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Modernizing New York's Non-Profit Law

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During an otherwise quiet legislative session, the New York State Legislature passed the Nonprofit Revitalization Act of 2013 on June 21, 2013. The act represents a major overhaul to the regulatory practices contained in New York's non-profit law. The comprehensive updates are the largest in over 40 years and will significantly affect New York's charities and other non-profit organizations.[1] With the hope of revitalizing New York's non-profit sector, the act seeks to modernize governance, reduce bureaucracy and red tape, and enhance oversight and accountability to prevent fraud and improve the public trust. The bill is awaiting delivery to Governor Andrew Cuomo and, if signed in its present form, will become effective July 1, 2014.

Non-profit organizations are an essential component of New York's economy. They account for one in every seven jobs by employing approximately 1.25 million people and generate billions of dollars in annual revenue.[2] Among the over 100,000 non-profits in New York, trust and estate practitioners are most familiar with charitable organizations, which are commonly utilized in the estate planning process. Accordingly, it is important to understand the opportunities and responsibilities created by the act and ensure that non-profits operate in a manner that is consistent with the new statutory requirements.

This article outlines the key proposals on the horizon so non-profit organizations can begin the process of evaluating changes that need to be made to existing governance and oversight procedures.[3]

Modernizing Activities

In an effort to better utilize technology, the Nonprofit Revitalization Act modernizes governance activities. Notices and waivers of notice for meetings can be given by electronic transmissions such as email or facsimile. Additionally, electronic transmissions can be used to give unanimous written consent in lieu of a meeting. If a meeting of the board, or any committee thereof, is to take place, the act allows a board member to participate through videoconference, Skype or other forms of video communication.

Participation through these means shall constitute in person presence at a meeting provided that all members can hear each other at the same time. Finally, the act amends Section 8-1.4 of the Estates, Powers and Trusts Law (EPTL) to make clear that the attorney general may accept non-profit registrations and other filings electronically. While not groundbreaking, these changes are practical. They will help maximize director participation in meetings and are necessary to govern efficiently in this day and age.

Reducing Bureaucracy

Another key goal of the act is to reduce outdated and costly burdens so non-profits can focus resources on programs and services and not on unnecessary red tape. To this end, the act simplifies the non-profit formation process and reduces barriers to entry by creating only two categories of corporations, charitable corporations and non-charitable corporations, and eliminates the four Types (A, B, C and D) that have historically existed. Former Type A corporations will be non-charitable, former Type B and C corporations will be charitable, and former Type D corporations formed for charitable purposes will be charitable with all other Type D corporations being non-charitable. Non-profits that have previously been formed as a certain type will not have to file new paperwork to comply with the new categories. Corporations formed for both charitable and non-charitable purposes will fall into the new charitable category.

To reduce the costs and burdens on smaller non-profit corporations and to be more consistent with the reporting requirements of other states, the act raises the gross revenue thresholds, which trigger the need for an independent CPA's audit and audit oversight procedures, from $250,000 to $500,000. The gross revenue threshold prompting the obligation to obtain an independent CPA's review is increased from $100,000 to $250,000.

For non-profits within the $250,000 to $500,000 range, the attorney general can request an independent CPA's audit after reviewing the non-profit's annual filings. Accordingly, only unaudited and un-reviewed financial statements are required for non-profits with gross revenues under $250,000. To avoid outdated thresholds in the future, the act includes escalation provisions so that the threshold for an independent CPA's audit and audit oversight procedures increases to $750,000 on July 1, 2017 and $1 million on July 1, 2021, while the thresholds for the independent CPA's review and the unaudited and un-reviewed statements remain the same.

In an attempt to reduce administrative burdens for more routine real estate transactions, the act relaxes the voting requirements to approve these transactions. Under the act, a majority vote is now required (as opposed to a two-thirds vote) by the non-profit corporation's board, or committee thereof, for any real estate transaction where the property does not constitute all, or substantially all, of the non-profit's assets. If the property constitutes all, or substantially all, of the non-profit's assets, the voting requirement remains a majority vote unless there are less than 21 directors, in which case a two-thirds vote is required. Additionally, if an authorized committee of the board acts with respect to real estate transactions, the new law requires the committee to promptly notify the board, and in no event after the next regularly scheduled board meeting.

The act also streamlines the approval process for certain major corporate actions to expedite these actions and reduce overall costs. Some of the actions that fall within the new law include the following: (1) the sale of all, or substantially all, of a non-profit's assets; (2) merger or consolidation; and (3) dissolution. Prior to the act, these actions either required court approval or an often cumbersome two-step process involving an attorney general review and court approval. Now, these actions can be approved by the attorney general without court intervention. In addition, a non-profit will retain the right to seek court approval at any time, if desired, and the attorney general will retain the right to refer such action to the court if it determines that judicial review is appropriate.

Enhanced Oversight

At a time when self-dealing and fraud are too often the headline of the day, the act seeks to restore donor confidence and the public trust through enhanced oversight requirements, revamped related-party transaction rules, and increased accountability.

