

California Attorney General's

# Guide For CHARITIES



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## **INTRODUCTION**

The California Attorney General has primary responsibility for regulating, enforcing and supervising organizations and individuals that administer and/or solicit charitable funds or assets in California. The Attorney General has the duty to protect donors to charity, charities themselves and the beneficiaries of charities. In addition, the Attorney General has broad authority under State statutes to regulate charitable organizations and trusts and to commence law enforcement investigations and legal actions to protect the public interest. This Guide summarizes California's laws that govern charitable organizations, professional fundraisers, and trusts, including laws that require registration with the Attorney General and laws that require notice to the Attorney General of some specific transactions involving charitable organizations and trusts.

In carrying out these charity oversight duties, the Attorney General's office also provides information and assistance to many individuals who serve as directors, officers, volunteers, fundraisers, accountants and attorneys for charitable organizations. Because of the dramatic growth in the number of charities operating in California, and the large increase in public requests for information, the Attorney General's office recognized the need to publish a practical written Guide for charitable organizations.

### **What is the "Guide for Charities"?**

The Attorney General's Guide for Charities is intended to help volunteers and others who serve as directors, officers or fundraisers for nonprofit charitable organizations. It provides practical information and answers to questions frequently asked about charities. In addition, the Guide summarizes some of the more important California laws affecting the creation and operation of nonprofit charitable corporations. At the end of the Guide, there are two important listings. The "Directory of Services" lists government agencies, legal services and general resources that assist charities. The "Bibliography" lists many useful publications for charities.

The Guide for Charities is not intended as a substitute for legal advice or tax consultation from private attorneys or tax experts. Depending on the circumstances, it may be important for your organization to hire a private attorney to assist with specific legal problems. Your local bar association chapter can provide for you the names of attorneys who specialize in nonprofit tax-exempt corporations and related matters. For low cost legal services, consult the "Directory of Services" in this Guide.



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## **Chapter 1**

### **WHAT IS A “CHARITY”?**

Many people contact the Registry of Charitable Trusts to ask if their organization is a charity. If the organization is classified as a California nonprofit public benefit corporation or has received federal tax exemption under Internal Revenue Code section 501(c)(3), it is a charity. Under the traditional common law definition, charitable purposes include relief from poverty, advancement of education, religion and other purposes beneficial to the community. Under the federal tax law definition and to qualify for tax-exempt charitable status, the organization must be organized and operated exclusively for an “exempt” purpose. Exempt purposes are religious, charitable, scientific, testing for public safety, literary, education, fostering national and international sports competition, or the prevention of cruelty to children or animals. In addition to these requirements, federal tax law also requires that there must be no “private” inurement or improper private benefit to anyone in a position of control over the charitable organization, and that the organization not engage in activity on behalf of political candidates or carry on substantial lobbying activity.

As of August, 2004, there were over 90,000 charitable organizations registered with the California Attorney General’s Registry of Charitable Trusts. These registered charities reported total revenues for 2003, their last reporting year, of over \$200 billion and total assets of over \$300 billion. Charities represent an important economic sector in California and have the ability to make a significant impact on the communities they serve.

#### **Charitable Purposes**

Historically, charities developed to meet certain needs of society. They were formed to do “public good” and to provide aid to segments of the community that fell outside of the general scope of public assistance. In common usage, the term “charity” refers to an organization that performs charitable programs or sets aside any fund to be used for charitable purposes. California common law defines “charitable purpose” very broadly to include relief of poverty, advancement of education or religion, promotion of health, governmental or municipal purposes, and other purposes that are beneficial to the community. Federal and California tax laws define charitable purposes more specifically for exemption from income tax. Federal and state laws have been enacted to encourage the making of charitable gifts and to facilitate the operation of charitable organizations. These laws reflect the public policy favoring charitable giving and recognize that many charities relieve the public tax rolls from the burden of financing human and community services. As a result, certain benefits and privileges are conferred on charities that are not available to for-profit businesses.

#### **Exemption From Income Tax**

One of the most important benefits available to a charity is its ability to qualify under federal and state income tax laws for “tax exempt status.” Income tax exempt status may confer on the charitable organization exemption from payment of income tax and also allow charitable donors to deduct from

their taxable income contributions made to the organization. Exemption from income tax is discussed in more detail in Chapter 3 of this Guide.

## **Legal Forms**

A charity may operate in California under any of several legal forms, including a nonprofit corporation, a trust or an unincorporated association. Most California charities are organized as nonprofit corporations. The three most common types of nonprofit corporations under California law are: public benefit corporations, mutual benefit corporations and religious corporations. The majority of the registered nonprofit corporations in California are organized as public benefit corporations.

