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New laws affect New York nonprofits

By Michael Cooney, Anita Pelletier, Jennifer Greco and Peter Millock

Nonprofit corporations formed in New York State are again the subject of legislative mandates, continuing the almost annual modification of the Not-for-Profit Corporation Law (the "N-PCL"). Governor Cuomo signed four bills into law during the close of the 2018 legislative session that will impact New York nonprofits in 2019.

UBTI for commuter benefits removed from New York taxable income (Chapter 369 of the Laws of 2018)

New York responded to an ill-conceived amendment of the Internal Revenue Code ("Code") Section 512(a)(7), imposing a tax on exempt organizations that afford transportation benefits to their employees. Congress felt compelled to "even the playing field" between tax-exempts and for-profit businesses over the treatment of such benefits. In a novel break from decades of well-settled tax policy and practice, Congress treated the value of such employee benefits as unrelated business taxable income ("UBTI"), despite the fact that there is, in fact, no "income" involved.

The New York tax regime for UBTI is derived largely from the federal tax rules, so, in order to blunt the effect of this federal change, the Code Section 512(a)(7) levy is excluded from UBTI for state purposes. The change applies to taxable years beginning on or after January 1, 2018.

Audit committee service for directors of controlled corporations (Chapter 468 of the Laws of 2018)

Multi-corporate nonprofit systems were only minimally accounted for in the passage of the Nonprofit Revitalization Act of 2013. One such accommodation was the ability to delegate to a parent corporation's governing board the ability to satisfy the audit requirements of N-PCL Section 712-A for the controlled system affiliates. This is one of the rare occasions under the N-PCL where a committee that is not comprised solely of corporate directors can act on behalf of the nonprofit corporation. This provision allowed the audit function at the parent level, in order to consolidate all audit functions at one level in a multi-corporate system.

That authority is now expanded to allow affiliate directors, who do not serve on the governing board of the parent nonprofit, to serve as voting members of the parent-level audit committee. The change assumes affiliate committee members are knowledgeable of business operations. Left

unresolved by this new law is the nature of the fiduciary duty owed by such affiliate committee members to both the parent and affiliate corporation, including such matters as the availability of director and officers' liability insurance coverage.

Updating New York solicitation disclosure language (Chapter 373 of the Laws of 2018)

As of March 21, 2019, charitable organizations are required to include a disclaimer referencing the New York State Office of the Attorney General on all solicitations for donations. Section 174-b of the New York Executive Law was amended to require that solicitations used by or on behalf of charitable organizations (including solicitations by professional fund raisers or professional solicitors on behalf of a charitable organization), include a statement that identifies the website and telephone number of the Attorney General's Charities Bureau where potential donors can receive information on charitable organizations. The change is one in a long-line of consumer protection initiatives by the state in the charitable giving area.

Concerns over control of charitable nonprofits (Chapter 411 of the Laws of 2018)

As with other recent amendments, this amendment was intended to close a perceived loophole in nonprofit governance, by requiring that certain nonprofit corporations have at least three members. The requirement is effective on July 1, 2019, and applies to existing nonprofits and those thereafter incorporated in New York.

For most non-charitable, nonprofit corporations formed in New York, the change has little impact. Corporations, like social clubs and trade associations, are already required to have members and, in fact, already have many more than three members.

Charitable nonprofit corporations formed in New York have had the option of using a self-perpetuating governing board in lieu of having any members. Such a provision must now be set forth in its certificate or by-laws. Unlike under Delaware, New York did not include a "saving clause," raising the challenge of ascertaining who the members are if non-member status is not referenced in the governing documents.

Two types of New York charitable nonprofit corporations in particular are affected by the change. The first is the "parent" nonprofit corporation functioning as the sole corporate member, a structure common in multi-corporate health care, social services and other systems. The amendment allows for a corporation, joint-stock association, unincorporated association or partnership to function as a sole member, as long as that parent entity itself is owned or controlled by no fewer than three persons. The language of the statute does not distinguish between business and nonprofit corporations in this regard. It is advisable for affiliates to include a proviso in the membership section of their by-laws that the sole corporate member shall at all times be controlled by three or more persons, whether as members or as directors of a self-perpetuating board.

The second type of entity particularly affected by the change is private foundations, and in particular family foundations. It is common practice to form a nonprofit corporation for this purpose with two parents as both members and directors, adding children and grandchildren to the board and eventually membership as the first generation sees fit. That structure is now prohibited under the N-PCL. Delaware may benefit since it allows for a single board member, an option

soundly dismissed in New York when the N-PCL was overhauled in 2013. Reincorporating a New York private foundation in Delaware is subject to challenge by the attorney general, despite the fact that the IRS made such changes easier in Revenue Procedure 2018-15.

Oddly, the memorandum accompanying the amendment stated that the purpose of the law was to "prevent a sole individual from being the only member of a charitable nonprofit corporation." If that indeed were the case, then the legislature created an unnecessarily hostile environment for family foundations in the process. Meanwhile, New York charitable trust law still allows for a single individual to be sole trustee.

Nixon Peabody will continue to report on any updates impacting these new laws and will continue to monitor the legislative activity associated with the N-PCL.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

- Michael Cooney at **mcooney@nixonpeabody.com** or 202-585-8188
- Peter Egan at **pegan@nixonpeabody.com** or 516-832-7633
- Jennifer Greco at **jgreco@nixonpeabody.com** or 516-832-7641
- Peter Millock at **pmillock@nixonpeabody.com** or 518-427-2651
- Anita Pelletier at **apelletier@nixonpeabody.com** or 585-263-1164
- Philip Rosenberg at **prosenberg@nixonpeabody.com** or 518-427-2709