



## Frequently Asked Questions Corporate Governance

### Part 1: Corporate Structure

#### **1. What are bylaws?**

Bylaws are an internal operating manual for the board (and members, if any). They guide the board of directors in governing effectively, and generally contain provisions on topics such as the roles of members (if any), directors, and officers; elections; meetings; committees; conflicts of interest; basic financial matters (e.g., check writing authority); and the authority to hire an executive director and other staff members. When an organization has a choice between putting a provision in the bylaws or in the certificate of incorporation, it is often advisable to put it in the bylaws because they are easier to amend.

Bylaws should be simple and flexible so that they are easy to follow and a helpful governance tool. It is a good idea to review them regularly to ensure that they reflect current practices and conform with the organization's certificate of incorporation.

Bylaws are filed with the application to the IRS for tax exemption (Form 1023), and sometimes are required to be filed with state charities bureau registrations. Otherwise, they generally are not required to be filed with government authorities. Significant changes to the bylaws may need to be reported on annual government filings (e.g., IRS Form 990 informational tax return). With respect to reporting changes in the bylaws and/or the certificate of incorporation to the IRS, see [IRS Publication 4221-PC, Compliance Guide for 501\(c\)\(3\) Public Charities](#).

#### **2. What are “members”? Are we required to have them? Do we want them?**

Generally speaking, nonprofits are organized as either membership or non-membership organizations. Membership organizations have members who are entitled to vote on certain organizational issues. In some ways, members are analogous to shareholders of a for-profit corporation in that they play a role in governance (e.g., they elect directors). But unlike shareholders, members do not have a pecuniary interest in a nonprofit corporation.

Non-membership organizations have self-perpetuating boards of directors, meaning that the directors nominate and elect people to serve on the board. Many non-membership organizations have people they call “members” but they are not members in the legal sense because they do not have voting rights.

Your organization's certificate of incorporation and/or bylaws should state whether it is a membership or non-membership organization. If it is a membership organization, the bylaws should set forth the requirements of membership, including the definition of a voting member, quorum and meeting requirements, notice requirements, and the specific voting rights of members.

Requirements about having members vary by state. New York organizations should note that under the New York Not-for-Profit Corporation Law, certain nonprofit organizations are required to have voting members; check with the Pro Bono Partnership or your organization's legal counsel for more information. For organizations with a choice, having members may make sense. But many organizations decide not to have members, primarily for ease of administration.

**3. Our organization is set up as a membership organization with members entitled to vote. However, we are actually operating as a non-membership organization, run entirely by our board of directors. What should we do?**

There are two ways to address this issue. One option is for your organization to change the way it governs to conform to its own corporate documents – that is, to begin holding regular membership meetings and member votes as stated in the certificate of incorporation and bylaws. Alternatively, the organization can change its corporate structure from a membership to a non-membership organization (although, as noted above, certain New York nonprofits may not have this option). Changing the corporate structure will require a vote of the members to eliminate their voting rights, and then an amendment of the organization’s certificate of incorporation and/or bylaws. If this is an issue for your organization, please contact the Pro Bono Partnership or your organization’s legal counsel.

**4. How many people must sit on our board?**

State law generally requires a minimum number of board members (also referred to as “directors” in Connecticut and New York and “trustees” in New Jersey). Connecticut, New Jersey, and New York require at least three (3) board members, all of whom must be at least 18 years old.

The organization’s corporate documents (generally the bylaws) should specify the number, which is often greater than the minimum required and is sometimes a range (e.g., at least 5 and no more than 11).

**5. Can our executive director serve on our organization’s board?**

Yes, an executive director may serve on the board, as long as it is not prohibited by the organization’s corporate documents (i.e., certificate of incorporation and/or bylaws).

It is strongly recommended that the organization have a conflict of interest policy to ensure that no director (including an executive director serving on the board) participates in any votes on issues where the director, his/her relatives, or his/her related entities stand to benefit. For example, the executive director should recuse him/herself when the board discusses his/her salary.

Some organizations avoid these types of conflicts by adopting a policy whereby the executive director attends board meetings to keep the board apprised of programmatic developments but is not a board member.

