

Henderson Caverly & Pum LLP

NONPROFIT ORGANIZATIONS NEWSLETTER September 2019

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 §§[5210](#), [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. If you have questions regarding board authority or fiduciary duties, please [contact us](#).

IRS Compliance Guide for 501(c)(3) Charities

The IRS offers [Publication 4221-PC](#) as a compliance guide for Internal Revenue Code Section 501(c)(3) charities. The compliance guide offers information on the following:

- Activities that may jeopardize a charity's exempt status.
- Federal information returns, tax returns or notice that must be filed.
- Recordkeeping..
- Governance considerations.
- Changes to be reported to the IRS.
- Required public disclosures.
- Resources for public charities.



To learn more about compliance rules and procedures that apply to public charities exempt from federal income tax under section 501(c)(3), see IRS [Publication 557](#), Tax-Exempt Status for Your Organization, and the IRS' [Life Cycle of a Public Charity](#).

If you have concerns about compliance matters for your charitable organization and desire assistance, please [contact us](#).

Is Your Entity In Good Standing with the Franchise Tax Board?

COMPLIANCE



You may use the Franchise Tax Board's online [portal](#) to check the status of your nonprofit organization. The FTB allows organization's to perform an entity status check and generate an entity status letter. You may search the FTB's [portal](#) using the entity's name or entity identification number.

An entity status letter verifies whether or not an entity is in good standing with the FTB and provides certification for:

- Verification of an organization's exempt status.
- An outstanding liability that could have an effect on an entity's credit rating.
- Legal status in court proceedings.
- Registering a corporation to transact business in another state.

The FTB's entity status portal does not reflect the entity's status with other agencies.

When your business has been [suspended](#) or forfeited, it is not in good standing and loses its rights, powers, and privileges to do business in California.

If you need assistance in determining your organization's status with the FTB, please [contact us](#) for assistance.

MEETING THE NEEDS OF NONPROFITS



The laws governing nonprofit organizations are becoming increasingly complex and specialized. Our attorneys and paralegals are experienced in advising and guiding nonprofit organizations through all stages of development and [business needs](#). Whether you are forming a new nonprofit organization or working for an established organization, our [Nonprofit Organizations Group](#) can assist your organization with its legal needs.

Contact the [Chair](#) of our Nonprofit Organizations Group, [Jon Grissom](#), to discuss formation of a charity or legal needs for your existing organization.



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