

Henderson & Caverly Pum Charney LLP

EXEMPT ORGANIZATIONS NEWSLETTER

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NONPROFIT CORPORATIONS: BOARD AUTHORITY AND FIDUCIARY DUTIES

Persons serving on boards of directors of California nonprofit corporations are often unaware of the authority held by the board and the duties each director owes to the organization they serve.

Pursuant to the California Corporations Code (the "Code"), the board of directors exercises, or directs the exercise of, all corporate powers, subject to member approval where required. (Code §§[5120](#), [7210](#), [9210](#))



The authority of the board is tempered by the fact that all decisions are made collectively by all members of the board. In addition, all decisions of the members of the board are made in light of four primary fiduciary duties owed by all directors to the organizations they serve. Those duties are as follows: (1) the duty of care; (2) the duty of inquiry; (3) the duty of loyalty; and (4) the duty to follow investment standards.

1. The Duty of Care.

The standard of conduct for directors of nonprofit public benefit corporations is set forth in Code §[5231\(a\)](#), which provides as follows: "A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

2. Duty of Inquiry.

The director's obligation to make reasonable inquiry is derived from Code §[5231](#). This duty provides that directors cannot close their eyes to the activities of the organization and, if they are put on notice by the presence of suspicious circumstances, they may be required to make such reasonable inquiry as an ordinarily prudent person would make under similar circumstances. In fulfilling their duty of inquiry, directors may obtain the services of and rely upon opinions, reports or other information prepared or presented by any of the following:

- One or more officers or employees of the corporation whom the directors believe to be reliable and competent in the matters presented;
- Counsel, independent accountants, or other persons on matters which the director believes to be within such person's professional or expert competence; and
- A committee of the board upon which the director does not serve, as to matters within the committee's designated authority, which committee the director believes to merit confidence. If a director has a reason to doubt information that he/she is being supplied, the director owes a fiduciary duty to inquire further into those matters. Such duty may be exercised by the board

through the retention of experts to assist the directors in verifying the information supplied, obtaining additional information, and analyzing the matters to which the information pertains.

3. Duty of Loyalty.

Directors must act in a manner that they believe to be in the best interest of the corporation. (Code §§ 5231, 7231, 9241) Where the organization does not have a membership that is served by the organization, the directors must strive to advance the organization's charitable purposes. The duty of loyalty includes a duty to avoid conflicts of interest between the directors individually and the corporation.

4. Duty to Follow Investment Standards.

This fiduciary duty applies to investment assets held by public benefit corporations, the assets of which are held in charitable trust. Code § 5240 sets forth the following applicable standards:

- Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital;
- Comply with additional standards, if any, imposed by the corporation's articles, bylaws, or the express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation; and
- In carrying out their investment duties, a director must comply with the duties of due care and reasonable inquiry, may rely upon others, and may delegate its investment powers as permitted by Code § 5210.

In addition to the duties mentioned above, directors of applicable organizations are obligated to use funds and assets, including but not limited to endowment funds, in accordance with the provisions of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). (California Probate Code §§ 18501-18510)

Directors of nonprofit and religious organizations are encouraged to learn more about the duties under which they operate and the standards to which they are held.

NONPROFIT ADMINISTRATIVE DISSOLUTION

With the enactment of Assembly Bill 557, the FTB began administratively dissolving nonprofit corporations that:

- The FTB suspended or forfeited for more than 48 continuous months.
- Are no longer in business.
- Have not filed returns with the FTB for 4 or more years.
- Have not filed a Statement of Information with California Secretary of State ("SOS") for 4 or more years.



What will be done?

Prior to such automatic dissolution, the FTB will mail a contact letter to selected nonprofit corporations informing them of the pending administrative dissolution to the last known valid mailing address. A list of the organizations facing pending administrative dissolution will be posted on the California SOS's website. A list will also be provided by the Attorney General's Registry of Charitable Trusts. If a corporation does not have a known valid mailing address, notification will only occur by the posting on the SOS website.

Corporations will have 60 days to object in writing to the pending administrative dissolution.

What happens if the corporation objects?

If the corporation objects in writing during the 60 day notice period, then it will have 90 days from the date of the written notice to pay any owed taxes, penalties, and interest and file any missing returns and a

current Statement of Information with the SOS. If the corporation does not complete these requirements, it will be administratively dissolved/surrendered at the end of the 90 day period. The FTB has the authority to grant one 90 day extension.

If a nonprofit is automatically dissolved pursuant to these procedures, the liabilities owed to any creditors of the nonprofit will not be discharged, and the dissolution will not impact the ability of the Attorney General to enforce any liabilities with respect to the corporation or its directors as provided by law. Similarly, liabilities of the director or persons related to the administratively dissolved or surrendered nonprofit corporation do not discharge. However, upon administrative dissolution or administrative surrender in accordance with § 5008 of the California Corporations Code, the nonprofit corporation's liabilities for qualified taxes, interest, and penalties as defined in § 23156 of the California Revenue and Taxation Code, if any, shall be abated.

The FTB noted that additional information will be made available on its [Charities and Nonprofits webpage](#) to provide guidance to nonprofit corporations on the administrative dissolution process as procedures are developed.



Reporting Nonprofit Organizations that Receive Public Resources and Engage in Campaign Activity

Effective January 1, 2017, the oversight of "reporting nonprofit organizations" that engage in campaign activity was moved from the Franchise Tax Board ("FTB") to the Fair Political Practices Commission ("FPPC"). The term "reporting nonprofit organizations" was changed to "publicly funded nonprofit organization," which is defined as a nonprofit organization for which public resources from one or more local agencies account for more than 20% of the nonprofit organization's annual gross revenue in the current fiscal year or either of the previous two fiscal years. Under [AB 2318](#), certain publicly funded nonprofit organizations are required to register as recipient committees and to file campaign statements (See registration and reporting requirements of California Government Code § [84222](#)). This act shifts the FTB's authority and duties to the FPPC and authorizes the FPPC, in addition to the Attorney General or the district attorney, to impose the monetary civil penalty of up to \$10,000 against a publicly funded nonprofit organization. FTB form 3589, Nonprofit Organization Report of Funds Received and Used for Campaign Activity will no longer be filed with FTB. Check for possible changes in filing requirements with the FPPC at fppc.ca.gov.

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