

Basics of Nonprofit Corporation Law (The Class You Missed in Law School)

by Bruce Olson

Introduction

Most Utah lawyers at some point have a “nonprofit” practice – their clients don’t always pay them. This article, however, is not about collection frustrations but rather summarizes selected state law and tax features of nonprofit corporations, an area of law that every Utah lawyer will experience, even if it is not a part of daily practice. We will examine certain concerns for practitioners who represent or sit on boards of nonprofit corporations. A supplementary review of additional features of Utah nonprofit corporations, including definitions, state law, tax incidents, and matters of organization and operation can be found at the end of this article.

State laws and tax exemptions relating to nonprofit corporations can be complex. Attorneys who hold themselves out in this area of law must be conversant with a vast number of statutory, regulatory, and administrative rules. This article is intended to assist attorneys who do not routinely practice in this area but who, for example, may be asked by a client to advise a favorite charity or who sit on a nonprofit board. For ease, “NPC” means “nonprofit corporation” and “Act” means the Utah Revised Nonprofit Corporation Act.

Critical Purposes of NPCs

NPCs, often referred to as NGOs or nongovernmental organizations, form a “third sector” of society in addition to for profit and governmental organizations, and include corporations, trusts, pass-through entities, and unincorporated associations, although most are formed as corporations (emphasized in this article). The law of NPCs includes both corporate and tax principles integral to formation, operation, and dissolution. Nonprofit practice in the Utah State Bar is associated with the Nonprofit, Tax, Estate Planning, and Business Sections.

NPCs serve as a foundation for virtually all societal needs from

arts to zoos and every purpose and condition in between. They are the principal vehicle to receive and deploy charitable contributions, provide opportunities for altruistic service, and administer voluntary care. While the names of community NPCs are familiar to most, their functions and limitations are often misunderstood. For example, nonprofit corporations can operate businesses and make a profit (although the destination of net income is limited), not all NPCs are tax-exempt, and not all tax-exempt NPCs are public charities. (What seems to be universally understood, however, is the expectation that attorneys should give NPCs free or reduced fee legal advice!)

Caution in Attorneys’ Multiple Roles

Attorneys are often appointed to NPC boards, where they can receive fulfillment through service and giving back. However, some cautions are in order. First, lay board members may naively look to the attorney board member for legal advice on almost any subject, a condition requiring attorneys to know their limitations and avoid providing more advice than they are competent to dispense.

More fundamentally, an attorney serving on a board must make clear in what capacity he or she serves and the effect of statements he or she makes. Thus, if an attorney serves only as a board member and not legal adviser, the board should be made aware and refrain from seeking legal advice. That attorney’s statements should not be viewed as *legal* advice, nor would the attorney-client

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privilege likely attach to those expressions.

On the other hand, if the attorney is acting both as board member (or officer) and legal adviser, the attorney should recognize what “hat” the attorney is wearing when he or she speaks. For example, if the attorney is giving legal advice, the minutes and notes of board meetings should specifically reflect that those statements constitute legal advice, protected by the attorney-client privilege. Any writings containing legal advice (including emails) similarly should be so classified. Attorneys should instruct boards about these principles.

Essential Governmental Filings

Double check the following:

Corporate Registration

Utah’s NPCs obtain and renew their “charter” by registering with the Division of Corporations. Utah Code Ann. §§ 16-6a-203(1), -1410(2). A suspension for failure to file an annual report can be remedied by reinstatement within two years, while a suspension exceeding two years results in complete termination of the charter, loss of the corporate veil, and potential loss of tax exemption. *Id.* § 16-6a-1412(1).

Charitable Solicitation Permit

Utah law requires NPCs that solicit charitable contributions to obtain a permit, initially and annually thereafter, from the Utah Division of Consumer Protection and imposes potentially significant civil and even criminal penalties for failure to do so. Utah Code Ann. §§ 13-22-1 to -23. If this requirement has been overlooked, resolve the delinquency with the division. Penalties may be waived in the absence of bad faith or intent to harm the public. *Id.* § 13-22-3(5)(b).

Tax Filings

Determine through tax advisors the organization’s eligibility for exemptions from income, sales, property, and other taxes and ensure that exemptions have been received and requirements satisfied, including the filing of income tax or information returns where required. Failures to file or pay (if due) can lead to sizeable, penalties (an amount per day!) and interest, and eventual loss of income tax exemption. Be absolutely sure that the NPC is withholding employee income taxes where due, as willful failure

in this regard can lead to personal liability of persons with the duty, status, and authority to withhold and pay. Personal liability also arises for failure to collect and pay state withholding and sales taxes (among others). Utah Code Ann. § 59-1-302. Note also that § 501(c)(3) organizations are not subject to the Federal Unemployment Tax Act. 26 U.S.C. § 3306(c)(8).

