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Is It Legal For A NonProfit To...

Indiana Continuing Legal Education Forum (ICLEF)

Is It Legal For A NonProfit To...
June 22, 2022
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IS IT LEGAL FOR A NONPROFIT TO...

Agenda

8:00 A.M. Registration

8:25 A.M. Welcome and Introduction

8:30 A.M. Is It Legal for a Nonprofit To…
- Charge for goods or services?
- Have more revenue (income) than expenses? (make a "profit")
- Run a "business"?
- Own a business?
- Own real property?
- Receive rent payments?
- Pay employees? Pay employees larger-than-average salaries and benefits?
- Pay bonuses to employees?
- Have a founder that cannot be removed?
- Offer _____ kinds of services?
- Have partnerships, commercial co-ventures or joint ventures with businesses?
- Give prizes or financial awards to volunteers?

10:00 A.M. Coffee Break

10:10 A.M. Is it Legal for a Nonprofit To…
- Contract for goods or services with Board Members?
- Make loans to officers or directors?
- Remove a member? Redefine membership?
- Limit member access to records?
- Limit Director or Officer access to records or the building/property?
- Limit Director or Officer access to clients or patients?
- Pass and enforce a resolution that ties the hands of future Boards?

11:40 A.M. Quick Break

11:45 A.M. Ethical Considerations in the Nonprofit Setting
- Representing the Organization
- Knowing Who the "Organization" Actually Is in Governance Conflict
- Communicating with the Organization
- Competency
- Common Conflicts in Representing Nonprofits
- Transferring the File at Conclusion of Representation
- Dual Representation of the Organization plus a Member, Officer or Director

12:45 P.M. Adjournment

June 22, 2022

IS IT LEGAL FOR A NONPROFIT TO...

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June 22, 2022

Zachary S. Kester, Executive Director, Charitable Allies Inc., Indianapolis

Professionally, *Zac Kester* has an LL.M. (Masters of Law) concentrating on the special needs of tax-exempt organizations and has practiced law primarily for charities, focusing on organizational and compliance services. He has also earned a CFRM (Certificate in Fundraising Management) from the Lilly Family School of Philanthropy. In addition, Zac has also been named a Practitioner-in-Residence at the IU Maurer School of Law in Bloomington.

Zac speaks and publishes regularly regarding the unique needs of charities. Topics include identifying effective outcome measures, governance, board liability, human resources for small nonprofits and property tax exemption issues, among many others.

Personally, Zac, his wife, Amanda, and their four children are passionate about serving those in their communities and people globally. The Kesters strongly support adopting and fostering children, having adopted two beautiful girls from Ethiopia who are wonderful older sisters to the Kesters' biological sons.

Along with others from their local church, the Kesters help with repairs and spring cleaning at the Dayspring Center, a homeless shelter for women and children, and serve breakfast to men and women who need a helping hand at Horizon House.

Zac volunteers on his children's school board, and he and Amanda are active at their church.

The Kesters also support Compassion International and World Vision in the fight against child poverty, International Justice Mission to end human trafficking and slavery, the Invisible Girl Project, protecting little girls from gendercide, and Mission to the World missionaries Lee and Dr. Jen Bigelow and their three girls on a long-term medical mission in rural Belize.

Ted R. Batson, Jr., CapinCrouse LLP, Indianapolis

Ted Batson, JD, MBA, CPA, CFP, is a certified public accountant and tax attorney. A partner with CapinCrouse LLP, Certified Public Accountants, Ted advises exempt organizations of all sizes on a wide range of issues, including exempt organization taxation and representation before federal and state tax authorities.

Ted is a past presenter at ICLEF conferences and is a frequent speaker the AICPA Advanced Estate Planning Conference and other industry conferences. Ted is a past member of the AICPA Trust, Estate, and Gift Technical Resource Panel.

Ted is a graduate of the Indiana University Robert H. McKinney School of Law (summa cum laude), the Indiana University Kelley School of Business, and Asbury University.

L. Kathleen Buckner, Charitable Allies Inc., Indianapolis

Katie Buckner uses her versatile skill set to provide legal representation for nonprofits. Prior to joining the Charitable Allies team in 2021, Katie worked in insurance defense, where she defended third-party tort claims against insureds and first-party contract claims against insurers. She also worked in franchise law, interned with the Indiana Solicitor General, and advised college students on a range of issues through Indiana University Student Legal Services.

