



# What You Need To Know About Serving on NONPROFIT BOARDS

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**WHAT YOU NEED TO KNOW  
ABOUT SERVING ON  
NONPROFIT BOARDS**



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**TEXAS YOUNG LAWYERS ASSOCIATION**

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## INTRODUCTION

Members of the Texas Young Lawyers Association (TYLA) strive on a daily basis to represent the motto that the organization adopted a while ago: “Be an Uncommon Leader.”

Nonprofit organizations play a pivotal role in our society as organizations that focus on advancing a public interest rather than focusing solely on generating profits. As such, nonprofit organizations are truly a breeding ground for Uncommon Leaders. TYLA has compiled several relevant articles for leaders that serve or want to serve in a nonprofit organization. Effective service on an organization, whether as a board member, officer or volunteer, requires skill and experience, but also knowledge. This TYLA publication is aimed to provide a general overview of the main subjects and issues that arise from a legal perspective for those people serving in a leadership position of a nonprofit organization.

# FORM OF NONPROFIT ORGANIZATIONS IN TEXAS

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## Synopsis:

*There are multiple entity options for Texas nonprofit organizations and many considerations for each. These considerations include, but are not limited to, complexity of formation or governance, funding, and tax-exemption concerns. This Chapter will provide a brief overview of these Texas-entity options as well as discussion regarding some of the primary considerations when forming a Texas nonprofit.*

## Introduction

In Texas, there are two primary forms of nonprofit organizations – Unincorporated Nonprofit Associations<sup>1</sup> and Nonprofit Corporations<sup>2</sup>. Each are authorized by the TEXAS BUSINESS ORGANIZATIONS CODE.<sup>3</sup>

## Unincorporated Nonprofit Associations

An Unincorporated Nonprofit Association (“Association”) is defined as “an unincorporated organization, other than one created by a trust, consisting of three or more members joined by mutual consent for a common, nonprofit purpose. A form of joint tenancy, tenancy in common, or tenancy by the entirety does not by itself establish a nonprofit association, regardless of whether the co-owners share use of the property for a nonprofit purpose.”<sup>4</sup>

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<sup>1</sup> TEX. BUS. ORGS. CODE ANN. §§ 252.001-.018

<sup>2</sup> TEX. BUS. ORGS. CODE ANN. §§ 22.001-.516

<sup>3</sup> TEX. BUS. ORGS. CODE ANN. §§ 252.001-.018; TEX. BUS. ORGS. CODE ANN. §§ 22.001-.516

<sup>4</sup> TEX. BUS. ORGS. CODE ANN. § 252.001(2)

An Association is simpler than a Nonprofit Corporation. As the name suggests, an “Unincorporated” Association does not formally incorporate like a Nonprofit Corporation and does not file formation documents with the Texas Secretary of State.<sup>5</sup> However, although not a formally organized entity, an Association is considered an entity separate and apart from its members.<sup>6</sup>

Additionally, subject to certain requirements regarding the contents of the Statement, an Association may, optionally, file a Statement registering an Agent (Registered Agent) with the Texas Secretary of State.<sup>7</sup> The Association may also amend or cancel a Statement appointing a Registered Agent.<sup>8</sup> Each of these Statements or filings is subject to fees imposed by the Texas Secretary of State.<sup>9</sup> The Texas Secretary of State provides a Form (Form 706) for registering an Agent.<sup>10</sup> In addition, the Association may, optionally, file a Statement of Authorization regarding real property with the county clerk offices throughout the state.<sup>11</sup>

A member is not liable for the liabilities, acts, or omissions of the Association based solely upon their status as a member.<sup>12</sup> Additionally, even when the Association is liable for a member’s acts or omissions, that liability is not imputed to other members of the Association based solely upon their status as a member.<sup>13</sup> Members and the Association may assert claims against one another.<sup>14</sup>

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<sup>5</sup> See TEX. BUS. ORGS. CODE ANN. §§ 252.001-.018; Texas Secretary of State: Nonprofit Organizations FAQs, <https://www.sos.state.tx.us/corp/nonprofitfaqs.shtml> (last visited Feb. 28, 2022)

<sup>6</sup> TEX. BUS. ORGS. CODE ANN. § 252.006(a)

<sup>7</sup> TEX. BUS. ORGS. CODE ANN. § 252.011(a)-(c)

<sup>8</sup> TEX. BUS. ORGS. CODE ANN. § 252.011(e)-(f)

<sup>9</sup> TEX. BUS. ORGS. CODE ANN. § 252.011(d)

<sup>10</sup> TEX. BUS. ORGS. CODE ANN. § 252.011(g); [https://www.sos.state.tx.us/corp/forms/706\\_boc.pdf](https://www.sos.state.tx.us/corp/forms/706_boc.pdf)

<sup>11</sup> TEX. BUS. ORGS. CODE ANN. § 252.005

<sup>12</sup> TEX. BUS. ORGS. CODE ANN. § 252.006(b)

<sup>13</sup> TEX. BUS. ORGS. CODE ANN. § 252.006(c)

<sup>14</sup> TEX. BUS. ORGS. CODE ANN. § 252.006(d)

An Association must keep complete and accurate books and records of its accounts covering at least the previous three (3) years.<sup>15</sup> Additionally, upon request of a member, the Association must make the books and records available for inspection and copying.<sup>16</sup> The attorney general may investigate the Association for potential violations of law and may inspect, examine, and make copies of the books, records, and other documents the attorney general considers necessary.<sup>17</sup>

An Association may qualify for 501(c)(3) status from the Internal Revenue Service (“IRS”) like other entities, but it must meet all requirements, file all forms, and obtain approval from the IRS.<sup>18</sup> The Association must satisfy the financial and activity-related constraints applicable to 501(c)(3) entities.<sup>19</sup>

## **Nonprofit Corporations**

Alternatively, a nonprofit may formally organize and incorporate as a Nonprofit Corporation (“Corporation”) under TEXAS BUSINESS ORGANIZATIONS CODE Chapter 22.<sup>20</sup>

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<sup>15</sup> TEX. BUS. ORGS. CODE ANN. § 252.010(a)

<sup>16</sup> TEX. BUS. ORGS. CODE ANN. § 252.010(a)

<sup>17</sup> TEX. BUS. ORGS. CODE ANN. § 252.010(b)

<sup>18</sup> IRS PUBLICATION 557, at 22, <https://www.irs.gov/pub/irs-pdf/p557.pdf> (“To qualify, the organization must be organized as a corporation (including a limited liability company), unincorporated association, or trust. Sole proprietorships, partnerships, individuals, or loosely associated groups of individuals won’t qualify.”); *See also* About Publication 557, Tax-Exempt Status for Your Organization, <https://www.irs.gov/forms-pubs/about-publication-557> (last visited Feb. 28, 2022)

<sup>19</sup> 26 U.S.C. § 501(c)(3) (“...no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”)

<sup>20</sup> TEX. BUS. ORGS. CODE ANN. §§ 22.001-.516



## ***Organizational Meeting***

After the certificate of formation is filed, the board of directors named in the certificate of formation of a Corporation shall hold an organizational meeting of the board at the call of the organizers or a majority of the directors to adopt bylaws, elect officers, and for other purposes determined by the board at the meeting.<sup>21</sup> The organizers or directors calling the meeting shall send notice of the time and place of the meeting to each director named in the certificate of formation not later than the third day before the date of the meeting.<sup>22</sup>

## ***Members***

A Corporation may have one or more classes of members or may have no members.<sup>23</sup> If the Corporation has one or more classes of members, the corporation's certificate of formation or bylaws must include:

- (1) a designation of each class;
- (2) the manner of the election or appointment of the members of each class; and
- (3) the qualifications and rights of the members of each class.<sup>24</sup>

A Corporation may issue a certificate, card, or other instrument evidencing membership rights, voting rights, or ownership rights as authorized by the certificate of formation or bylaws.<sup>25</sup>

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<sup>21</sup> TEX. BUS. ORGS. CODE ANN. § 22.104(a)

<sup>22</sup> TEX. BUS. ORGS. CODE ANN. § 22.104(a)

<sup>23</sup> TEX. BUS. ORGS. CODE ANN. § 22.151(a)

<sup>24</sup> TEX. BUS. ORGS. CODE ANN. § 22.151(b)

<sup>25</sup> TEX. BUS. ORGS. CODE ANN. § 22.151(c)

## *Meetings*

### **Annual Meeting**

Generally, a Corporation shall hold an annual meeting of the members at a time that is stated in or determined in accordance with the Corporation's bylaws.<sup>26</sup> If the bylaws provide for more than one regular meeting of members each year, an annual meeting is not required.<sup>27</sup> If an annual meeting is not required, directors may be elected at a meeting as provided by the bylaws.<sup>28</sup>

### **Notice of Meeting**

Except for churches, a Corporation shall provide written notice of the place, date, and time of a members' meeting.<sup>29</sup> If the meeting is a special meeting, the notice must also state the meetings' purpose(s).<sup>30</sup> The notice shall be delivered to each member entitled to vote at the meeting not later than the 10th day and not earlier than the 60th day before the date of the meeting.<sup>31</sup>

Notice may be delivered personally, by pre-paid mail addressed to the person's address as noted on the membership records of the entity, transmitted by facsimile, or transmitted by electronic message.<sup>32</sup>

### **Special Bylaws Affecting Notice**

A Corporation may provide in the bylaws that notice of an annual or regular meeting is not required.<sup>33</sup> A Corporation having more than 1,000 members at the time a meeting is scheduled or called may

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<sup>26</sup> TEX. BUS. ORGS. CODE ANN. § 22.153(a)

<sup>27</sup> TEX. BUS. ORGS. CODE ANN. § 22.153(b)

<sup>28</sup> TEX. BUS. ORGS. CODE ANN. § 22.153(b)

<sup>29</sup> TEX. BUS. ORGS. CODE ANN. § 22.156(a)

<sup>30</sup> TEX. BUS. ORGS. CODE ANN. § 22.156(a)

<sup>31</sup> TEX. BUS. ORGS. CODE ANN. § 22.156(a)

<sup>32</sup> TEX. BUS. ORGS. CODE ANN. §§ 22.156(a), 6.051(b).

<sup>33</sup> TEX. BUS. ORGS. CODE ANN. § 22.157(a)

provide notice of a meeting by publication in a newspaper of general circulation in the community in which the principal office of the Corporation is located (if the Corporation provides for that notice in its bylaws).<sup>34</sup>

### **Preparation and Inspection of List of Voting Members**

After setting a record date for notice of a meeting, the Corporation shall prepare an alphabetical list of all the names of all its voting members.<sup>35</sup> The list must identify:

- (1) the members who are entitled to notice and the members who are not entitled to notice of the meeting;
- (2) the address of each voting member; and
- (3) the number of votes each voting member is entitled to cast at the meeting.<sup>36</sup>

Not later than the second business day after the date notice is given of a meeting, and continuing through the meeting, the list of voting members must be available at the corporation's principal office or at a reasonable place in the municipality in which the meeting will be held.<sup>37</sup>

### **Voting of Members**

A Quorum of members, unless otherwise specified in the certificate of formation or bylaws, is established by members holding one-tenth of the votes entitled to be cast.<sup>38</sup> The vote of the majority of the votes entitled to be cast unless the vote of a greater number is required by law or the certificate of formation or bylaws, is the action of the members.<sup>39</sup> There are differing rules for churches.<sup>40</sup>

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<sup>34</sup> TEX. BUS. ORGS. CODE ANN. § 22.157(b)

<sup>35</sup> TEX. BUS. ORGS. CODE ANN. § 22.158(a)

<sup>36</sup> TEX. BUS. ORGS. CODE ANN. § 22.158(a)

<sup>37</sup> TEX. BUS. ORGS. CODE ANN. § 22.158(b)

<sup>38</sup> TEX. BUS. ORGS. CODE ANN. § 22.159(a)

<sup>39</sup> TEX. BUS. ORGS. CODE ANN. § 22.159(b)

Each member of the Corporation, regardless of class, is entitled to one vote on each matter submitted to a vote of the Corporation's members, except to the extent that the voting rights of members of a class are limited, enlarged, or denied by the certificate of formation or bylaws of the Corporation.<sup>41</sup>