Ex Officio Directors

Bylaws of many NPCs provide for the appointment of “Ex Officio Directors,” a widely misunderstood term. In some cases, the term describes a director whose status relates to an officerial or leadership position held inside or outside of the NPC. The position may or may not come with voting rights, and the bylaws typically do not specify. Such a person with voting rights would be considered a regular director, whose presence is counted in determining a quorum. In other cases, the NPC confers the title to honor or recognize a person, who usually does not have voting rights and is not counted in determining a quorum. The presence of such a person in a board meeting or email thread, a non-director in substance, could jeopardize the attorney-client privilege if that person receives confidential communications or documents. It is essential that bylaws clearly define the rights and duties of ex officio directors with these cautions in mind.

Size and Involvement of Board

The size of an NPC board should consider the needs and circumstances of the NPC. Often, that determination may have been made in the distant past and not recently reviewed. For example, a board should be large enough and have members with sufficient expertise to adequately address the needs of the organization. A board of three for a multinational NPC is probably too small. On the other hand, fifteen board members for a small NPC is likely unwieldy, inefficient, and detrimental to proper management of the organization.

Related to this concern is whether board members are actively engaged in their duties. For example, if the board is very large and there are members who only occasionally attend a meeting, a quorum may be difficult to achieve, and the business of the NPC may be thwarted (not to mention the ire of directors who traveled far). A large board can also act through written consent, discussed below.

Update Articles and Bylaws

Many NPCs operate with organizational documents that have not been updated (or sometimes read) for months or years. You should examine both documents, including amendments, and be alert for the following, which may warrant action.

Articles of Incorporation

Some older articles of incorporation have an expiration date, so be sure that date has not passed. Also, note that the requirement to include “Inc.,” “Co.,” or similar abbreviations in the name of for profit corporations, Utah Code Ann. § 16-10a-401(1), does not apply to an NPC, and those references can be deleted to minimize the name’s commercial hue. *Id.* Further, because the articles must contain only the minimal information set forth in section 16-6a-202, eliminating unnecessary paragraphs such as principal office, duration, powers, and board governance matters usually addressed in the bylaws will help simplify them. On the other hand, the articles should contain additional provisions if required by the Act (e.g., delegating board duties to non-directors, *id.* § 16-6a-801(2)(b), or where longevity or direction is desired, such as restrictions in appointment of directors, procedures to amend the articles, or director liability limitations, (see, e.g., *id.* § 16-6a-823(1)(a)(i)(A).

Bylaws

NPC bylaws are the “workhorse” for corporate governance and management provisions. The content and length should be adequate for the size and scope of the NPC’s purpose and operations. You can find boilerplate bylaws provisions from many sources, but they should be customized for the needs of the NPC. Most importantly, bylaws should be read, understood, and followed by the board of directors (in far too many cases they are seldom referred to).

Deadlines for Governmental NPCs

Be aware of requirements imposed on NPCs by the 2017 Governmental Nonprofit Corporations Act, Utah Code Ann. §§ 11-13a-101 to -106. NPCs that are owned, controlled, or receive requisite support from a governmental entity are classified as “Governmental Nonprofit Corporations” and are subject to Utah’s Open and Public Meetings Act, Utah Code Ann. §§ 52-4-101 to -305, Fiscal Procedures for Interlocal Entities, *id.* §§ 11-13-501 to -532, and the Government Records Access and Management Act, *id.* §§ 63G-2-101 to -901. In addition, board members of such entities must complete certain

training by the state auditor. New board members must undergo the training within six months of appointment or re-appointment. *Id.* § 11-13a-106. Failure to complete the training potentially could result in a board member’s disqualification.

On or before July 1, 2019, “limited purpose entities,” which include the above governmental NPCs, must register and annually provide certain information to the office of the Utah Lieutenant Governor, tasked to compile a registry of such entities (and provide information about certain changes within thirty days of occurrence). Utah Code Ann. § 67-1a-15. Also, beginning July 1, 2019, counties are required to include on their websites information from the registry about such entities operating within their boundaries. Utah Code Ann. § 17-15-32(2).

Failure to meet the foregoing requirements can result in sanctions and disqualifications enumerated in the respective code sections. Practitioners should be aware of these provisions and counsel their governmental NPC clients accordingly.

Minimizing Liability

You should educate your clients about risks that could jeopardize an NPC’s ability to fulfill its nonprofit purposes and should help the NPC minimize, avoid, transfer, or eliminate those risks.

