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Carefully Review Creation and Composition of Your Executive Committee

Article by Warren J. Casey

Nonprofit organizations often have sizable boards of trustees, reflecting their wish to have significant contacts in the community and in the corporate world, as well as to have available a breadth of experience. Most nonprofit boards also have an Executive Committee, consisting of a smaller number of trustees who act on behalf of the full board. However, as often as not, the Executive Committee may have been informally established over time without necessarily following the formalities required under state corporate law or the organization's governing documents.

For many reasons, it is important to ensure that an Executive Committee has been properly established pursuant to the requirements of applicable state corporate law and the organization's charter and bylaws.

First, the general purpose of an Executive Committee is to enable a smaller group of trustees legally to act on behalf of the full board between board meetings. This may be important when certain board approvals or other board action needs to be taken and the mechanics and timing of convening an in-person or telephonic formal board meeting are impractical.

For example, an organization proposes to obtain a new bank loan or other financing, which requires board approval of the particular loan transaction and financing documents, but the next scheduled board meeting is two months away. Management is often reluctant to assemble an in-person or telephonic board meeting, particularly when the trustees may have considered and broadly approved such financing at its last regular meeting. In this instance, assuming a duly constituted and authorized Executive Committee exists, the Executive Committee may be in the position to provide all required approvals of the final transaction and transaction documents.

In addition, chief executive officers often have ongoing matters they wish to review and discuss with a representative group of trustees, and at times to approve proposed actions that the chief executive officer wishes to take. Having a properly constituted Executive Committee not only provides an established audience and sounding board for the chief executive officer, but this group will also be viewed by the full board as the appropriate representative group to consider and act on matters with the chief executive officer. Where a less formal group of trustees is consulted, issues often arise (i) as to who is and who is not included in that group and (ii) regarding the perceived authority of an informally selected group of trustees.

1. **Membership of the Executive Committee.**

   In order to ensure that the Executive Committee is properly constituted and authorized, the membership of the Executive Committee needs to be set, either by a resolution of the board or by an appropriate provision of the organization's bylaws. Membership on the Executive Committee may be by "title" (such as a committee consisting of

the organization's chairman, vice chairman and chairs of each of the principal named committees of the board) or by a board resolution naming the particular members of the committee. Where specific trustees are named by a board resolution, care must be taken to ensure that the membership of the committee at any time is consistent with the most recent board resolution. Caution should be exercised; often what a board and management believe is the current makeup of an Executive Committee may not in fact be consistent with the most recent board resolution.

2. **Authority of the Executive Committee.**

   The authority of an Executive Committee likewise needs to be established by the organization's bylaws or by board resolution?-- which generally would mean having the equivalent authority of the board to act on matters between board meetings. However, the authority of an Executive Committee to act on behalf of the full board has limits, generally set by state statute. For example, under the nonprofit statutes of many states, an Executive Committee may not enact, modify or repeal any bylaw of the organization. Likewise, Executive Committees often do not have statutory authority to elect or appoint any new trustee, or to remove any trustee or any officer of the organization. Removal of an officer is often a highly sensitive action and is not broadly communicated for obvious reasons. Accordingly, obtaining the appropriate approvals for the removal of an officer should be carefully considered and effected.

3. **Non-Trustees on the Executive Committee.**

   The applicable state statute and the organization's governing documents should also be reviewed to determine whether non-trustees may be members of the Executive Committee. If, for example, the chief executive officer or executive director of the organization?-- who often is not a board member?-- is designated as a member of the Executive Committee, the applicable state statute and the organization's bylaws should be reviewed to determine whether a non-trustee is permitted to be a member of the committee. If an Executive Committee is not properly constituted, that may impair actions or approvals of the Executive Committee.

Although the existence of an Executive Committee may be beneficial for a nonprofit organization, it is important to carefully review the creation and composition of the committee to ensure that it is properly constituted under applicable law and the organization's governing documents. Deficiencies should be corrected so that inopportune challenges or questions as to the authority or makeup of the Executive Committee are avoided.

IRS Will Revise Proposed Regulations for 501(c)(4) Organizations

Article by Jennifer M. Pagnillo

In November, the Internal Revenue Service and the Treasury Department released proposed regulations regarding permissible political activity for Section 501(c)(4) organizations?-- those that are required to have social welfare as a primary purpose.

The IRS received a record-breaking number of public comments on the proposed regulations (over 150,000!), mainly from those who felt the proposed rules were too restrictive on the activities of social welfare organizations. Although the IRS originally planned to hold a public hearing on the proposed regulations this summer, given the extremely strong substantive response the IRS recently announced it will first revise the proposed regulations before holding a public hearing. Although the IRS has not announced what form the revisions will take or when to expect a revised draft, IRS Commissioner John Koskinen recently told lawmakers not to expect a revised version of the rules until next year.

