



# Not So Fast – Exempt Organization Changes and Your State Attorney General + New Rules Imposed by the Florida Department of Agriculture & Consumer Services

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# Acknowledgment

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# Overview

- Attorney General Oversight
- State Law Statutes
- Tax Issues Associated with Reorganizations
- Governance Issues and Fiduciary Duties
- Changes in Florida's Solicitation of Contributions Act

# Overview: Role of Attorney General

## » Florida

- Attorney General is the constitutional officer entrusted to enforce charitable trusts and organizations in Florida (true at common law as well)
- Assistant Attorney General Blaine Winship typically represents Florida in charitable trust and organization matters.
- Portions of Florida Trust Code involve local state attorneys, who are subject to Attorney General's supervision (who can intervene in any case).
- Coordination with Florida Department of Agriculture and Consumer Services, which requires registration and informational filings (to be discussed later).

# Overview: Role of Attorney General (cont.)

- Charitable trusts governed by Florida Trust Code (FTC), Fla. Stat. (FS) 736.0101 *et seq.*

Attorney General has the rights of a qualified beneficiary with respect to charitable trusts. FS 736.0110(3).

- Judicial and Non-judicial Acts Involving Attorney General (Required in Some Cases)
  - FS 736.0108(6) – Change of principal place of administration of trust
  - FS 736.0111 – Non-judicial settlement agreements
  - FS 736.0405 – Enforcement of charitable purposes
  - FS 736.0410 – Modification or termination of trust; proceedings for disapproval of non-judicial acts
  - FS 736.04113 – Judicial modification of irrevocable trust when modification is not inconsistent with settlor's purpose
  - FS 736.04115 – Judicial modification of irrevocable trust when modification is in best interests of beneficiaries
  - FS 736.04117 – Trustee's power to invade principal in trust

# Overview: Role of Attorney General (cont.)

- Judicial and Non-judicial Acts Involving Attorney General (Required in Some Cases) (cont.)
  - FS 736.0413 – Cy pres
  - FS 736.0414 – Termination of uneconomical trust
  - FS 736.0415 – Reformation to correct mistakes
  - FS 736.0416 – Modification to achieve settlor's tax objectives
  - FS 736.0417 – Combination and division of trusts
  - FS 736.0704 – Vacancy in trusteeship; appointment of successor
  - FS 736.0705 – Resignation of trustee
  - FS 736.0706 – Removal of trustee
  - FS 736.0813 – Duty to inform and account

# State Law Statutes

- Most states have multiple corporate statutes, including a business corporation statute and a non-profit corporation statute.
    - FS 607.0101 *et seq.*: Florida Business Corporation Act
    - FS 617.01011 *et seq.*: Florida Not for Profit Corporation Act
- (Delaware is an exception. Non-stock corporations are organized and operated under the Delaware General Corporation Law.)

# State Law Statutes (cont.)

- Various state statutes restrict the ability of one enterprise to merge into an enterprise organized under a different statute.
  - Examples:
    - A Florida not for profit corporation cannot merge into a Florida business corporation (surviving corporation must be not for profit).
    - The opposite is permitted.
  - A few other states now provide much broader options (e.g., Tennessee's 2014 changes that became effective in 2015)

# Changes in Form

- Does a change in form or domicile require the filing of an application for exemption?
- Revenue Ruling 67-390, 1967-2 C.B. 179, considered four situations, and held that all required the filing of an exemption application even though there was no change in purposes or operations.
  - Exempt trust reorganized and adopted a corporate form
  - Exempt unincorporated association incorporated under state law
  - Exempt corporation reincorporated by an Act of Congress
  - Exempt corporation reincorporated under laws of a different state

# Changes in Form (cont.)

- PLR 201446025: Organization changed its state domicile by the filing of Certificate of Conversion in former state and Articles of Domestication with new state.
  - No change in date of incorporation
  - Corporation remained, a new corporation was not created
  - Distinguished a merger into a new corporation