Katie earned her bachelor's degree at Cedarville University before attending Indiana University Maurer School of Law. She attends College Park Church with her husband and loves exploring the outdoors, especially national parks.

Jacqueline M. Pimentel-Gannon, Faegre Drinker Biddle & Reath LLP, Indianapolis

Jacqueline Pimentel-Gannon helps all types of nonprofit organizations navigate laws and IRS and tax regulations and provides legal services for nonprofit organizations at every stage in their life cycles.

Nonprofit Organizations
Jacqueline counsels a wide array of nonprofit organizations on matters ranging from formation and tax exemption, to governance, ongoing IRS compliance, and dissolution. She advises clients on grantmaking, charitable solicitation, annual returns, unrelated business income, activities of related and subsidiary entities, and various other nonprofit-related issues. She also provides real estate and other general legal services to organizations that are exempt from federal and state income taxes.

The types of organizations she represents include, among others:

Public charities
Private foundations (family foundations, company foundations, operating foundations)
Educational institutions (pre-K to higher ed)
Sports-related organizations
Hospitals
Churches and other religious organizations
Governmental organizations
Life science organizations
Trade associations and labor organizations
Social welfare organizations
Greek organizations
Real Estate & Financial Services
Before transitioning to the nonprofit organizations practice, Jacqueline represented real estate developers, financial institutions and corporate clients in transactions including:

Debt and equity financing
Leasing
Credit tenant leases
Acquisitions
Dispositions

Property transfers
Title and survey issues
Jacqueline has helped clients navigate the U.S. Department of Housing and Urban Development (HUD) TPA (transfer of physical assets) process, U.S. Environmental Protection Agency (EPA) compliance, and Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) issues. She continues to provide real estate services for nonprofit organizations. She also assists clients in obtaining property tax exemptions.

Past Experience
Prior to attending law school, Jacqueline was a third grade teacher at Our Lady of Perpetual Help School in Dallas, Texas.

Personal Interests
In her free time, Jacqueline plays all kinds of sports, but she has a particular affinity toward racquet sports. While she enjoys watching a variety of sports, she can usually be found cheering on the Fighting Irish, Colts and Pacers. Jacqueline also enjoys traveling both across the United States and abroad.

TOPICS: *Is It Legal for a Nonprofit To…*

1. **Charge for goods or services?** (See also the answers to questions 3, 6, 10 and 11, below.)

   Ind. Code Ann. § 23-17-4-1 – "A corporation incorporated under this article has the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation."

   IRC § 509(a)(2) – ". . . (2) an organization which normally receives more than one-third of its support in each taxable year from any combination of…**gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities**, in an activity which is not an unrelated trade or business…"

2. **Have more revenue (income) than expenses? (Make a "profit"?)**

   There is no prohibition against nonprofits generating a profit. In fact, if a nonprofit fails to have more revenue than expenses for long enough, then it will eventually need to dissolve for lack of funding. The upper limit is that a nonprofit must "carry[] on . . . a charitable program commensurate in scope with its financial resources" and not merely amass resources without a plan for utilizing them in furtherance of its charitable purpose. Rev. Rul. 64-182.

   The concept of "profits" is sometimes confused with the non-distribution constraint. I.R.C. § 501(c)(3) – " . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual . . ." 26 C.F.R. § 1.501(c)(3)-1(c)(2) – "***Distribution of earnings.*** An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals." 26 C.F.R. 1.501(a)-1(c) – ***Private shareholder or individual defined***. The words private shareholder or individual in section 501 refer to persons having a personal and private interest in the activities of the organization.

   Thus, tax-exempt organizations must not distribute their "profits" (e.g., net revenue) to directors, officers, or other insiders other than through ordinary compensation (and, commercially reasonable transactions approved by non-conflicted board members).

3. **Run a "business"?**

   Ind. Code Ann. § 23-17-4-2 – Unless a corporation's articles of incorporation provide otherwise, a corporation has perpetual duration and succession in the corporation's corporate name and has the same powers as an individual to do all things necessary or convenient to carry out the corporation's affairs, including the power to do the following:

…

(16) Carry on a business.