Under the existing rules, such organizations are permitted to engage in an unlimited amount of lobbying and some lesser amount of political activity, and are not required to disclose their donor lists, thus permitting wealthy donors to anonymously spend money to influence political campaigns. The proposed guidelines explicitly define certain political activities as "candidate-related political activities" and thus outside the category of social welfare. Notably, nonpartisan activities, such as voter registration drives, are included in the proposed guidance as candidate-related political activities. Given that the proposed rules are intended to limit advocacy on behalf of or against any particular political candidate, one questions whether voter registration drives and other nonpartisan activities are broadly includable as candidate-related political activities. It will be interesting to see if the revised draft of the guidance continues to define such nonpartisan activities as outside the category of social welfare.

Background Check Guidance Issued by the EEOC and FTC

Article by Daniel L. Schwartz and Basil C. Sitaras

In March, the Equal Employment Opportunity Commission (EEOC) and the Federal Trade Commission (FTC) issued new guidelines regarding the interplay between federal antidiscrimination laws, the Fair Credit Reporting Act (FCRA), and background checks. According to the guidelines, employers are reminded that although they may ask questions about an individual's background or require a background check, they are prohibited from doing so with respect to medical and genetic information, including family medical history. In the case of medical background, employers should not delve into this area before making a conditional job offer, and they may inquire only if there is objective evidence that the prospective or current employee is unable to perform the job's duties and responsibilities, or if the individual poses a safety risk.

Employers should be consistent in their background check policies; they should seek the same background information from all applicants. The EEOC and FTC also cautioned employers about basing employment decisions on background problems that may be more common among persons of protected classes (e.g., race, age, gender, religion).

Regarding the FCRA, the guidelines remind employers that when seeking a background report, they must (i) obtain the individual's written permission; (ii) inform the individual in writing, in a separate and independent document (not buried in legal jargon), that the background report might be used in making an employment decision; and (iii) provide the individual with written notice when the employer has made an adverse employment decision based on the background check.

As the guidelines note, background checks are an important resource for employers, but they must be done properly. For those interested in reviewing the guidelines in full, they can be accessed at http://www.eeoc.gov/eeoc/publications/background_checks_employers.cfm.

Donor Restrictions?- Will Your Organization Be Stuck With Them Forever?

Article by Brooke Pollak

Donors often want to ensure that a gift is used for the donor's intended purpose long after the gift is initially made. Donor restricted funds are created in a number of ways, including through conditions in a written gift agreement or under the terms of a charitable trust. Donor restrictions typically fit into one of two categories: (i) restrictions on the purposes for which the gift can be used, such as "to fund scholarships for students to travel to the Czech Republic," and (ii) restrictions on the timing and amount of expenditures from the gifted funds, usually called "endowed gifts."

Donors are not omniscient, and in many cases there may come a time when the restrictions they impose no longer make sense. For example, if the restriction had been "to fund scholarships for students to travel to Czechoslovakia," what happens to those funds now that there is no country called Czechoslovakia?

If the donor is alive and agreeable, the donor and the charitable organization can often modify the restriction without court intervention. If the donor is deceased or not agreeable, the charity can petition the court to modify the restriction under either the doctrine of *cy pres* or the doctrine of equitable deviation.

Cy pres derives from the Norman French phrase *cy pres comme possible?*-- as near as possible?-- and is also referred to as "the doctrine of changed circumstances." The doctrine of *cy pres* is invoked to modify a purpose-driven restriction. The analysis requires (i) finding that the charitable purpose has become illegal or impossible to fulfill and that the donor's intent was general and (ii) the identification of another "close" purpose that falls within the donor's general intent. As trust law has evolved, the *cy pres* doctrine has been broadened to apply to situations in which continued adherence to the restriction would be wasteful.

Equitable deviation is invoked to modify an administrative restriction. The analysis requires finding that there has been a change in circumstances unforeseen by the donor and that the administrative restriction would now defeat the charitable purpose. Whether the restriction is truly purpose-driven or administrative is somewhat subjective, and many practitioners will argue that a particular restriction is administrative in nature because the requirements of equitable deviation are easier to meet.

COAH Releases New Affordable Housing Regulations in New Jersey

Article by Craig M. Gianetti and Joshua J. VandenHengel

After years of litigation and court orders directing the New Jersey Council on Affordable Housing (COAH) to adopt new rules,

on April 30, COAH released its latest iteration of Third Round affordable housing regulations. The proposed regulations comprise both Procedural Rules (N.J.A.C. 5:98-1 et seq.) and Substantive Rules (N.J.A.C. 5:99-1 et seq.) that will determine the number of affordable units each New Jersey municipality is required to provide for low-income residents. Consistent with the prior rules, municipalities that submit to COAH's jurisdiction and comply with the proposed regulations will continue to be protected from builder's remedy lawsuits.

