

Nuts & Bolts of Nonprofit Board Service

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4:00-5:00*

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The Philadelphia Bar Association's Young Lawyers Division | Philadelphia Bar Foundation

BOARD OBSERVER PROGRAM

- Opportunity to observe a nonprofit Board
- Learn how nonprofit Boards operate
- Develop leadership skills
- Expand your professional network
- Add a unique perspective to the Board



Agenda

- Overview
- Due Diligence as a Prospective Board Member
- Corporate Governance
- Liability Protections



OVERVIEW



Pros and Cons of Serving on a Nonprofit Board

PROS	CONS
Improving current skills	Being asked to make legal decisions
Trying something new	Ethical considerations
Making personal and professional connections	Conflicts of Interest
Helping a meaningful cause	Time commitment



Due Diligence

- Understanding the organization:
 - *What form of entity is it? Nonprofit?*
 - *Does it have tax-exempt status?*
 - *What is its mission?*
- Documents to request:
 - *Copies of governing documents (Articles, Bylaws, policies)*
 - *IRS Form 1023*
 - *IRS Determination Letter*
 - *Most recent IRS Form 990*
 - *Recent financial statements*
 - *D&O Insurance Policy*
 - *Minutes Book*



Due Diligence (cont.)

- Questions to ask:
 - What position will you be filling?
 - What is the time commitment?
 - Is there a financial give or get?
 - Who are the other Board members and what is their background?
 - **MOST IMPORTANT:** What is your role?
 - Attorney
 - Director
 - Attorney-Director



Nonprofit vs. Tax-Exempt

- Nonprofit vs. for-profit
- Nonprofits under state law
 - No owners or shareholders
- To be tax-exempt, must apply to IRS



State Versus Federal

- State Level (Pennsylvania)
 - PA Attorney General
 - PA Orphans' Court
 - Exempt from state level taxes
 - Income
 - Sales
 - Property
- Federal Level
 - Internal Revenue Service
 - Exempt from most federal income tax





Tax-Exempt Organizations

- Section 501(c) describes many different types of organizations, including:
 - *501(c)(3) charitable organizations*
 - *501(c)(4) social welfare organizations*
 - *501(c)(6) business leagues*
 - *501(c)(7) social clubs*



Advantages & Disadvantages of 501(c)(3) Tax Exempt Status

Advantages of 501(c)(3) Status	Disadvantages of 501(c)(3) Status
Exempt from Federal (and PA) income tax	Time and money to obtain tax-exempt status
Ability to receive tax-deductible charitable contributions	Time and money to maintain tax-exempt status (including ongoing compliance)
Increased likelihood of obtaining grants from private foundations	Restrictions on amount of compensation that may be paid and public disclosure of same
Ability to receive tax-exempt bond proceeds	Transparency
Public perception – “halo effect”	Restrictions on certain activities
Usually required to obtain exemptions from certain state and local taxes	
Eligible for preferential postal rates	