Nonprofits can engage in business-like activities so long as they:

Are Not Unduly "Commercial" – Tax-exempt organizations should not generally operate businesses as their primary activity. Factors include whether the organization (1) sells goods or services to the general public; (2) is in direct competition with businesses; (3) utilizes pricing formulas are comparable to businesses; (4) utilizes of promotional materials and commercial catch phrases; (5) advertised its good and services; (6) has similar hours of operation as businesses; (7) require management to have "business ability" or similar; (8) pay salaries instead of rely upon volunteers; and (9) did not receive charitable contributions. See Living Faith, Inc. v. Comm'r, 950 F.2d 365 (7th Cir. 1991).

Avoid more than "insubstantial" UBTI, IRC § 512(a)(1) – "…the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b)."

4. **Own a business?**

Ind. Code Ann. § 23-17-4-1 – "A corporation incorporated under this article has the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation."

Ind. Code Ann. § 23-17-4-2 – Unless a corporation's articles of incorporation provide otherwise, a corporation has perpetual duration and succession in the corporation's corporate name and has the same powers as an individual to do all things necessary or convenient to carry out the corporation's affairs, including the power to do the following:

…

(4) Purchase, receive, take by gift, devise, or bequest, lease, or otherwise acquire, and own, hold, improve, use, and otherwise deal with, real or personal property, or any legal or equitable interest in property, wherever located.

…

(6) Purchase, receive, subscribe for, or otherwise acquire, own, hold, vote, use, sell, mortgage, lend, pledge, or otherwise dispose of, and deal in and with, shares or other interests in, or obligations of any entity.

…

(9) Be a promoter, a partner, a member, an associate or a manager of any partnership, joint venture, trust, or other entity.

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26 CFR § 1.512(b)-1(l), Interest, annuities, royalties, and rents from controlled organizations: (1) In general. [I]f an exempt organization (hereinafter referred to as the controlling organization) has control (as defined in subparagraph (4) of this paragraph) of another organization (hereinafter referred to as the controlled organization), the controlling organization **shall include as an item of gross income in computing its unrelated business taxable income, the amount of interest, annuities, royalties, and rents** derived from the controlled organization determined under subparagraph (2) or (3) of this paragraph.

(4) Control –

(i) In general. For purposes of this paragraph –

(a) Stock corporation. In the case of an organization which is a stock corporation, the term control means ownership by an exempt organization of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation.

(b) Nonstock organization. In the case of a nonstock organization, the term control means that at least 80 percent of the directors or trustees of such organization are either representatives of or directly or indirectly controlled by an exempt organization. A trustee or director is a representative of an exempt organization if he is a trustee, director, agent, or employee of such exempt organization. A trustee or director is controlled by an exempt organization if such organization has the power to remove such trustee or director and designate a new trustee or director.

5. **Own real property?**

Ind. Code Ann. § 23-17-4-1 – "A corporation incorporated under this article has the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation."

Ind. Code Ann. § 23-17-4-2 – Unless a corporation's articles of incorporation provide otherwise, a corporation has perpetual duration and succession in the corporation's corporate name and has the same powers as an individual to do all things necessary or convenient to carry out the corporation's affairs, including the power to do the following:
…

(4) Purchase, receive, take by gift, devise, or bequest, lease, or otherwise acquire, and own, hold, improve, use, and otherwise deal with, real or personal property, or any legal or equitable interest in property, wherever located.

6. **Receive rent payments?**

26 CFR § 1.512(b)-1(c)(2) – "[E]xcept as provided in subdivision (iii) of this subparagraph, rents from property described in subdivision (ii) of this subparagraph, and the deductions directly connected therewith, shall be excluded in computing unrelated business taxable income. However, notwithstanding subdivision (ii) of this subparagraph, certain rents from and certain deductions in connection with either debt-financed property (as defined in section 514(b)) or property rented to controlled organizations (as defined in paragraph (l) of this section) shall be included in computing unrelated business taxable income."

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26 CFR § 1.512(b)-1(c)(5) – Rendering of services. For purposes of this paragraph, payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts, or motels, or for the use of occupancy of space in parking lots, warehouses, or storage garages, does not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exists, stairways, and lobbies, the collection of trash, etc., are not considered as services rendered to the occupant. Payments for the use or occupancy of entire private residences or living quarters in duplex or multiple housing units, of offices in any office building, etc., are generally treated as rent from real property.

