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Client Alert

Real Estate

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New York Revises Its Not-for-Profit Corporation Laws

For the first time in 40 years, New York has adopted major revisions to its Not-for-Profit Corporation Act that could impact all domestic and foreign corporations in New York, as well as those entities required to register in New York for charitable solicitation purposes regardless of where they are incorporated. The Act's major objectives are to ease the obstacles and burdens to incorporation and operation in New York, while enhancing public confidence in not-for-profit corporations and strengthening the state's enforcement powers. With certain exceptions, the provisions of the Non-Profit Revitalization Act of 2013 ("Act") went into effect July 1, 2014. Organizations impacted by the legislation will need to review their organizational documents and internal policies to ensure compliance. As more fully set forth below, the Act amends the financial reporting obligations, incorporates provisions affecting internal corporate governance and state filings, and imposes requirements for adopting written policies and handling related party transactions.

Financial Reporting New gross income thresholds have been instituted that mandate when a financial report filed with the attorney general must be accompanied by an annual financial statement that includes either (i) an independent certified public accountant's audit report containing an opinion that the financial statements presented, fairly comply with generally accepted accounting principles ("Audit Report"), or (ii) a review report in accordance with "statements on standards for accounting and review services" issued by the American Institute of Certified Public Accountants.[1] The dollar thresholds provided increase again in 2017 and 2021. The dollar threshold for organizations permitted to file unaudited financial reports was increased, as well, to $250,000.[2]

These financial reporting requirements also apply to entities that are not incorporated in New York, but that are required to register for charitable solicitation purposes.

Audit Oversight The board, or a designated audit committee of the board, of a corporation required to file an Audit Report with the attorney general shall oversee the accounting and financial reporting processes and audit of the corporation's financial statements. The board or audit committee shall annually (i) retain or renew the retention of an independent auditor to conduct the audit, and (ii) review the audit and any related management letter with the independent auditor.[3]

In addition, if the corporation is required to file an Audit Report and in the prior fiscal year had or in the current fiscal year reasonably expects to have annual revenue in excess of $1 million, the board, or audit committee, must also comply with additional oversight requirements. These requisites include reviewing with auditor the scope of the audit prior to its commencement; a discussion with the auditor of certain specific matters upon completion of the audit; and annual consideration of the performance and independence of the auditor.

Only independent directors may participate in any board or committee deliberations or voting relating to matters set forth in this section. A designated audit committee must be comprised solely of independent directors.

Internal Corporate Governance The Type A, B, C and D designations for nonprofit corporations have been abolished and replaced with Charitable and Non-charitable designations. Charitable corporations are those formed for charitable purposes defined as charitable, educational, religious, scientific, literary, cultural, or for the prevention of cruelty to children or animals. Organizations formed prior to July 1, 2014 shall be deemed Charitable or Non-charitable based on the type of organization and its purposes. Type A organizations shall be deemed Non-charitable, Type B and C organizations shall be deemed Charitable, and Type D organizations formed for charitable purposes shall be deemed Charitable, and all other Type D organizations shall be deemed Non-charitable.[4]

A new definition of "entire board" was adopted to clarify confusion that existed under the prior statute. The definition as of the effective date will be the total number of directors entitled to vote, which the corporation would have if there were no vacancies. For example, if an organization's bylaws provide a fixed number of directors, the entire board shall consist of that number of directors. If the bylaws provide for a range of directors, then the entire board shall consist of the number of directors within such range that were elected as of the most recently held election of directors.

The board approval necessary to take certain corporate action was also revised. The purchase of real property, or the sale, mortgage, lease, exchange or other disposition of its real property, can be authorized by a vote of a majority of

directors of the board or of a majority of a committee authorized by the board, provided that if such property would constitute all, or substantially all, of the assets of the corporation, the vote of two-thirds of the entire board shall be required, or if 21 or more directors, the vote of a majority of the entire board shall be sufficient.[5]

The Act allows consents (unless restricted in the certificate of incorporation or bylaws) and waivers to be written or electronic. If written, they must be executed by the director by signing such consent or waiver, or causing his or her signature to be affixed by facsimile signature. If electronic, the transmission of the consent or waiver must be sent by electronic mail and set forth, or be submitted with, information from which it can reasonably be determined that the transmission was authorized by the director. Similar provisions for members of the corporation exist for electronic notices, waivers, and consents.[6]

Unless otherwise restricted by the organizational documents, members of the board or a committee not physically present at a meeting may participate by means of a conference telephone or similar communications equipment, or by electronic video screen communications, and such will be considered presence in person at the meeting so long as all persons participating in the meeting can hear each other and each director can participate in all matters, including the ability to propose, object to and vote on specific action.[7]

