

GOOD GOVERNANCE AND OTHER CORPORATE CONCERNS

Presented by

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WHY BOTHER ORGANIZING?

Personal Considerations

- **Length of activities**
- **Resources involved**
- **Ability to maintain proper procedure**
- **Long term goals**
- **Return on Investment expected /desired /needed**
- **Personal exposure**

WHY BOTHER ORGANIZING?

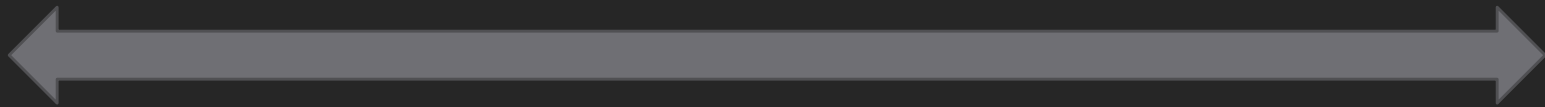
General Legal Considerations

- **Personal liability issues**
- **Tax issues**
- **Structuring assets**
- **Transfer of entity**
- **Pooling of responsibility and assets**
- **Image and Fundraising**

SLIDING SCALE OF ENTITIES

Personal Benefit

Social Benefit



C/S Corp

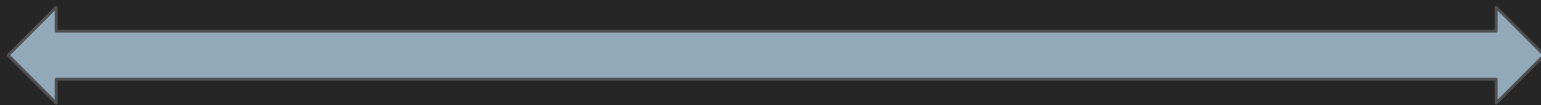
Flex Purpose

L3C

Nonprofit

LLC

Benefit Corp



Privacy
Transparency

Personal Control
Control

Public

↓ Oversight & Regulation
Regulation

↑ Oversight &

Easier Setup & Maintenance

PITA Setup and

OWNING COMMUNITY PROJECTS

- **Except for a not for profit corporation, all other entities have owners**
- **Picking the correct owners**
 - Risk of Insolvency, Divorce, Death, Criminal Behavior
 - Length of time and reputation in the community
 - Potential for conflict of interest
- **Protecting the community in corporations that have owners**
- **Conflict of Interest and Transparency**
- **Buy-sell Agreement / Shareholder Agreement with appropriate triggers**

WHY GOOD GOVERNANCE MATTERS

- **Protect the corporate assets and future**
- **Protect yourself from personal liability**
- **Maintain the reputation of the entity in the community**
- **Ensure smooth succession**
- **Good fences make good neighbors**
- **You owe it to the community!**

KEY GOVERNANCE TOOLS

- **Legal Knowledge & Advice (technical tool)**
- **Common Sense (practical tool)**
- **Organizational Documents**
 - **Certificate of Incorporation**
 - **Articles of Organization**
- **By-Laws (Corporation)**
- **Shareholders Agreement (Corporation)**
- **Operating Agreement (LLC)**
- **Minutes / Unanimous Written Consent**

ORGANIZATIONAL DOCUMENTS

- **Often fairly simple and short**
- **Filed with the state**
- **Harder to amend**
- **Basic framework of share structure**
- **Various state laws and regulations applicable**
- **Non profits often have more rigorous requirements and specific language**

BY-LAWS/SHAREHOLDER AGREEMENTS / OPERATING AGREEMENTS

- **Describe relationships amongst members**
- **Describe procedures for governing company**
- **Describe voting procedures (Board and Members)**
- **Committees**
- **Transfer of Shares (Buy-Sell Agreement)**
- **Budgets and Spending**

BY-LAWS

ARTICLE I – NAME

**The name of this corporation shall be
Pompous Facilitation Corp. The
business of the corporation may be
conducted as Pompous Facilitation
Corp. or CircleJerk R Us**

BY-LAWS

ARTICLE II – PURPOSE AND POWERS

Pompous Facilitation Corp. is a non-profit corporation and shall be operated exclusively for [charitable] purposes within the meaning of Section 501 (c)(3) of the Internal Revenue Code of 1986, or the corresponding section of any future Federal tax code.

[Insert more descriptions, if you choose, but beware]

BY-LAWS

ARTICLE II – PURPOSE AND POWERS

The corporation shall have the power to do any and all lawful acts which may be necessary or convenient to affect the purposes for which the corporation is organized.....

