Not-for-Profit
Alert

Weil

June 2018

An Update to the Key Provisions of the New York Non-Profit Revitalization Act

By Gabriel Gershowitz and Glen Forster

Signed into law in 2013, the New York Non-Profit Revitalization Act (as amended to date, the Act) subjects not-for-profit corporations incorporated under or otherwise subject to New York law to many new governance and oversight rules. In this Alert we provide a comprehensive overview of the key provisions of the Act, as amended to date.[1]

The adoption of the Act in 2013 was a major overhaul of the state's Not-for-Profit Corporation Law (the N-PCL). The Act focuses primarily on: (i) governance and oversight reforms; (ii) processes and procedures relating to specified corporate transactions, such as a merger, consolidation, or transfer or sale of all or substantially all of a not-for-profit organization's assets; and (iii) elimination of certain statutory and administrative requirements considered to be outdated and/or unnecessarily burdensome and confusing. Most of the provisions summarized below apply to not-for-profit corporations incorporated under New York law (regardless of whether they are tax-exempt under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the Code)). Provisions described under "Independent Audit Oversight" relating to financial audits and reporting also apply to not-for-profit organizations incorporated elsewhere but registered in New York for charitable solicitation purposes.[2]

Set forth below is a chart summarizing the applicability of the Act, followed by a summary of its key provisions. At the end of this Alert, we include recommendations on "what to do now." New York not-for-profit corporations should, to the extent they have not yet done so, review and modify, as necessary, their governance structure, oversight functions, policies, and day-to-day operations to ensure compliance with the Act.

Not-for-Profit Corporations to Which the Act Applies

Type of Entity	Scope of Applicability
New York not-for-profits:	
■ Not-for-profit corporations incorporated in the State of New York (referred to in this chart as "NY NFPs")	Entire Act except where noted below
■ NY NFPs that are not registered in NY for charitable solicitation purposes	Not required to comply with any provisions discussed under "Independent Audit Oversight" below
■ NY NFPs that have $750,000 or less annual gross revenue	Not required to comply with any provisions discussed under "Independent Audit Oversight" below
■ NY NFPs that have annual revenue of $1 million or less	Not required to comply with certain provisions discussed under "Independent Audit Oversight" below
■ NY NFPs that have fewer than 20 employees and annual revenue of $1 million or less	Not required to comply with any provisions discussed under "Whistleblower Policy" below
Not-for-profits incorporated outside of New York:	
■ Registered in NY for charitable solicitation purposes and with gross revenues in excess of the thresholds described in "Raising Thresholds Requiring an Independent Audit or Review"	Required to comply with provisions discussed under "Independent Audit Oversight" below
■ Authorized to conduct or conducts activities in NY	Generally not required to comply; however, Act provisions related to mergers are applicable

Governance and Oversight Reforms

The Act amends corporate governance requirements applicable to New York not-for-profit corporations in the following notable ways:

- **Employee Board Chair.** In order for an employee to serve as chair of the board or hold any other title with similar responsibilities, the board must approve such appointment by a two-thirds vote of the "entire" board (i.e., including vacancies) and document in writing the rationale for approval. No employee serving as chair of the board can be considered an "independent director" (as discussed below).
- **Raising Thresholds Requiring an Independent Audit or Accountant Review.** The Act amends the New York Executive Law to raise the gross revenue and support thresholds that trigger the requirement that not-for-profits that are registered in New York for charitable solicitation purposes obtain and file with the New York Attorney General an independent certified public accountant audit report or review report, as set forth below. In addition, charitable organizations which use paid fundraisers are no longer required to obtain an audit report unless they meet the gross revenue and support thresholds.

Requirement	Gross Revenue & Support Threshold Applicability	
	July 1, 2017 until June 30, 2021	**Beginning July 1, 2021**
Audit report	In excess of $750,000	In excess of $1 million
Review report	$250,000 to $750,000	$250,000 to $1 million

