

The Nonprofit Management Center of the Permian Basin

Nonprofit Compliance with the Texas Business Organizations Code

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Areas of Law for Nonprofit Organizations

Governance

Intellectual
Property

Financial
Compliance/
Investments

Corporate
Law

Human
Resources

Security/
Real Estate

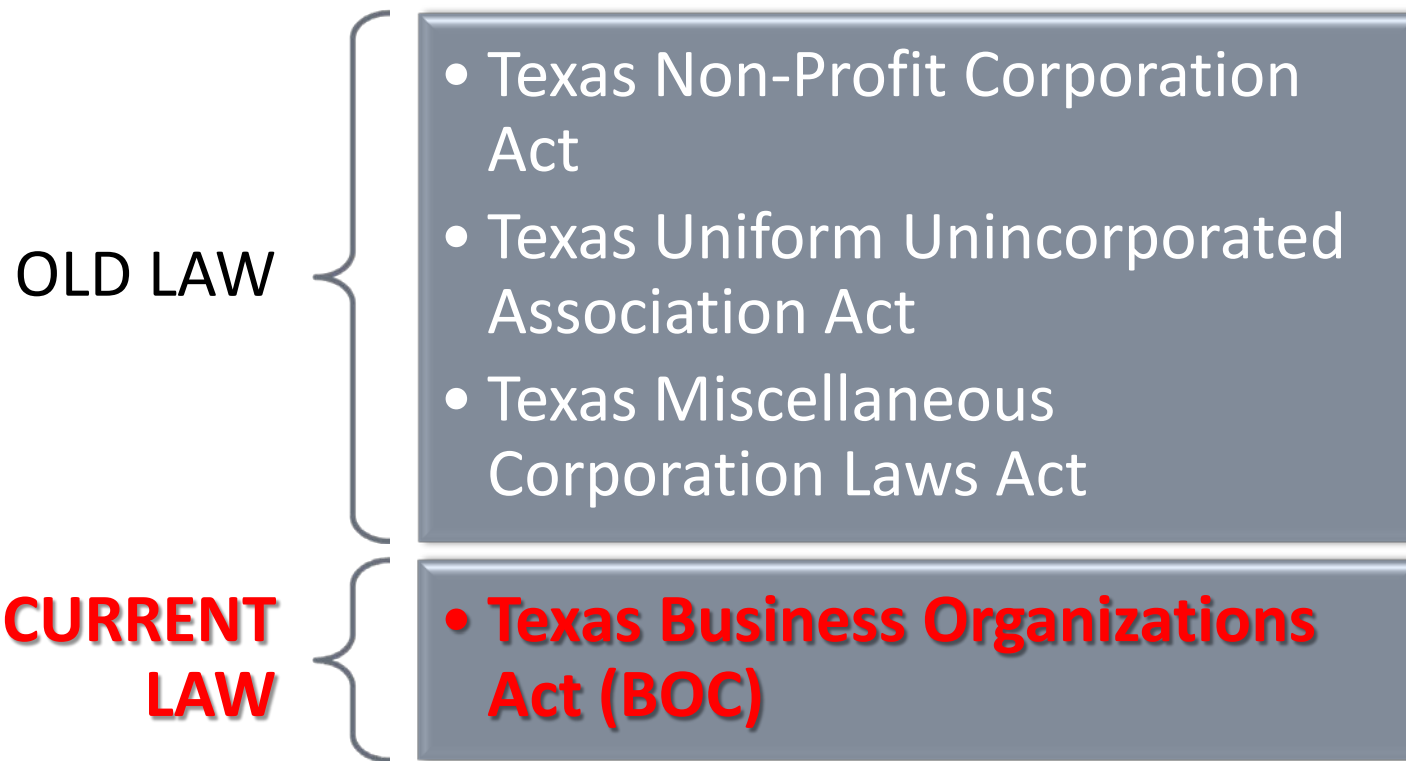
Tax Law

Contracts

Politics/
Lobbying

Fundraising/
Solicitation

Source of Corporation Law in Texas for Nonprofit Corporations/Associations



❖ BOC applies to all Texas “filing entities” including nonprofit corporations and associations as of January , 2010.