- Nonprofit Legal Status**
- Exempt Activities Limitation**
- Distribution Upon Dissolution**

BY-LAWS

ARTICLE III – MEMBERSHIP

- **Members and Classes of Members**
- **Qualifications for Members**
- **Dues for members**
- **Voting or other rights of each class of Members**

BY-LAWS

ARTICLE IV – BOARD OF DIRECTORS

- **Number of Directors**
- **Powers**
- **Terms**
 - **Length**
 - **Staggered terms**
- **Qualifications**
- **Elections**

BY-LAWS

ARTICLE IV – BOARD OF DIRECTORS

- **Vacancies**
- **Removal of Directors**
 - Cause
 - Without Cause
- **Meetings**
 - Regular Meetings
 - Special Meetings
 - Notice of Meetings

BY-LAWS

ARTICLE IV – BOARD OF DIRECTORS

- **Taking Action**
 - Quorum
 - Majority/Supermajority/Unanimous
- **Compensation of Directors**
- **ALSO – Officers & Committees**

BY-LAWS

OTHER NOTABLE THINGS

- **Authority over contracts and money**
- **Indemnification**
- **Amendment Provisions**
- **Conflict of Interest**
- **Ethics**
- **Ten Principles**
- **Ownership Provisions nowhere to be found!**

MINUTES / WRITTEN CONSENT

- **Preferable to authorize action without meeting if allowed by state law**
- **Most states require at least yearly meetings**
- **Authorize all actions which require Board Vote by law or by corporations own governing documents**
- **Protection for person binding corporation or acting on behalf of corporation**

DANGERS OF DOCUMENTATION

- **Always assume that anything put in writing (electronic or otherwise) will last forever and always appear when you least want to see it**
- **Official minutes or consent documents are legal documents that can protect you or work against you. Exercise caution while spawning them**
- **Always consult someone who knows better. If nobody knows better, the buck stops with you!**
- **On sensitive topics especially – you are creating a record with your minutes**

COVERING YOUR ASS

- **Maintain good corporate structure and procedures**
- **Piercing the corporate veil**
- **Duty of care and loyalty**
- **Professionals as Directors**
- **Accounting, taxes**
- **Insurance**

EYES ON THE PRIZE

- **10 Principles**
- **Public perception can kill you even when laws can't touch you**
- **Transparency akin to a not for profit may be desirable even for corporations/LLCs**
- **Clear budgets**
- **Clear oversight**
- **Committees and multiple people with ability to track spending**
- **Watch your cash!**

501(C)(3) LIMITATIONS

- **Operational Test**
- **No Private Inurement**
- **No Private Benefit**
- **Lobbying and electioneering restrictions**
- **Unrelated business income tax**
- **Commerciality doctrine**

OPERATIONAL TEST

- An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization will not be so regarded if a substantial part of its activities does not further an exempt purpose.
- The exempt purposes set forth in section 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

PRIVATE INUREMENT

- **Generally only applies to insiders**
- **Relates to the earnings of Organization**
- **Qualitative test, not quantitative**
- **Decided on a case by case basis**
- **Reasonable salary, commissions, benefits, etc is not private inurement**
- **Nonprofit organizations are not prevented from making a profit**
- **Penalties can be large and can lose exempt status**

PRIVATE BENEFIT

- **There can be some private benefit**
- **Qualitative AND quantitative test**
- **For ALL parties receiving a benefit not accorded to the public as a whole (not just insiders)**
- **Must be substantial private benefit to jeopardize status**
- **Is the private benefit necessary?**
- **How large is the private benefit compared to the public benefits?**
- **Member Benefits – nothing too private/personal**

LOBBYING AND LEGISLATIVE RESTRICTIONS

- Some lobbying is permitted, but can not be the primary purpose of the organization**
- Nonprofits can educate the public about causes but are limited in ability to be involved with legislative activity**
- Political affiliation is prohibited**

UNRELATED BUSINESS INCOME TAX

General Rule: An activity is an unrelated business and subject to UBIT if:

1. It is a trade or business;
2. Regularly carried on; and
3. Not substantially related to furthering the exempt purpose of the organization

EXCEPTIONS:

- Volunteer Labor
- Convenience of Members
- Selling Donated Merchandise
- BINGO!!!

COMMERCIALITY DOCTRINE

501(c)(3) organization may operate a trade or business (even as a substantial part of its activities) if:

- The operation of such trade or business is in furtherance of its exempt purposes, and**
- The organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business**

COMMERCIALITY FACTORS

- **Competition with for-profit entities**
- **Business model focused on generation and accumulation of profits**
- **Commercial-like business and marketing practices**
- **Serving general public as opposed to a more discrete charitable class**
- **Lack of significant donative support**

**Substantial, commercial, unrelated business
may result in loss of exemption!!**

Get in touch!

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