If authorized by the certificate of formation or bylaws of the Corporation, a member vote on any matter may be conducted by mail, by facsimile transmission, by electronic message, or by any combination of those methods.<sup>42</sup>

## ***Board Members***

### **Board Member Eligibility Requirements**

A director of the Corporation is not required to be a resident of this state or a member of the Corporation unless the certificate of formation or a bylaw of the Corporation imposes that requirement.<sup>43</sup> The certificate of formation or bylaws may prescribe other qualifications for directors.<sup>44</sup>

### **Number on the Board of Directors**

If the Corporation has a board of directors, the Corporation may not have fewer than three directors.<sup>45</sup> The number of directors shall be set by, or in the manner provided by, the certificate of formation or bylaws of the Corporation, except that the number of directors on the initial board of directors must be set by the certificate of formation.<sup>46</sup>

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<sup>40</sup> *E.g.*, TEX. BUS. ORGS. CODE ANN. § 22.159(c)

<sup>41</sup> TEX. BUS. ORGS. CODE ANN. § 22.160(a)

<sup>42</sup> TEX. BUS. ORGS. CODE ANN. § 22.160(d)

<sup>43</sup> TEX. BUS. ORGS. CODE ANN. § 22.203

<sup>44</sup> TEX. BUS. ORGS. CODE ANN. § 22.203

<sup>45</sup> TEX. BUS. ORGS. CODE ANN. § 22.204(a)

<sup>46</sup> TEX. BUS. ORGS. CODE ANN. § 22.204(a)

The number of directors may be increased or decreased by amendment to, or in the manner provided by, the certificate of formation or bylaws.<sup>47</sup> A decrease in the number of directors may not shorten the term of an incumbent director.<sup>48</sup> Unless the certificate of formation or bylaws state otherwise, the number of directors is the same as the number constituting the initial board of directors.<sup>49</sup>

### **Designation of Initial Board of Directors**

If the Corporation is to be managed by a board of directors, the certificate of formation of the Corporation must state the names of the members of the initial board of directors.<sup>50</sup>

### **Election or Appointment of Board of Directors**

Directors other than the initial directors are elected, appointed, or designated in the manner provided by the certificate of formation or bylaws.<sup>51</sup> If the method of election, designation, or appointment is not provided by the certificate of formation or bylaws, directors, other than the initial directors, are elected by the board of directors.<sup>52</sup>

A member entitled to vote at an election of directors is entitled to vote for as many persons as there are directors to be elected and for whose election the member has a right to vote.<sup>53</sup> If expressly authorized by the Corporation's certificate of formation, the member may cumulate the member's vote by:

- (1) giving one candidate a number of votes equal to the number of the directors to be elected multiplied by the member's vote; or

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<sup>47</sup> TEX. BUS. ORGS. CODE ANN. § 22.204(b)

<sup>48</sup> TEX. BUS. ORGS. CODE ANN. § 22.204(b)

<sup>49</sup> TEX. BUS. ORGS. CODE ANN. § 22.204(c)

<sup>50</sup> TEX. BUS. ORGS. CODE ANN. § 22.205

<sup>51</sup> TEX. BUS. ORGS. CODE ANN. § 22.206.

<sup>52</sup> TEX. BUS. ORGS. CODE ANN. § 22.206.

<sup>53</sup> TEX. BUS. ORGS. CODE ANN. § 22.161(a)

(2) distributing the votes on the same principle among any number of the candidates.<sup>54</sup>

A member who intends to cumulate votes shall give written notice of the member's intention to the secretary of the Corporation not later than the day preceding the date of the election.<sup>55</sup>

### **Term of Office**

Unless the director resigns or is removed, a director on the initial board of directors of the Corporation holds office until the first annual election of directors or for the period specified in the certificate of formation or bylaws of the Corporation.<sup>56</sup> Directors other than the initial directors are elected, appointed, or designated for the terms provided by the certificate of formation or bylaws.<sup>57</sup>

In the absence of a provision in the certificate of formation or bylaws setting the term of office for directors, a director holds office until the next annual election of directors and until a successor is elected, appointed, or designated and qualified.<sup>58</sup>

### **Removal of Director**

A director of the Corporation may be removed from office under any procedure provided by the certificate of formation or bylaws of the Corporation.<sup>59</sup> In the absence of a provision for removal in the certificate of formation or bylaws, a director may be removed from office, with or without cause, by the persons entitled to elect, designate, or appoint the director.<sup>60</sup> If the director was elected to

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<sup>54</sup> TEX. BUS. ORGS. CODE ANN. § 22.161(b)

<sup>55</sup> TEX. BUS. ORGS. CODE ANN. § 22.161(c)

<sup>56</sup> TEX. BUS. ORGS. CODE ANN. § 22.208(a)

<sup>57</sup> TEX. BUS. ORGS. CODE ANN. § 22.208(a)

<sup>58</sup> TEX. BUS. ORGS. CODE ANN. § 22.208(b)

<sup>59</sup> TEX. BUS. ORGS. CODE ANN. § 22.211(a)

<sup>60</sup> TEX. BUS. ORGS. CODE ANN. § 22.211(b)

office, removal requires an affirmative vote equal to the vote necessary to elect the director.<sup>61</sup>

### *Officers*

The officers of the Corporation shall include a president and a secretary and may include one or more vice presidents, a treasurer, and other officers and assistant officers as considered necessary.<sup>62</sup> Any two or more offices, other than the offices of president and secretary, may be held by the same person.<sup>63</sup>

### **Election or Appointment of Officers**

An officer of the Corporation shall be elected or appointed at the time, in the manner, and for the terms prescribed by the certificate of formation or bylaws of the Corporation.<sup>64</sup> The term of an officer may not exceed three years.<sup>65</sup>

If the certificate of formation or bylaws do not include provisions for the election or appointment of officers, the officers shall be elected or appointed annually by the board of directors or, if the management of the Corporation is vested in the Corporation's members, by the members.<sup>66</sup>

### *Maintaining Finances*

### **Financial Records and Annual Reports**

The Corporation shall maintain current and accurate financial records with complete entries as to each financial transaction of the

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<sup>61</sup> TEX. BUS. ORGS. CODE ANN. § 22.211(b)

<sup>62</sup> TEX. BUS. ORGS. CODE ANN. § 22.231(a)

<sup>63</sup> TEX. BUS. ORGS. CODE ANN. § 22.231(a)

<sup>64</sup> TEX. BUS. ORGS. CODE ANN. § 22.232(a)

<sup>65</sup> TEX. BUS. ORGS. CODE ANN. § 22.232(a)

<sup>66</sup> TEX. BUS. ORGS. CODE ANN. § 22.232(b)

Corporation, including income and expenditures, in accordance with generally accepted accounting principles.<sup>67</sup>

The board of directors of the Corporation shall annually prepare or approve a financial report for the Corporation for the preceding year.<sup>68</sup> The report must conform to accounting standards as adopted by the American Institute of Certified Public Accountants and must include:

- (1) a statement of support, revenue, and expenses;
- (2) a statement of charges in fund balances;
- (3) a statement of functional expenses; and
- (4) a balance sheet for each fund.<sup>69</sup>

### **Availability of Financial Information for Public Inspection**

The Corporation shall keep records, books, and annual reports of the Corporation's financial activity at the Corporation's registered or principal office in Texas for at least three years after the close of the fiscal year.<sup>70</sup>

The Corporation shall make the records, books, and reports available to the public for inspection and copying during regular business hours.<sup>71</sup> The Corporation may charge a reasonable fee for preparing a copy of a record or report.<sup>72</sup>

### **LLCs**

Although limited liability companies ("LLCs") are a popular form of business entity in Texas, they are not a prevalent option, at this time, for establishing a nonprofit organization. Additionally, the TEXAS

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<sup>67</sup> TEX. BUS. ORGS. CODE ANN. § 22.352(a)

<sup>68</sup> TEX. BUS. ORGS. CODE ANN. § 22.352(b)

<sup>69</sup> TEX. BUS. ORGS. CODE ANN. § 22.352(b)

<sup>70</sup> TEX. BUS. ORGS. CODE ANN. § 22.353(a)

<sup>71</sup> TEX. BUS. ORGS. CODE ANN. § 22.353(b)

<sup>72</sup> TEX. BUS. ORGS. CODE ANN. § 22.353(b)



BUSINESS ORGANIZATIONS CODE does not use the term “nonprofit limited liability companies.”<sup>73</sup>

Unlike for-profit corporations, which are expressly prohibited from forming for nonprofit activities, LLCs are not expressly prohibited from forming for nonprofit activities.<sup>74</sup> Therefore, it is possible to form a Texas LLC for a nonprofit purpose.

However, it is important to note that the IRS has rules applicable to LLCs seeking tax exempt status.<sup>75</sup>

All organizations and entities should seek professional advice and assistance when forming a nonprofit or seeking tax exemption.

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<sup>73</sup> See TEX. BUS. ORGS. CODE ANN. § 101.001

<sup>74</sup> Compare TEX. BUS. ORG. ANN. § 2.008 (“A corporation formed for the purpose of operating a nonprofit institution, including an institution devoted to a charitable, benevolent, religious, patriotic, civic, cultural, missionary, educational, scientific, social, fraternal, athletic, or aesthetic purpose, may be formed and governed only as a nonprofit corporation under this code and not as a for-profit corporation under this code.”), *with* TEX. BUS. ORG. ANN. § 101.001-.622

<sup>75</sup> *E.g.*, IRS PUBLICATION 557, at 5, 22, <https://www.irs.gov/pub/irs-pdf/p557.pdf>  
See also About Publication 557, Tax-Exempt Status for Your Organization, <https://www.irs.gov/forms-pubs/about-publication-557> (last visited Feb. 28, 2022)

# FORMATION AND TAX CONSIDERATIONS FOR TEXAS NONPROFIT ORGANIZATIONS

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## Synopsis:

*People often believe that all nonprofits are automatically exempt from paying federal income tax and that their organizations may automatically receive tax-deductible contributions. The purpose of this article is to give a brief overview of the process a nonprofit organization should follow in order to obtain tax-exempt status under the Internal Revenue Code. The first section of this article provides a brief introduction of some of the main issues that nonprofit organizations have to consider when deciding to seek tax exempt status. The second section of this article discusses the main documents that nonprofit organizations will require to apply for tax exempt status. The third section of the article describes the rules applicable to Texas State Franchise and Sale Tax for exempt organizations. Finally, the fourth section of this article discusses the main differences between a public charity and a private foundation as vehicles to receive tax-deductible funding.*

## Introduction

One of the greatest benefits that not-for-profit organizations have is that they may qualify and seek recognition of exemption from federal income tax under the Internal Revenue Code (the “Code”). However, nonprofit organizations must apply and seek recognition as it is not given automatically or *de facto* by the Internal Revenue Service (the “IRS”). Another benefit that organizations described in section 501(c)(3) of the Code have, is that, other than testing for public safety organizations, 501(c)(3) organizations are eligible to receive tax-deductible contributions in accordance with section 170 of the Code.<sup>1</sup>

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<sup>1</sup> *Idem.*

Once an organization submits an application and it is approved by the IRS, the IRS will then issue a determination letter recognizing the organization's exemption, as well as certain other information that would apply generally to all exempt organizations.

## **Obtaining Tax Exempt Status**

The most important requirement to qualify for exemption under the Code is that the nonprofit organization must be organized for one or more of the purposes specifically designated in the Code.<sup>2</sup> Therefore, the first element a nonprofit organization has to determine is if the organization and its activities in fact actually fall within 501(c)(3) exemption category. The IRS provides that an organization may qualify for exemption from federal income tax under section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- Religious
- Charitable
- Scientific
- Testing for public safety
- Literary
- Educational
- Fostering national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment)
- The prevention of cruelty to children or animals<sup>3</sup>

Thus, to be tax-exempt under section 501(c)(3) of the Code, an organization has to be organized and operated exclusively for the purposes set forth above. In addition, the organization's earnings must not inure to any private shareholder or individual. The IRS further provides that the organization may not be an "action organization",

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<sup>2</sup> IRS PUBLICATION 557, at 3, <https://www.irs.gov/pub/irs-pdf/p557.pdf>; *See also* About Publication 557, Tax-Exempt Status for Your Organization, <https://www.irs.gov/forms-pubs/about-publication-557> (last visited March 30, 2022)

<sup>3</sup> *Idem*, at 22.

i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates.<sup>4</sup>

IRS Publication 557 explicitly provides that to qualify, the organization must be organized as a corporation (including a limited liability company), unincorporated association, or trust. Sole proprietorships, partnerships, individuals, or loosely associated groups of individuals won't qualify. The Texas Business Organizations Code specifically authorizes and regulates the two main forms of business organization for nonprofits which are Unincorporated Nonprofit Associations and Nonprofit Corporations.