Liability to Third Parties

As a general rule, the directors, officers, employees, and members of an NPC are not personally liable in such capacities for the acts, debts, liabilities, or obligations of the NPC. Utah Code Ann. § 16-6a-115. Exceptions include circumstances where a party assumes liability, such as a guaranty; fails to properly collect and withhold certain federal or state taxes; or, in other circumstances, is personally culpable for an act or omission from which liability may rest, such as motor vehicle negligence. Moreover, a director who votes for or agrees to a distribution of property in violation of the Act or the NPC’s articles of incorporation can be personally liable to the NPC for the amount of the distribution that exceeds what could have been distributed without the violation. *Id.* § 16-6a-824(1)(a). Also, a director or officer who agrees to or participates in a loan by the NPC to a director, officer, related person, or entity is quite appropriately liable to the NPC until the loan is repaid. *Id.* § 16-6a-825(3)(b).

Liability to the NPC

Directors or officers are not liable to the NPC, its members, any conservator, receiver, assignee, or successor in interest for any action or failure to act unless the director or officer breaches or fails to perform the duties of office through gross negligence, willful misconduct, or an intentional infliction of harm on the NPC or its members. In effect, this provision limits action against a director or officer unless the conduct arises to the level of gross negligence. *Id.* § 16-6a-822(6). Even further, an NPC may eliminate or limit the liability of a director to the NPC or its members for any action or failure to act if there is a provision in the articles of incorporation, bylaws, or a resolution to that effect. This protection does not reach circumstances where the director receives an improper financial benefit, intentionally inflicts harm on the NPC or its members, intentionally violates criminal law, or receives an unlawful distribution. *Id.* § 16-6a-823. Every NPC would be prudent to include this provision in one of the specified documents.

Liability Protection for Acts of Volunteers

Utah law provides generally that NPCs described under 26 U.S.C. § 501(c) are not liable for the torts of their volunteers in certain circumstances. For example, unless the NPC was reckless or wanton in allowing the volunteer to provide services, it is not liable if the volunteer intentionally acts in a way that constitutes illegal, willful, or wanton misconduct. Moreover, an NPC is not liable for the torts of a volunteer if a business employer, in the same circumstances, would not be liable for the torts of an employee. Utah Code Ann. §§ 78B-4-102, -103; *see Glover ex rel. Dyson v. Boy Scouts of Am.*, 923 P.2d 1383, 1389 (Utah 1996) (requiring establishment of vicarious liability under doctrine of respondeat superior); *see also* Alex G. Peterson, *Recent Development, Liability Protection for Volunteers and Nonprofit Organizations*, 119 Utah L. Rev. 273 (1991).

Liability Protection for Volunteers

An NPC can encourage volunteer service (including directors) and increase volunteers' comfort level through indemnification provisions that include "agents" of the NPC. Further, Utah Code Sections 78B-4-101 to -103 provide immunity to volunteers of tax-exempt section 501(c) NPCs if certain conditions are satisfied, including that the organization has "provide[d] a financially secure source of recovery for individuals who suffer injuries as

a result of actions taken by the volunteer on behalf of the nonprofit organization." Utah Code Ann. § 78B-4-102(2)(c). The source of recovery is typically "an insurance policy in effect that covers the activities of the volunteer and has an insurance limit of not less than the limits established under the Utah Governmental Immunity Act in Section 63G-7-604." *Id.* § 78B-4-101(1)(a).¹ Boards of NPCs, especially NPCs with limited assets to satisfy potential claims, would be wise to consider securing insurance coverage that meets the required limits.

Insurance

Every NPC should have adequate insurance for all potential risks that may be incurred. Before accepting service as a board member for an NPC, an attorney is well advised to ensure that the NPC has liability insurance covering directors (typically known as "errors and omissions" or "directors and officers" insurance). Also, a review of other coverage applicable to the activities and needs of the NPC should be made and acted upon. Attorneys should also review their malpractice insurance policies to determine whether service on an NPC board is permitted, and if so, whether disclosure of that appointment is required by the carrier.

Committees

NPCs often have one or more committees of the board that perform duties for the board and are accountable to the board. It is important that the bylaws of the NPC carefully describe the rights and duties of committees. These committees possess whatever authority the board may grant to them, other than for major corporate actions, but only if the committee has two or more members and each voting member of the committee is a director. *Id.* § 16-6a-817. NPCs sometimes overlook this rule, especially with an executive committee, and discover that certain actions taken may be subject to a challenge, or later require unanticipated board ratification.