IRC § 514 – (b)Definition of debt-financed property
(1) In general. For purposes of this section, the term "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year (or, if the property was disposed of during the taxable year, with respect to which there was an acquisition indebtedness at any time during the 12-month period ending with the date of such disposition), except that such term does not include—

(A)(i)any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the

exercise or performance of any purpose or function designated in section 501(c)(3)), or (ii) any property to which clause (i) does not apply, to the extent that its use is so substantially related.

7. **Pay employees? Pay employees larger-than-average salaries & benefits?**

   Yes, nonprofits can pay its employees. The compensation is then reported on Schedule J of the Form 990-EZ/990. The compensation needs to be reasonable. Reasonable compensation is the value that would ordinarily be paid for like services by like enterprises under like circumstances. Reasonableness is determined based on all the facts and circumstances. For more information on reasonable compensation, see Form 990 instructions, Appendix G, Section 4958 Excess Benefit Transactions.

8. **Pay bonuses to employees?**

   Yes, nonprofits can pay bonuses to its employees, but they should not be based on the amount of revenues earned as that is the sharing of profits which is prohibited by the IRS, i.e. "no part of the net earnings of which inures to the benefit of any private shareholder or individual" (§ 501(c)(3)). Bonuses must also be fixed, rather than non-fixed. The discretion is in the making of the bonus structure, not in choosing the amount later in the year.

   See instructions for Schedule J of the Form 990-EZ/990 for examples on proper and improper bonuses.

9. **Have a founder that cannot be removed?**

   No, nonprofits cannot have a founder that cannot be removed. Except for designated or appointed directors, the term of a director may not exceed five (5) years. Ind. Code Ann. § 23-17-12-5.

   Ind. Code Ann. § 23-17-12-12 – (a) A designated director may be removed by an amendment to articles of incorporation or bylaws deleting or changing the designation.
   (b) Except as provided in articles of incorporation or bylaws, an appointed director may be removed with or without cause by the person appointing the director. The person removing the director must do so by giving written notice of the removal to the following:
   (1) The director.

   (2) The presiding officer of the board of directors or the corporation's president or secretary.
   A removal is effective when the notice is effective under this article unless the notice specifies a future effective date.

However, it is permissible to have classes of directors and to have provisions making it more difficult to remove founders.

10. **Offer _____ kinds of services?**

Ind. Code Ann. § 23-17-4-1 – "A corporation incorporated under this article has the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation."

IRC § 501(c)(3) – "…organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals…"

There is very little that nonprofits cannot do so long as they are done in a permissible way. Charities must generally engage in inherently charitable activity, or serve a charitable class. A charitable class must be sufficiently large or indefinite so that aiding them provides a benefit for the community as a whole. Additionally, a charitable class must be made up of individuals, organizations, animals, etc. that are eligible to receive assistance from nonprofit organizations due to their connection with one of the permissible charitable purposes.

Ind. Code Ann. § 23-17-4-2 – Unless a corporation's articles of incorporation provide otherwise, a corporation has perpetual duration and succession in the corporation's corporate name and has the same powers as an individual to do all things necessary or convenient to carry out the corporation's affairs, including the power to do the following:

(1) Sue, be sued, complain, and defend in the corporation's corporate name.

(2) Have a corporate seal or facsimile of a corporate seal, which may be altered at will, to use by impressing or affixing or in any other manner reproducing it. However, the use or impression of a corporate seal is not required and does not affect the validity of any instrument.

(3) Make and amend bylaws not inconsistent with the corporation's articles of incorporation or with Indiana law for managing the affairs of the corporation.

(4) Purchase, receive, take by gift, devise, or bequest, lease, or otherwise acquire, and own, hold, improve, use, and otherwise deal with, real or personal property, or any legal or equitable interest in property, wherever located.

(5) Sell, convey, mortgage, pledge, lease, exchange, and otherwise dispose of all or any part of the corporation's property.

(6) Purchase, receive, subscribe for, or otherwise acquire, own, hold, vote, use, sell, mortgage, lend, pledge, or otherwise dispose of, and deal in and with, shares or other interests in, or obligations of any entity.

(7) Make contracts and guaranties, incur liabilities, borrow money, issue notes, bonds, and other obligations and secure any of the corporation's obligations by mortgage or pledge of any of the corporation's property, franchises, or income.

(8) Lend money, invest and reinvest the corporation's funds, and receive and hold real and personal property as security for repayment, except as provided under IC 23-17-13-3.