**6. Are there limits on the number of terms a director or a trustee of a nonprofit organization can serve, or on the length of each term?**

In Connecticut, New Jersey, and New York, there are no limits on the number of terms a director or trustee may serve, unless the organization’s certificate of incorporation or bylaws provide otherwise. However, there are limits on term lengths.

In Connecticut, directors serve until the next annual meeting of the members (in a membership organization) or directors (in a non-membership organization) following their election. In practice, this means that directors will serve a one-year term, unless the certificate of incorporation or bylaws provide for staggered terms. If the board’s terms are staggered, directors’ terms shall not

exceed a number of years equal to the number of classes into which the board of directors is classified. Staggered boards may have up to five classes of directors, meaning that board member terms may be five years at most.

In New Jersey, trustees serve until the next annual or biennial meeting of the members (in a membership organization) or trustees (in a non-membership organization) following their election, unless the certificate of incorporation or bylaws provide for staggered terms. If the board's terms are staggered, trustees' terms must be at least one year but not exceed six years. Elections must be held at least every two years, and if the trustees are grouped into classes, the term of office of at least one class must expire every two years.

In New York, directors serve until the next annual meeting of the members (in a membership organization) or directors (in a non-membership organization) following their election. In practice, this means that the term of a director (other than an ex-officio director) will be one year, unless the certificate of incorporation or bylaws provide for longer or staggered terms. If the certificate of incorporation or bylaws provide for staggered terms, such terms shall not exceed a number of years equal to the number of classes into which the board of directors is classified. Staggered boards may have up to five classes of directors, meaning that terms may be five years at most.

### **7. Can our founder be on the board forever?**

It is not recommended for anyone to have the right to be on the board forever, even the founder. And, as explained in the answer to Question 6 above, Connecticut, New Jersey, and New York require that all members of the board be elected periodically. Thus, in these three states, unless the certificate of incorporation and/or bylaws provides for term limits, it is possible for a founder to serve the organization for many years, but this way there is a periodic check on performance.

Organizations and those serving on the board evolve over time, and it is not a good idea to be stuck without the ability to make leadership changes. Oversight of the organization ultimately is the responsibility of the board (and voting members, if any), and it should have the ability to remove anyone, including the founder.

If someone wants certainty that he/she will be part of an organization forever, forming a nonprofit may not be the right route.

### **8. How can a member of the board of directors of a nonprofit organization be removed?**

The answer to this question depends on state law.

In Connecticut, the members entitled to vote (in a membership organization) or the other directors (in a non-membership organization) may remove a director with or without cause, unless the certificate of incorporation limits removal to only for cause.

In New Jersey, if the organization's bylaws or certificate of incorporation provides for election of trustees by the members, then the members may remove a trustee for cause, unless the bylaws or certificate of incorporation allow removal without cause. If the trustees are elected by the board, then a trustee may be removed only for cause.

In New York, a director may be removed for cause by vote of the members or by vote of the directors (provided there is a quorum of at least a majority of directors at the meeting). If the organization's bylaws or certificate of incorporation so provide, a director may also be removed without cause by vote of the members.

None of the relevant statutes in any of these three states define “cause”. Therefore, what constitutes cause is very fact specific and the circumstances of a given situation should be analyzed carefully.

### **9. Can we have an advisory board?**

Yes, an organization can have an advisory board (or any other group of constituents), but everyone involved should recognize that such a group does not have the legal rights and responsibilities that the board of directors has, and cannot bind the organization in any way. It may be a good idea to have a charter for the advisory board that clearly defines its role and limits.

## **Part 2: Board Meetings, Duties, and Decisions**

### **10. How much responsibility do board members have?**

Board members have significant fiduciary duties and are ultimately responsible for the organization. It is critical that board members understand their responsibilities to lead the organization, and recognize that they can be held personally liable in certain limited circumstances.

Board members may delegate responsibility for day-to-day management of the organization to an executive director, but the board must exercise oversight as appropriate and continues to bear ultimate responsibility for the organization.