Ch. 22. Nonprofit Corporations

- A. General Provisions
- B. Purposes & Powers
- C. Formation & Governing Documents
- D. Members
- E. Management
- F. Fundamental Business Transactions
- G. Winding Up & Termination
- H. Records & Reports
- I. Church Benefits Board

MISCELLANEOUS
TRANSITION
Title 6

Ch. 23. Special-Purpose
Corporations

LIABILITY COMPANIES
SPOKE

ASSOCIATIONS
SPOKE
Title 6. Associations
Ch. 251. Cooperative
Associations
Ch. 252. Unincorporated
Nonprofit Associations

Investment Trusts
SPOKE

Meetings of the Governing Board

Number: *At least* one meeting per year (annual)

Notice:

- * Not required for regular meetings (but see bylaws)
- * Required for special meetings
- * Purpose/Business not required to be specified (but see bylaws)
- * Delivery: Personal, US Mail, fax, email, (but see bylaws)
- * Attendance = waiver of notice unless attend to object that meeting not properly called/convened

Quorum/Attendance

Quorum

- **Lesser** of: (a) Majority of number of directors set by Bylaws or if not set by Bylaws, majority number of directors stated in Certificate of Formation, or (b) Any number set by Certificate of Formation or Bylaws as quorum but not less than three
- Presence by proxy is not counted toward quorum

Attendance

- May be in person or by use of remote communications equipment (telephone, videoconference, Skype)
- Only if: (a) each person entitled to participate consents, and (b) system allows each participant to communicate concurrently

Voting at Meetings



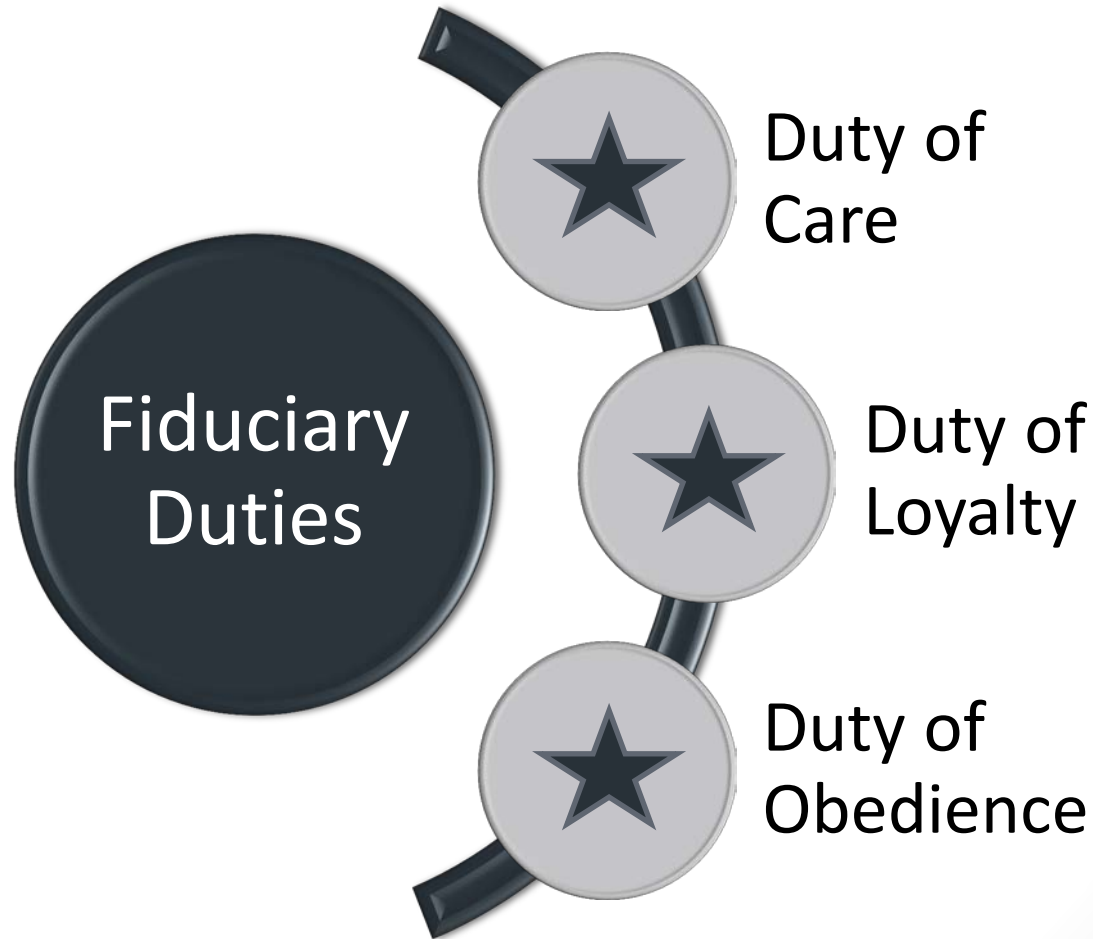
Act of a majority of directors present in person (or by proxy if authorized) is the act of the board unless act of a greater number required by governing documents