(9) Be a promoter, a partner, a member, an associate or a manager of any partnership, joint venture, trust, or other entity.

(10) Conduct the corporation's activities, locate offices, and exercise the powers granted by this article inside or outside Indiana.

(11) Elect directors, elect and appoint officers, and appoint employees and agents of the corporation, define the duties and fix the compensation of directors, officers, employees and agents.

(12) Pay pensions and establish pension plans, pension trusts, and other benefit and incentive plans for the corporation's current or former directors, officers, employees, and agents.

(13) Make donations not inconsistent with law for the public welfare or for charitable, religious, scientific, or educational purposes and for other purposes that further the corporate interest.

(14) Impose dues, assessments, admission, and transfer fees upon the corporation's members.

(15) Establish conditions for admission of members, admit members, and issue memberships.

(16) Carry on a business.

(17) Have and exercise powers of a trustee as permitted by law, including those set forth in IC 30-4-3-3.

(18) Purchase and maintain insurance on behalf of any individual who:

(A) is or was a director, an officer, an employee, or an agent of the corporation; or

(B) is or was serving at the request of the corporation as a director, an officer, an employee, or an agent of another entity; against any liability asserted against or incurred

by the individual in that capacity or arising from the individual's status as a director, an officer, an employee, or an agent, whether or not the corporation would have power to indemnify the individual against the same liability under this article.

(19) Do all things necessary or convenient, not inconsistent with law, to further the activities and affairs of the corporation.

(20) Adopt, either in the corporation's articles of incorporation or bylaws, a provision establishing exclusive jurisdiction in the circuit or superior courts of any county in Indiana or in the United States district courts of Indiana, for:

(A) any action asserting a claim for breach of a fiduciary duty owed by any director, officer, employee, or agent of the corporation to the corporation;

(B) any action asserting a claim arising under:

(i) any provision of this article; or

(ii) the corporation's articles of incorporation or bylaws; or

(C) any actions otherwise relating to the internal affairs of the corporation.

11. **Have partnerships, commercial co-ventures or joint ventures with businesses?**

Yes, nonprofits can engage in partnerships and joint ventures with business. See Rev. Rul. 98-15 (seminal ruling from the IRS on joint ventures); Gen. Couns. Mem. 39,862 (Nov. 21, 1991) & Gen. Couns. Mem. 39,005 (Dec. 17, 1982) (IRS statements on exempt organizations' involvement with operating LLCs); PLR 9207033 (EO operating as a limited partner); PLR 9112013 (EO operating as a lender); Rev. Rul. 2004-51 (ancillary joint ventures).

Partnerships and joint ventures are very, very complex in the tax-exempt organization space. When they are cross-species (e.g, with business entities or individuals) there are often warranties that must be made by nonprofits to secure certain types of funding that can, if done incorrectly, violate various prohibitions on inurement. The activities of a partnership are also attributed to the tax-exempt organization, so often a blocker corporation is necessary or advisable. A deep dive on this topic is beyond the scope of this CLE.

Commercial co-ventures are a different kind of relationship entirely from partnerships or joint ventures where the nonprofit allows a for-profit to publicize the fact that the for-profit will be donating an amount of revenue generated from certain activities to the nonprofit. Many states require registration of the agreement to avoid misleading marketing tactics, i.e. saying the for-profit will donate 10% of proceeds, but capping the total in the fine print to a low dollar amount. However, Indiana does not require commercial co-venture registrations.

Common example of a misleading tactic was back in 1999 when Yoplait agreed to donate $0.50 for every aluminum lid from the yogurts that got sent back to them without disclosing that the total donation was capped at $100,000. Something like 9.4 million lids were ultimately returned to Yoplait, which would put the donation amount at $4.7 million, and yet they only gave about $163,000 to support breast cancer research.

12. **Give prizes or financial awards to volunteers?**

Nonprofits can give prizes or gift cards to their volunteers. However, they are generally considered to be income to the recipient. The question then becomes whether the NPO has an obligation to issue a Form 1099-Misc or 1099-NEC (desponding on the applicable form and threshold). If the amount it too high, it would also raise an issue with the Fair Labor Standards Act and the determination as to whether the person was an employee (and employment taxes should have been withheld).