## Changes in Form (cont.)

- PLR 201426028
  - Organization originally formed by state legislature (public nonprofit corporation), legislation directed organization to file certificate of formation or conversion to become a nonprofit corporation under state law
  - Legislation specifically stated that corporate existence continued uninterrupted

## Changes in Form (cont.)

- PLR 201521017: 501(c)(6) organization reincorporated in another state. New exemption application required.
- New York City Bar Association has asked for guidance in this area
- IRS response to request: request more appropriately handled through a guidance project and should be placed on Priority Guidance Plan

# Changes in Situs or Form

- Interest of Attorney General in change of principal place of administration (situs) or form
  - The Terra Foundation for the Arts litigation involved the movement of the foundation to another jurisdiction. Buntrock v. Terra Foundation for the Arts, 810 N.E. 2d 991 (Ill. Ct. App. 2004).
  - The Maddox Foundation's changes in situs and form resulted in extensive litigation. State ex rel. Working v. Costa, 216 S.W.3d 758 (Tenn. Ct. App. 2006).

# State Law Statutes

- Unique Issues for Charitable Trusts
  - duPont cases (Delaware/Florida): Series of cases, primarily focused on State of Del. ex rel. Gebelein v. Belin, 456 So.2d 1237 (Fla. 1st DCA 1984), revolving around interests of Delaware and Florida in Mr. duPont's pre-1969 testamentary charitable trust and disputes among trustees.
  - Maddox case (Tennessee/Mississippi) (cont.)  
See discussion of FTC (above)

# State Law Statutes (cont.)

- **Membership issues**
  - Are there voting members or others entitled to vote on a transaction or change of form or domicile?
  - Membership approval processes – largely state law driven

## State Law Statutes (cont.)

- **Florida Uniform Prudent Management of Institutional Funds Act (UPMIFA): FS 617.2014**
  - Only applies to endowment funds (not charitable trusts).
  - Donor can consent to release of fund's restriction. However, donor cannot redirect property to another use by charity. Comment to Section 6(a).
  - If particular charitable purpose or restriction on use of fund becomes unlawful, impracticable, impossible to achieve, or wasteful and upon institution's application, court may modify fund's purpose or use restriction, consistent with charitable purposes expressed in gift instrument. Institution must notify Attorney General to give opportunity to be heard in court. Comment to 6(c).

# Tax Issues

- If merger or other transaction results in fundamental change in organization/trust or in significant disposition of assets, IRS requires reporting. See IRS Publication 4779, "Facts about Terminating or Merging Your Exempt Organization" (May 2009).
    - Disclosure generally on Form 990, 990-PF, 990-EZ, or 990-N
- Forms 990 include “termination” box in header on page 1
- Form 990: Check “Yes” to question whether organization liquidated, terminated, or dissolved (line 31 of Part IV) and, if applicable, to question whether organization engaged in significant disposition of net assets (line 32 of Part IV).
  - Form 990-EZ: Check “Yes” to question whether organization liquidated, terminated, dissolved or substantially contracted (line 36 of Part V).

Also, for all Forms 990, complete Schedule N (Liquidation, Termination, Dissolution, or Significant Disposition of Assets), which includes certified copy of articles of dissolution or merger, resolutions, and plans of liquidation or merger.

# Tax Issues (cont.)

- Transfers by Foundations to Other Foundations or to Publicly-Supported Charities and Donor Advised Funds (DAFs)
  - Formerly a more tedious process, with potential application of ominous termination tax under IRC 507.
  - Now relatively clear. See, e.g., Rev. Rul. 2002-28, 2002-1 CB 941 (to one or more private foundations that are related to the terminating foundation; need to review expenditure responsibility rules); Rev. Rul. 2003-13, 2003-1 CB 305 (to one or more publicly-supported charities – simplified process).
  - Termination tax generally avoided altogether if private foundation's assets transferred to publicly-supported charities in existence for five or more years. Rev. Rul. 2003-13.
  - Partial transfers possible as well, but a ruling is probably advisable. See, e.g., PLR 201244020.

