Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

REPORT ON LEGISLATION BY THE COMMITTEE ON NON-PROFIT ORGANIZATIONS

S.3698 **Senator Perkins**

AN ACT to amend the not-for-profit corporation law, in relation to the classification of type C not-for-profit corporations.

THE BILL IS APPROVED

The Committee on Non-Profit Organizations of the Association of the Bar of the City of New York endorses Senate bill 3698 and urges its approval by the Senate and Assembly and its adoption by Governor Paterson as a long-overdue step to remove a confusing provision in New York's Not-for-Profit Corporation Law.

The bill would eliminate one of the four "types" of not-for-profit corporations under the Not-for-Profit Corporation Law ("N-PCL"), the Type C corporation. Nonprofits that were formed, and nonprofits that would otherwise have been formed, as Type C corporations would be deemed to be Type B nonprofits if the legislation is approved. Elimination of Type C corporations would greatly simplify the process of forming nonprofit corporations in New York and would not result in any loss of protection for the public

New York divides nonprofits into four categories: A, B, C and D, named after the subparagraphs of paragraph (b) of Section 201 of the N-PCL. This attempt to categorize nonprofits is one area where New York is unique and, along with other anomalies of New York law, gives those wishing to form a nonprofit a reason to consider forming the corporation outside of New York.

- Type A corporations are formed for "any lawful non-business purpose" including civic, patriotic, social, fraternal, athletic, agricultural, horticultural, animal husbandry organizations or professional, commercial, industrial trade or service associations. If a corporation could be a "B" or an "A," it is considered a "B." This category is most often applied to membership organizations where the activities by or for members are foremost, such as clubs, civic associations, business leagues, professional or trade groups, tenant organizations, PTAs and labor unions.

- Type B corporations are formed for "any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals." This listing correlates substantially to the classic definition of charities under the federal tax laws.

- Type C corporations are formed for any "lawful business purpose to achieve a lawful public or quasi-public objective." This is a confusing category. While the purpose of the organization must be to conduct "business," that business must still be for a purpose

which is not pecuniary profit or financial gain. In other words, the ultimate objective of the organization must be public benefit. Any organization having a Type C purpose, even if predominantly within another type such as Type B, is considered a Type C corporation. Examples of corporations that have been held to be Type C entities include thrift shops, entities formed to hold, lease or sell real estate, local development corporations, farms that educate students about farming, dance companies and nonprofit theater companies. Type C corporations with an appropriate charitable purpose are usually able to obtain Internal Revenue Service recognition as charities, just as are Type B corporations.

- Type D corporations are corporations formed under the N-PCL when the formation is authorized by some other corporate law for any business or non-business and pecuniary or non-pecuniary purpose, whether otherwise falling within the categories described as Types A, B or C. Housing development fund companies formed under the Private Housing Finance Law are one example of this type of entity.

If the bill is passed, Type B corporations would also include corporations formed for a lawful business purpose to achieve a lawful public or quasi-public objective.

The classification can be important for certain categories, as some of the burdens that fall on nonprofits vary depending on the type. With the exception of the need to have members (which Type Cs must have but Type Bs are not required to have), however, there are few regulatory differences between Type B and Type C corporations. For instance, the consents required for formation, the degree of regulation by the courts and the Attorney General and the dissolution processes and other approval procedures between these two types of entities are similar.

The dividing lines between Types B and C are not always clear. In practice, it is sometimes difficult for even the regulatory agencies to determine if an organization is a Type B or a Type C corporation. For instance, with respect to a charity that had among its purposes raising funds for medical education in Africa and providing "consultation" to recipients of such funding, the first examiner from the Department of State insisted that consulting was a "business purpose," thus requiring a refiling as a Type C corporation. But the examiner of the second filing said that he and others in the department could not find a "C" purpose.

Since there seems to be no rationale for or benefit to the distinction between the two categories, and too often this issue becomes source of confusion and delay when incorporation papers are filed with the Department of State, we see no good reason to maintain the distinction and therefore strongly support the bill. Adoption of the bill will lead to a better use of limited resources at the Department of State by simplifying the process of reviewing certificates of incorporation submitted for filing. We understand that the bill was introduced at the request of the Department of State and we applaud the department's thinking on this point.

We also see positive benefits to the change. Organizations which would otherwise need to form as Type C corporations could elect not to have members, an option currently available only to Type B entities. Most charitable nonprofits these days are board-managed, with no separate membership. Organizations which must have members by statutory requirement often satisfy that need, if a membership structure is not truly appropriate, by cumbersome machinations, such as having those persons who are the directors also be the members, meaning that care must be taken to do certain things "wearing a member hat" and other things "wearing a director hat." Another benefit would be the elimination of the need to include certain language in the certificate of incorporation by

Type C nonprofits regarding "the lawful public or quasi-public objective which such business purpose will achieve," which is information that provides no benefit to the public.

We believe that elimination of this requirement will not in any way result in the loss of appropriate information or safeguards. If a nonprofit's purpose was to operate a business for charitable ends, the purpose provision of the nonprofit's certificate of incorporation would need to so state and any agency whose consent is necessary for the nonprofit's formation and the Internal Revenue Service, when ruling on the nonprofit's application for recognition of exempt status, would thereby have all the information necessary for its purposes.

For the reasons noted above, the Committee on Non-Profit Organizations supports S3698 and urges its passage

Eliot P. Green, Chair
Kenneth W. Sussman, Non-Voting Secretary

Members:

Daniel R. Alcott
Edward Berkovitz
Sally Blinken
Amy K. Bonderoff
Nishka Chandrasoma
Peter Z. Cobb
Jennifer M. Coffey
Michael A. Corriero
Ingrid Criterion
Rebecca H. Dent
Claire Evans
Uzoma Alex Exe
Kate Fitzpatrick
Anne Kathryn Goldstein
Valerie Kennedy
Dipty Jain
Yoo-Kyeong Kwon *
Jasmine M. Hanif
Laura Lavie
Diana J. Lee
Jeffrey Liang
David W. Lowden *
Elizabeth S. Mandell
Serge A. Martinez *
Judith Moldover *
Sophia A. Muirhead
Catherine Oetgen *
Angelique C. Mamby Pannell
Robert L. Pitkofsky
Bruce Rabb
Tamar R. Rosenberg
Benjamin Brian Roth
Amarah K. Sedreddine
Barbara E. Shiers
Remi Silverman
Vera V. Zlatarski

* member of subcommittee reviewing proposed revisions to the Not-for-Profit Corporation Law

December 2009