- **Independent Audit Oversight.** The Act requires that, in the case of any not-for-profits required to file an independent certified public accountant's audit report with the Attorney General (as discussed above), either the full board or an audit committee comprised entirely of independent directors (with only independent directors participating in deliberations and voting) is required to:
  - oversee the accounting and financial reporting of the organization and the audit of the organization's financial statements;
  - annually retain the independent auditor;
  - review the results of the audit and any related management letter with the independent auditor; and
  - in the case of a New York not-for-profit expected to have annual revenues in excess of $1 million:
    - review with the independent auditor the scope and planning of the audit prior to its commencement;
    - upon completion of the audit, discuss with the independent auditor material risks and weaknesses in internal controls identified by the auditor, any restrictions on the scope of the auditor's activities or access to requested information, any significant disagreements between the auditor and management, and the adequacy of the corporation's accounting and financial reporting processes; and
    - annually consider the performance and independence of the independent auditor.
- **Independent Directors.** Unless the board already performs such governance activities, New York not-for-profits need to form an audit committee composed of "independent" directors or identify "independent" directors to oversee the audit (if any) and approve certain transactions. Note that only independent directors may participate in any board or committee deliberations or voting relating to such matters. The Act does not prescribe a minimum number of audit committee members although the N-PCL generally requires that committees of the board[3] have at least three members. The Act defines an "independent director" as a director who:
  - is not, and has not been within the last three years, an employee or a "key person"[4] of the corporation or an affiliate[5] of the corporation, and does not have a "relative" who is, or has been within the last three years, a key person of the corporation or an affiliate of the corporation;
  - has not received, and does not have a relative who has received, in any of the last three fiscal years, more than $10,000 in direct compensation from the corporation or an affiliate of the corporation, other than reasonable compensation for service as a director or expenses reasonably incurred as a director; and
  - is not an employee of or does not have a substantial financial interest in, and does not have a relative who is an officer of or has a substantial financial interest in, any entity that has provided payments[6], property or services to, or received payments, property or services from, the corporation or an affiliate thereof for property or services in an amount that, in any of the last three fiscal years, exceeds:
    - the lesser of $10,000 or 2 percent of such other entity's consolidated gross revenues if the entity's consolidated gross revenue was less than $500,000 dollars,
    - $25,000 if the entity's consolidated gross revenue was $500,000 or more but less than $10,000,000 or
    - $100,000 if the entity's consolidated gross revenue was $10,000,000 or more;[7] or
  - is not and does not have a relative who is a current owner, whether wholly or partially, director, officer or employee of the corporation's outside auditor or who has worked on the corporation's audit at any time during the past three years.

- **Mandatory Related Party Transaction Procedures and Ability of Attorney General to Unwind.** Prior to undertaking a transaction with a "related party,"[8] the board, or an authorized committee of the board, of a New York not-for-profit must first determine if the proposed transaction is fair, reasonable, and in the corporation's best interest. This requirement applies to all transactions that meet the definition of a "related party transaction." In addition, where a related party has a "substantial financial interest" in a proposed transaction, the board (or authorized committee) must follow certain procedural requirements, including the consideration of alternative transactions to the extent available, majority board or committee approval, and contemporaneous documentation of the board's considerations and decision.[9] Notably, the Act enhances the power of the Attorney General to bring an action to enjoin, void, or rescind related party transactions that have been entered into without complying with applicable procedural requirements, as well as to remove directors or officers, order payment of double the amount of certain improperly obtained benefits, or seek restitution.[10]
- **Conflict of Interest Policy.** The board of each New York not-for-profit corporation – regardless of size – must adopt and oversee a conflict of interest policy applicable to directors, officers and key persons. While some not-for-profits have previously adopted a conflict of interest policy, disclosure of which is required by IRS Form 990, the Act expressly mandates the adoption of such policy.[11] The Act requires that such policy, among other things: (i) define the circumstances that constitute a conflict; (ii) include procedures for disclosing, addressing and documenting a conflict of interest, potential conflict of interest or related party transaction and for determining whether a conflict exists; (iii) prohibit a conflicted person from participating in deliberations or voting or influencing the vote; and (iv) require directors to disclose to the corporation (upon joining the board and annually thereafter) any entities with which they are affiliated and with which the corporation has a relationship, and any corporate transactions possibly giving rise to a conflict for the director.
- **Whistleblower Policy.** The board of each New York not-for-profit corporation that has 20 or more employees and annual revenue above $1 million must adopt and oversee a whistleblower policy that includes anti-retaliation provisions and procedures for reporting and investigating violations or suspected violations of law or corporate policies. In addition, the policy must designate a specific employee, officer or director to administer the policy and report to the audit committee or the full board, except that directors who are employees may not participate in any board or committee deliberations or voting relating to administration of the whistleblower policy. Only those persons not subject to a whistleblower complaint may participate in any board or committee deliberations or vote on matters relating to the policy. The Act requires that the policy be distributed to all directors, officers, employees and to volunteers who provide substantial services to the corporation, and provides that posting the policy on the corporation's website or at the corporation's offices (in a conspicuous, accessible location) will satisfy the distribution requirement. Some not-for-profits have previously adopted whistleblower policies in response to applicable provisions of the Sarbanes-Oxley Act prohibiting retaliation against whistleblowers. IRS Form 990 also requires disclosure of whether the organization has a whistleblower policy.