# Tax Issues (cont.)

- **Unrelated Business Taxable Income (UBTI) Issues**
  - Generally becomes an issue in this context where tax-exempt organization wants to pursue for-profit activities
  - Possible to create taxable subsidiary to house those activities, particularly where they are “substantial” and might jeopardize exempt status
  - Also a consideration where activities give rise to potential liability
  - Complex issues and numerous exceptions that apply

# Various Duties of Directors & Officers of Not for Profit Corporation

- Duty of Care
- Duty of Loyalty
- Duty of Obedience

# Duty of Care

- Directors must discharge their duties with the care an ordinarily prudent person in a like position would exercise under similar circumstances. FS 617.0830 (based on pre-2008 Model Nonprofit Corporation Act).
- Model Nonprofit Corporation Act 8.30:
  - Directors must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.
- Change in focus of the Act: a reasonable belief that the director is acting in the best interests of the corporation. Standard not changed for officers.

# Duty of Care (cont.)

- UPMIFA provides that in addition to complying with the duty of loyalty, each person responsible for managing and investing an institutional fund shall manage and invest the “fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” FS 617.2014(3)(b).
- Similar standard for expenditure or accumulation of funds. FS 617.2014(4)(a).

- Duty of care requires each director:
    - To become appropriately informed about issues requiring consideration, and to devote appropriate attention to oversight; and
    - To act with the care that an ordinarily prudent person would reasonably exercise in a like position and under similar circumstances.
- Principles of the Law of Nonprofit Organizations, the American Law Institute, Tentative Draft No. 1, 2007 (“ALI Principles”) § 315).

# Duty of Care: Business Judgment Rule

- » A director who makes a business judgment in good faith satisfies his or her duty of care if he or she:
  - is not interested, directly or indirectly, in the subject of the business judgment and is otherwise able to exercise independent judgment;
  - is informed with respect to the subject of the business judgment to the extent he or she reasonably believes to be appropriate under the circumstances; and
  - reasonably believes that the business judgment is in the best interests of the charity, in light of its stated purposes.

ALI Principles § 365.

# Duty of Care: Business Judgment Rule (cont.)

- A doctrine that insulates directors for errors in judgment exercised in good faith, without bias or conflict, and with the rational belief that the particular decision is in the best interests of the organization. ALI Principles § 4.01(c) (Comment).
- FS 617.0830 addresses the business judgment rule.
- Mistakes in the exercise of honest business judgment do not subject directors to liability for negligence in the discharge of their fiduciary duties.

# Duty of Loyalty

- Generally prohibits directors and others from using their positions in an organization to further their own personal interests.
- Addresses self-dealing transactions, conflicts of interest, usurpation of corporate opportunities, and obligations of confidentiality.

## Duty of Loyalty (cont.)

- Requires adherence to conflict of interest policies and those state law processes requiring disclosure and approval by independent members of the board. See generally FS 617.0832.
- Failure to fulfill duty of loyalty may result in non-applicability of business judgment rule.

# Duty of Obedience

- A stand-alone duty or a subset of the duties of care and loyalty?
- The Revised Model Nonprofit Corporation Act does not recognize the duty but assumes that the duty is subsumed in the duties of care and loyalty. Not aware of any corporate state statute that expressly codifies such a duty.
- UPMIFA provides that, subject to the intent of a donor, an institution, in managing and investing an institutional fund, shall “consider the charitable purposes of the institution and the purposes of the institutional fund.” FS 617.2014(3)(a).

# Duty of Obedience (cont.)

- Requires directors and officers to ensure that the organization is operated in accordance with its governing instruments, and in compliance with applicable laws.
- Less clear is whether duty of obedience requires adherence to donor restrictions.

## Duty of Obedience (cont.)

- “It is axiomatic that the Board of Directors is charged with the duty to ensure that the mission of the charitable corporation is carried out. This duty has been referred to as the ‘duty of obedience’. It requires the director of a not-for-profit corporation to be ‘faithful to the purposes and goals of the organization,’ since [u]nlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives: perpetuation of particular activities are central to the *raison d'etre* of the organization.” Manhattan Eye, Ear & Throat Hospital v. Spitzer, 715 NYS2d 575 at 593 (1999).