Board members must exercise due care in the performance of their duties, which includes overseeing the nonprofit, approving its financial and accounting practices, and ensuring compliance with all applicable laws. However, board members generally will not be liable for failure to exercise due care if they have relied, in good faith, on advice provided by competent professional advisors, such as lawyers and independent/certified public accountants. Boards can therefore protect themselves by hiring reliable professionals, asking pertinent questions, and familiarizing themselves with their nonprofits’ finances, legal responsibilities, and internal controls.

### **11. Do board members have the right to review all corporate records?**

Generally, yes. Every board member is a fiduciary with the obligation to make decisions in the best interests of the organization. To satisfy this duty, board members must be able to review any information necessary to reach an informed, independent judgment prior to casting a vote on any issue. Board members also are responsible to ensure that the organization is appropriately reporting, filing, and managing its corporate documents. For these reasons, it would be inappropriate for the staff of a nonprofit to prevent the board from reviewing most corporate documents.

However, there are certain documents that typically are not shared with all board members, because they relate to employees (e.g., social security numbers, the name of a witness in an internal investigation) or highly confidential issues. Individual board members should only review these types of documents as necessary, and must recognize the documents’ sensitivity and treat them appropriately.

Board members who do not respect the confidentiality of any sensitive corporate document, including board agenda packets or board minutes, should be counseled by the board chairperson or another appropriate colleague on the board about the necessity of maintaining the confidentiality of certain records. If necessary, board members should be reminded that their

legal duties to the organization prohibit them from using information from corporate records for personal gain or to benefit any outside interest.

**12. How many board meetings are we required to have?**

In Connecticut, New Jersey, and New York, the statutory default is that nonprofit corporations are required to have at least one annual board meeting. Beyond that, a board is required to have at least as many meetings as specified in its corporate documents (i.e., its certificate of incorporation and/or bylaws) and as necessary to oversee the organization effectively. Failure to hold sufficient meetings may give rise to a claim that board members breached their fiduciary duties.

**13. Can we have a board meeting by telephone or email?**

In Connecticut, New Jersey, and New York, state laws allow an organization to hold a board meeting via a telephone conference call or video conference, so long as all the participants can speak to and hear each other, and all other formalities of board meetings are met (such as proper notice of meeting or waiver of such notice, quorum, and voting procedures).

None of the three states permit board meetings to be held via email or internet chat room. One of the key benefits of a board meeting is the informed and meaningful discussion that occurs among directors. Consequently, state laws do not allow “virtual” meetings unless the organization is using a device that allows the board members to hear and speak to one another in real time, just as they would during an in-person meeting.

**14. If there is a quorum at the start of a board meeting, but one or more directors leave the meeting so that the number of those present falls below quorum, may the remaining directors continue to conduct business?**

Under the New Jersey Nonprofit Corporation Act, once a quorum is destroyed, no other business can take place except for adjournment. The Connecticut Nonstock Corporation Act and the New York Not-For-Profit Corporation Law do not have similar provisions. In these states, various court cases have examined the intent of directors who leave a meeting, thereby destroying a quorum. When a director’s intent is to destroy a quorum for improper purposes (i.e., to prevent the board from taking certain actions), courts have held that the meeting may continue even though a quorum no longer exists. However, when no such ill intent exists, courts have held that the only additional business that may take place is the adjournment of the meeting.

**15. Can the board of directors hold a meeting when neither the Chair nor Vice Chair are present? If so, who can call the meeting to order?**

In Connecticut, New Jersey, and New York, there is no statutory requirement that the Chair or Vice Chair be present to call to order a meeting of the board of directors. The only requirement is that a quorum be present. However, your organization may have more detailed requirements contained in its bylaws or certificate of incorporation. Therefore, before calling a board meeting without the Chair or Vice Chair, it is necessary to review your organization’s bylaws and certificate of incorporation to determine if there are specific requirements detailing who is authorized to preside at a meeting of the board.

**16. Are we subject to “sunshine laws”? Do we have to open our meetings to the public or make minutes of those meetings available to the public?**

The answer to both questions is probably not. Private nonprofit corporations generally are not

subject to sunshine laws. Sunshine laws apply to public and quasi-public agencies, meaning agencies established by local, state, or federal government, such as public school boards. These types of organizations must open their meetings and minutes to the public.