May modify required vote in Certificate of Formation or Bylaws for all or specific actions/votes

Proxy voting allowed only if *expressly* authorized in Certificate of Formation or Bylaws

- If allowed, expires 3 months after date executed
- If allowed, revocable unless otherwise provided by the proxy or made irrevocable by law
 - Standard differs for member proxies

Duties of Decision Makers



Duty of Care


Act in good faith

Use care that a person of ordinary prudence would use in same or similar circumstances (reasonable skills)

Make decisions reasonably believed to be in the best interest of the corporation

- Reasonableness based on objective facts available to the decision maker

Duty of Care: Business Judgment Rule and Directors



Directors of nonprofit corporations are not liable where they exercise their business judgment in making decisions on behalf of organization.

Parameters not clearly defined
(compare for profit context)

Statutory law governing nonprofit corporations simply refers to the duty of care

Essentially means directors are not liable for simple negligence absent fraud, illegality or a disabling conflict of interest

A director
should
seek to
do the
following:

Familiarize herself with material aspects of the organization

Faithfully attend meetings

Read materials and prepare for meetings

Ask questions before, during and after meetings

Exercise independent judgment

Rely on appropriate sources of information

Review minutes of the board

Seek to stay informed as to legal obligations and good governance

Duty of Care Checklist

All decision makers should know the following:

- Legal form of the organization
- Mission of the organization
- Provisions of Articles of Incorporation/Certificate of Formation
- Provisions of Bylaws
- Any policies affecting decision makers (e.g. Conflict of Interest Policy)
- Financial Picture (budget and financials)
- Most recent 990
- Existence/operations of related entities
- Where the organization is conducting activities
- Tax status and applicable legal requirements of the organization
- Activities being conducted by the organization
- Management structure
- Key employees
- Committee Structure
- How directors and officers are selected

Duty of Loyalty

Exercise an “extreme measure of candor, unselfishness and good faith”

Don't usurp corporate opportunities

Transactions with organization must be fair to the organization

Maintain appropriate confidentiality



Corporate Opportunity

- Prohibits a director from usurping corporate opportunities (i.e. opportunities in which the corporation has a legitimate interest or expectancy and the financial resources to exploit)
- Where closely related to corporate operations, must disclose (timely)
- Defenses where no disclosure:
 - Not same line of business
 - Corporation abandoned opportunity
 - Corporation lacked financial resources to pursue the opportunity

Interested Transactions

An officer or director is interested if he:

Makes a personal profit from the transaction with the corporation

Buys or sells assets of the corporation

Transacts business in the officer's or director's capacity with a second corporation of which the officer or director has a significant financial interest

Transacts corporate business in the officer's or director's capacity with a member of his family

Interested Transactions



Not inherently unethical or a violation of law

- **Note: Loans to directors are a statutory violation**

Key is disclosure and how the director and board then deal with a disclosed conflict (i.e. upon disclosure the board should provide a disinterested review of the matter)

Decision makers should consider adopting a conflict of interest policy

Dealing with Disclosed Conflict

Interested transactions are presumed unfair on the part of the decision maker, fraudulent on the corporation and generally voidable.