Nonprofit organizations often incorporate in the state where their operations are located. The organization may also need to register to do business in other states if it has a sufficient physical presence in such other states. Unless the organization actually has a principal place of business in a state other than Texas, or solicits charitable funds in other states, it would not need to register as a charity in any state.

### **Applying for Tax Exempt Status**

Organizations described in section 501(c)(3) of the Code are commonly referred to as charitable organizations.<sup>5</sup> The most common form of organization for nonprofit organizations that seek to obtain tax exempt status in Texas is the Nonprofit Corporation.

The main documents that a Nonprofit Corporation would need to complete the Form 1023, Application for Recognition of Exemption under Section 501(c)(3) or Form 1023-EZ, Streamlined Application<sup>6</sup>, are the following:

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<sup>4</sup> See Exemption Requirements - 501(c)(3) Organizations, <https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3-organizations> (last visited March 30, 2022)

<sup>5</sup> *Idem.*

<sup>6</sup> Form 1023-EZ is the streamlined version of Form 1023, Application for Recognition of Exemption Under Section 501(c) (3) of the Internal Revenue Code. Form 1023-EZ is available for organizations with assets of \$250,000 or less and annual gross receipts of \$50,000 or less.

- *Certificate of Formation.* The Certificate of Formation which would be filed with the Texas Secretary of State and will legally form the organization. A Texas registered agent would be named in the Certificate of Formation.
- *Resolutions of the Board of Directors.* The Board of Directors would adopt resolutions approving the organization bylaws, electing officers, and approving other organizational matters.
- *Bylaws.* The bylaws govern the management of the organization and are generally the operation manual of the governance of the organization.
- *Conflict of Interest Policy.* Nonprofit organizations need a board-approved Conflict of Interest Policy. A conflict of interest policy governs the process to follow when a conflict of interest (or potential conflict of interest) arises.
- *Application for Employer Identification Number (Form SS-4).* The organization will need an EIN before it can open a bank account or apply for tax exempt status. The form is completed online at the IRS website once the corporation has been created.

Nowadays the application is done entirely in electronic form and it can be submitted at any time after the organization has been incorporated and the other organizational matters outlined above have been completed. The application asks for detailed information regarding the organization's governance and contemplated activities, and it takes time to prepare and finalize. Some of the information required in the application includes a detailed narrative of the activities the organization will conduct, an estimate of the total amount of contributions the organization intends to receive, as well as a list of estimated expenses (including grants) to be paid. The IRS only requires the organization to provide estimates in order to give the IRS some idea of the total amounts to be received and distributed by an organization during its initial three-year period.

Once the application is submitted, unless there are request letters from the IRS, the approval process is likely to take at least 4-6 months.

### **Texas State Franchise and Sale Tax for Exempt Organizations**

Nonprofit organizations should also consider specific state requirements that apply to their organizations. Nonprofit organizations should register as a charitable organization in the state in which it has its principal office, if any, or in any state in which it solicits charitable funds. In Texas, nonprofit organizations are subject to regulations by the Office of the Comptroller in Texas.

Every profit and nonprofit corporation in Texas must file all franchise tax reports and public information reports with appropriate payment until the Texas Comptroller's office has granted tax exemption. Failure to do so will cause the loss of corporate privileges as well as the forfeiture of charter by the Texas Secretary of State.

In order to be exempt of state sales and franchise tax, a nonprofit charitable organization "must devote all or substantially all of its activities to the alleviation of poverty, disease, pain and suffering by providing food, drugs (medicine), medical treatment, shelter, clothing or psychological counseling directly to indigent or similarly deserving individuals for little or no fee. The organization's funds must be derived primarily from sources other than fees or charges for its services."<sup>7</sup> 501(c)(3), (4), (8), (10) or (19) organizations are exempt from Texas franchise tax and sales tax, but being classified as a 501(c) organization is not a requirement to qualify for the state tax exemption.

To apply for franchise and sales tax exemptions, nonprofit charitable organizations must complete and submit Form AP-204, Texas Application for Exemption – Federal and All Others (PDF) to the Texas Comptroller's office. If the organization has already received the 501(c)(3) determination letter from the IRS, then the organization only has to include a copy of the IRS-issued exemption determination

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<sup>7</sup> Texas Application for Exemption – Charitable Organizations, AP-205-2(Rev.12-18/10)

letter with any addenda, otherwise the organization must submit additional organizational documents and information pursuant to the application.<sup>8</sup>

Once a nonprofit organization is approved for exemption, the organization has to provide the exemption certificate to the applicable vendors in order for the purchase, lease, or rental of a taxable item to be exempt. Note that, in any event, exempt organizations that sell taxable items must obtain sales tax permits and must collect and remit any tax on sale of taxable items.<sup>9</sup>

### **Funding a Nonprofit Organization – Public Charity or Private Foundation**

Another crucial item that nonprofit organizations have to determine is whether the organization will have *Public Charity* or *Private Foundation* status.

The main difference between a public charity and a private foundation is that public charities get funding from the general public while a private foundation gets funding from a small group of donors. As such, private foundations allow the organization to stay in “control” of the donor and allows to set it up in a way that the donor’s charitable giving continues as originally set up by the donor (i.e. usually allows donors to set up foundations that continue ever after the death of the donor). However, private foundations are subject to more onerous rules and reporting requirements than public charities.

- *Private Foundation.* Each and every organization that has qualified for tax exemption as a 501(c)(3) organization is deemed to be a private foundation, unless it explicitly falls in a category that excludes the organization from such term (i.e. hospitals or universities and those organizations with broad

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<sup>8</sup> See Texas Comptroller - Taxes, [https://comptroller.texas.gov/taxes/exempt/501\(c\)-exemptions-1.php](https://comptroller.texas.gov/taxes/exempt/501(c)-exemptions-1.php) (last visited April 14, 2022)

<sup>9</sup> See Title 34 of the Texas Administrative Code, §3.322(h)(1).

public support).<sup>10</sup> In addition, certain nonexempt charitable trusts are also treated as private foundations. Organizations that fall into the excluded categories are institutions such as hospitals or universities and those that generally have broad public support or actively function in a supporting relationship to such organizations.

- *Public Charity Status.* In order to qualify as a public charity under section 501(c)(3) (as opposed to a private foundation), the organization will need to show that it receives its funding from a broad base of support rather than a small number of private donors. The organization will have 5 years to show that it meets the IRS's public support test (generally, one-third of the support of the organization must come from "public" sources over the 5-year measuring period) and qualifies as a public charity.

Some of the main reporting requirements, restrictions and burdens that apply specifically to private foundations, include: (i) annually filing Form 990-PF, Return of Private Foundation (Forms 990-PF and 1023 (where applicable) are subject to public disclosure); (ii) being subject to an excise tax on the net investment income (applicable to most domestic private foundations); (iii) being subject to a tax on gross investment income derived from United States sources; (iv) being subject to certain restrictions on self-dealing between private foundations and their substantial contributors and other disqualified persons; (v) requiring that the foundation annually distributes income for charitable purposes; (vi) being subject to limits on the private foundation holdings in private businesses; (viii) being subject to provisions that investments must not jeopardize the carrying out of exempt purposes; and (ix) provisions to assure that expenditures further exempt purposes.<sup>11</sup>

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<sup>10</sup> See Private Foundations, <https://www.irs.gov/charities-non-profits/charitable-organizations/private-foundations> (last visited March 30, 2022)

<sup>11</sup> *Idem.*



# WHAT DO NONPROFIT BOARDS DO?

**Nick Guinn**  
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## **Synopsis:**

*As a young professional you are often bombarded with directives to “get involved” and “join nonprofit boards.” You know you should do it, but do you know what it entails? Read this article and learn what board membership entails—from board meetings to committees and everything in between.*

## **Introduction**

Before joining a nonprofit board, it is important to appreciate the activities of nonprofit boards. While a nonprofit organization may endeavor to improve the lives of members of the community, help the environment, or perform other tasks for the betterment of others, the board makes higher level decisions about the operations envisioned of the nonprofit itself. While volunteers and staff have their boots on the ground, can serve on nonprofit boards, nonprofit boards often comprise members of the community who provide particular skills and expertise. These members might include lawyers, accountants, advertising moguls, and other professionals. It is a benefit when the board members have an interest and passion for the missions of the nonprofit, although that is not necessarily a requirement.

nonprofit boards meet at regular intervals (monthly, bimonthly, quarterly, etc.). The board meets to discuss one of several topics, which may generally fall into the categories of old and new business. Old business frequently includes updates from one or more committees (i.g., committee reports). For example, the finance and social committees might provide updates on what they have been working on and what they plan to work on moving forward. Old business

might also involve recaps of recently encountered projects or ongoing updates. New business involves topics that the board has not discussed previously but is worthy of discussion to the board.

Board meetings may last thirty minutes, an hour, half a day, etc. Board members generally have an idea of how much time they should allocate to the board meeting, depending on the meeting's topic. Ideally, the secretary or someone else on the leadership of the board circulates a board meeting agenda ahead of the meeting.

One of the professional benefits of joining a nonprofit board is building and making relationships with fellow board members and board staff. The author encourages board members to get to know each other during and outside of board meetings. Consider inviting your fellow board members to lunch from time to time or finding other opportunities to connect. Not only will this benefit the board and the nonprofit, but it will also benefit you and your professional network.

## **Board Meetings**

The president, chairperson or other designated person will call the board meeting to order at the designated time. There may be certain matters that have been previously reviewed, pursuant to agenda and board notes, that can be decided by consent vote. That is, the chairperson might ask: "Has everyone had an opportunity to review the agenda? The agenda included a consent vote. If there's no discussion, we will accept the consent vote." Typically, items subject to consent vote are not expected to be controversial or worthy of much discussion.

The treasurer will circulate and discuss documents pertaining to the organization's finances. Some commonly discussed documents include profit and loss statements, and balance sheets. One strength a board member may bring to a nonprofit is the ability to read financial statements. A board member may possess the ability to analyze the organization's financial statements, pose important questions, and

ultimately approve or reject the finances. From time to time, often once or twice a year, the executive director, or someone else with the nonprofit, will propose a budget for the upcoming term and ask the board members to discuss, and approve the budget.

If the board has committees, those committees typically provide reports as to their recent and upcoming activities. For example, a fundraising committee's chairperson or other representative may report on a recent bake sale, car wash or other activity. The committee chairs may enlist the support of fellow board members or discuss ways the committees may work together on projects. For example, one project may contain a social component and a fundraising component, presenting an opportunity for the social committee and the fundraising committee to work together. The board members may discuss opportunities to pull resources from one another, and sharing their connections.

The board will also discuss current challenges, which might include financial deficits, HR issues, etc. Board members work together to identify solutions.

The board meeting will likely include a discussion of new business. New business consists of matters that have not previously been presented to the board, but are worthy of discussion. At the conclusion of old and new business discussions, assuming there are no other issues to discuss, the meeting will come to a close. After the close of the board meeting, the secretary will compile, review, and finalize the minutes from the meeting. The meeting minutes will summarize issues discussed, meeting activities, vote results and list meeting attendees. The secretary will then circulate the meeting minutes to the board members for review and approval at a future meeting. The meeting minutes constitute the formal record of the board meetings

### **Board Committees**

Many boards create committees to assist with projects and achieving the nonprofit's objectives. Common committees may include finance

committee, executive committee, social committee, and membership committee, just to name a few.

A finance committee is often chaired by the treasurer of the organization, who monitors the organization's revenues, expenses, and other financial information. The treasurer, or someone assisting the treasurer, will prepare the financial statements. The committee and the treasurer review the financial statements and ultimately submit the financial statements to the board for approval.