# Duty of Obedience (cont.)

- Compliance with tax laws: “If an organization is operated for non-exempt purposes, the directors have violated their duty of obedience. Directors should have in place procedures and systems that are likely to assure compliance and enable them to monitor compliance appropriately.” Fishman & Schwartz, Nonprofit Organizations Cases and Materials at p. 222 (3d ed. 2006).

## Duty of Obedience (cont.)

- Delaware has not applied a duty of obedience to comply with laws out of a concern of explicitly making officers and directors responsible for compliance with non-corporate norms. However, Delaware courts have made clear that personal liability can attach only when officers and directors consciously disregard their duties, including the duty to monitor corporate illegality. Stone v. Ritter, 911 A. 2d 362 (Del. 2006).

# Standing Issues

- Because fiduciary duties are owed to the organization, there are restrictions on who may bring suit against directors and officers that allegedly have breached their fiduciary obligations.
- These claims are distinct from those alleging direct claims against the corporation, e.g., breach of a donor restriction brought directly by the donor.

# Standing Issues (cont.)

- » 3 classes of persons generally have standing (FS 617.0304(2)):
  - Voting members of an organization
  - Corporation, directly, derivatively, or through a receiver, trustee, or other legal representative, or through members in a representative suit, against an incumbent or former officer, employee, or agent of the corporation
  - Attorney General

# Standing Issues (cont.)

- Attorneys General: Generally authorized by states to enforce fiduciary obligations.
  - Queen of Angels Hospital v. Younger, 66 Cal. App. 3d. (1977) (hospital filed action for declaratory relief against Attorney General seeking to determine the validity of lease agreement with for profit corporation; hospital intended to use proceeds to operate outpatient clinics; court ruled that hospital could not abandon the operation of a hospital)
  - Attorney General v. Hahnemann Hospital, 397 Mass. 820 (1986) (Attorney General sought declaratory relief that hospital could not abandon the purposes set forth in its charter and to enjoin sale of hospital assets to a for profit corporation; hospital was largely funded with a gift from a charitable trust, the terms of which were reflected in hospital bylaws; hospital and its board would violate its fiduciary duties if they used funds for certain amended purposes)

# Standing Issues (cont.)

- Manhattan Eye, Ear & Throat Hospital v. Spitzer, 715 N.Y.S. 2d. 575 (2000) (requirement under New York law that hospital had to demonstrate that terms of transaction were “fair and reasonable” and that “purposes of the corporation...will be promoted” by sale of hospital; court analyzed the reasonableness of the terms of the transaction and consideration, reviewed the approval process and the information relied upon by the board, considered the independence of the strategic advisor and the board’s consideration of alternatives)
- Summers v. Cherokee Children of Family Services, Inc., 112 S.W. 3d (Tenn. Ct. App. 2002) (director’s duty to ensure operations further corporation’s public interest purposes is part of duty of loyalty; business judgment rule has no application to allegations that a corporation has abandoned any charitable purposes and had pursued private, rather than public, purposes)

# Standing Issues (cont.)

- Special relationships (limited)
  - College students, faculty and staff. Jones v. Grant, 344 So. 2d 1210 (Ala. 1977) (overruled by subsequent statutes)
  - Hospital patients. Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 367 F. Supp. 536 (D.D.C. 1973) (hospital patients brought a class action against trustees alleging self-dealing that resulted in higher charges and injury to hospital)
  - Charitable Trusts

Florida allows settlor of charitable trust to maintain proceeding to enforce charitable trust. FS 736.0405(3) ("others" with valid interest/standing may also enforce).