“Safe Harbor”

- Interested decision maker discloses material facts
- Majority of the disinterested directors, in good faith and the exercise of ordinary care, authorize the transaction

Duty of Obedience

- Remain faithful to and pursue the goals of the organization
- Follow the governing documents of the organization, laws applicable to the organization (including reporting and regulatory requirements), and restrictions imposed by donors
- Ensure charitable assets are not diverted to non-charitable uses
- Liability requires personal participation or actual knowledge of the wrongful act

Selected Membership Issues

Entitled to review voting list (before and during meeting)

Entitled to one vote on each matter submitted to membership vote unless voting right of class are limited/enlarged/denied by Certificate of Formation/Bylaws

Entitled to use proxies unless otherwise provided in Certificate of Formation/Bylaws

Entitled to vote on fundamental actions (requires 2/3 of votes cast)

Books and Records - Minutes



What are they?

- Official record of the actions taken at a meeting
- Evidence of the actions taken at a meeting



Statutorily required for meeting of members, board of directors, and committees (§3.151(a))



May be in written paper form or another form capable of being commuted into written paper form within a reasonable time (§3.151(b))



Members, directors, the Office of the Attorney General have a right to inspect the minutes

Minutes Continued

Minimalist vs. Comprehensive

- Drafter should be skilled
- Document compliance with fiduciary duties and exercise of business judgment
- Tapes do not replace minutes

Always Include

- Date, time, location, duration, nature (regular or special), participants, quorum, materials distributed, agenda discussed, actions taken, conflicts / dissents / abstentions, professionals who provided advice

And Finally

- Circulate to Board prior to or at the next meeting to be approved and signed

Financial Records

- Current and accurate financial records with complete entries as to each financial transaction of the corporation including income & expenses, in accordance with GAAP
- Annual Financial Report
 - Must conform to AICPA standards
 - Statement of support, revenue, expenses
 - Statement of changes in fund balances
 - Statement of functional expenses; and
 - Balance sheet for each fund
- * **Failure to maintain records, prepare annual report, or make available to public is a Class B misdemeanor**
- Exceptions for specific types of organizations and organizations that do not intend to solicit and do not receive more than \$10,000 from non-members



State Reporting



Must file franchise tax report annually unless apply for and granted exemption



Must file Periodic Report of Nonprofit Corporation (Form 802) at least once every four years as requested by Secretary of State



Must maintain registered agent/office and file changes as necessary



Private Foundations must provide copy of Form 990-PF to Attorney General

Fundraising Through Raffles/Auctions/Etc.



Raffles

- Charitable Raffle Enabling Act legalizes certain raffles
 - Must be a qualified organization
 - No more than two non-overlapping raffles per calendar year
 - Must possess/post full value bond for award
 - Specific information required on tickets
 - Limitations on value of awards (no cash)
 - Net proceeds for charitable purposes



Poker Tournaments

- General Rule: Poker and casino nights are gambling
- Legal if:
 - No consideration by participants (combine with dinner)
 - No prizes or prizes go to choice of charity



Auctions

- Not considered gambling
- Special rules when auction item is alcoholic beverage
- Exempt from sales tax on purchases; exempt from collecting sales tax for up to 2 one-day sales/calendar year (unless items are over \$5,000 and not manufactured by/donated to charity)

**GENERAL RULE: Gambling is illegal in Texas
(Texas Penal Code Ch. 47)**

The information set forth in this outline should not be considered legal advice, because every fact pattern is unique.

The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein.

Non-lawyers are advised to consult an attorney before undertaking any issues addressed herein.

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