Simplified Written Consent

Board informality and distance sometimes encourage approval of board actions through casual email exchanges. Attorneys should ensure that their clients follow the requisite formalities that will make board action immune from legal challenge. The Act was modified in 2015 to simplify approval of resolutions by consent outside of a meeting. Under section 16-6a-813, action is taken when all board members (i) receive appropriate notice,² (ii) timely

sign a writing approving the action or sign a writing against the action, abstain in writing from voting, or fail to respond or vote; and (iii) fail to demand in writing that action not be taken without a meeting. Writings include electronic transmissions. This provision is as liberal as most all other nonprofit acts in the nation and will assist attorneys to streamline actions by their NPC boards.

Minutes and Records

It is essential for NPCs to keep accurate minutes of board meetings, and even committee meetings. Leading in most discovery requests and tax agency examinations are requests for NPC minutes, often a trove of useful information, which may include unfiltered attorney-client communications, harmful admissions, and fragmentary statements inviting scrutiny. Casual expressions or jokes can also be taken the wrong way and harm an NPC.

At a minimum, board meeting minutes should note directors and other persons who attend a meeting, the outcome of each vote taken (noting those for or against an action and abstentions), conflicts of interest and substantiation when approved (including establishing a “rebuttable presumption of reasonableness” in approving salaries and certain payments to avoid “excess benefit transaction[s]” under Internal Revenue Service regulation, 26 C.F.R. § 53.4958-6), and directors that did not vote or were absent for a discussion or vote. Minutes also should block disclosure of attorney protected communications, note convening of “executive sessions,” and should be approved by the board.

Federal Tax Requirements

Supplementary material at the end of this article addresses several requirements to secure and maintain an NPC’s federal tax exemption, including requirements under 26 U.S.C. § 501(c)(3). Space prohibits a more detailed discussion of those imperatives, but a few general reminders may be useful. First, attorneys unfamiliar with the tax area should advise the NPC board to seek assistance from others versed in tax compliance matters, whether inside or outside of the NPC. Second, all national, state, and local tax filings should be accurate, complete, and timely filed. Third, the board should be taught minimal tax requirements, review annual tax or information returns, and ask questions for understanding. Fourth, to minimize noncompliance, the NPC should promote preventative measures by, for example, periodically conducting tax compliance reviews and managing tax checklists, similar to the example checklist at the end of this article.

NPCs that file IRS Forms 990 should be aware of best practices relating to that form. Over a decade ago, the IRS began asking questions on Form 990 about state law governance matters (and has been criticized among quarters of the professional community for its delving into those matters). Although NPCs that do not respond in the affirmative to state law-related questions on Form 990 are not likely subject to a higher risk of tax audits, they should strive to meet best practices addressed by the questions on Form 990.

For example, question 11 in Part VI, Section B of Form 990 asks if the organization’s board was provided a copy of Form 990, a wise step even if the IRS did not recommend it. Section B of Part VI asks if the organization has the following written policies: (i) conflict of interest; (ii) whistle blower; and (iii) document retention and destruction, and inquires if the organization has a process to determine compensation for management officials (e.g., executive director). As their attorney or board member, you should ask about these questions and their answers, and if policies are desired, assist the NPC in adopting them.

Conclusion

NPCs and the hosts of their directors, officers and volunteers are an integral component of society and make essential contributions to the welfare of Utah citizens. As a favored class, NPCs deserve the exemptions, benefits and support given them. Although this area of law is somewhat complex and unfamiliar to many, Utah attorneys should be informed about basic concepts of state law and federal taxation so that they can make their NPC clients and friends aware of duties, help them understand legal limitations, and steer them from potential risks.

1. As of July 1, 2018, the maximum amount of liability to which a government agency is subject, and thus the minimum amount of insurance coverage required by an NPC (or alternatively the value of a “qualified trust” set aside for these purposes) to take advantage of this immunity provision, must be at least \$745,200 for injury to one person in a single occurrence, \$2,552,000 for aggregate amount of individual awards in a single occurrence, and \$295,000 property damage in any one occurrence, all adjusted for inflation in even years. Utah Code Ann. § 63G-7-604; Utah Admin. Code R37-4-2.
2. The notice must contain required elements including (i) the action to be taken; (ii) the time by which a director must respond to the notice; and (iii) that failure to respond by the time stated will have the same effect as abstaining in writing and failing to demand in writing that action not be taken without a meeting. A defective notice could later give a board member a reason to invalidate that member’s vote and possibly the action altogether, with damage or other detriment to the NPC. Utah Code Ann. § 16-6a-813(2)(b).

Basic Features of Utah Nonprofit Corporations

The terms “nonprofit,” “exempt,” “foundation,” and “§ 501(c)(3)” are used interchangeably in common parlance. Thus, a better understanding of these and related terms is essential.