# Changes in Solicitation of Contributions Act (cont.)

- » **Solicitation of Contributions Act (FS 496.401 et seq.)**
  - Originally enacted in Florida in 1991, but substantially revised in 2014 (effective as of July 1, 2015) (for underlying reasons, see <http://www.nonprofitcpa.com/new-florida-law-tightens-rules-charitable-solicitation/>)
    - Has required registrations of charities or sponsors that intend to solicit in Florida since original enactment.
    - Recent changes require charities soliciting **from** Florida to register as well, regardless of whether soliciting Florida resident donors.
    - Enforcement mechanisms, including revocation in various circumstances, added to law.
    - Must notify Department of Agriculture and Consumer Services (DOACS) if organization ceases to solicit.

# Changes in Solicitation of Contributions Act (cont.)

- Informational changes
  - Must report “material change” within ten days if any leadership or employees convicted or incarcerated for fraud- and financial-oriented crimes.
  - Charity also must report if registration adversely affected (e.g., by court order) or any violation of charitable solicitation rules (e.g., by employee).

# Changes in Solicitation of Contributions Act (cont.)

- Financial statements
  - Organizations and sponsors must submit annual financial statement (or consolidated financial statement if chapters, branches, or affiliates).
    - Contributions between \$500K - \$1,000,000: CPA must review and/or audit.
    - Contributions > \$1,000,000: Audited financials required.
  - In lieu of financial statement, any charity may submit its IRS Form 990.
    - However, if contributions > \$500K, tax return must be prepared by CPA or “regular” preparer (ordinary course of business).
    - Query why failed to use “certified preparer” with PTIN (IRS).

# Changes in Solicitation of Contributions Act (cont.)

- Financial statements (cont.)
  - More detailed financial report required for charities that (a) spend less than 25% of annual expenses on program services or (b) solicit for disaster relief situations. FS 496.4071 - 496.4072.
  - Extension of 180 days permitted, but automatic expiration or revocation of registration if fail to file financial statement.

# Changes in Solicitation of Contributions Act (cont.)

- Conflict of interest policy
  - Now required by Florida law for every organization.
  - Must submit annual certification that policy in place as part of annual registration. FS 496.4055(2).
  - IRS provides sample conflict of interest policy on website, which is also provided via DOACS website:  
<http://www.freshfromflorida.com/Divisions-Offices/Consumer-Services/Business-Services/Charitable-Organizations> (right-hand column under “Forms > Additional Forms” – last bullet/item)

# Changes in Solicitation of Contributions Act (cont.)

- Professional fundraisers
  - Required to register. FS 496.404(21).
  - Now only permitted to enter into agreement with charitable organization or sponsor in compliance with revised rules. FS 496.409(4).
  - Cannot employ within 10 years anyone guilty of crimes mentioned above (under “Informational changes”). FS 496.409(9).
  - DOACS enforcement right to deny or revoke registration of professional fundraising consultant if he or she had similar registration revoked in any state, by court order, or by administrative process. FS 496.405(10).

# Changes in Solicitation of Contributions Act (cont.)

- Enhanced enforcement and penalties
  - Upon appropriate notice from law enforcement, court, or state attorney, DOACS must suspend registration or processing of application for same if registrant or applicant formally charged with one of crimes mentioned above (under “Informational changes”) until final disposition of case or removal/resignation of offending officer or director. FS 496.4191.
  - Now DOACS authority to remove organization’s sales tax exemption as penalty for violations of rules above. FS 496.430.
  - Administrative penalties increased to maximum of \$5,000 and \$10,000 if fraudulent/deceptive acts. Failure to file registration for charity remains \$500. FS 496.419(5)(f)-(g).

