Permanent
Employee - Timesheets	7 years
Employee -	7 years

	Withholding Records	
	Employee - Worker's Compensation Documents	11 years
	Finance - Accounts Payable Ledgers and Schedules	7 years
	Finance - Accounts Receivable Ledgers and Schedules	7 years
	Finance - Audit Reports by Independent Accountants	Permanent
	Finance - Audit Reports by Internal Auditors	3 years
	Finance - Bank and Brokerage Statements & Reconciliations	7 years
	Finance - Cancelled Checks (for important payments	Permanent

	- purchases of property, tax payments, large or significant contracts)	
	Finance - Cancelled Checks (ordinary)	7 years
	Finance - Cash Books	Permanent
	Finance - Cash Receipts and Disbursements	7 years
	Finance - Chart of Accounts	Permanent
	Finance - Credit Card Records	7 years
	Finance - Depreciation Schedules	Permanent
	Finance - Donor Contribution Records (cash)	7 years [5]
	Finance - Donor Contribution	So long as property is held

Records (tangible)	
Finance - Duplicate Deposit Slips	3 years
Finance - Expense Analyses & Distribution Schedules	7 years
Finance - Financial Statements (inc. trial balances)	Permanent
Finance - Fixed Asset Records & Appraisals	Permanent
Finance - General Ledgers	Permanent
Finance - Inventories	7 years
Finance - Invoices from Vendors	7 years
Finance - Invoices to Others	7 years
Finance - Notes	7 years

Receivable Ledgers	
Finance - Paid Bills & Vouchers	7 years
Finance - Subsidiary Ledgers	Permanent
Finance - Tax Return Worksheets	7 years
Finance - Tax Returns	Permanent
Finance - Uncollectable Accounts & Write-offs	7 years
Finance - Vendor Payment Request Forms & Supporting Documents	7 years
Finance - Voucher Registers & Schedules	7 years
Finance - W-2 / W-4 / 1099	7 years

Forms, etc.	
Insurance - Accident Reports and Claims (current and settled cases)	Permanent
Insurance - Policies (current and expired)	Permanent
Patents, Copyright, Trademark and Other Intellectual Property Papers	Permanent
Property Appraisals	Permanent
Property Documents - Deeds, Mortgages, Bills of Sale, etc.	Permanent

FN1. Retention periods for important documents should begin at the end of the fiscal year during which the document was created, not from the date on the document itself. For tax documents, the clock shouldn't start until the end of the year of filing (or the end of the year in which the form was due, if later).

FN2. But if there are controversial or aggressive positions by an organization that may have to be supported or defended in future years, the period for warehousing documents may be longer than for those years when the entity is just doing "business as usual." Note that tax authorities may claim at any time that they never received a tax return and therefore the statutory period of limitations for that run has not yet started; unless the organization has evidence that the return was in fact received (such as return receipts), there can be no assurance that the standard statutory period of limitations has run.

FN3. Personnel maintaining such records should be able to exercise appropriate discretion in determining where any specific item should be maintained, so long as the choice of such location is logical and the item remains generally retrievable by other personnel of the Company needing to retrieve such record.

FN4. Under the federal Fair Labor Standards Act, the employer has the burden to present evidence of the hours worked by employees. Accordingly, If adequate records are not maintained, an employee may be able to successfully seek payment for hours that were not in fact worked.

FN5. A listing of all donors shall be maintained permanently, with amounts

This prototype policy is provided with the understanding that Stroock & Stroock & Lavan LLP is not rendering legal, accounting, or other professional advice or service. Professional advice on specific issues should be sought from an accountant, lawyer, or other professional.

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