TERMINOLOGY

Nonprofit – Relating to an organization in which the earnings and profits, if any, cannot be distributed to private individuals or organizations, with certain exceptions (e.g., water companies, cooperatives, Mutual Benefit Corporations), but must be used to further the organization’s purposes. Not all nonprofit organizations are tax-exempt, although virtually all tax-exempt organizations are nonprofit.

Exempt – An organization upon which federal and some or all types of state taxes (income, sales, property, etc.) are not imposed and contributions to which may or may not be deductible for income tax purposes.

§ 501(c)(3) – Public Charity or Private Foundation – The section from the Internal Revenue Code that describes organizations whose purposes are charitable, educational, scientific, religious, etc. and contributions to which are deductible for income, estate and gift tax purposes, subject to certain limitations.¹ Section 501(c)(3) organizations are classified as “private foundations” unless they meet certain governance and support tests representative of the general public and qualify as “public charities.” Private foundations generally are managed and supported by a family or small group and are subject to more limitations and reporting obligations than public charities, a discussion of which is beyond the scope of this article.

As of the end of 2018, there were 1,682,091 exempt organizations registered with the IRS, of which 1,327,714, or about 79%, were described under § 501(c)(3). *Tax-Exempt Organizations and Nonexempt Charitable Trusts – IRS Data Book Table 25*, <https://www.irs.gov/statistics/soi-tax-stats-tax-exempt-organizations-and-nonexempt-charitable-trusts-irs-data-book-table-25> (last visited Sept. 15, 2019). Classification as a public charity yields other benefits besides donors’ ability to deduct contributions, including lower postal rates and the ability to receive in-kind goods and services from governments and commercial businesses.

Sections 501(c)(1) – (c)(29) other than § 501(c)(3) – Organizations formed under these code sections differ from one another in purpose and scope but generally are exempt from income taxation. Contributions to these organizations in most cases are not deductible. Section 501(c)(4) organizations have received a great deal of press recently because of their use as recipients of funds to support or oppose political candidates. (Note that retirement plans are exempt from taxation under other provisions of 26 U.S.C.).

Foundation – A term often used in the name of an NPC that typically qualifies under § 501(c)(3). Use of this word in a name does not render an NPC a private foundation under federal tax law.

Governmental Organization – Organizations exempt from federal income taxation (and in some cases contributions to which are deductible) because of their governmental status.² Taxation and exemption law in this area is complex and not well settled. In 2017, the Utah Legislature created a class of “governmental nonprofit corporations,” which because of their control by or support from “governmental entities” (e.g., state, counties, municipalities, etc.) are subject to certain public oversight provisions normally imposed on governmental units. Utah Code Ann. §§ 11-13a-101 to -106.

Donor Advised Fund or “DAF” – A fund set up by a donor in a public charity known as a “sponsoring organization” and that functions like a checking account, permitting the founder of the DAF to direct contributions for charitable purposes, flexible in amount and time, subject to the sponsoring organization’s ultimate legal right of control.

Corporation Sole – Of ancient origin, a legal nonprofit entity whose single incorporated office is occupied by a natural person, typically a governmental or religious leader in a designated position, whose successor automatically assumes the same powers and duties, e.g., “The Corporation of the Archbishop, President, Presiding Bishop, Rector,” etc. Because of promoter abuses, no new corporations sole could be formed in Utah after May 3, 2004. Utah Code Ann. § 16-7-5.

STATE NONPROFIT LAW

Background: The Utah Revised Nonprofit Corporation Act (Act) governs NPCs and is found in Utah Code Sections 16-6a-101 to -1705. Passed in 2000 through the foresight of Senator Lyle Hillyard, it replaced an archaic statutory framework. The Act shares some provisions with the Utah Revised Corporation Act but possesses many distinctive features including, for example, a more flexible option to conduct meetings by consent through electronic means. *Id.* § 16-6a-813. A principal goal in drafting the Act was to provide a workable and user-friendly regime in organization, governance, and operation, balanced with the need for transparency and public accountability.

Oversight of NPCs: NPCs are governed by state law. NPCs that operate in Utah typically incorporate here but may choose to form in another state and qualify to do business in Utah. *Id.* §§ 16-6a-1501 to -1518. Activities such as formation, amendment, and dissolution are documented through the Utah Division of Corporations, which has broad powers related to these administrative functions. *Id.* § 16-6a-104 (“The Division has the power reasonably necessary to perform the duties required of the division under this chapter.”). The powers of the attorney general are generally limited to those enumerated in the Act, and include, for example, initiating a proceeding to dissolve an NPC for certain abuses, *Id.* § 16-6a-1414(1), although the attorney general has plenary authority to restrain and enjoin corporations from acting illegally, in excess of their corporate powers or contrary to public policy, Utah Code Ann. § 67-5-1(13), and generally to oversee nonprofit organizations and institute legal proceedings to protect the public’s interest where other parties lack standing. When a nonprofit organization is structured as a charitable trust, the role of the attorney general is even greater, as that office has common law powers under the doctrine of *parens patriae* to represent an indefinite class of beneficiaries and enforce the terms of the trust for their benefit. *See id.* §§ 59-18-101 to -113 (the Utah Charitable Trust Act).