In general, only directors and invited staff should attend the board meetings of a nonprofit organization, and meeting minutes should note when other guests are in attendance. Minutes of board meetings are business records, and often contain confidential information about the organization, its personnel, or clients. For these reasons, minutes should not be shared with anyone who is not a director of the organization or a staff member or volunteer who needs to know their contents.

There are two major exceptions exception to the foregoing. First, an organization might be subject to public disclosure requirements based on contractual obligations arising out of funding it receives from government sources. Second, the Attorney Generals in Connecticut, New Jersey, and New York exercise supervisory authority over the charities located within their individual states and have authority to request documents from charities.

In addition, there are other public disclosure requirements that apply generally to nonprofit organizations. Upon request by any member of the public, a tax-exempt organization must provide a copy of the organization's application for tax-exempt status, which includes the IRS Form 1023 and any related correspondence with the IRS. The organization must also be able to produce copies of its annual tax returns (IRS Form 990, 990-EZ, or 990-N) for the three previous years. However, public charities are not required to disclose the names and addresses of their donors as reported on Schedule B of the Form 990.

For more detailed directions on when and how disclosure is required, the IRS has posted [responses](#) to frequently asked questions concerning an organization's obligation to disclose certain documents to the public. See also [IRS Publication 4221-PC, Compliance Guide for 501\(c\)\(3\) Public Charities](#).

**17. One of our board members has proposed that he provide his accounting services to the nonprofit for a reduced rate. How should we handle this?**

This is an example of a potential conflict of interest. Board members have a legal duty of loyalty that requires them to make decisions and enter into transactions that are in the best interests of the organization. Where a board member's self-interest could potentially conflict with the nonprofit's best interests, s/he must disclose the conflict and all the pertinent facts to the rest of the board and recuse him/herself from the deliberations and vote of the independent board members with respect to entering into the transaction. The independent board members must make an informed judgment as to whether it is in the organization's best interests to enter into the transaction, and whether the compensation/cost of such services is appropriate. The rationale for the board's decision should be documented in the minutes of the meeting. In this example, the accountant should inform the rest of the board what financial gain, if any, s/he (or possibly, his/her business or immediate family members) would realize from providing services to the nonprofit. Then the rest of the board must make an independent determination as to whether hiring the board member would be in the organization's best interests.

Boards should also beware of less obvious conflicts. For example, "insiders" (people or entities that exercise control over the nonprofit, such as board members, founding executive directors, and major donors) may not directly benefit from a transaction with the organization, but their immediate family members may. Those situations are also conflicts of interest and need to be handled just as if a board member was directly benefiting from the transaction. Failure to do so may subject the organization and the board members who approved the conflicted transaction to IRS penalties.

Note that an apparent conflict of interest does not automatically bar an organization from entering into a transaction with an interested board member. To the contrary, it will often be in the best interests of a nonprofit to receive services from an interested party, particularly when the services are offered at below-market rates.

Pro Bono Partnership strongly recommends that organizations adopt a written conflict of interest policy, which will guide the board in responding appropriately to potential conflicts of interest. In New York, all nonprofits are required to have a conflict of interest policy that conforms to certain statutory requirements. At the federal level, the application for tax-exempt status (Form 1023) and the annual informational tax return (Form 990) also ask organizations if they have a written conflict of interest policy. Contact the Pro Bono Partnership whenever you have questions about conflicts of interest or if you'd like to see a sample conflict of interest policy for board members.

#### **18. Can our organization make a loan to a board member?**

Generally speaking, loans to board members are not recommended, and in some states, they are prohibited. The assets of a tax-exempt organization are meant to further the organization's exempt public purposes; they are not a private bank for board members.

In Connecticut, loans to board members are permitted; however, directors who vote for or assent to the making of a loan to an officer or a director of the nonprofit are jointly and severally liable to the organization for the amount of the loan until it is repaid (meaning that each assenting director could be liable for the entire amount of the loan). In New Jersey, loans to board members are impermissible unless the loan is authorized by the certificate of incorporation or bylaws and approved by a two-thirds vote of the entire board (not counting the interested trustee). In New York, loans to board members are prohibited.