# Changes in Solicitation of Contributions Act (cont.)

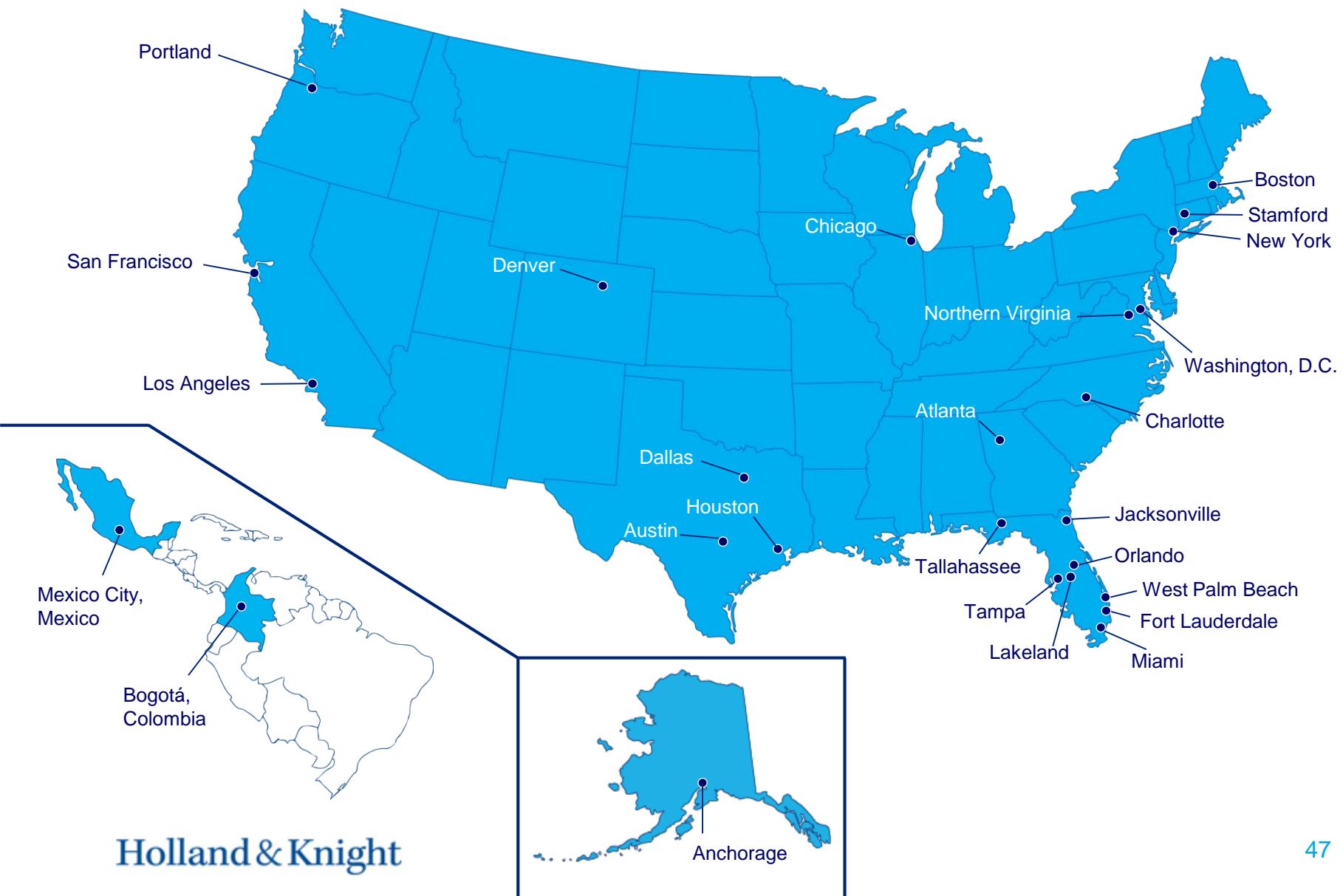
- Enhanced website
  - Updated DOACS website includes interactive database containing collected information on charities and sponsors called “Gift Givers’ Guide”:
  - <https://csapp.800helpfla.com/cspublicapp/giftgiversquery/giftgiversquery.aspx>
  - Link to Gift Givers’ Guide included on updated “Tips for Giving to Charity” page of DOACS website:
  - <http://www.freshfromflorida.com/Divisions-Offices/Consumer-Services/Consumer-Resources/Consumer-Protection/Publications/Giving-to-Charity>

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