Effective January 1, 2016, no employee of the corporation shall serve as chair of the board or hold any other title with similar responsibilities.[8]

Attorney General Approval Under the prior law, a sale, lease exchange, or other disposition of all, or substantially all, of the assets of a Charitable corporation required leave of the Supreme Court. That provision was revised to allow approval of the attorney general or the Supreme Court, unless the corporation is insolvent or would become insolvent by the transaction, or the attorney general concludes that a court should review the petition. Specific guidelines to obtain such approvals have been set forth in the Act.[9]

The legislation also allows the attorney general to approve a Charitable corporation's merger or consolidation or plan of dissolution or distribution of assets. Similarly, an amendment to the Certificate of Incorporation of a Charitable corporation seeking to change, eliminate or add a power or purpose can now be approved by the attorney general instead of a justice of the Supreme Court. Approval of a justice of the Supreme Court can still be obtained, including when the attorney general does not approve the requested action or concludes that court review is appropriate.

The attorney general has been directed to institute rules or regulations allowing or requiring any submission to the attorney general to be effected by electronic means.

Policies The Act requires corporations to adopt a conflict-of-interest policy, meeting certain minimum requirements to ensure that its directors, officers and key employees act in the corporation's best interest and comply with applicable legal requirements. A review of any existing policy is necessary to ensure it complies with the statutory provisions.

In addition, any corporation that has 20 or more employees and in the prior fiscal year had annual revenue in excess of $1 million shall be required to adopt a whistleblower policy, meeting the specified statutory requirements to ensure there will be no retaliation against persons who report suspected improper conduct.[10]

Related Party Transaction The Act prohibits corporations from entering into any related party transaction unless the transaction is determined by the board to be fair, reasonable and in the corporation's best interests. Any director, officer or key employee who has an interest in a related party transaction shall disclose in good faith to the board, or authorized committee thereof, the material facts concerning such interest.[11]

The Act increased the approval procedures for a related party transaction involving a Charitable corporation when a related party has a substantial financial interest. In such cases, the board or authorized committee thereof shall: (i) prior to entering a transaction, consider alternate transactions to the extent available; (ii) approve the transaction by not less than a majority vote of the directors or committee members present at the meeting; and (iii) contemporaneously document in writing the basis for the approval, including consideration of any alternatives.[12]

The above procedures are minimum actions an entity must take. The certificate of incorporation, bylaws, or any policy adopted may contain additional restrictions and procedures for approval, or provide that any transaction in violation of such restrictions shall be void or voidable.[13]

A related party may not participate in the deliberations or vote on a related party transaction. Moreover, no person may be present at or otherwise participate in any board or committee's deliberation or vote concerning such person's compensation, provided such person may provide background information or answer questions prior to the commencement of deliberations or voting.

The attorney general may bring an action to enjoin, void or rescind any related party transaction or proposed related party transaction that violates any provision of the Act, or was otherwise not reasonable or in the best interests of the corporation at the time the transaction was approved; or seek restitution and the removal of directors or officers; or seek to require any person or entity to: (i) account for any profits made from such transaction, and pay them to the corporation; (ii) pay the corporation the value of the use of any of its property or other assets used in such transaction; (iii) return or replace any property or other assets lost to the corporation as a result of such transaction, together with any

income or appreciation lost to the corporation by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate; and (iv) pay, in the case of willful and intentional conduct, an amount up to double the amount of any benefit improperly obtained.[14]

As evidenced above, the statutory revisions could require amendments to a corporation's organizational documents and policies. An entity's corporate documents should therefore be reviewed for compliance.

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1. Non-Profit Revitalization Act of 2013, sections 3, 3-a, and 3-b amending N.Y. Exec. Law § 172-b (2014).
2. N.Y. Exec. Law § 172-b (2014) .
3. N.Y. Not-For-Profit Corp. Law § 712-a (2014).
4. N.Y. Not-For-Profit Corp. Law § 201 (2014).
5. N.Y. Not-For-Profit Corp. Law § 509 (2014).
6.N.Y. Not-For-Profit Corp. Law §§ 605, 606, and 614 (2014)
7. N.Y. Not-For-Profit Corp. Law § 708 (2014).
8. 2014 N.Y. Sess. Laws Ch. 81 N.Y.
9. N.Y. Not-For-Profit Corp. Law § 510 (2014).
10. N.Y. Not-For-Profit Corp. Law § 509 (2014).
11. N.Y. Not-For-Profit Corp. Law § 715 (2014).
12. N.Y. Not-For-Profit Corp. Law § 715 (2014).
13. N.Y. Not-For-Profit Corp. Law § 715 (2014).
14. N.Y. Not-For-Profit Corp. Law § 715 (2014).