13. **Contract for goods or services with Board Members?**

Nonprofits are permitted to contract with their directors for goods or services so long as the contracts are negotiated at arm's length and are approved consistent with the Excess Benefit Transaction rules. See 26 C.F.R. § 1.4958-6 and Instructions for Form 1023 pg. 11, column 1, Part V, line 4 (2021). Notwithstanding the above, there are special rules for private foundation that generally prohibit transactions between disqualified persons (like officers and directors) and the private foundation.

14. **Make loans to officers or directors?**

No, it is impermissible for nonprofits to give loans to their Officers or Directors in Indiana.

Ind. Code Ann. § 23-17-13-3 – (a) A corporation may not:

(1) lend money to; or

(2) guarantee the obligation of;

a director or an officer of the corporation.

(b) A loan or guaranty that is made in violation of this section does not affect the borrower's liability on the loan.

Furthermore, loans *from* directors or officers to the nonprofit corporation are also strongly discouraged by the Office of the Attorney General as this causes great incentive for the directors and officers to place the obligations owed to them *before* other creditors out of the order of

priority. However, they are permissible and in some contexts there are specific regulations on how they should be done (e.g., interest-free in the private foundation context).

15. **Remove a member? Redefine membership?**

Yes, it is permissible for a nonprofit to remove a member. It is important to understand that member in this context is a specifically defined legal term as follows:

Ind. Code Ann. § 23-17-2-17 – (a) "Member" means a person who, on more than one (1) occasion, has the right to vote for the election of a director under a corporation's articles of incorporation or bylaws.

(b) A person is not a member because of any of the following:

(1) Any rights the person has as a delegate.

(2) Any rights the person has to designate a director.

(3) Any rights the person has as a director.

In order to remove a member, the law says the following:

Ind. Code Ann. § 23-17-8-2 – (a) A member of a public benefit or mutual benefit corporation may not be expelled or suspended and a membership or memberships in such a corporation may not be terminated or suspended except under a procedure that is:

(1) fair and reasonable; and

(2) carried out in good faith.

(b) A procedure is fair and reasonable under either of the following conditions:

(1) The articles of incorporation or bylaws set forth a procedure that provides the following:

(A) Not less than fifteen (15) days prior written notice of the expulsion, suspension, or termination and the reasons for the expulsion, suspension, or termination.

(B) An opportunity for the member to be heard, orally or in writing, not less than five (5) days before the effective date of the expulsion, suspension, or termination by a person authorized to decide that the proposed expulsion, termination, or suspension should not take place.

(2) The procedure is fair and reasonable taking into consideration all of the relevant facts and circumstances.

(c) Written notice given by mail must be given by first class or certified mail sent to the last address of the member shown on the corporation's records.

(d) A proceeding challenging an expulsion, a suspension, or a termination, including a proceeding in which defective notice is alleged, must be commenced within one (1) year after the effective date of the expulsion, suspension, or termination.

(e) A member who has been expelled or suspended or whose membership is terminated may be liable to the corporation for dues, assessments, or fees as a result of obligations incurred or commitments made before expulsion, suspension, or termination.

The Board of Directors of a nonprofit can redefine or clarify the conditions or qualifications for membership by amending the Articles of Incorporation or Bylaws if they have the authority to do such, see Ind. Code Ann. § 23-17-7-1, or by adopting membership qualification policies.

However, if such amendments act to remove members, then the procedures described above in Ind. Code Ann. § 23-17-8-2 should be followed.

16. **Limit member access to records?**

Member access to records is controlled by Ind Code Ann §§ 23-17-11-1 and 23-17-27 et al.

Specifically, nonprofits are allowed to limit access as follows:

Ind. Code Ann. § 23-17-11-1 (List of members) – (g) The articles of incorporation or bylaws of a religious corporation may limit or abolish the rights of a member under this section to inspect and copy the corporation's records.

(h) The articles of incorporation of a public benefit corporation may limit or abolish the right of a member, the member's agent, or an attorney authorized in writing to inspect or copy the membership list if the corporation provides a reasonable means to mail communications concerning the corporation to other members through the corporation at the expense of the member making the request.

Ind. Code Ann. § 23-17-27-2 – (a) Subject to subsection (e) and section 3(c) of this chapter, a member is entitled to inspect and copy, at a reasonable time and location specified by the corporation…
…
(c) A member may inspect and copy the records identified in subsection (b) only if the following conditions exist:

(1) The member's demand is made in good faith and for a proper purpose.