Streamlined Corporate Transactions

The Act streamlines the state law hurdles associated with certain corporate transactions, including:

- **Eliminating Two-Step Approval for Certain Transactions.** Under previous law, a merger, dissolution, and certain other transactions (including, in the case of certain not-for-profits, amending the charter by changing, eliminating, or adding a purpose or power) required both Attorney General and Supreme Court approval. Pursuant to the Act, certain transactions no longer require both types of approvals – rather, they only require Attorney General approval. However, court approval (i) is still required if the corporation is insolvent or would become insolvent as a result of

the transaction or if the Attorney General concludes that court approval is appropriate and (ii) is still available to the organization if the Attorney General does not approve the transaction.

- **Majority Vote for Routine Real Estate Transactions.** The Act requires only a majority of the board or authorized committee to approve routine real estate transactions (such as the purchase, sale, mortgage or lease of real property that does not constitute, after giving effect to the transaction, all or substantially all of the assets of the not-for-profit). However, a real estate transaction that constitutes an acquisition (after giving effect to the transaction) or disposition of all or substantially all of the assets of the not-for-profit still requires the approval of two-thirds of the entire board (or a majority of the entire board if there are 21 or more directors).

Simplified Formation and Day-to Day Operations

The Act includes features designed to simplify and reduce statutory and administrative requirements considered to be burdensome, including:

- **Permitting Electronic Meetings, Consent and Communications.** The Act expressly permits electronic technology for certain meetings, notices, waivers, proxies and other communications, and allows boards or committees to take action by written consent in electronic form. In certain cases, the Act permits website posting in lieu of newspaper publications.
- **Eliminating Organization "Types."** Ending a statutory construct that caused decades of confusion and undue burden for the not-for-profit community, the Act replaces the "letter types" of not-for-profits ("A" through "D") with two basic categories: charitable and non-charitable. A "charitable corporation" means any corporation formed or deemed to be formed for charitable purposes. "Charitable purposes" are defined to mean purposes contained in the certificate of incorporation that are charitable, educational, religious, scientific, literary, cultural, or for the prevention of cruelty to children or animals. A "non-charitable corporation" means any not-for-profit corporation other than a charitable corporation, including but not limited to one formed for any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, or relate to animal husbandry or for the purpose of operating a professional, commercial, industrial, trade, or service association. Type A not-for-profits incorporated before July 1, 2014 are deemed "non-charitable," Type B and C not-for-profits incorporated before July 1, 2014 are deemed "charitable," and Type D corporations formed before July 1, 2014 are deemed "charitable" or "non-charitable" depending on the purposes as reflected in their existing charters.
- **Eliminating State Education Department Consent for Certain Entities.** The Act eliminates the requirement that certain not-for-profits obtain advance approval of the New York State Education Department for formation. Previously, not-for-profits involved in any type of education were required to obtain pre-approval from the State Education Department or the regents of the state university system. Under the Act, State Department approval is only required for a school, library, museum, or historical society; note that the approval of the regents of the state university system is required for a college or university. Other not-for-profits whose charters include a purpose for which a corporation might be chartered by the regents of the state university system are required only to provide the Commissioner of Education with a certified copy of the certificate of incorporation within 30 business days after formation.
- **Permitting Correction of Typographical or Similar Non-Material Errors in Certificates or Instruments.** The Act allows certificates and other instruments relating to not-for-profits that contain typographical or non-material errors to be corrected by e-mailing the New York Department of State.

What To Do Now (If You Have Not Done So Yet!)

- Review corporate governance policies and procedures for compliance with the Act. In particular, bylaws, corporate governance guidelines, committee charters, codes of conduct, whistleblower and conflict of interest or related party transaction policies should be reviewed.
- Review the organization's board leadership structure and succession plan to ensure that if an employee is chair of the board, appropriate procedures have been followed.
- Determine which directors qualify as "independent" in accordance with the Act's independence standards and, if necessary, plan to elect or appoint independent directors who are responsible for providing oversight of the organization's audit (where applicable).
- Confirm whether it is anticipated that the organization's gross revenues are such that the organization's financial statements are required to be audited or reviewed by an independent certified public accountant in light of the revised thresholds.