Directors and Officers: The Act designates directors as the governing body (the board) in an NPC and confers upon them substantial flexibility to oversee and exercise

the powers of the NPC, conduct meetings, make resolutions, and amend organizational documents and other matters, but also imposes upon them fiduciary duties and standards of accountability. A minimum of three directors (which optionally can be referred to as “trustees,” “regents,” or any other name) are required.³ *Id.* §§ 16-6a-801(4), -803(1). Directors and officers are subject to the duties of care and loyalty but can rely on professionals and others in carrying out those duties. Directors also must avoid conflicting interest transactions that could impose personal liability upon them. *Id.* §§ 16-6a-822, -825. If provided in the articles of incorporation, a non-director may be delegated prerogatives and duties of a director(s) and thereby relieve the directors of the authority and duty so delegated. *Id.* § 16-6a-801(2)(b). The directors may, and are highly encouraged to, adopt bylaws, and must do so for certain IRS exemption filings. *Id.* § 16-6a-206 (as used in this article, “bylaws” includes articles of incorporation unless otherwise indicated).

A board may be self-perpetuating or selected in other ways. There is no requirement for the length or number of directors’ terms, which may also be staggered. Directors may resign and be removed for cause or no cause as the bylaws may provide. *Id.* §§ 16-6a-805 to -810.

As guided by the bylaws, the board may organize committees, which must consist of at least two directors and no non-directors for the committee to exercise the authority of the board. Committees have the authority granted them by the bylaws or board but may not take action to authorize distributions, make proposals required to be approved by members, appoint directors, amend the articles of incorporation, adopt, amend, or repeal bylaws, or approve major corporate actions, such as mergers, major property sales, etc. *Id.* § 16-6a-817.

The board may (and should) hold regular and special meetings and, unless the bylaws eliminate the requirement, must hold an annual meeting, although the failure to do so does not affect the validity of any corporate action or work a forfeiture on the corporate charter. *Id.* § 16-6a-812. The Act has very flexible provisions for the board to take action without a meeting, the details of which are set forth in section 16-6a-813. Proxies are allowed as set forth in section 16-6a-816(4). A quorum may consist

of no fewer than one-third of the number of directors and no fewer than two directors. *Id.* § 16-6a-816(2). Minutes should be kept of each member, director, and committee meeting.

There is a misunderstanding among many, including some who serve and lead in the nonprofit sector, that directors (and sometimes even officers) cannot be compensated. As a general matter, there is no federal tax or state law prohibition on compensating directors (as independent contractors for tax purposes) and officers (as employees) for services rendered or reimbursement for costs incurred, so long as that remuneration is fair and reasonable. *See, e.g.*, Utah Code Ann. § 16-6a-811. Whether and how much to pay (subject to reasonableness) is more a matter of corporate tradition, preference, strategy, public perception, and available resources (e.g., some NPCs impose a “pay to play” constraint where board service is conditioned on an annual contribution). Nonpayment of directors and officers is more accurately characterized as “typical practice” than “best practice.” This issue is a matter for the board’s resolution based on the considerations above.

The bylaws, and if not included therein, the board, may establish selection criteria for the appointment of a chair and any suite of officers, designated by whatever names may be desired, and the same individual may simultaneously hold more than one office. *Id.* § 16-6a-818(4).

Members: In contrast to its for-profit sister, an NPC generally does not have shareholders (with exceptions such as water companies and cooperatives). Rather, it optionally may have either or both of voting and nonvoting members. Voting members are cousins to shareholders and typically have the right to elect directors and approve major corporate actions and decisions, although in most cases voting members do not own the property of the nonprofit corporation. Nonvoting members are persons who can pay dues, receive newsletters, be listed as supporters, etc. but typically do not govern or vote on major decisions. Articles of incorporation must disclose whether an NPC has voting members. *Id.* § 16-6a-202(1)(e). The rights and duties of members including member meetings, notice provisions, action by written ballot, proxies, voting groups, quorum requirements, etc. generally are set forth in the bylaws.