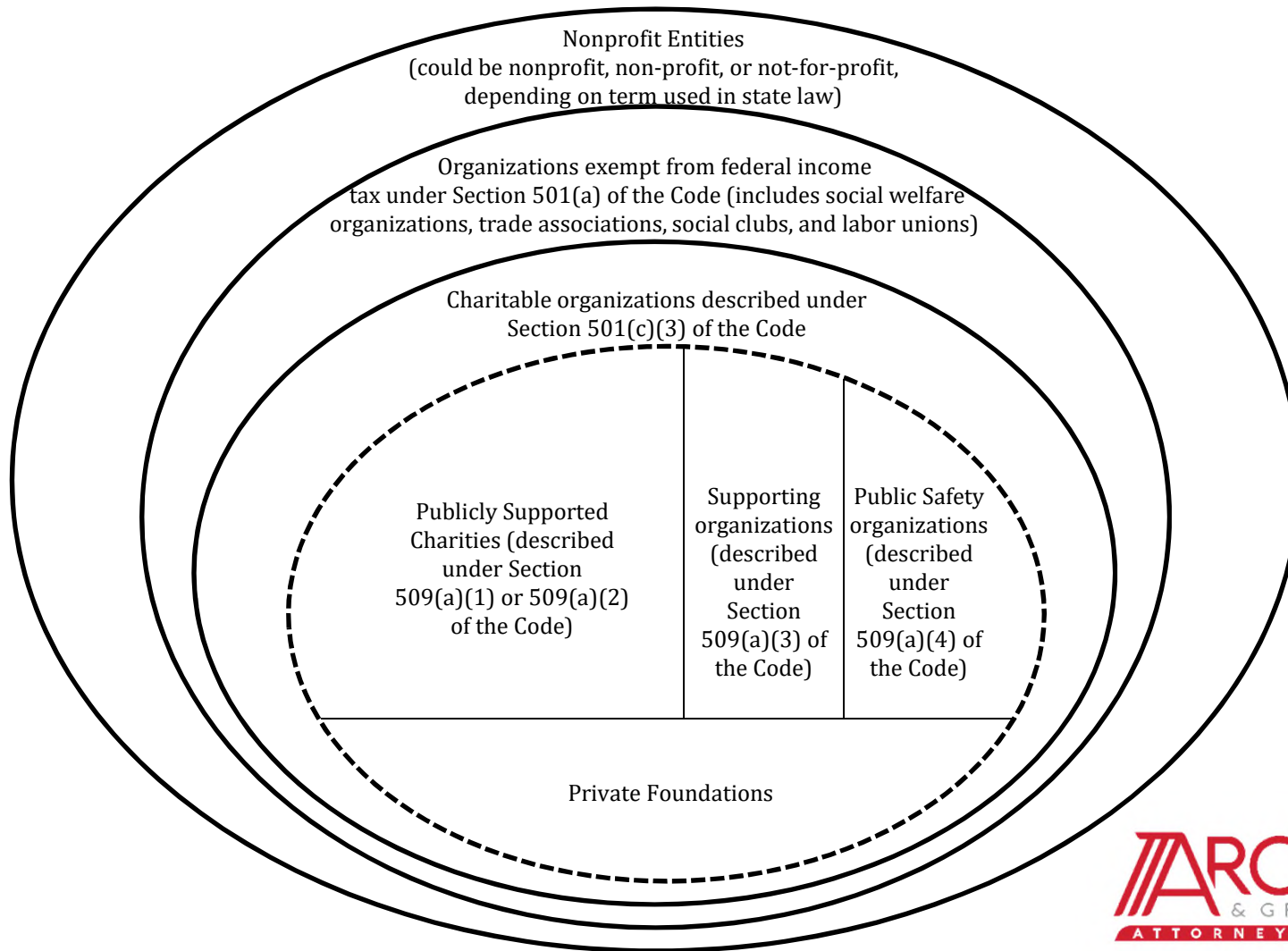


Within Section 501(c)(3)

- Private Foundation
 - Private Operating Foundation
 - Private Nonoperating Foundation
- Public Charity
 - Publicly Supported Charity
 - Supporting Organization



Universe of Nonprofit Entities





PA State Tax Exemptions

- **State Taxes:**

- Income Tax
 - Annual State Tax Return
- Sales and Use Tax
 - PA Department of Revenue, Form REV-72, Sales and Use Tax Exemption
- Property Tax
- Local Tax
- Pennsylvania Institution of Purely Public Charity
 - HUP Test / Act 55





DUE DILIGENCE AS A PROSPECTIVE BOARD MEMBER



Articles of Incorporation

- Primary Governing Document
 - Filed with the State (State lists what must be included)
 - Purpose
 - Legal structure
 - Membership
 - Important restrictive provisions



Bylaws

- Secondary Governance Document
 - Legally binding rules that regulate the operation of the organization
 - Not filed with the State, adopted by the Board
 - Provisions of the Articles will control if inconsistent
 - Classes of membership and rights
 - Board and Member meeting requirements and quorum/voting
 - Limited liability and indemnification



