

RELIEF IN SIGHT FOR NEW YORK NONPROFITS WITH PROSPECT OF ADDITIONAL AMENDMENTS TO THE NONPROFIT REVITALIZATION ACT OF 2013

Tax-Exempt Organizations Alert
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Relief in Sight for New York Nonprofits with Prospect of Additional Amendments to the Nonprofit Revitalization Act of 2013

On June 16, 2016, the New York Legislature passed A10365-B approving further changes to the Nonprofit Revitalization Act (the “Revitalization Act” or “Act”), including major changes to the rules on independent directors and related party transactions. These substantive changes provide significant relief for some New York nonprofit corporations (“nonprofits”) and charitable trusts from the overburdensome requirements of the Revitalization Act, specifically aimed at correcting inconsistencies in the Revitalization Act and allowing for smoother and more efficient implementation of the Act. The amendments will not become effective unless Governor Cuomo signs the bill. He has until the end of the year to do so. If he does, the amendments would go into effect 180 days after the bill is signed.

The Revitalization Act first went into effect on July 1, 2014 and was amended on December 11, 2015. The December amendments implemented changes to the definition of “independent director” and other definitions regarding related party transactions. You can read more about the December 2015 amendments in our prior alert [here](#).

Amendments to the Role of the Independent Directors

Under current law, New York nonprofits (including not-for-profit corporations, religious corporations and educational corporations) need three or more independent directors, who are responsible for handling:

- Conflict of interest matters,
- Whistleblower policy matters, if applicable, and
- Audit matters, if applicable.

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Every New York nonprofit must have a Conflict of Interest Policy pursuant to the Revitalization Act. Only nonprofits with twenty (20) or more employees and annual revenues in excess of \$1 million must have a Whistleblower Policy. The audit matters set forth in the Act apply only to those nonprofits that are registered or should be registered with the Charities Bureau to solicit charitable contributions in New York and meet a particular financial threshold. The current financial threshold is gross revenues greater than \$500,000, which will increase to \$750,000 on July 1, 2017, and then \$1 million on July 1, 2021.

The June 2016 legislation provides that independent directors need not handle conflict of interest and whistleblower policy matters. As a result, the only nonprofits that will be required to have independent directors will be those corporations which have audit obligations under the Act. For other nonprofits, the board or any committee of the board (regardless of independence) would be able to oversee the conflict of interest and whistleblower policy matters. If the June 2016 legislation becomes law, this significant change will alleviate the burden many nonprofits have faced trying to identify and appoint independent directors.

Amendments to the Definition of Independent Director

Under the June 2016 legislation, the definition of “independent director” will change in several ways:

- The definition will continue to exclude persons such as employees of the nonprofit or its affiliates, persons receiving more than \$10,000 in compensation from the corporation or its affiliates, persons who work for the corporation’s outside auditor, and relatives of such persons.
- The most complex section of the definition of independent director would be revised. Currently this section excludes a director (or relative of a director) who is an employee of or has a substantial financial interest in an organization that has provided payments to or received payments from the corporation or its affiliate if a threshold amount is met, unless an exception applies. The result of this section has been, for example, that a person such as a banker or attorney might not be deemed an independent director because of payments made by the nonprofit to the bank or law firm. The June 2016 amendment would change this section in several ways, including new exceptions. This would result in fewer directors being excluded from the definition of independent director.
- Just as the law provides today, the June 2016 amendments would continue to allow nonprofit directors who fail to meet the independent director test to nevertheless handle many of the votes that come before a nonprofit board. Only the specific matters that the Act relegates to independent directors must be handled by directors meeting that test.