An executive committee typically consists of the officers of the board, which generally include the president, secretary, treasurer, and other officers, etc. Typically, the officers are board members who have served on the board for a longer tenure than the directors or other board members. Executive committee members meet periodically to discuss the mission of the organization, finding future leaders to join the board, and other tasks.

Social committees are often tasked with keeping things fun and interesting for the board and other nonprofit stakeholders. Social committees plan parties and networking events to build the board's reputation.

A membership committee can work alongside a social committee to help build and strengthen the membership period. Membership includes several facets, recruitment and retention, for example. For a nonprofit to grow and to increase membership, it needs to market its name and build intrigue and interest among non members. Ensuring current members do not lose interest in the organization will increase member retention.

Although the prototypical member of a nonprofit board might be a lawyer or other professional, board membership is open to anyone. Once you find a board and nonprofit that interests you, it is important that you express that interest and get involved. Rest assured, there is a role that suits you.

# NONPROFIT BOARD MEMBER DUTIES, OBLIGATIONS AND LIABILITY

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**Lawline**

## **Synopsis:**

*Being a Board Member is fun and rewarding but can be hard work. This section informs attorneys on the potential duties, obligations, and liabilities of being a Board Member. You will also learn about potential ways to protect yourself and other Board Members through indemnification and Directors and Officers Liability Insurance.*

## **Introduction**

Nonprofits have a wide range of missions — including everything from providing shelter to the homeless to advocating for the interests of members. But all nonprofits have one thing in common: a board of directors or trustees.

While the nature of the relationship between a nonprofit's staff and its board varies across organizations, all boards have practical, legal, and ethical duties. These responsibilities ensure proper oversight and enable the organization to make consistent progress toward its mission.

Your nonprofit board steers your organization toward a sound future by ensuring that it's fulfilling its mission in the most effective way possible. Setting expectations upfront will lay the groundwork for an effective team that understands exactly what it needs to be doing. Everyone will be on the same page. Plus, there won't be any room for excuses when members are called out for not carrying their weight.

No matter what your mission is or what expertise your members bring, any nonprofit board member must fulfill three specific core legal responsibilities. For any organization, the following duties are adopted

across many organizations and should be expected of your board members.

## **Board Member Duties**

### **1. Duty of Care**

Being a board member is more than a résumé builder. Members should be committed to following through on promises and assisting the organization to the best of their abilities. This means:

- Attending meetings and actively participating in committees
- Communicating with the executive director and other board members
- Following through on assignments
- Supporting program initiatives

Board members who neglect this prime duty are simply taking up space in the boardroom. Ideally, your entire board is motivated and truly passionate about your mission. As a result, fulfilling the duty of care is easy.

### **2. Duty of Loyalty**

Board members should do more than show up. They should fully support and embody your organization's mission and be loyal ambassadors for your cause. When acting on behalf of the organization, each board member must put aside their personal and professional interests.

All activities and decisions should be in the best interest of the organization, not in the best interest of the individual board member.

Those who successfully fulfill this duty are those who proactively mingle with volunteers, visit your nonprofit's facilities, and participate

in community initiatives. These individuals fully embrace your mission, not just board service.

### **3. Duty of Obedience**

One of the more subtle duties of a nonprofit board member is obedience. The board should do everything in its power to reach organizational goals, but members still have an obligation to follow your organization's guidelines. These are found in your governance documents, and every board member has a legal responsibility to understand them.

A board that strays from your governance rules could steer your organization in the wrong direction or even impact your nonprofit's standing in the community.

Every new board member should have these documents and ensure to obey applicable laws and regulations. It is also good practice to encourage existing board members to refresh themselves on the organization guidelines at least once a year. This ensures they understand exactly what they can (and can't) do.

## **The Most Important Board Member Responsibilities**

While each leadership position entails its own responsibilities, there are several duties that each and every board member must complete, regardless of their position. As a whole, your nonprofit's board should adhere to the following seven core responsibilities.

### **1. Board Members Should Advance the Mission of the Organization**

Your nonprofit's biggest advocates are its board members. These individuals are the face of your cause and should be expected to use their efforts and abilities to promote the organization's core mission in an ethical manner.

This responsibility will come naturally for your most enthusiastic board members. All directors should proactively promote your work, attempting to ignite that same passion in others. This pertains not only to their personal and professional networks but to public relations as well. When speaking to the media on behalf of your nonprofit, they should paint your organization in the best light possible.

Overall, spreading awareness for your mission will promote growth and empower your team to flourish in its work.

## **2. Board Members Have Legal and Fiduciary Responsibilities**

There's a lot at stake when it comes to managing a nonprofit. Every board of directors needs to understand internal policies and the legal implications of your organization. Failure to do so can result in severe consequences, such as heavy fees.

It's up to board members to understand federal, state, and local laws that apply to your organization. Then, they must assure that the organization adheres to those legal obligations.

- Additionally, boards should be aware of the penalties caused by:
- Overpaying staff or other individuals
- Engaging in excessive lobbying or political activities
- Making egregious bad bargains on behalf of the nonprofit

Many states also implement laws that require board members to assume a fiduciary responsibility to the served population. This means acting in good faith and working for the benefit of those you serve, never against it.

## **3. Board Members Should Attend Board Meetings**

It should go without saying that board members should attend and contribute during meetings. After all, this is when they can share their



insight, get creative, and have deep conversations about promoting a mission that has a special place in their hearts. However, many board members fall short of expectations and become too lax with meetings.

Share the following suggestions to establish a much more collaborative (and much less chaotic) boardroom:

- **Review the agenda in advance.** Everyone should make sure to understand all matters on the agenda heading into the meeting. Participation in discussions is a big part of why you choose someone for a role on the board. Fulfilling these duties is part of acting in good faith for any board member.
- **Adhere to the outlined rules of order.** For instance, many organizations adopt Robert's Rules of Order to maintain order in the boardroom. The rules of conduct during meetings are established for a reason and facilitate fruitful conversation. Observing the Rules of Order shows decorum and respect for the organization.

To prevent any issues upfront, consider also implementing an attendance requirement, with exceptions for emergencies and other unavoidable situations. After all, members should have sufficient time to give to your organization. Otherwise, they're not fulfilling their basic duties.

#### **4. Board Members Must Hire and Set Compensation for the CEO or Executive Director**

Hiring and overseeing the executive director is one of the most important board responsibilities as it has the greatest impact on the organization's growth and vitality. The executive director serves as the gateway between the nonprofit's staff and board members.

#### **5. Board Members are Responsible for Recruiting New Members**

Your board members are the most knowledgeable on what skills and qualities are missing from the boardroom. By leveraging this insight,

they're highly qualified to locate the next best board members to fill those gaps.

Current board members should constantly be on the lookout for passionate, qualified recruits who will bring additional knowledge, talent, and background experience to the table. Just like with selecting an executive director, your board is responsible for locating qualified prospects, conducting interviews, and selecting the most qualified candidates.

Not only should they participate in recruitment, but current board members should also assist in onboarding new directors. For those who are retiring from their positions, this means training their successors. As for those who are returning for another term, this means proactively getting to know new members, ensuring they have access to the board platform, and simply providing a friendly face in the boardroom.

## **6. Board Members Should Find Digital Tools to Improve Communication**

As part of the board's primary responsibilities, they should make the most of their resources and take the necessary steps to ensure proper governance.

## **7. Board Members Should Serve on at Least One Committee**

Most of the board's work is completed in committees. There simply isn't enough time for the entire board to have lengthy conversations and research specific issues in depth. Because of this, every board member should serve on a committee, effectively steering the organization toward its goals.

Individuals should be assigned to committees based on past experience, skills, and interests. For instance, a board member who has a background in accounting would be a great fit for the finance committee.

Like with individual board members, each committee should receive a written document that covers their responsibilities, guidelines, and goals. It's the full board's responsibility to regularly assess each committee's success and adjust accordingly.

## **Wrapping Up**

Enthusiastic board members can breathe new life into any organization. But, that's only if they first fulfill their basic responsibilities. As a leader of your nonprofit's board, it's up to you to ensure your fellow board members understand what they should (and shouldn't) be doing. This way, they can leverage their skills and direct their energy into advancing your organization's mission in a sound, legal, and ethical manner.

A board of directors does not exist solely to fulfill legal duties, but rather, they contribute to the organization's culture, strategic focus, and financial sustainability. A well-functioning board that adheres to its responsibilities is essential to the health and sustainability of any nonprofit.

## **BOARD MEMBER LIABILITY & INDEMNIFICATION**

As community-serving nonprofits grow and many assume responsibility for social services previously delivered by governments, the need for committed, enthusiastic, and capable volunteer board members has never been greater. While claims against nonprofit boards remain rare — most nonprofits will never be sued in their institutional lifetimes — the fear of liability continues to grow. This fear is fueled, in part, by widespread publicity surrounding celebrated cases. This publicity in turn leads to more claims. Nonprofit and corporate directors share a common concern: that of personal liability for serving on a board. At the end of litigation against nonprofits, nonprofit board members are rarely required to use personal funds to pay for harm committed by the board or organization, but the possibility remains. Some party or the nonprofit itself may charge the director with a breach of duty that he or she owed to that party.

Every nonprofit must work diligently to recruit and retain suitable board leaders. One strategy is to address the potential for personal liability by taking steps that substantially reduce the likelihood that a board member's personal assets will be exposed to loss. There is a three-part protection strategy for nonprofit boards as described below:

**Risk Control** — Every nonprofit should begin the process of reducing the potential of a director being held personally responsible by minimizing the risk. This effort begins with examining the board's governance activities, and the common law duties owed by each and every board member. Do board members fully understand their legal duties? Do board operations reflect a commitment to fulfill these duties? What actions are taken when a breach of a fiduciary duty is suspected? Has the board established rules and procedures governing its operations? Are these procedures followed?

The process of identifying priority risks and implementing strategies to address them should continue with all major operational areas. Form a volunteer risk management committee to coordinate the process of risk identification and strategy development. Even the smallest nonprofit can and should establish a risk management committee. In smaller nonprofits volunteers will hold most of the seats on the committee, while in a midsize or large nonprofit the committee may consist principally of paid staff. The nonprofit should focus first on high priority risks — those most likely to occur and those with the greatest financial and other adverse impact on the organization.

**Indemnification & Volunteer Protection** — Most nonprofit bylaws include indemnification provisions — language that expresses the intent of the nonprofit to cover the expenses a board member might incur in defending an action and paying settlements or judgments related to his service on the board. There are circumstances, however, when indemnification is not available or becomes a hollow promise. These include:

- When the nonprofit does not have sufficient resources to pay the losses and expenses incurred by a director or officer;

- When state or federal law limits the protection that may be afforded through indemnification due to public policy considerations;
- When the board is unsympathetic to the plight of the director who has been sued and refuses to authorize the indemnification;
- When the organization decides that it is inappropriate to use the nonprofit's financial resources to indemnify a director.

Every state has a volunteer protection law and the federal Volunteer Protection Act (“VPA”) became the law of the land in September 1997. The Volunteer Protection Act provides that, if a volunteer meets certain criteria, he or she shall not be liable for simple negligence while acting on behalf of a nonprofit or governmental organization. The VPA also provides some limitations on the assessment of noneconomic losses and punitive damages against a volunteer. The Volunteer Protection Act does not, however, protect a volunteer from liability for harm “caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer action.” The Act does not prohibit lawsuits against volunteers nor does it provide any protection for nonprofits.

The state volunteer liability laws vary significantly. Some states only protect directors and officers while other states extend the protection to all volunteers, however, every volunteer protection statute has exceptions. The most common exclusions are for claims based on a volunteer's willful or wanton misconduct, criminal acts, or self-dealing.

**Risk Financing** — Every nonprofit must consider how it will pay for injuries, damages, legal expenses and other costs that stem from the harm it causes. For some organizations, reserve funds are sufficient to pay for anticipated losses. For the majority of the nation's 1.5 million nonprofits, reserves are inadequate. For this reason, a growing number of nonprofits choose to purchase insurance and pay an annual

premium in exchange for the promise that funds will be available in the event a covered loss occurs.

## **D&O Insurance**

Directors and officers (D&O) liability insurance protects the personal assets of corporate directors and officers, and their spouses, in the event they are personally sued by employees, vendors, competitors, investors, customers, or other parties, for actual or alleged wrongful acts in managing a company.

