

# **BECOMING A DIRECTOR OF A NONPROFIT ORGANIZATION**

## **The Pinnacle**

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There are many worthwhile nonprofit organizations that serve communities throughout our country. These organizations include youth activities (such as the Boys and Girls Club), family activities (such as the YMCA), churches, food pantries, homeless shelters, sports clubs and civic organizations (such as Rotary), to name just a few. Each one of these organizations almost always has a board of directors that oversees its operation, and typically the board of directors is composed of people that volunteer to serve as directors. If a person has been asked to serve on the board of directors of a nonprofit organization, then there are a number of factors that a person should consider in determining whether to serve on the board of directors.

A person must understand the legal structure of the nonprofit organization. Nonprofit status is a function of state law and tax exempt status is function of both federal and state law. Some nonprofit organizations are incorporated and others are unincorporated associations. California recognizes three primary categories of nonprofit corporations, those being public benefit corporations, religious corporations and mutual benefit corporations. A corporation is formed in California by filing articles of incorporation with the California Secretary of State, along with preparing bylaws, obtaining an employer identification number and several other steps. A person should request and then review a copy of the file-stamped articles of incorporation and the bylaws so that he or she understands the legal structure of the organization. You should also find out the authorized number of directors, the duration of a director's term on the board and if the director is obligated to sit on any committees of the board.

Simply because a corporation has been formed as a nonprofit corporation under California law does not mean that it is exempt from federal or state income taxes. A nonprofit corporation must file for tax-exempt status with the Internal Revenue Service and with the Franchise Tax Board. In addition, there are different types of tax-exempt status. If a nonprofit corporation is granted tax-exempt status, then it will not pay any income tax. However, depending upon the type of tax-exempt status, the donors may or may not be able to take a deduction for the contributions to the nonprofit corporation. Therefore, it is important that the organization explain to a potential director what type of nonprofit corporation it is and the status of its tax-exempt status (e.g. has it applied for and obtain tax-exempt status, and what type of tax-exemption did it receive). You should also inquire if the nonprofit organization is current on filing its federal and state tax returns and if the corporation has registered with the Registry of Charitable Trusts.

A director of a nonprofit organization has various fiduciary duties to the organization, including the duties of loyalty and care and the duty to comply with investment standards. The scope of these duties is governed by California law but also by the formation documents for the nonprofit corporation. A person should inquire if the nonprofit corporation has members. If so, then the

members are going to have fiduciary duties to the corporation and this may reduce the authority of the directors to act on the corporation's behalf. The duty of loyalty requires that the director act in a manner that he or she believes is in the corporation's best interest. The duty of care requires that a director act in a manner that a reasonably prudent person would act in similar circumstances. Finally, the duty to comply with investment standards requires that a director (on the corporation's behalf) avoid unduly risky investments, act to preserve the corporation's assets and obtain a reasonable return on any investments, and comply with any investment standards established in the articles of incorporation or the bylaws.

It is important that a potential director understand these fiduciary duties and ask the current board of directors what steps they have taken so as to comply with these fiduciary duties. How these fiduciary duties apply to a nonprofit organization will depend upon the purpose and activities undertaken by the nonprofit organization. A potential director should ask for an explanation of his or her fiduciary duties if they were to serve on the board of directors. You should also inquire as to whether the directors have documented the actions taken so as to comply with their fiduciary duties. This would include keeping minutes of all board of directors meetings and having the minutes of each board of directors' meeting ratified and approved at the subsequent board of directors' meeting.

There has been a recent high profile case in Monterey County about the California Attorney General's office suing a Monterey County nonprofit organization over the misappropriation of funds, among other charges. This raises the issue of the potential liability of a director for violating his or her fiduciary duties to the nonprofit organization and the group (which is typically the public) served by the organization. California law does have certain statutory protections for directors of nonprofit organizations, but they are complicated and there are many exceptions to the protections. Any nonprofit organization really should purchase errors and omissions insurance for its directors and officers. In general, this will insure anyone that serves on a nonprofit organization for almost any actions taken by that director on the organization's behalf. There are certain exceptions that come with this insurance. Therefore, it is very important that a potential director request and receive a copy of the errors and omissions insurance and have the scope of coverage explained to them. If the potential director is not satisfied with the explanation, then he or she should speak with the insurance company that actually issued the policy so that they do understand the scope and terms of such coverage.

Serving as a director of a nonprofit organization can be a rewarding and satisfying experience. It is an excellent way to give back to the community and to help people that are less fortunate. If a person is considering being a director, then that person needs to have a thorough understanding of the goals and operation of the nonprofit organization in addition to their duties as a director of the organization. A person can then make a fully informed decision as to whether he or she is willing to serve as a director of the nonprofit organization.

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