Bylaws: Role of Director & Officers

- Rules for Board members and Officers
 - Qualification
 - Election/Appointment
 - Number and Term
 - Removal/Resignation
 - Responsibilities and Powers



IRS Determination Letter

- Letter granting tax-exempt status to the organization
- “We have determined that you are exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code”
- Effective Date
- Based on what was submitted with IRS Form 1023 or 1023-EZ
- Can use the Employer Identification Number to obtain records on the IRS website

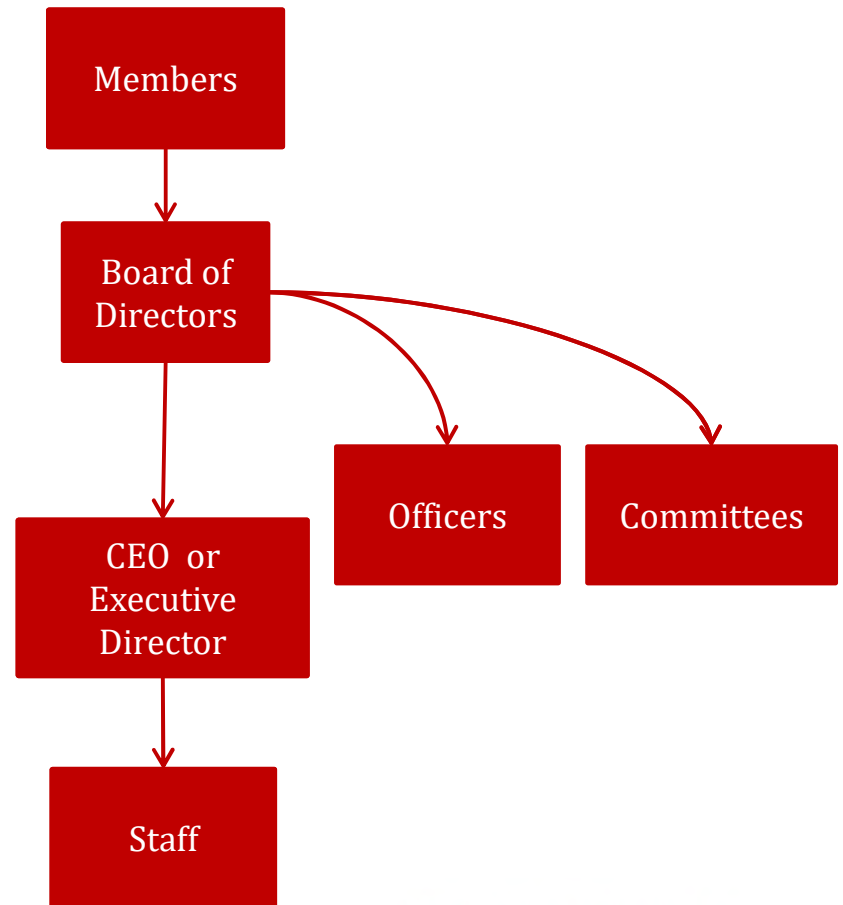


CORPORATE GOVERNANCE



Corporate Hierarchy

- Members?
- The Board reports to the members, if any
- The Board delegates to:
 - Committees
 - Officers
 - Chief Executive Officer or Executive Director
- ONLY the CEO or ED delegates to, or supervises, staff





Corporate Governance

- Board Meetings and Minutes
 - Notice
 - Quorum, Voting Rules
- Annual Board Meeting
 - Election of Directors
 - Review Policies
 - Financial Statements
- Board Manual
- Reporting Requirements
 - Annual Report