Other Amendments

The June 2016 legislation, if enacted, will also make the following changes, among others:

Related Party Transactions: The Revitalization Act imposes certain requirements when a nonprofit is considering a transaction with a related party such as a director, officer or other key individual. Essentially, a related party transaction must be approved in a specified manner and based upon certain findings about the appropriateness of the proposed transaction. The June 2016 legislation would make clear that a Board committee may approve a related party transaction and would create three exceptions to the definition of related party transaction: (1) an exception for a *de minimis*

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transaction or where the related party's interest is *de minimis*, (2) a transaction not customarily reviewed by the board in the ordinary course of business if the transaction is available to others on similar terms, or (3) a transaction that provides a charitable benefit to a related party as a member of a class of persons that the corporation assists as part of its mission where the benefit is available to others on similar terms. In addition, if a corporation fails to take the necessary steps to preapprove a related party transaction, the June amendments would allow ratification after the fact under certain conditions. The June amendments would also bring under the related party transaction rules a transaction with a "key person", as opposed to the current "key employee" language.

Disclosure of Possible Conflicts of Interest: The Revitalization Act required all nonprofits to adopt a Conflict of Interest Policy, which must include certain procedures. The June 2016 legislation would expand these requirements to require nonprofits to include procedures to disclose *possible* conflicts of interest and procedures for the board or committee to determine whether a conflict exists. The current law requires only procedures for disclosing an actual conflict of interest.

Appointment of Board Committee Members: The June 2016 amendments make clear that the Board must appoint members of Board committees and, as to the appointment of Executive Committee members, the Board will need to approve the appointment by at least a majority of the entire Board, but for boards of 30 or more directors, the appointment must be approved by a three-fourths vote of the directors present at a meeting, a quorum being present.

Ex-Officio Committee Members: The June 2016 legislation would implement a clarification to expressly permit directors who hold certain positions in the corporation to be *ex-officio* members of committees. Thus, for example, a director who is the CFO could automatically be a member of the Executive Committee by reason of being the CFO. The by-laws will need to make clear whether the person does or does not have voting rights on the committee, because the term *ex officio* does not govern voting rights, contrary to popular belief.

Authority of Board Committees. Current law allows the Board to delegate most of its powers to an Executive Committee or other Board committee, but there are five items that cannot be delegated (for example, the amendment of by-laws). The new legislation will expand the list to nine items that cannot be delegated (for example, a vote to remove an officer or director).

Members of Non-Board Committees. Current law allows the Board to create committees of the corporation, whose members need not be directors. An example would be a Fundraising Dinner Committee. The June 2016 amendments would strike the provision that says members of such non-Board committees are subject to the same provisions as corporate officers.

Prohibition on an employee serving as Chair: Current law provides that, starting January 1, 2017, no employee of the corporation may serve as Chair or hold any other title with similar responsibilities. The new legislation would allow an exception to this rule if approved by a two-thirds vote of the entire board. The new two-thirds vote exception would take effect on January 1, 2017, without a 180-day delay like the rest of the bill. Another pending bill approved by the Legislature in June 2016 and awaiting the Governor's signature, A10555, would delay the effective date of the no-employee-as-chair rule until January 1, 2018.

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Who votes on whistleblower policy matters: The June 2016 legislation would prohibit any director who is an employee of the corporation from participating in board or committee deliberations or voting related to a whistleblower policy matter. In addition, the legislation would require that a nonprofit's whistleblower policy include a requirement that the person who is the subject of a whistleblower complaint not be present at or participate in a board or committee deliberations or vote on the matter. However, the person would be allowed to present information to or answer any questions of the board or committee in advance of deliberations and voting.

Need Assistance?

The Revitalization Act came into effect on July 1, 2014 and brought about major changes for all New York non-profit corporations, including education corporations and religious corporations, as well as New York charitable trusts. As a result, we have assisted our non-profit clients with updating their By-Laws, adopting new Conflict of Interest and, in some cases, Whistleblower Policies, analyzing which directors meet the "independent director" definition, implementing applicable audit oversight obligations and taking other steps required by the Revitalization Act.

If your New York non-profit organization has not yet become compliant with the Act including the December 2015 amendments, please contact us to discuss the necessary steps. We are ready to assist clients with all aspects of the Revitalization Act and amendments. Please feel free to contact the attorneys listed below.

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