---

1. Our prior alerts on the Act were published in February and July 2014. See https://www.weil.com/~/media/files/pdfs/140074_not_for_profit_alert_jan_2014_v4_final and https://www.weil.com/articles/new-york-nonprofit-revitalization-act-update. This Alert focuses primarily on not-for-profit corporations, but readers should be aware that there are alternative structures that may be utilized such as trusts or LLCs (and note that New York does not have an LLC statute expressly permitting the formation of a not-for-profit LLC).
2. Certain provisions of the Act also apply to charitable trusts that are subject to the New York Estates, Powers and Trusts Law.
3. The Act distinguishes between (i) committees of the board, which may bind the board and which may be composed solely of directors, and (ii) the more advisory-in-nature committees of the corporation, which may not bind the board and which may include non-directors.
4. A "key person" is defined as any person, other than a director or officer who (i) has responsibilities or exercises powers of influence over the corporation as a whole similar to a director or officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation or (iii) alone or with others controls or determines a substantial portion of the corporation's capital expenditures or budget.
5. An "affiliate" of a corporation is defined as any entity controlled by, or in control of, such corporation.
6. "Payment" does not include charitable contributions, dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes or payments made by the corporation at fixed or non-negotiable rates or amounts for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms, and such services received by the corporation are not available from another source.
7. While, the terms "related party" and "independent director" are also relevant for the purposes of compliance with the tax laws, it should be noted that tax laws and the Act differ in their definitions of these terms.
8. A "related party" is defined by the Act as: (i) any director, officer, or key person of the corporation or any of its affiliates; (ii) any relative of any director, officer, or key person of the corporation or its affiliates; or (iii) any entity in which an individual described in clause (i) or (ii) has a 35 percent or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5 percent. The Act defines a "related party transaction" as any transaction, agreement, or other arrangement in which a "related party" has a financial interest and in which the corporation or any of its affiliates is a participant, other than a transaction in which (i) the transaction or the related party's financial interest is de minimis; (ii) the transaction would not customarily be reviewed by the board or boards of similar organizations in the ordinary course of business and is available to others on similar terms or (iii) the transaction is a benefit to a related party solely as a member of a class that the corporation intends to benefit as part of its mission, and the benefit is available to all similarly situated members of the class on the same terms.
9. For a number of years, the Code has imposed analogous rules setting parameters around "related party" transactions. The so-called "intermediate sanctions" provisions of Code Section 4958 establish specific guidelines, similar (but not identical) to the procedures required under the Act, that serve to protect the not-for-profit organization from violating the prohibition against private inurement and thereby incurring penalties. Notably,

the Code's guidelines in this area are not mandatory, but merely establish a "safe harbor," whereas the Act *requires* that a not-for-profit take specific steps prior to participating in a related party transaction. The Act provides that in an action by any person or entity other than the Attorney General, it is a defense that the transaction was fair, reasonable, and in the corporation's best interest at the time the corporation approved the transaction.

10. The Act provides that a corporation has a defense to an action by the Attorney General with respect to a related party transaction that was not approved in accordance with the Act if several requirements are met in advance of any request for information from the Attorney General; namely that (i) the transaction was ratified in good faith; (ii) alternatives were considered; (iii) the reason for the violation and ratification were documented in writing and (iv) procedures were put in place to ensure future compliance. *See* §715(j).
11. IRS Form 990 (the annual tax return filed by most not-for-profit organizations) requires disclosure of whether the organization has a conflicts of interest policy. The tax law (and IRS Form 990) does not require that an organization have a conflicts policy; however, the IRS believes that the absence of a conflicts policy is a factor suggesting substandard corporate governance, which (the IRS maintains) may lead to violation of tax law principles applicable to exempt organizations and therefore warrants heightened scrutiny.

Not-for-Profit Alert is published by the Not-for-Profit Practice Group of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

If you have questions concerning the contents of this issue, or would like more information about Weil's Not-for-Profit Practice Group, please speak to your regular contact at Weil, or to the editors, practice group leaders or contributing author:

Editors:

Lyuba Goltser (NY)	View Bio	lyuba.goltser@weil.com	+1 212 310 8048
Mark Hoenig (NY)	View Bio	mark.hoenig@weil.com	+1 212 310 8146

Contributing Author:

Gabriel Gershowitz (NY)	View Bio	gabriel.gershowitz@weil.com	+1 212 310 8465
Glen Forster (NY)		glen.forster@weil.com	+1 212 310 8176