Deviating from the prior growth share methodology invalidated by the New Jersey Supreme Court, the proposed regulations set a municipality's (i) Rehabilitation Obligation, (ii) Unanswered Prior Round Obligation and (iii) Prospective Need Obligation. They also provide for certain caps on municipal affordable housing obligations.

The proposed regulations allow towns to establish a 10 percent set-aside for inclusionary zoning that constitutes part of a municipality's Fair Share Plan (FSP). However, in certain instances, COAH may approve "reduced affordable housing set-asides or increased densities to ensure the economic feasibility of an inclusionary development." In addition, each site or zoning district assigned for inclusionary development in an FSP must include an "Economic Feasibility Study" demonstrating that the opportunity for development is realistic.

The proposed regulations, which are currently available on the New Jersey Department of Community Affairs website, will be published in the June 2 *New Jersey Register*. There will be a 60-day public comment period ending on August 1. Unless the proposed regulations are withdrawn or substantially altered by COAH during the public comment period, they are expected to become effective upon publication of the final rule in the November 17 New Jersey Register.

Form 1023-EZ?- Is the Application Process Simplified for Smaller Charities?

Article by Jennifer M. Pagnillo

In February the IRS released a draft of Form 1023-EZ (which was further updated in May), a simplified application for tax-exempt status that may be used by smaller organizations. The simplified form drastically reduces the burden on smaller charities by permitting them to attest that they meet the organizational and operational tests for tax-exempt status.

Prior to this, an organization that wished to be recognized by the IRS as tax-exempt under Section 501(c)(3) of the Internal Revenue Code would need to complete the 25-page Form 1023, which, in the IRS's estimation, requires 101 hours to complete. Currently, the proposed Form 1023-EZ is only three pages long, and the IRS estimates it can be completed in 14 hours. Unlike Form 1023, Form 1023-EZ does not require a narrative description of an organization's activities, nor does it require budgetary information.

In order to use Form 1023-EZ, an organization must attest that it has completed an eligibility worksheet with 22 questions. If your organization answers "yes" to any of the following questions, then it is not eligible to use Form 1023-EZ:

1. Are your projected annual gross receipts expected to exceed $200,000 in any of the next three years or have your annual gross receipts exceeded $200,000 in any of the past two years?
2. Do you have total assets in excess of $500,000?

3. Were you formed under the laws of a foreign country?
4. Are you a successor to, or controlled by, an entity suspended under 501(p)?
5. Are you a limited liability company?
6. Are you a successor to a for-profit entity?
7. Were you previously revoked or are you a successor to a previously revoked organization (other than automatic revocation for failure to file Form 990)?
8. Are you a church or a convention or association of churches described under IRC 509(a)(1) and 170(b)(1)(A)(i)?
9. Are you requesting classification as a school, college or university under IRC 509(a)(1) and 170(b)(1)(A)(ii)?
10. Are you requesting foundation classification under IRC 509(a)(1) and 170(b)(1)(A)(iii) as a hospital or medical research organization?
11. Are you applying for exemption as a cooperative hospital service organization under section 501(e)?
12. Are you applying for exemption as a cooperative service organization of operating educational organizations under section 501(f)?
13. Are you applying for exemption as a charitable risk pool under section 501(n)?
14. Are you requesting classification as a supporting organization under IRC section 509(a)(3)?
15. Is a substantial purpose of your activities to provide assistance to individuals with credit counseling activities such as budgeting, personal finance, financial literacy, mortgage foreclosure assistance or other consumer credit areas?
16. Are you investing or do you plan to invest 5% or more of your total assets in securities or funds that are not publicly traded?
17. Do you or will you participate in joint ventures, including partnerships or limited liability companies treated as partnerships, in which you share profits and losses with partners other than section 501(c)(3) organizations?
18. Do or will your activities include selling carbon credits or carbon offsets?
19. Are you an HMO?
20. Are you an ACO, or do or will your activities include ACO activities?
21. Are you a sponsoring organization as defined in section 4966(d)(1) that maintains or intends to maintain one or more Donor Advised Funds?
22. Are you organized and operated exclusively for testing for public safety and requesting a foundation classification under IRC 509(a)(4)?

The draft instructions do not indicate the user fee for filing Form 1023-EZ, but it is expected the user fee will be reduced.

Although on its face a simplified exemption application might appear to be beneficial, the limited nature of Form 1023-EZ could cause compliance issues, specifically because the IRS may not receive enough information to ensure that an applicant qualifies for tax-exempt status. For example, it appears as if an applicant may not need to provide the IRS with its governing documents, which is important because an applicant may not be equipped to evaluate whether its documents meet the basic requirements for tax exemption.

As the comment period is still open, the final draft of Form 1023-EZ is not yet released.