The insurance, which usually protects the company as well, covers legal fees, settlements, and other costs. D&O insurance is the financial backing for a standard indemnification provision, which holds officers harmless for losses due to their role in the company. Many officers and directors will want a company to provide both indemnification and D&O insurance.

Directors and officers are sued for a variety of reasons related to their company roles, including:

- Breach of fiduciary duty resulting in financial losses or bankruptcy
- Misrepresentation of company assets
- Misuse of company funds
- Fraud
- Failure to comply with workplace laws
- Theft of intellectual property and poaching of competitor's customers
- Lack of corporate governance

Illegal acts or illegal profits are generally not covered under D&O insurance.

# CONFLICTS OF INTERESTS & RELATED-PARTY TRANSACTIONS

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## **Synopsis**

*This section informs attorneys on the potential pitfalls associated with conflicts of interest and related-party transactions when certain issues arise for consideration and voting while you are serving on a board of directors.*

## **Introduction**

Contrary to popular belief, conflicts of interest and related-party transactions do not automatically violate a Director or Officer's fiduciary duty. Being an effective Board member or Executive Officer often entails having a network of people and financial interests in a particular industry or field. Conflicts will inevitably arise from time to time, and Board members can and should rely on a written conflicts of interest policy to ensure that all conflicts are dealt with in a uniform and neutral manner.

Good governance requires having a written conflicts of interest policy in place that obliges each Director to disclose known conflicts and report to the Board any transactions with a related party. A good conflicts of interest policy will contain several elements: (1) a clear definition of related parties, in other words, to whom does this policy pertain; (2) what constitutes a conflict of interest, (3) the process for a regular (annual) disclosure of conflicts as well as a protocol for disclosing conflicts as they arise, (4) a requirement that the conflict is documented in the minutes along with how the conflict was resolved, (5) a procedure for disclosing and dealing with related party transactions.

It is common and expected that companies would engage in business with entities with whom they already have a relationship. Companies often engage in transactions with their affiliates, subsidiaries, or entities in which directors or donors may hold an interest. Nevertheless, related-party transactions present a significant legal and reputational risk for corporations and their directors. The Board of Directors is accountable to its donors, its staff, and to the public to avoid the appearance of impropriety in dealings that involve a conflict of interest of a Board member.

By way of comparison, public companies have specific guidelines from the SEC about what kind of transactions must be reported. For public companies, Regulation S-K of the SEC defines a “related person” as any director, executive officer, a certain percentage stockholder, and their immediate family members. Any related transaction greater than certain amounts in which the related party has a “material interest” is reportable in various statements. The company must also describe their policies to review and approve related party transactions.<sup>1</sup>

## **The IRS**

Nonprofits and charitable entities have a particular interest in maintaining a reputation of that their Board members are not using the nonprofit for personal gain. Even the appearance of impropriety could result in a loss of confidence among donors, staff, and the community served by the nonprofit. Failing to guard against interested transactions that benefit the personal interests of the directors over the nonprofit’s charitable mission could result in loss of tax-status.<sup>2</sup>

The IRS has stated, “A conflict of interest arises when a person in a position of authority over an organization, such as a director, officer, or manager, may benefit personally from a decision he or she could make.”<sup>3</sup> In a nonprofit context, related parties are generally the

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<sup>1</sup> See 17 C.F.R. § 229.404

<sup>2</sup> <https://www.irs.gov/charities-non-profits/form-1023-purpose-of-conflict-of-interest-policy>

<sup>3</sup> Instructions for Form 1023 (Rev. January 2020) Application for Recognition of



members of the Board and the executive director. The conflicts of interest policy should outline a process for an interested Director to disclose the potential or actual conflict. A conflicted director should remove themselves from discussing or voting on the interested transaction. However, the policy could also allow the shareholders/members to authorize an otherwise prohibited transaction. Nonprofit organizations have much leeway to craft a conflicts of interest policy that makes sense for their particular circumstances.

While adoption of a conflict of interest policy is not required to maintain tax exempt status, the IRS does include a sample policy as Appendix A to the Instructions to Form 1023.<sup>4</sup>

### **Texas's Interested Director Rule**

The Texas Business Organizations Code provides statutory guidelines and statutory protections for directors and other fiduciaries of nonprofit and for-profit corporations. The Interested Director Rule applies to transaction between a corporation and (1) one or more of the corporation's director or officer, or their affiliates or associates or (2) an entity in which a director or officer is a managerial official or has a financial interest.<sup>5</sup>

If a corporation engages in an interested transaction, the transaction will be not be voidable because of the conflict if the Board is aware of the material facts of the transaction and the related party and the Board votes to approve the transaction in good faith. The Board can appoint a committee to review and approve the interested transaction or can put the approval to a vote of shareholders who have been informed of the material facts. If a director acts in accordance Texas' Interested Director Rule, "safe harbor" immunity will protect an interested director, provided certain conditions are met. Material facts

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Exemption Under Section 501(c)(3) of the Internal Revenue Code

<sup>4</sup> Instructions for Form 1023 (Rev. January 2020) Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code

<sup>5</sup> Tex. Bus. Org. Code § 21.418.

would include all facts relevant to evaluating the fairness of the transaction, taking into consideration the basic terms of the transaction and the extent of the conflict.<sup>6</sup>

Even if the Board of Directors fails to adhere to the statutory procedures for approving an interested transaction, Texas' Interested Director Rule provides a wider safe harbor. If the contract or transaction between the corporation and an interested director or officer is fair to the corporation at the time it is approved, it will be presumed valid.

### **The Business Judgment Rule**

In Texas, the business judgment rule generally protects directors and officers from liability for breaches of their fiduciary duties as long as their actions are within “the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.”<sup>7</sup>

### **Take-Home Advice**

- (1) The Board should approve a conflict of interest policy. While the Board has much freedom to craft a policy that is implementable, a good policy will always require disclosure, a process to determine whether an actual conflict exists, a procedure to remove the interested Board member from discussion or decision making, and documentation of who was involved at each step of the process.
- (2) Each Board member should disclose annually actual or potential conflicts of interest. For example, the disclosure could cover other Board service, prior workplace history, or nonprofits to which a Board member is a significant donor.

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<sup>6</sup> *Navigating Safe Harbors: Review of the Protections Provided to Governing Persons by the Texas Interested Party Statute and the Business Judgment Rule*, 10 NAT'L L. REV. 328 (2000),

<sup>7</sup> *Sneed v. Webre*, 465 S.W.3d 169, 173 (Tex. 2015).

- (3) The results of the annual disclosure should be shared with the Board, or, at a minimum the Chair of the Board and the Executive Committee.

## **Conclusion**

Conflicts of interest are an unavoidable and managing conflicts is an integral part of Board service. Grounded in a Director's duty of loyalty to put the interests of the corporation ahead of her own personal interests.<sup>8</sup>

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<sup>8</sup> Gearhart Indus., Inc. v. Smith Int'l, 741 F.2d 707, 719 n.4 (5th Cir. 1984).

**ACTING AS AN ATTORNEY AND BEING A BOARD MEMBER:  
WEARING TWO HATS**

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**Synopsis:**

*Serving on nonprofit boards and serving a nonprofit as its legal counsel are fulfilling activities. The only thing better is wearing both hats. If you want to serve in both roles, you should take careful steps to preserve privilege and avoid conflicts. Read this article and learn about risks to avoid when serving a nonprofit as a board member and outside counsel.*

It is not uncommon for a lawyer serving on a nonprofit board of directors to be asked, either formally or informally, to offer legal advice. It is also not uncommon for a lawyer to a nonprofit organization to receive an invitation to serve on its board of directors. Both situations present issues that must be carefully considered and handled early and often. These issues impact advising clients regarding the dual role, protecting the attorney client privilege, and respecting ethical obligations.

With respect to the first issue, it is important that the attorney advise the nonprofit board as to the attorney's dual role as a board member. This is important for at least three reasons: conflicts of interest may arise, fellow board members and management of the nonprofit may be confused as to the dual role, and concerns exist regarding the protection of confidential information, including attorney client privilege. An attorney serving in the dual role would be well advised to prepare a written memorandum and oral explanation to the management of fellow board members regarding the dual role. For example, the attorney should advise that that he or she represents the nonprofit entity and not the individual constituent officers and

directors. Further, the attorney should also explain the difference between serving as a director versus serving as an attorney to the nonprofit board. Importantly, the attorney should not only provide the memorandum and explanation, but also follow its direction in practice.

Second, extreme care should be taken to preserve the attorney client privilege. Attorneys serving clients and outside counsel roles are generally comfortable relying on the attorney client privilege with respect to communications between himself/herself and the client. The issue becomes a little bit more complicated when the attorney serves as the nonprofit board director. For example, the attorney may continue to engage in conversations with board members, management, or other persons associated with the nonprofit in a legal capacity. Stated differently, the attorney may continue to provide legal advice to the nonprofit. Those types of communications will likely remain treated as privileged under the attorney client privilege. Things change, however, when the attorney begins to participate in the nonprofit's financial and business decisions, which are often the topics of nonprofit board meetings. Those communications mightnot be subject to attorney client privilege. To the extent that communication contains legal advice, as well as business and financial discussions or other general matters of the nonprofit organization, things become less clear. The attorney must always fulfill his or her obligations under the rules of professional conduct and do his or her best to preserve the attorney client privilege.

In preserving the attorney client privilege, the attorney would be well suited in bifurcating meetings involving the provision of legal advice versus meetings involving other matters. For example, to the extent that the attorney meets with the nonprofit to provide legal advice, the attorney should make clear that the meeting is solely for the purpose of providing legal advice and avoid the tendency to discuss other matters, such as business or financial matters of the nonprofit organization. The attorney might also consider involving another member of his or her law firm at the meeting and having that person

provide the legal advice. Even safer, and if appropriate, the attorney board member might consider having separate outside legal counsel provide the legal advice to the nonprofit board. Circumstances may dictate the appropriate strategy.

Third, the attorney serving as director to the nonprofit board must remain careful to follow the ethical rules and avoid conflicts. Conflict issues may arise in various situations, for example, the attorney might confront an issue to which he or she is opposed as a director, offer opinions on board decisions to which the attorney was previously opposed, encounter matters involving the nonprofit board hiring his or her law firm, or potentially represent the board or the nonprofit in litigation. To the extent that the board discusses or votes on an issue to which the attorney is personally opposed, the attorney should voice his or her concerns. In particular, the attorney must always provide the independent professional judgment of a competent lawyer. If the board is inclined to take action which is illegal or likely to harm the nonprofit organization, the attorney must express his or her disagreement to that issue. Assuming, however, the remaining directors and officers ultimately vote and approve a course of conduct contrary to the attorney's wishes, the attorney must act diligently to represent and advocate on behalf of the nonprofit board. That assumes, however, that the board is not taking an action that involves self-dealing, fraudulent or criminal conduct, or otherwise places the attorney in a position that violates the rules of professional conduct. Stated succinctly, once the vote is taken, the attorney must diligently follow his or her role as an attorney and as a board member, while avoiding fraudulent conduct, self-dealing conduct, or any conduct that violates ethical rules.

Also, to the extent that the board is confronted with the decision of whether to hire the attorney or the attorney's law firm on a matter (perhaps a large litigation or a large transaction), the attorney might consider recusing him or herself from the decision and/or proposing that the nonprofit consider a different law firm for the matter.

Circumstances will vary from case to case, but the attorney must avoid self-dealing.

To summarize, there is nothing inherently wrong with an attorney serving in the dual role of outside counsel and as a board member. In fact, the dual role may be quite fulfilling. It is important that certain measures are taken and considered throughout the representation.

# THE WHAT, WHY, AND HOW OF DIVERSE NONPROFIT BOARDS

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## **Synopsis:**

*Nonprofit organizations exist to make a positive impact on the community. To be most effective in this pursuit, boards should make diversity of its membership a top priority. Nonprofit boards should embrace diversity as a broad concept—one that actively seeks differing perspectives, experiences, skill sets, educational backgrounds, industries, leadership levels, etc., in addition to demographic data points.*

## **Introduction**

As our world grapples with issues related to diversity, equity, and inclusion, nonprofit boards of directors are not immune to these concerns. The diversity (or lack thereof) of nonprofit boards has been a hot topic, particularly in recent years. This brief article will (1) define what diversity means as it relates to nonprofit boards; (2) address why diversity is important for nonprofit boards to consider; and (3) provide suggestions on how nonprofit organizations can develop diverse boards. A list of suggested resources is also available at the end of this article.