Mutual Benefit Corporations and Water Companies:

“Mutual Benefit Corporations” are nonprofit corporations whose assets are contributed by and for the members, such as, for example, a neighborhood park or a houseboat on Lake Powell. *Id.* § 16-6a-102(34). Members could contribute the capital for such a park, enjoy protection of the corporate shield and the aura of nonprofit status. Upon sale of the park, the members would be entitled to the net proceeds, if any. *Id.* § 16-6a-1302(1)(a)(ii).

Water companies are specifically addressed in the Act, although their governance by the Act can be viewed as somewhat awkward.⁴ For example, because water companies typically issue stock to their shareholders, the Act authorizes issuance of stock, *id.* § 16-6a-202(1)(f), but provisions for the management and governance of stock are not found in the Act but in the Utah Revised Business Corporation Act, *id.* §§ 16-10a-101 to -1902. As stated above, the Act provides for voting members and has robust provisions for that optional class of participation, obviating the need for most NPCs, other than water companies and certain others, to issue stock or shares. *See generally Dansie v. City of Herriman*, 2006 UT 23, 134 P.3d 1139 (construing property rights of water company stockholder under the Act and predecessor); *Okelberry v. West Daniels Land Ass’n*, 2005 UT App 327, 120 P.3d 34 (construing rights of shareholders in Livestock grazing NPC).

Liability Matters: The practice of nonprofit law is not a paradise for litigators, judging from very sparse case law. NPCs can sue and be sued and are liable to third parties in the same manner as their for-profit counterparts. As more fully addressed above, members, directors, officers, and employees of NPCs are not personally liable in their capacity as such for the debts and liabilities of the NPC. Utah Code Ann. § 16-6a-115. Moreover, directors and officers are not liable to the NPC, its members, receivers, or assignees unless they have breached the duties of office and the breach constitutes willful misconduct, intentional infliction of harm, or gross negligence. *Id.* § 16-6a-822(6). Additional protection can be afforded directors if the NPC includes a provision in its articles, bylaws or a resolution eliminating or limiting directors’ liability other than for unauthorized financial benefit, intentional infliction of harm, criminal conduct, or receipt of unlawful distributions. *Id.* § 16-6a-824.

OTHER SELECTED LAWS

Utah Tax Law

Utah law exempts certain organizations exempt from federal tax from imposition of one or more types of taxes, including income tax, *id.* § 59-7-102(1)(a); sales tax, *id.* § 59-12-104(8); and property tax, Utah Const. art. XIII, § 3, and Utah Code Ann. § 59-2-1101.

Securities Laws

Federal securities laws remove most exempt organizations from the registration and reporting requirements that otherwise could apply to the fundraising activities of exempt organizations.⁵ Utah also exempts from registration, and filing of sales literature, securities issued by organizations exclusively organized and operated for religious, educational, benevolent, charitable, fraternal, social, athletic, or reformatory purposes, or as a chamber of commerce or trade or professional association. Utah Code Ann. § 61-1-14(1)(f)(i).

Federal Tax Law

A nonprofit corporation that does not qualify for tax exemption is taxed as a standard “C” corporation under federal tax law. NPCs that qualify under one of the subsections of § 501(c) avoid imposition of federal income tax as provided in section 501(a), except for unrelated business income tax described below. The following discussion applies mainly to public charities, but often similar provisions apply to other exempt organizations.

Organized and Operated: Public charities must be both organized (required provisions in organizational documents) and operated exclusively for one or more exempt purposes. This requirement includes avoidance of private inurement to directors and officers, an analog to the state law limitations imposed on NPC insiders. Thus, for example, like state law, directors and officers cannot receive more than reasonable compensation for services rendered (and they and potentially the board can be penalized if they do). Moreover, under what is known as the private benefit doctrine, an NPC cannot provide benefits to insiders or any other persons, even if otherwise reasonable, unless the benefit is both *quantitatively and qualitatively incidental*.

Political and Lobbying Intervention: Public charities may not support or oppose a candidate for public office⁶ and, subject to a liberalizing election, 26 U.S.C. § 501(h), may not devote more than an “insubstantial part” of their activities to influence legislation. These limitations are generally more relaxed for other § 501(c) organizations.

Operating a Business: There are no restrictions for NPCs to operate a trade or business, although the prohibition of profit distribution to insiders renders the nonprofit form unattractive for those wanting to maximize personal wealth. Tax-exempt NPCs likewise can operate a trade or business, although limitations exist depending on the class of exemption involved. For example, a public charity can operate a trade or business as a substantial part of its activities only if in furtherance of its exempt purpose(s) and if its primary purpose is not the operation of an unrelated trade or business. 26 C.F.R. § 1.501(c)(3)–1(e)(1).