When permitted, loans to board members need to be carefully structured so as not to run afoul of IRS Intermediate Sanctions rules that govern transactions between tax-exempt organizations and "disqualified persons", a term that includes board members. For example, a loan to a board member should never be at a below-market interest rate. For these reasons, the Pro Bono Partnership advises that a nonprofit consult legal counsel before approving a loan to a board member.

#### **19. Can our charity make a donation to another charitable organization? Can we send flowers or make a memorial donation if someone close to our organization passes away?**

When considering a payment or charitable donation, the organization's board should ask: "Is it in our organization's best interests to use our assets in this fashion?" For the two questions above, the answer could be yes, depending upon the facts and details of the payments.

A charity may make a donation to another charitable organization, so long as the contribution will further the donating charity's mission and purposes. Such contributions are generally disclosed on the donating charity's Form 990 (its annual federal tax return) as a "grant" to another organization.

Similarly, when someone close to an organization dies, it may be appropriate to use some of the organization's assets to send the charity's condolences, assuming that the amount paid by the charity is reasonable.

#### **20. If our organization wants to go dormant for a period of time, what are the responsibilities of the board?**

In New York, New Jersey, and Connecticut, an inactive nonprofit must maintain a skeleton board

of at least three directors who are responsible for corporate filings during the inactive period. The organization must continue to abide by all state requirements. For example, it must continue to maintain a registered office and agent in the state where it is incorporated, and, if required, continue to file annual reports with the state. The organization must also continue to file an IRS Form 990, 990-EZ, or 990-N. There are no penalties for an organization that does not formally dissolve, but there are penalties for failing to make required state and federal filings and an organization that fails to file any version of the 990 for three consecutive years will have its tax-exempt status automatically revoked by the IRS.

### **Part 3: Organizational Records**

#### **21. How can we obtain a copy of our organization's certificate of incorporation?**

Obtaining a copy usually entails completing a form or writing a letter and submitting a payment for copying fees.

In Connecticut: Either submit a written request clearly stating the documents you want copied or fill out the form "Request for Certificates or Copies", available on the Connecticut Secretary of State website. The cost will vary, depending upon whether you are requesting a plain copy or a certified copy. You can specify expedited processing of your request (within 24 hours of receipt) for an additional charge.

In New Jersey: Submit a written request by mail to the New Jersey Division of Revenue, Records Unit, PO Box 450, Trenton, NJ 08646. Supply the number of a major credit card and its expiration date. There is a per-page fee. You may also request expedited service by faxing a request with credit card information to (609) 984-6855. The request will be processed within 8.5 business hours. The telephone number for the Records Unit is (609) 292-9292.

In New York: Send a letter stating your request to: New York State Department of State, Division of Corporations, One Commerce Plaza, 99 Washington Avenue, Albany, NY 12231. The cost will vary, depending upon whether you are requesting a plain copy or a certified copy. You can specify expedited processing of your request (with 24 hours of receipt) for an additional charge. Alternatively, the Division of Corporations will accept written requests for copies of documents by fax; the fax number is (518) 473-1654. Fees for faxed requests must be paid using your credit or debit card, and there is a required credit/debit card authorization form that must be submitted with your request.

#### **22. Our organization would like to change its name. What's involved?**

To change its official name, a nonprofit corporation must amend its certificate of incorporation by means of a board resolution approving the name change. The amendment must then be filed with the state where the nonprofit is incorporated. Each state has its own procedures for amending and its own filing fees.

After the amendment has been filed with the state, the nonprofit should send the IRS a copy of the filed amendment, with a cover letter explaining the name change and requesting that the Service issue an affirmation letter referencing the nonprofit by its new name. Copies of the amendment should also be sent to the Secretary of State in any other state(s) where the nonprofit is registered to do business.



In some cases, as an alternative to officially amending the corporation's name, a nonprofit might consider registering an alternate name for business use. Please contact Pro Bono Partnership for guidance on this issue.

#### **Part 4: Liability of Board Members**

##### **23. When can board members be personally liable?**

Generally, the limited liability structure of a corporation will shield board members from liability, but there are exceptions. As discussed in greater detail below, the most common scenario in which a board member may be personally liable is when the organization fails to file withholding taxes for its employees. In such cases, the state and federal taxing authorities have the authority to assess tax withholding payments and penalties directly from board members.