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## What Does It Mean to Have a Diverse Board of Directors

At its most basic level, diversity means, “the condition of having or being composed of differing elements.”<sup>1</sup> This core definition is instructive because, too often, diversity is addressed only in terms of race, gender, age, religion, disability status, sexual orientation, and other demographic data. But nonprofit boards of directors need to have a view of diversity that is not limited to just these demographic data points.<sup>2</sup>

To state it more plainly: nonprofit organizations should not use board diversity as a photo opportunity for marketing brochures, merely displaying people from different demographic communities.<sup>3</sup> Rather, nonprofit boards should embrace diversity as a broad concept—one that also actively seeks differing perspectives, experiences, skill sets, educational backgrounds, industries, leadership levels, etc., in addition to demographic data points.

Each nonprofit board should define what diversity means for its own unique context, with a focus on the mission of the organization, and the board should include the definition in its governance and training documents. Furthermore, this definition of diversity should incorporate the distinctive features of the community served: “[A] healthy board should reflect the diversity of the nonprofit itself and the population of the community that it exists in.”<sup>4</sup> In other words,

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<sup>1</sup> *Diversity*, MERRIAM-WEBSTER.COM DICTIONARY, <https://www.merriam-webster.com/dictionary/diversity> (last accessed March 1, 2022) (emphasis added).

<sup>2</sup> See, e.g., Boardable, *Why Nonprofit Board Diversity Matters: A Q&A Guide* (September 17, 2020), available at <https://boardable.com/blog/board-diversity/>.

<sup>3</sup> *Id.* (“Diversity is incredibly important to any nonprofit board. But board diversity can’t be a method by which boards attempt to prove a point or check a box.”).

<sup>4</sup> *Id.*; see also Sahar Andrade, *Why Diversity On Nonprofit Boards Is Crucial To Their Mission* (September 27, 2021), available at <https://www.forbes.com/sites/forbescoachescouncil/2021/09/27/why-diversity-on-nonprofit-boards-is-crucial-to-their-mission/?sh=12581aa71d05> (“When nonprofits boards do not reflect the diverse communities they serve, it creates a disconnect and can sew mistrust.”).

organizations should strive to develop a board of directors that reflects the diversity of the community served.

## **Why is Diversity a Relevant Consideration for Nonprofit Boards of Directors**

Board diversity is the backbone of a strong nonprofit organization.<sup>5</sup>

Having a board with diverse perspectives is critically important. Each person will bring his or her own personal and professional contacts and life experiences to their service on a nonprofit board. With a diversity of experience, expertise, and perspectives, a nonprofit is in a stronger position to plan for the future, manage risk, make prudent decisions, and take full advantage of opportunities.<sup>6</sup>

A nonprofit board with members who have differing viewpoints, experiences, and proficiencies will be more effective and more productive because the board will have the ability to consider challenges, opportunities, and risks from a variety of perspectives. This variety will allow for creative problem solving and expanded decision-making options.

As nonprofit boards work to increase diversity, the board should also ensure that all members have a voice. Are differing perspectives welcomed or silenced? An inclusive board will allow its members to bring their unique perspectives, experiences, and expertise to the table, which will enhance the effectiveness and creativity of the board.<sup>7</sup>

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<sup>5</sup> See, e.g., Boardable, *supra* note 2 (“Just remember that a diversity of experience and expertise brings with it a diversity of perspectives, and that positions your nonprofit to be stronger.”).

<sup>6</sup> National Council of Nonprofits, *Diversity on Nonprofit Boards*, available at <https://www.councilofnonprofits.org/tools-resources/diversity-nonprofit-boards> (last accessed March 1, 2022) (emphasis added).

<sup>7</sup> See, e.g., Boardable, *supra* note 2 (“A board isn’t inclusive when it doesn’t value its composition, and board members will be able to tell when they were recruited for a ‘diversity’ label rather than being truly valued.”).

The result will be a board that serves its target community well as it makes decisions based on the varied perspectives of its members.

## **How to Incorporate Diversity Principles When Selecting Board Members**

As a practical matter, developing a diverse board of directors will take intentionality, commitment, and joint effort. Each current member of the board will need to “buy-in” to the importance of diversity. With this buy-in, the board has a greater likelihood of increasing its diversity because “the more diverse the board, the greater the likelihood that the board has been intentional about identifying the desired board composition.”<sup>8</sup> Consequently, boards should assess their current makeup—are all of the members similar in perspectives, experiences, and expertise?

To develop a diverse board, its members should consider a broad pool of applicants in the recruitment process. For example, the board can “[l]ook for candidates with a variety of professional expertise, cultural backgrounds, spectrum of life experiences, and geographic reach, who can help the nonprofit respond to future needs.”<sup>9</sup>

As mentioned previously, nonprofit organizations should strive to develop a board of directors that reflects the diversity of the community served,<sup>10</sup> though, unfortunately, most nonprofit boards do not.<sup>11</sup> One possible way to accomplish this reflection of diversity is to include members of the community served in the search for new board members. Invite clients or customers of the nonprofit organization to be involved in the solicitation, recommendation, and selection of new board members.

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<sup>8</sup> BoardSource, *Leading with Intent: Reviewing the State of Diversity, Equity, and Inclusion on Nonprofit Boards* at 9 (June 2021).

<sup>9</sup> National Council of Nonprofits, *supra* note 6; see also Boardable, *supra* note 2 (“Consider non-traditional board members—people in the community who have demonstrated leadership.”).

<sup>10</sup> See Andrade, *supra* note 4 (“[B]oards need to seek out leaders that look like the communities they serve.”).

<sup>11</sup> BoardSource, *supra* note 8, at 3.

The board should also be intentional about expanding its search for new members beyond recommendations from current members. This is necessary because one challenge boards face is the influence of affinity bias on the selection process. Affinity bias is the “tendency to connect with others who share similar backgrounds, beliefs, and interests.”<sup>12</sup> This bias may result in a homogenous board, with members who are all similar because current members have chosen replicas of themselves.

Unfortunately, this homogeneity may stifle the board’s effectiveness in serving its target community,<sup>13</sup> especially if the board members do not reflect the community served.<sup>14</sup> But having a diverse board “can bring a realistic view of the community, strengthen the organization’s connection and credibility to its constituency, improve fundraising and assist with grants distribution. In essence, it makes the group more effective at carrying out its mission.”<sup>15</sup>

## Conclusion

Nonprofit organizations exist to make a positive impact on the community. To be most effective in this pursuit, boards should make diversity of its membership a top priority.

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<sup>12</sup> Jeffrey Davis, *The Bias Against Difference*, PSYCHOLOGY TODAY (June 25, 2020), available at <https://www.psychologytoday.com/us/blog/tracking-wonder/202006/the-bias-against-difference>.

<sup>13</sup> See, e.g., National Council of Nonprofits, *supra* note 6 (“Boards that are not diverse risk becoming stagnant.”).

<sup>14</sup> See, e.g., Andrade, *supra* note 4 (“Sometimes when recruiting new board members, trustees tend to seek out those from their immediate circles of influence, almost cloning themselves, with look-alike, think-alike individuals that experience life just like they do. That creates a homogenous board that might be disconnected from its communities.”); see also Boardable, *supra* note 2 (“When a board becomes homogeneous, it can be difficult to notice things that are outside of the board’s general life experiences.”)

<sup>15</sup> Andrade, *supra* note 4 (emphasis added).

## Suggested Resources

- **National Council of Nonprofits**  
<https://www.councilofnonprofits.org/tools-resources-categories/diversity-equity-and-inclusion>
- **BoardSource**  
<https://boardsource.org/research-critical-issues/diversity-equity-inclusion/>
- **Boardable**  
<https://boardable.com/blog/addressing-diversity-and-inclusion-on-nonprofit-boards-ebook/>
- **BoardBuild**  
<https://www.boardbuild.org/building-a-business-case-for-nonprofit-board-diversity/>

# WHAT TO KNOW ABOUT THE TEXAS CHARITABLE IMMUNITY AND LIABILITY ACT

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## **Synopsis:**

*The Texas Charitable Immunity and Liability Act exists to protect charitable organizations, and their employees and volunteers, in matters of civil liability. This article provides a broad overview of immunity and reduced liability under the Act, and the exceptions, exemptions, and loopholes to watch out for.*

## **Purpose of the Texas Charitable Immunity and Liability Act**

If you serve on a nonprofit board, it is important to remember that the charitable organization may fall within the protections of the Texas Charitable Immunity and Liability Act. The Act exists to encourage volunteer services and maximize resources devoted to delivering charitable services.<sup>1</sup> But as summarized below, the Act does not entirely shield a nonprofit, its employees, or volunteers from civil liability. Instead, the Act reduces their liability exposure.

## **Application of the Texas Charitable Immunity and Liability Act**

Broadly speaking, the Act applies to 501(c)(3) and 501(c)(4) organizations, their employees, and volunteers.<sup>2</sup> To take advantage of the Act's liability limitations, the charitable organization must have adequate liability insurance coverage.<sup>3</sup>

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<sup>1</sup> TEX. CIV. PRAC. & REM. CODE § 84.002.

<sup>2</sup> TEX. CIV. PRAC. & REM. CODE § 84.003(1).

<sup>3</sup> TEX. CIV. PRAC. & REM. CODE § 84.007(e), (g).

## **Volunteers are Generally Immune from Liability**

A volunteer whose acts or omissions result in death, damage, or injury is immune from civil liability if the death, damage, or injury occurred while acting in the course and scope of the volunteer's duties or functions.<sup>4</sup> This includes acting as an officer, director, or trustee of the charitable organization.<sup>5</sup> Immunity is limited to the volunteer, however, and does not extend to the charitable organization.<sup>6</sup> To qualify as a volunteer, the person must not receive compensation beyond reimbursement for incurred expenses.<sup>7</sup>

## **The Act Limits Liability for Charitable Organizations and their Employees**

Instead of generally rendering them immune to civil liability like volunteers, the Act limits a non-hospital charitable organization employee's liability to \$500,000 per person and \$1 million per occurrence of bodily injury or death, and \$100,000 per occurrence of property injury or destruction.<sup>8</sup> These liability limitations also apply to a nonhospital charitable organization based on an act or omission of the organization, its employees, or volunteers.<sup>9</sup>

## **Limitations of the Texas Charitable Immunity and Liability Act**

Unsurprisingly, the Act includes a variety of exceptions, exemptions, and loopholes. For example, the immunity and liability limitations do not apply to acts or omissions that are intentional, willfully negligent, or done with conscious indifference or reckless disregard for the safety of others.<sup>10</sup> Limitations also apply when the act or omission involves operation or use of motor-driving equipment, or when a religious charitable organization provides transportation services to certain

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<sup>4</sup> TEX. CIV. PRAC. & REM. CODE § 84.004(a).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at § 84.004(e).

<sup>7</sup> TEX. CIV. PRAC. & REM. CODE § 84.003(2).

<sup>8</sup> TEX. CIV. PRAC. & REM. CODE § 84.005.

<sup>9</sup> TEX. CIV. PRAC. & REM. CODE § 84.006.

<sup>10</sup> TEX. CIV. PRAC. & REM. CODE §§ 84.004–84.007.

individuals receiving government assistance.<sup>11</sup> The Act also distinguishes between hospitals and hospital systems, and nonhospital charitable organizations, and does not apply to certain organizations, including those formed substantially to limit liability under the Act.<sup>12</sup>

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<sup>11</sup> TEX. CIV. PRAC. & REM. CODE §§ 84.004(d), § 84.0061.

<sup>12</sup> TEX. CIV. PRAC. & REM. CODE §§ 84.0065, 84.007.