Minutes Book

- An organization should maintain (secured electronic or hard copy), a corporate record book with current, legible copies of the following:
 - Articles of Incorporation and any amendments and other filed reports
 - Current Bylaws
 - IRS determination letter
 - Application to the IRS for tax-exempt status IRS Forms 990 (and other federal tax filings) for the 3 most recent tax years
 - Copies of all state tax filings
 - Names, addresses, and terms of office of all officers and directors
 - Membership Organizations- List of current members and addresses
 - Minutes of all meetings of the members, Board, and committees
 - Insurance Policies
 - Contracts or Leases
 - List of contributors
 - Annual Reports (requirement starting January 2024)



Director Fiduciary Duties

- The Board is the governing body of the organization that is responsible for:
 - determining the organization’s mission, strategies, and program priorities;
 - ensuring the organization uses its resources only in fulfillment of its purposes as laid out in its Articles of Incorporation; and
 - ensuring compliance with local, state, and federal laws and regulations.
- No Director has the authority to act alone (decisions must be made by an act of the full board), but each Director has separate and independent fiduciary duties.



Director Fiduciary Duties: *Duty of Care*

- Directors should act in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- Directors must attend meetings and read the materials.
- Directors must make decisions based on their own independent judgment, not the opinions or judgments of the other Directors.



Director Fiduciary Duties: *Duty of Loyalty*

- Directors must demonstrate undivided allegiance to the organization and do what is reasonably believed to be in the best interests of the organization and not a Director's own self-interest or the interest of another entity or person.
- Directors must keep confidential information confidential and cannot use information for their own personal gain.
- Directors should avoid any conflicts of interest.
 - Any potential conflict must be disclosed.
 - The potentially conflicted Director should not participate in any vote regarding that conflict.



Director Fiduciary Duties: *Duty of Obedience*

- Directors should ensure that the organization is fulfilling its charitable mission and in compliance with all federal, state, and local laws.
- Directors must ensure that the organization acts in accordance with its own policies and does not engage in unauthorized or illegal activities.



LIABILITY PROTECTIONS



Internal Controls & Procedures

- Conflict of Interest
- Whistleblower
- Document Retention & Destruction
- Audit Procedures
- Gift Acceptance
- Code of Conduct
- Compensation
- Privacy
- Employee Handbook
- Harassment



Limitation of Liability

- Provided for in the PA Nonprofit Statute
- Typically also covered in the Bylaws, particularly if additional coverage is provided
- “Shall not be personally liable for monetary damages for any action taken or failure to take any action other than as expressly provided in the Pennsylvania Law.”
- “It is the intention of this Section to limit the liability of Directors of this Corporation to the fullest extent permitted by any present or future provision of Pennsylvania law.”



Indemnification

- “The Corporation shall hold harmless, defend, and indemnify Directors and officers to the fullest extent permitted by the Pennsylvania Law or any other present or future provision of Pennsylvania law.”
- Also typically in the Bylaws
- Good for recruiting new Board members
- Advancement of expenses



Directors & Officers Insurance

- Insurance policy to safeguard the Board and the organization for causes of action not covered by a general liability policy. An important benefit of D&O insurance is broad coverage for employment-related claims.
- Who is covered?
- In what circumstances are they covered?
- What is the limit?
- Advancing of expenses?



Attorney's Professional Liability Coverage

- Does it cover your Board service?
- Does it cover pro bono legal services provided?
- Locate any gaps that may exist between your coverage and the organization's D&O coverage.
- **Reminder:** the RPCs apply to attorneys working with nonprofits.



Volunteer Protection Act of 1997

- Provides limited immunity for volunteers serving nonprofits, but does not prohibit lawsuits against volunteers.
- Provides immunity in the following circumstances:
 - Volunteer was acting within the scope of his/her responsibilities.
 - Volunteer was properly licensed (if applicable).
 - The harm was not caused by willful, criminal or reckless misconduct nor gross negligence.
 - The operation of vehicles is not involved.
- There is no protection from employment-related acts, such as harassment or discrimination, the most often cited basis for lawsuits that name board members.
- No laws protect the organization itself.



Questions?

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