(2) The member describes with reasonable particularity the purpose and the records the member desires to inspect.

(3) The records are directly connected with the purpose.

…

(e) The articles of incorporation or bylaws of a religious corporation may limit or abolish the right of a member under this section to inspect and copy a corporate record.

(f) The articles of incorporation of a corporation may limit or abolish the following:

(1) The right of a member to obtain from the corporation information as to the identity of contributors to the corporation.

(2) The right of a member or the member's agent or attorney to inspect or copy the membership list if the corporation provides a reasonable means to mail communications to other members through the corporation at the expense of the member making the request.

Ind. Code Ann. § 23-17-27-3 – (a) A member's agent or attorney, if authorized in writing, has the same inspection and copying rights as the member the agent or attorney represents.

(b) The right to copy records under section 2 of this chapter includes, if reasonable, the right to receive copies made by photographic, xerographic, or other means.

(c) A corporation may impose a reasonable charge, covering the costs of labor and material, for copies of any documents provided to the member. The charge may not exceed the estimated cost of production or reproduction of the records.

(d) A corporation may comply with a member's demand to inspect the record of members under section 2(b)(3) of this chapter by providing the member with a list of the corporation's members that was compiled not earlier than the date of the member's demand.

Ind. Code Ann. § 23-17-27-5 – Without the consent of a board of directors, all or part of a membership list may not be obtained or used by a person for a purpose unrelated to a member's interest as a member. Without the consent of the board of directors, all or part of a membership list may not be:

(1) used to solicit money or property unless the money or property will be used solely to solicit the votes of the members in an election to be held by the corporation;

(2) used for a commercial purpose; or

(3) sold to or purchased by a person.

17. **Limit Director or Officer access to records or the building/property?**

Generally, Directors and Officers have access to the records and property of the nonprofit. However, nonprofits can establish that certain aspects of the business are to be run by some subset of the Board or by other people entirely:

Ind. Code Ann. § 23-17-12-1 – (c) Articles of incorporation may authorize a person or a group of persons or the manner of designating a person or a group of persons to exercise some or all of the powers that would otherwise be exercised by a board of directors. To the extent authorized:

(1) the person or group of persons has the duties and responsibilities of the directors;

(2) the directors are relieved to that extent from the duties and responsibilities; and

(3) the person or group of persons should be considered a director or directors for purposes of IC 23-17-13 and IC 23-17-16.

Section 802 of the Sarbanes-Oxley Act makes it a crime to knowingly alter, destroy, conceal or falsify any record or document with intent to impede, obstruct, or influence a federal investigation or the administration of any other federal matter. Unlike most provisions of the Act, the applicability of the document retention provision is not limited to companies that report under the Securities and Exchange Act of 1934, and hence likely applies to nonprofit organizations as well. Violations of this provision are punishable by fines or imprisonment up to 20 years.

Many nonprofit organizations, particularly those with paid employees, would benefit from having a document retention/destruction policy that would enable them to comply with various existing state and federal laws (such as the Fair Labor Standards Act, which requires that payroll records be kept for a certain minimum period of time) and to maintain useful evidence for potential lawsuits. Section 802's likely applicability to nonprofit organizations provides one more reason to adopt a written policy.

18. **Limit Director or Officer access to clients or patients?**

See above. Also, for nonprofits that are engaged in services subject to the Indiana Professional Code of Ethics, HIPAA, or other similar confidentiality laws, Directors' and Officers' access to records of the clients and patients should be limited to the extent required by such laws and regulations. Sometimes, these can be very significant limitations on a Director or Officer's access to records.

19. **Pass & enforce a resolution that ties the hands of future Boards?**

Yes, current Boards can tie the hands of future Boards, but not permanently or indefinitely; and once a Director has left the Board, they no longer have any enforcement capabilities.

Ind. Code Ann. § 23-17-12-1 – Except as otherwise provided in this article:

(1) corporate powers shall be exercised by or under the authority of; and

(2) the business and affairs of the corporation managed under the direction of;

the corporation's board of directors.

The current Board has full authority over the operations of the nonprofit, but that then means any future iteration of the Board also has full authority. So, a future Board would be able to undo whatever action a past Board took to the extent possible.