**NONPROFIT FUNDRAISING:  
THE PENALTIES OF NONCOMPLIANCE  
AREN'T WORTH THE RISK!**

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**Synopsis:**

*Nonprofits rely upon the generosity of donors for some or all their funding. But did you know that fundraising can be a regulated activity? We first dive into a little about the history and policy considerations of fundraising laws. Then, before your nonprofit solicits donations, consider the type of nonprofit you are and which of the specific charitable fundraising laws apply to you. Further, we evaluate applicable laws to certain types of fundraisers. Finally, we touch on additional issues and considerations that you may have along the way.*

**Introduction**

Will you host or support an upcoming nonprofit fundraiser? Do you serve on a nonprofit board or advise nonprofits? With over 80,000 charitable organizations registered in the state of Texas and national giving to U.S. charities totaling \$471.44 billion, you've likely answered yes to at least one of those questions.<sup>13</sup> Before you hit send on that email to friends or donors, what do you need to know—from a legal

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<sup>13</sup> Ken Paxton, Attorney General of Texas, Charitable Trusts, <https://www.texasattorneygeneral.gov/divisions/financial-litigation/charitable-trusts>; Giving USA Special Report (2021).

perspective? This article provides lawyers with an understanding of the legal implications of fundraising—to promote transparency, compliance, and confidence in fundraising.

Before exploring compliance and legal obligations, let's reflect on what it means to fundraise. Booker T. Washington regarded fundraising as a privilege and a medium for good,<sup>14</sup> and Hank Rosso, the founder of The Fund Raising School, has defined it as “the gentle art of teaching the joy of giving.”<sup>15</sup> Fundraising is both an art and science with eight recognized mechanisms to encourage donations, including an awareness of need and solicitation.<sup>16</sup> Fundraisers help donors and organizations mutually realize a vision for the world by engaging communities, stakeholders, and leaders and executing tailored fundraising plans.

Fundraising includes annual campaigns, major gifts, capital campaigns, and planned giving.<sup>17</sup> Capital campaigns might involve pledges, while annual campaigns might involve social media or letters to donors. Depending on the tools used, different regulations might be at play. Regardless of the type of campaign, transparency is vital. Transparency is central to the donor's rights upon the organization, which is held for the public trust.<sup>18</sup> In fact, rules and regulations are premised upon the government's interest in ensuring transparency and protecting the public against fraud and deception. Overall, nonprofits

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<sup>14</sup> BOOKER T. WASHINGTON, *UP FROM SLAVERY: AN AUTOBIOGRAPHY*, Chapter 12: Raising Money, Lit2Go Edition. (1901). Web. <<https://etc.usf.edu/lit2go/92/up-from-slavery/1624/chapter-12-raising-money/>>. March 02, 2022.

<sup>15</sup> HENRY ROSSO & ASSOCIATES, *ACHIEVING EXCELLENCE IN FUND RAISING*, Jossey-Bass (1991).

<sup>16</sup> Bekkers, R. & Weipking, P. (2008). A literature review of empirical studies of philanthropy: Eight mechanisms that drive charitable giving. *Nonprofit and Voluntary Sector Quarterly*, 40(5), 924-973.

<sup>17</sup> *Supra*, note 3.

<sup>18</sup> Indiana University Lilly Family School of Philanthropy, *The Giving Environment: Understanding Pre-Pandemic Trends in Charitable Giving* (2021), available at <https://scholarworks.iupui.edu/bitstream/handle/1805/26290/giving-environment210727.pdf>.

should certainly care about fundraising compliance to mitigate the risk of legal problems and government scrutiny. But they should also take the opportunity to avoid lousy publicity and steward positive relationships with donors who share their vision of a better world.

## Key Concepts

Fundraising involves asking or soliciting a gift to support a nonprofit organization's mission. A solicitation can include crowdfunding, giving days, grant proposals, phone calls, email campaigns, website donation buttons, fundraising events, letters and mail campaigns, and personal requests for donations. According to the Charleston Principles established by the National Association of State Charity Officials, a solicitation is a specific targeting of an individual or a repeated, ongoing, and substantial receipt of contributions from a state.<sup>19</sup> These rules are not binding and are not followed by all states, and nonprofits should not rely solely on these guiding principles. *Id.*

On the other hand, state statutes are binding. Forty-one jurisdictions require nonprofits to register to solicit funds, and twenty-five states require some form of disclosure on solicitation materials.<sup>20</sup> The most common reason for charity enforcement is fundraising abuse.<sup>21</sup> The key state agencies involved are the Office of the Attorney General (OAG), the Secretary of State, or the Consumer Protection Agency. For example, Ohio requires professional solicitors and fundraising counsel to register with the state's OAG before starting any fundraising work. A nonprofit must register within the first six months after

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<sup>19</sup> The National Association of State Charity Officials, *The Charleston Principles: Guidelines on Charitable Solicitations Using the Internet*, <http://www.nasconet.org/wp-content/uploads/2018/04/Charleston-Principles.pdf>, March 2, 2022.

<sup>20</sup> Harbor Compliance, *Fundraising Compliance Guide, Charitable Solicitation Registration and Compliance*, (Revised January 22, 2020), <https://www.harborcompliance.com/information/charitable-registration>.

<sup>21</sup> The Urban Institute, *State Regulation and Enforcement in the Charitable Sector* (2016), <https://www.urban.org/sites/default/files/publication/84161/2000925-State-Regulation-and-Enforcement-in-the-Charitable-Sector.pdf>.

creating the nonprofit organization, and the registration is valid for one year.<sup>22</sup>

## Texas Specific Issues

Under Texas laws, most nonprofit organizations need not register to solicit donations.<sup>23</sup> A few exceptions include certain law enforcement groups that appeal by telephone, public safety organizations, and veteran organizations.<sup>24</sup> However, keep in mind that if a nonprofit incorporates in Texas but solicits donations across state lines, other states may still require registration and/or reporting.<sup>25</sup>

Going once, going twice...not so fast! Even if your nonprofit is not required to register, certain events may be regulated. In fact, *games of chance* are highly regulated in Texas, and these events may be illegal in a few other states. There are no exceptions to the gambling law in Texas for nonprofits to hold poker or casino night fundraising events in Texas. The gambling law applies equally to nonprofits and for-profits.<sup>26</sup> The Charitable Raffle Enabling Act (“CREA”) does permit “qualified organizations” to hold up to two raffles per calendar year, with certain specified restrictions.<sup>27</sup> Events that fall under this category include raffles and bingo nights. CREA defines a raffle as “the award of one or more prizes by chance at a single occasion among a single pool or group of persons who have paid or promised a thing of value for a ticket that represents a chance to win a prize.”<sup>28</sup>

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<sup>22</sup> David Yost, Ohio Attorney General, Charitable Registration and Filing User Guide (2015), <https://www.ohioattorneygeneral.gov/Files/Business-and-nonprofits/Charity/Reggie-Online-User-Guide-2015>.

<sup>23</sup> Ken Paxton, Attorney General of Texas, Registration and Filings, <https://www.texasattorneygeneral.gov/divisions/financial-litigation/charitable-trusts/registration-and-filings>.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> See TEX. PEN. CODE ANN. §47 (Vernon 2003), Chapter 47, Gambling.

<sup>27</sup> TEX. OCC. CODE ANN. §2002 (Vernon 1999), Charitable Raffle Enabling Act, <https://statutes.capitol.texas.gov/Docs/OC/htm/OC.2002.htm>.

<sup>28</sup> *Id.*

Not all organizations are permitted to conduct raffles. A closer look at the statute and the Attorney General's Frequently Asked Questions page is important to assess whether your nonprofit meets eligibility requirements.<sup>29</sup> Furthermore, there are additional requirements for required information on printed raffle tickets, the prohibition of cash prizes, the value limit of prizes, and the timing of prize possession.<sup>30</sup>

Under the Texas Penal Code, an unauthorized raffle is considered gambling.<sup>31</sup> Conducting a raffle is a Class A misdemeanor, and participating in an unauthorized raffle is a Class C misdemeanor.<sup>32</sup> A county attorney, district attorney, or the OAG may bring an action in state court to stop a violation or potential violation of CREA.

## Other Considerations

There are some additional issues to consider when fundraising generally. First, any income from *games of chance* activities could be regarded as unrelated business income tax, in which case the nonprofit would owe tax on the income.<sup>33</sup> In some states (e.g., Pennsylvania), the proceeds you earn from games of chance must be kept in a special bank account.<sup>34</sup> Further, winners of a raffle or giveaway may also owe tax that the nonprofit is required to withhold.<sup>35</sup> If you plan to host an event where alcohol is served, you may need a separate alcohol license.<sup>36</sup> A nonprofit might be subject to gaming excise taxes for

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<sup>29</sup> Ken Paxton, Attorney General of Texas, Charitable Raffles and Casino/Poker Nights, <https://www.texasattorneygeneral.gov/divisions/financial-litigation/charitable-trusts/charitable-raffles-and-casinopoker-nights>.

<sup>30</sup> *Id.*

<sup>31</sup> *Supra*, note 14.

<sup>32</sup> *Supra*, note 14.

<sup>33</sup> Internal Revenue Service, Unrelated Business Income Tax, <https://www.irs.gov/charities-non-profits/unrelated-business-income-tax>.

<sup>34</sup> Pennsylvania Department of Revenue, Small Games of Chance Overview Rev-1750, <https://www.revenue.pa.gov/FormsandPublications/FormsforBusinesses/SGOC/Documents/rev-1750.pdf>.

<sup>35</sup> Internal Revenue Service, Tax-Exempt Organizations and Raffle Prizes-Reporting Requirements and Federal Income Tax Withholding Notice 1340 (2005), [https://www.irs.gov/pub/irs-tege/notice\\_1340.pdf](https://www.irs.gov/pub/irs-tege/notice_1340.pdf).

<sup>36</sup> Texas Alcoholic Beverage Commission, Certain Nonprofit Entities Serving

specific contests or lotteries.<sup>37</sup> Check out [IRS Publication 3079](#) for more information.

### **Pending 501(c)(3) status**

What happens when your organization has incorporated under the Texas Code, has timely filed with the IRS for recognition by the IRS as a tax-exempt 501(c)(3) entity (within 27 months of filing), but the IRS still hasn't given you the official green light? Fundraising is not off-limits, but some risks and additional steps extend beyond state registrations. First, the nonprofit must inform donors that 501(c)(3) status is still pending/in-process.<sup>38</sup> We suggest including language suggested by the IRS. Donors assume the risk that if the tax-exempt status does not get approved, the donation is not deductible. Nonprofits must make donors aware of this risk by being transparent about the pending status. Nonprofits might also consider a fiscal sponsorship relationship with an established 501(c)(3) to collect tax-deductible donations.

### **Pledges vs. Donations**

Pledges are donors' promises to give an organization a certain amount of money over a set amount of time.<sup>39</sup> Pledges are commonly associated with capital campaigns. Both a pledge and a donation result in donors giving money or goods to a nonprofit. However, the big difference between a donation and a pledge is the timing. A donation describes the immediate exchange of money or goods from a donor,

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Alcoholic Beverages at Temporary Events (2008),  
<https://www.tabc.texas.gov/static/sites/default/files/2020-06/mpb-026a.pdf>.

<sup>37</sup> Internal Revenue Service, Tax-Exempt Organizations and Gaming Publication 3079, <https://www.irs.gov/pub/irs-pdf/p3079.pdf>; *see also* Exempt Organization Gaming and Unrelated Business Taxable Income. <https://www.irs.gov/charities-non-profits/exempt-organization-gaming-and-unrelated-business-taxable-income>.

<sup>38</sup> Internal Revenue Service, Tax Law Compliance Before Exempt Status Is Recognized <https://www.irs.gov/charities-non-profits/tax-law-compliance-before-exempt-status-is-recognized>.

<sup>39</sup> Kindful, Donation Pledges, <https://kindful.com/nonprofit-glossary/donation-pledges/>.

and a pledge is the promised future exchange of money or goods from a donor. A pledge results in a donation eventually, just not right away.<sup>40</sup>

From a legal standpoint, a charitable pledge is a contract,<sup>41</sup> and therefore, its enforceability is governed by general contract law and, more specifically, by the applicable state law.<sup>42</sup> The Restatement (Second) of Contracts provides that charitable pledges are binding without consideration or detrimental reliance.<sup>43</sup> Some states have adopted this view on public policy grounds. “The real basis for enforcing a charitable subscription is one of public policy—that enforcement of a charitable subscription is a desirable social goal.”<sup>44</sup>

Some donors may want to make alternative gifts in the emerging digital age, such as cryptocurrency. Maintaining records is critical for nonprofits accepting cryptocurrency. Cryptocurrency is generally treated as real, noncash property with additional reporting requirements for \$5,000 and greater valuations. For nonprofits that may not be internally equipped to accept such gifts, outside financial or consulting can facilitate the gift transfer.