The act creates two new sections to the not-for-profit corporation law, which focus on protecting against self-dealing and fraud. First, Section 715-a requires that all non-profits have a conflict of interest policy to ensure that its directors, officers and key employees[4] act in the non-profit's best interests. The policy must include, at a minimum, the following provisions: (1) a definition of the circumstances that constitute a conflict of interest; (2) conflict disclosure procedures to the audit committee or board; (3) a requirement that the individual who is the subject of the conflict of interest not be present at, or participate in, any board or committee deliberation or vote concerning such conflict; (4) a prohibition against any attempt by the individual with the conflict to improperly influence deliberations concerning such conflict; (5) procedures for documenting the existence and resolution of a conflict; and (6) procedures for dealing with related-party transactions.

Moreover, the policy must require that prior to the initial election of any director, and annually thereafter, such director shall complete a written statement identifying any potential conflict known to such director. Given this new requirement, non-profits that already have a conflict of interest policy may need to update it and others, who do not have such a policy in place, will need to adopt one.[5]

Along with requiring procedures for addressing related-party transactions in a conflict of interest policy, the act revamps the rules governing related-party transactions. In general, non-profit corporations are prohibited from entering into a related-party transaction unless such transaction is determined to be fair, reasonable and in the non-profit's best interests. Any director, officer or key employee who has an interest in such a transaction must disclose, in good faith, to the board, or committee

thereof, the material facts concerning such interest. In addition, the related-party is prohibited from participating in the deliberations or vote concerning the transaction, but may provide information relating to the transaction if requested.

Regarding charitable corporations, the act provides additional requirements when dealing with a related-party transaction. For these charitable non-profits, an independent board, or committee thereof, must: (1) consider alternative transactions to the extent available; (2) approve the transaction as fair and reasonable through a majority vote; and (3) contemporaneously document its approval of the transaction and consideration of alternative transactions. Finally, for improper transactions that violate the act, or are deemed to be not reasonable or not in the best interest of the non-profit, the act grants the attorney general the power to enjoin, void or rescind such transactions or seek restitution or other remedies.

The second new Section 715-b requires certain non-profit corporations to adopt a whistleblower policy. Non-profits that fall into this category are those with 20 or more employees and annual revenues in the prior fiscal year of over $1 million. As with other whistleblower policies, the act seeks to protect individuals who, in good faith, report suspected improper conduct from intimidation, harassment, discrimination or, in the case of employees, adverse employment consequences. According to this new section, the policy must include the following provisions: (1) procedures for reporting suspected violations and keeping such information confidential; (2) a requirement that an employee, officer or director of the non-profit administer the policy and report to the board or committee thereof; and (3) a requirement to provide copies of the policy to employees, officers, directors and volunteers who provide substantial services to the non-profit.

In addition to the new policy requirements and revamped related-party transaction rules, the act sets forth key changes to improve accountability across the non-profit sector. Under the act, any employee of a non-profit is specifically prohibited from serving as chair of its board or any other position with similar responsibilities.[6] Also, by becoming a director, officer, key employee or agent of a non-profit, such individual becomes subject to the personal jurisdiction of the Supreme Court of the state of New York and may be served with process by the attorney general. Regarding compensation, the act clarifies that an individual who may benefit from compensation cannot be present at or participate in any board or committee deliberation or vote concerning that individual's compensation.

Charitable Trusts

The new requirements discussed above concerning audits, related-party transactions, conflict of interest policies and whistleblower polices apply to trusts created solely for charitable purposes through the enactment of a new section to the EPTL, Section 8-1.9. This new section extends to trusts that continue for charitable purposes after all non-charitable interests have terminated. The sum and substance of this section is substantially similar to the new sections that apply to charitable corporations and therefore will not be restated here.

Conclusion

In its present form, the new law represents significant progress towards strengthening governance, oversight and accountability while reducing unnecessary burdens for New York's non-profits. The key unknown is whether the act creates the correct balance between increasing governance and oversight with the need for less bureaucracy and red tape. The revitalization will be a success only if the public's trust is restored and maintained. In these times of economic uncertainty, a renewed level of support from the public is essential to keep the non-profit sector funded and focused on serving its communities.

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Endnotes:

1. It is worthwhile to note that the act also applies to non-profits that solicit contributions in New York regardless of where they are incorporated.

2. Press Release, Senate Passes Bill to Revitalize Not-For-Profit Laws, June 20, 2013 available at www.nysenate.gov/press-release/senate-passes-bill-revitalize-not-profit-laws.

3. This article does not discuss every change under the act. Once effective, it is highly recommended that the entire law be carefully reviewed to ensure compliance with the act.

4. The reach of the act extends beyond directors and officers of non-profits by including a class of individuals defined as "key employees," who are employees in a position to exercise substantial influence over the affairs of the corporation.

5. Section 715-a(d) provides guidance as to whether an existing conflict of interest policy will be compliant with the act and

Section 715-b(c) provides similar guidance in connection with the whistleblower policy discussed infra.

6. To allow an additional year for compliance with the act, this new requirement does not become effective until Jan. 1, 2015.