20. **Ethical Considerations in the Nonprofit Setting**
    - **a. <u>Representing the Organization (see b., below)</u>**
    - **b. <u>Knowing Who the "Organization" Actually Is in Governance Conflict</u>**

Indiana Rules of Professional Conduct
<u>Rule 1.13. Organization as Client</u>

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents, generally the board of directors.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but

only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

c. Communicating with the Organization

Rule 1.4. Communication

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;

(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;

(3) keep the client reasonably informed about the status of the matter;

(4) promptly comply with reasonable requests for information; and

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law or assistance limited under Rule 1.2(c).

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Comment

Explaining Matters

[5] The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued, to the extent the client is willing and able to do so. Adequacy of communication depends in part on the kind of advice or assistance that is involved. For example, when there is time to explain a proposal made in a negotiation, the lawyer should review all important provisions with the client before proceeding to an agreement. In litigation a lawyer should explain the general strategy and prospects of success and ordinarily should consult the client on tactics that are likely to result in significant expense or to injure or coerce others. On the other hand, a lawyer ordinarily will not be expected to describe trial or negotiation strategy in detail. The guiding principle is that the lawyer should fulfill reasonable client expectations for information consistent with the duty to act in the client's best interests and the client's overall requirements as to the character of representation. . . .

[6] Ordinarily, the information to be provided is that appropriate for a client who is a comprehending and responsible adult. . . . When the client is an organization or group, it is often impossible or inappropriate to inform every one of its members about its legal affairs; ordinarily, the lawyer should address communications to the appropriate officials of the organization. See Rule 1.13.

d. Competency

Rule 1.1. Competence

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Comments

Legal Knowledge and Skill

[1] In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.

[2] A lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar. A newly admitted lawyer can be as competent as a practitioner with long experience. Some important legal skills, such as the analysis of precedent, the evaluation of evidence and legal drafting, are required in all legal problems. Perhaps the most fundamental legal skill consists of determining what kind of legal problems a situation may involve, a skill that necessarily transcends any particular specialized knowledge. A lawyer can provide adequate representation in a wholly novel field through necessary study. Competent representation can also be provided through the association of a lawyer of established competence in the field in question.

e. Common Conflicts in Representing Nonprofits

Rule 1.7. Conflict of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Comments

Generally

[5] Unforeseeable developments, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation, might create conflicts in the midst of a representation, as when a company sued by the lawyer on behalf of one client is bought by or merged with another client represented by the lawyer in an unrelated matter. Depending on the circumstances, the lawyer may have the option to withdraw from one of the representations in order to avoid the conflict. The lawyer must seek court approval where necessary and take steps to minimize harm to the clients. See Rule 1.16. The lawyer must continue to protect the confidences of the client from whose representation the lawyer has withdrawn. See Rule 1.9(c).

Organizational Clients

[34] A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary. See Rule 1.13(a). Thus, the lawyer for an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer, there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates, or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client.

[35] A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be

called on to advise the corporation in matters involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer's resignation from the board and the possibility of the corporation's obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer's independence of professional judgment, the lawyer should not serve as a director or should cease to act as the corporation's lawyer when conflicts of interest arise. The lawyer should advise the other members of the board that in some circumstances matters discussed at board meetings while the lawyer is present in the capacity of director might not be protected by the attorney-client privilege and that conflict of interest considerations might require the lawyer's recusal as a director or might require the lawyer and the lawyer's firm to decline representation of the corporation in a matter.

Rule 1.8. Conflict of Interest: Current Clients: Specific Rules

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

Comments

Person Paying for a Lawyer's Services

[11] Lawyers are frequently asked to represent a client under circumstances in which a third person will compensate the lawyer, in whole or in part. The third person might be a relative or friend, an indemnitor (such as a liability insurance company) or a co-client (such as a corporation sued along with one or more of its employees). Because third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client. See also Rule 5.4(c) (prohibiting interference with a lawyer's professional judgment by one who recommends, employs or pays the lawyer to render legal services for another).

f. Transferring the File at Conclusion of Representation

Rule 1.16. Declining or Terminating Representation

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that

has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

Comments

Assisting the Client upon Withdrawal

[9] Even if the lawyer has been unfairly discharged by the client, a lawyer must take all reasonable steps to mitigate the consequences to the client. The lawyer may retain papers as security for a fee only to the extent permitted by law. See Rule 1.15.

g. Dual Representation of the Organization plus a Member, Officer or Director

See c. and e., above.