Another significant area of potential personal liability for board members is "private inurement", which occurs when a director or a member of a director's family receives an excessive amount of compensation from the charity. In such cases, the directors who approved the transaction and the person who received the excessive benefit can be subject to penalties in the form of excise taxes. For guidance on what the IRS considers "automatic" excess benefit transactions, click [here](#).

Although the corporate structure generally protects directors from liability, if a lawsuit is filed against a nonprofit, the plaintiff may name board members as individual defendants. For this reason, the Partnership recommends purchasing D&O (Directors & Officers) liability insurance and, where appropriate, employment practices liability coverage, both of which can cover board members' defense costs.

##### **24. I serve as a volunteer board member for a nonprofit organization. Will my own homeowner's insurance policy or my personal umbrella liability policy provide protection to me from any liability for my service as a volunteer board member?**

Possibly, but any such protection will be very limited. Some umbrella policies or homeowner's policies have a clause that will protect the policyholder in his/her capacity as an unpaid board member. Board members may wish to check their own policies to see if they contain such a clause and should confirm coverage with their insurance agents. However, any such protection generally applies only to claims for personal injury or property damage (e.g., a lawsuit stemming from a slip-and-fall in the nonprofit's offices).

An umbrella or homeowner's policy will not cover most of the other types of claims that are likely to result in a suit against a board member – for example, claims for breach of fiduciary duty, misappropriation of funds, wrongful termination, or harassment. Board members are best served by ensuring that their organizations have D&O (Directors and Officers) liability insurance and, where appropriate, employment practices liability coverage.

##### **25. Can a volunteer board member be held personally liable for a nonprofit's failure to either withhold and remit payroll taxes or pay employees?**

In some circumstances, yes. A board member or manager with control over the financial affairs of a nonprofit can be held personally liable for the organization's failure to withhold and remit payroll taxes to the appropriate state and federal taxing authorities and/or pay employees.

Section 6672(a) of the Internal Revenue Code imposes a penalty on any “responsible person” who willfully evades or fails to collect, pay, or account for payroll taxes. Similar liability is imposed under the laws of Connecticut, New Jersey, and New York.

For example, if an organization’s monthly finance reports showed unpaid tax liabilities, and the board member responsible for reviewing and approving those reports did not act to ensure that the organization paid the liabilities, he/she could be held personally liable for the unpaid taxes. Liability may attach even if that board member was not the only person responsible for the payment of the taxes; delegating a staff employee the authority to remit payroll taxes will not necessarily relieve the board member from personal liability.

Thus, a board member who is aware of a tax problem (or reasonably should be aware), and does nothing, faces potential personal liability. In contrast, a board member who addresses a tax problem in a timely fashion and makes sure the IRS and/or state taxation authorities are paid generally will not be liable. If a board is aware of a tax problem and decides not to resolve tax arrearage in a timely manner, any dissenting board members should consider resigning from the organization.

A board member who joins a nonprofit that owes back withholdings to the IRS and/or state taxation authority generally will not be individually liable if the board member, upon learning of the arrearages, takes steps to ensure that: (1) current withholding taxes are being timely remitted; and (2) the nonprofit pays the past monies owed (which may require establishing a payment schedule with the IRS and/or state taxation authority).

In difficult financial times, executive directors and boards often wrestle with questions of which monthly bills to pay first. It’s almost always in the organization’s best interest to prioritize timely payment of wages to employees first, then withholdings to the tax collectors, then payment to other creditors, then any other bills.

It is generally not legal to delay paying employees, even if the employees agree to the delay. Board members and managers who have sufficient control over the financial affairs of a corporation may be liable to employees for the organization’s failure to pay wages on a timely basis.

However, a nonprofit facing a cash flow shortage should not ignore any bill from any source. Nonpayment to creditors can result in costly interest, late fees, liens, service shut-offs, and other legal exposure to the organization. A nonprofit in these circumstances is advised to contact each creditor to work out any necessary extensions or payment schedules. Doing so will help the organization avoid default and other negative consequences.

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