## **Donor Privacy and Data**

Donors have a myriad of reasons for donating anonymously: modesty, avoidance of future solicitations, and religious practices among them. In Americans for Prosperity v. Bonta, the Supreme Court ruled 6-3 in

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<sup>40</sup> *Id.*

<sup>41</sup> William A. Drennan, *Charitable Pledges: Contracts of Confusion*, 120 DICK. L. REV. 477 (2015). Available at <https://ideas.dickinsonlaw.psu.edu/dlra/vol120/iss2/4>.

<sup>42</sup> Restatement (Second) of Contracts § 90(2) (1981). [https://www.texasaxsection.org/Content/Newsletters/Winter\\_2010.pdf](https://www.texasaxsection.org/Content/Newsletters/Winter_2010.pdf).

<sup>43</sup> *Id.*

<sup>44</sup> *Jewish Fed’n of Cent. N.J. v. Barondess*, 560 A2d 1353, 1354 (NJ Super Ct. Law Div. 1989); see also *The Texas Tax Lawyer*, Winter 2010, Vol. 37, No. 2, [https://www.texasaxsection.org/Content/Newsletters/Winter\\_2010.pdf](https://www.texasaxsection.org/Content/Newsletters/Winter_2010.pdf)

favor of donor privacy, given that the implications for chilling the right to association outweighed California's interest in ensuring transparency and charitable purposes of donations.<sup>45</sup> More specifically, the Supreme Court ruled that California's compelled disclosure of major donors on Schedule B was *not* narrowly tailored to the state's interest in investigating charitable misconduct.<sup>46</sup> The implications of this decision should continue to be followed.

The Controlling the Assault of Non-Solicited Pornography and Marketing (CAN-SPAM) Act of 2003 is a federal law that protects consumers from receiving emails they never consented to receive.<sup>47</sup> It applies equally to nonprofits and sets commercial email rules, establishes commercial messages requirements, gives recipients the right to have you stop emailing them, and spells out tough penalties for violations. Each separate email in violation of the CAN-SPAM Act is subject to penalties of up to \$46,517! Check out the FTC's website for specific requirements.<sup>48</sup>

The General Data Protection Regulation (GDPR) is considered the most rigid privacy and security law globally.<sup>49</sup> While it was drafted and passed by the European Union (E.U.), it imposes obligations onto organizations worldwide, so long as they target or collect data related to people in the E.U.<sup>50</sup> The regulation was put into effect on May 25, 2018. The GDPR will levy harsh fines against those who violate its privacy and security standards.<sup>51</sup>

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<sup>45</sup> *Americans for Prosperity Foundation v. Bonta*, 141 S.Ct. 2373 (2021).

<sup>46</sup> *Id.*

<sup>47</sup> The Federal Trade Commission, The CAN-SPAM Act: A Compliance Guide for Business, <https://www.ftc.gov/tips-advice/business-center/guidance/can-spam-act-compliance-guide-business>.

<sup>48</sup> *Id.*

<sup>49</sup> GDPR-EU Information, <https://gdpr-info.eu/>.

<sup>50</sup> *Id.*

<sup>51</sup> GDPR-EU, "What is GDPR, the EU's New Data Protection Law?" <https://gdpr.eu/what-is-gdpr/>.



Of note and in a similar vein, the California Consumer Privacy Act of 2018 (CCPA) gives consumers more control over the personal information that businesses collect about them. This landmark law secures new privacy rights for California consumers, including the right to know about the personal information a company collects about them and how it is used and shared; the right to delete personal information collected from them (with some exceptions); the right to opt-out of the sale of their personal information; and the right to non-discrimination for exercising their CCPA rights.<sup>52</sup> Donor and data privacy laws are a great space to watch for future developments in Texas and nationwide.

## **Conclusion**

Fundraising is a meaningful way to support your nonprofit organization's mission and partake in the public good. While this chapter does not address international activities—which require additional compliance considerations—it does provide a general framework for issue spotting and evaluation of legal issues involving fundraising campaigns. With informed decision-making, you can help your nonprofit assess the risks and benefits of the different types of fundraising methods across geographies. Ultimately, fundraising compliance can be a tool to help nonprofits build sustainable and effective fundraising campaigns that meet the size and needs of their organization sustainably.

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<sup>52</sup> Rob Bonta, Attorney General, <https://oag.ca.gov/privacy/ccpa>.

## HOW TO JOIN A NONPROFIT BOARD

### **A. Identify causes that are meaningful to you**

Consider groups that you currently give money and/or volunteer for. Also consider groups that you have previously given to in the past or volunteered for. You may also want to consider groups that have hosted benefits or events that you have attended that benefited causes that were meaningful or impactful to you.

Learn more about a particular organization by reading promotional materials, as well as written board policies, bylaws and previous minutes.

Visit with members of the board and staff. Ask former and current members of the board for coffee, and find out what their experience has been like. Make sure that it is a good fit between you and the individuals involved with the board.

Matching services like [volunteerpath.com](http://volunteerpath.com) pair volunteers with nonprofit organizations. Matching services also offer training courses for a nominal fee, so that volunteers can learn important skills to effectively serve nonprofit organizations.

### **B. Prepare yourself to join the board**

#### ***1. Volunteer for the Organization***

Volunteer for the organization, meet other volunteers and staff, or even participate in committee work. For instance, help the fundraising, finance, or marketing committees. Committees are usually governed by directors and officers of the board. Committee work is a great way to learn about the organization, and build relationships with existing directors and staff.

#### ***2. Fundraise***

Help the organization with fundraising. Although typically a responsibility of directors, fundraising is appreciated wherever it comes from as fundraising is a skill that every nonprofit board needs.

### ***3. Offer to Take Meeting Notes***

Offer to take meeting notes. Serving as a note-taker gives you access and builds trust. The note-taker often grows into the secretary role, which often leads to chairing the committee.

#### **C. Know what skills you have to offer.**

Nonprofit organizations typically want leaders with specific skills. If you can identify your skill sets, you can better match and present yourself for prospective board opportunities.

The ability to understand financial issues pertaining to nonprofit organization is valuable to most organizations—regardless of professional background. Know the difference between an income statement and a balance sheet.

#### **D. Understand what a board wants from you**

##### ***1. Know how much time is expected of you***

Don't underestimate the amount of time required to effectively serve a board. It is better to turn down a board position because you cannot commit to the board's time requirements than it is to accept a position and later leave the board hanging because you can't follow through on your obligations. Recognize that the time required to serve on a board is often substantial.

In addition to the committee work and projects that boards take on—board members are typically required to serve on one or more committees—most boards meet on a monthly or quarterly basis. Meetings may last an hour or upwards of multiple days. In addition to the time spent at board meetings, board members should allocate a few hours to preparing for upcoming board meetings (e.g., drafting committee reports, reviewing past and future projects of the board). It's not unusual to spend seventy-five to one hundred hours per year serving a single nonprofit board.

***2. Know what donation you will need to make to the organization, and how often***

Although some nonprofit organizations rely on government funding or endowments, many nonprofit organizations rely on donations from businesses or individuals. Those organizations typically ask their board members to donate or raise a specific amount of money for the organization.

***3. Know if you are expected to use your connections to raise funds***

Before accepting a board position, consider whether the organization's mission is important enough that you are willing to donate some of your own financial resources, as well as encourage your friends, family and colleagues to commit theirs, as well.

**E. Put yourself out there, then keep your eyes and ears open**

Don't be afraid to contact current board members/leadership of an organization and to share your interest. Ask how you can volunteer within the organization and learn more about how the organization operates.

Most of your friends and family won't assume that you're interested in joining a nonprofit board. Let them know. It's not a bad idea to send a personalized email to your contacts and share your interest.

## **BENEFITS OF SERVING ON A NONPROFIT BOARD**

### **A. Business Development**

You can increase your network and meet and develop relationships with other professionals and make key contacts for the future.

Through active participation in board meetings and board leadership, you might secure new clients or networking opportunities.

You can gain new perspective by interacting with people from diverse backgrounds.

You can expand your understanding of your community, its residents and their needs.

### **B. Professional Development**

Building skill sets helps you improve your current skills as well as develop new skills to add to your resume. Such skills include but are not limited to marketing, finance, human resources, governance, public relations and grant writing.

Serving on a nonprofit board also provides you with a better understanding of the role and responsibilities of corporate governance and gives you hands-on experience.

Provides you with an opportunity to be a leader by chairing a committee or serving as an officer

### **C. Giving Back**

Serving on a nonprofit board gives you the ability to make a substantial and ongoing impact in your local community by advancing a worthy mission.

Your participation while serving on a nonprofit board helps build awareness and endorsements for the particular nonprofit or cause

through your participation. Your participation may introduce the cause to new individuals in the community who would not have been aware of the organization or the cause if you had not served on the board.

Helping others can provide personal fulfillment by improving your emotional health and well-being.

## MAKING THE MOST OF YOUR EXPERIENCE ON A NONPROFIT BOARD

### **A. Introduction**

The timeless expression, “you get what you give” is no truer than in service on nonprofit boards.

“Nonprofits need, want and very much appreciate the work, wisdom and talent of committed and passionate volunteers. Nonprofits are almost always short staffed and overwhelmed, so the extra help is necessary. Taking the important first step and saying you want to help is key. Don't wait to be asked. Asking the staff about what they need and then helping the staff do those tasks is the next best step. Offering your own creative and productive ideas can also lead to some exciting collaborations with staff. The most important part of the staff and volunteer relationship is trust and dependability. A staff person needs to know he or she can trust the volunteer to listen, do and complete the task at hand. The volunteer needs to know the staff person appreciates the volunteer and will allow the volunteer to bring his or her own creativity into the project. It takes a village to run a nonprofit . . . both staff and lay leaders...working together...can achieve more than they can on their own.”

-Jodi Bernstein, Senior Associate Director of the Southwest Region of the Anti-Defamation League

### **B. Hands-on volunteering – get to know the nonprofit**

Nothing will motivate your service more than understanding the work the nonprofit does and as saying goes, “getting your hands dirty.” It is a great idea to try to have as many hands-on experiences with the actual work of the nonprofit so that when you advocate, fundraise, or even make decisions for the nonprofit you have a true understanding of the great work they do and where they can improve. So, if your organization volunteers in schools, try to attend a session, even if the actual “work” is more often left to staff, rather than lay leadership. If you're serving on the board of an organization that raises money for

medical research, try to work with the organization to tour research facilities funded by the nonprofit and/or visit patients affected by the disease. The more personal the work is to you, the better board member you will be.

### **C. Fundraising and development**

Generally, it is expected that nonprofit board members participate in raising funds and development endeavors for the nonprofit. Each nonprofit fundraises differently, focusing on either event-based and/or campaign-driven fundraising. You will want to familiarize with what the organization has done in the past to raise money, how successful those efforts have been, and what the organization's funding needs and goals are for the future.

“Give or get”

“Involving your network”

“Chairing fundraisers”

### **D. Lay leadership and staff – how to most effectively work together**

Make sure what the roles and expectations are between staff and lay leadership.

### **E. Time-management**

As professionals, especially as attorneys, it is often hard to make time commitments outside of your practice; however, by agreeing to serve on the nonprofit board, you have decided that you both have the time and that the service is worth your time. As such, it is important to block time in your schedule and understand what is expected of you. For example, determine if you will need to attend any other meetings other than regular board meetings. Will you be expected to do committee work? Is there a policy on attendance at board meetings? If you cannot attend a meeting and you serve in a voting capacity, can you give another board member your proxy? Are there any events that board members are expected to attend on behalf of the nonprofit or that specifically benefit the nonprofit such as a gala or a fundraiser dinner that you need to



attend? These are all important questions to ask to demonstrate your commitment when trying to balance a hectic schedule with board service.

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