Unrelated Business Taxable Income: An exception to both federal and state tax exemption is “unrelated business taxable income” (UBTI), a regime conceived by Congress in 1950 in response to exempt organizations conducting business operations in unfair competition with non-exempt enterprises (the poster child was a spaghetti factory owned by New York University). Thus, if an exempt organization regularly carries on a trade or business that does not “contribute importantly” to its exempt purpose (and solely raising money is not such a purpose), or if debt is used to finance capital acquisition or operations that do not further an exempt purpose, net income is taxable under ordinary corporate (or trust) tax rates and is reported on a separate tax return, which is available to the public. “Too much” UBTI can have the effect of jeopardizing an organization’s tax exemption. Exceptions and planning opportunities (e.g., taxable subsidiaries) can minimize this risk. *See generally*, 26 U.S.C. §§ 511–514.

Application for Public Charity Status: An NPC cannot qualify under § 501(c)(3) unless it gives “notice” to the IRS by applying for and receiving that status (generally using Form 1023 or 1023 EZ for certain smaller applicants), with limited exceptions.⁷ Many of the other types of exempt organizations can “self-declare” their exempt status,

although they proceed at their own risk without IRS confirmation of the desired status. In most cases, Utah automatically confers exempt status upon organizations that are federally exempt and taxes income recognized as UBTI under federal law. *See, e.g.*, Utah Code Ann. §§ 59-7-102(1)(a), -801.

Tax Returns: Exempt organizations must file information tax returns, which are available to the public. Exempt organizations generally file Forms 990, 990-EZ (smaller organizations) and 990-N (electronically filed “post cards” if annual gross income is “normally” \$50,000 or less). If not exempt, an NPC must file the return typically required (e.g., Form 1120). Some organizations, such as certain religious organizations, are exempted from filing returns.

1. The popularity of 26 U.S.C. section 501(c)(3) rests principally on the ability of donors to deduct their contributions, subject to limits set forth in 26 U.S.C. section 170.
2. Income earned by a state, its political subdivisions, or “integral parts,” is not taxable to the federal government generally because of implied statutory immunity. Moreover, 26 U.S.C. section 115(1) excludes gross income from taxation if (i) derived from an essential government function and (ii) accrues to a State or its political subdivisions.
3. When the Act was proposed in 2000, the only change requested by anyone was to require a minimum of three directors, contrary to the Act’s first draft permitting one or two directors, philosophically consistent with nonprofit trusts which require only one trustee. Note also that the Act changed the name of board members from “trustees” to “directors.”
4. There has been a call for a separate statutory regime in Utah addressing the needs of water companies.
5. *See generally* the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. The Philanthropy Protection Act of 1995 (codified in scattered sections of 15 U.S.C.) added additional protections and securities exemptions in behalf of nonprofit organizations. A discussion of the specific exemptions under each of the foregoing acts is beyond the scope of this article.
6. This limitation is referred to as the “Johnson Amendment,” often referred to by President Trump and others. It became law in 1954 by the introduction, without objection, in the U.S. Senate by then Senator Lyndon B. Johnson.
7. Very small organizations, many religious organizations, and members of “group rulings” are exempt in whole or part from this requirement. Also, if an application is timely filed, a subsequent IRS determination of exempt status relates back to the organization’s date of formation.

SAMPLE TAX COMPLIANCE CHECKLIST

The following are points that should be periodically reviewed for tax compliance:

1. Representations in IRS application followed.
2. Public charity or other exempt status managed and maintained with Board involvement.
3. No private inurement to insiders or private benefit to anyone.
4. Compensation to insiders reasonable.
5. No loans to directors or officers.
6. No support of or opposition to political campaigns except as permitted by law.
7. Influencing legislation limited as permitted by law.
8. Material changes reported to IRS.
9. IRS recommended policies enacted.
10. Trades or businesses of NPC further NPC’s exempt purposes.
11. Unrelated trade or business income not excessive.
12. Estimated taxes paid for unrelated trade or business income.
13. Information (tax) returns prepared accurately and filed timely.
14. Joint ventures with non-exempt parties comply with IRS requirements.
15. Gifts and dispositions of non-cash properties properly reported.
16. Compliance with donor instructions but avoidance of excessive donor control.
17. Required receipts for gifts provided to donors.
18. Activities of for profit subsidiaries not attributed to NPC.
19. Access to tax returns and IRS application materials made publicly available.
20. Employees and independent contractors appropriately distinguished.
21. NPC website maintained consistent with exempt purposes and applicable tax rules.
22. Excise taxes for private foundations avoided.
23. Applications for exemption from State income, sales, and property taxes as needed.
24. Charitable solicitation laws followed in affected States.
25. Corporate registrations maintained.