Under California law, a public benefit corporation must be formed for public or charitable purposes and may not be organized for the private gain of any person. A public benefit corporation cannot distribute “profits,” gains or dividends to any person. Public benefit corporations often qualify for exemption from income tax. Public benefit corporations (except for educational institutions and hospitals) must register and report to the Attorney General’s Registry of Charitable Trusts.

Religious corporations are organized for religious purposes. They are usually exempt from income tax and are not required to register or report to the California Attorney General. A religious organization may also be formed as a corporation sole.

Mutual benefit corporations are organized most often for the benefit of their own members. They may not be formed exclusively for charitable purposes. If a mutual benefit corporation holds some of its assets for charitable purposes, however, it must register and report on the charitable assets to the Attorney General.

Mutual benefit corporations may qualify for different income tax benefits than public benefit corporations. Familiar examples of mutual benefit corporations include private homeowners associations, private clubs, and trade and professional associations.

A trust may be created by language in a will or in a written trust instrument. The trust creates legal obligations for the person (“trustee”) who manages the assets of the trust. A trust for charitable purposes can be enforced by the Attorney General, and the trustee must register and report to the Attorney General.

It is not essential to form a nonprofit corporation, a trust or other legal entity to create a charity. In California, any individual or organization who solicits funds and represents that such funds will be used for charitable purposes may be held to be a “trustee for charitable purpose” and accountable for such funds. In addition, the failure of a public benefit corporation or trust to qualify for exemption from income tax does not necessarily free the organization and its responsible directors, officers or trustees from accountability as a charity.

Any individual or group of persons who operates as a charitable organization, but does not create a nonprofit corporation or a trust, may be treated under California law as an “unincorporated association.” Under this classification, the individuals may be exposed to substantial risk of personal liability if the organization is sued.



## Chapter 2

# HOW TO FORM A NONPROFIT CORPORATION

This chapter considers how to organize in the form that most new charities in this state select, the California nonprofit public benefit corporation. For discussion of tax benefits for which charities may be eligible, see Chapter 3 of this Guide.

A corporation is a distinct legal entity under California law. A new corporation is “born” when its articles of incorporation are filed with the Secretary of State. The basic steps and minimum requirements for forming a public benefit corporation are summarized in this chapter.

### **Preliminary Considerations: Do You Really Want to Create a Charity?**

Although public benefit corporations may qualify for many important benefits, including exemption from income tax, they are also subject to important legal restrictions. One very critical restriction is that the assets of a public benefit corporation must be irrevocably dedicated to charitable purposes, and cannot be distributed for private gain. If the organizers of a public benefit corporation later decide that they do not wish to operate the corporation as a charity, they may terminate the corporation, but they cannot take back its assets. Legally, those assets belong to charity, and must be transferred to another charity that has the same or similar purposes.

It is important to consider carefully the goals of the new organization before taking any steps to form a public benefit corporation. There are many factors to consider before choosing the legal form for the organization and evaluating whether the advantages of income-tax exemption outweigh the legal restrictions on public benefit corporations. Some important factors to review are:

- What are the purposes of the new organization?
- What are the projected income needs and sources of income?
- Will donations or grants be an important source of income?
- How will any “surplus” income be used?
- Are various benefits of nonprofit status important (for example, reduced-rate mailing privileges)?
- Is exemption from income tax important?
- What are the government regulations and filing requirements regarding nonprofit corporations as compared to for-profit business corporations?
- What additional requirements apply to tax-exempt charities?
- Who will make sure the new entity complies with them?
- Are qualified and interested people available to serve as directors?
- Will any payments be made by the organization to its founders, directors, or officers?
- What are the limitations on such payments applicable to a public benefit corporation?
- What alternate legal forms exist for creating a charity?

- How do the standards of liability for directors vary between nonprofit and for-profit corporations, and as compared to trusts and unincorporated associations (or other possible forms of organization)?
- Will the organization have members, and will they be voting members?
- Will the organization have chapters or other related groups?
- How much flexibility of operation is desired?
- How long is the entity anticipated to be in existence?

This Guide may help to answer some of these preliminary questions. Additional guidance from a qualified attorney or other tax expert may be needed.

## Basic Steps For Incorporation Of A Public Benefit Corporation

A California nonprofit public benefit corporation may be formed by completing the steps summarized here:

- 1. Choose a corporate name.** You may clear and reserve the corporate name by contacting the Secretary of State’s office. After clearing the corporate name, you can reserve it by paying the appropriate fee to the Secretary of State (\$10 as of this writing). For additional information, contact the Secretary of State’s office. See the “Directory of Services” for listings.
- 2. Draft and file articles of incorporation with the Secretary of State.** The articles of incorporation typically specify the purpose of the organization, its name, place of business, key officers and limitations on its operations. In California, the articles of incorporation filed with the Secretary of State (original and two copies) must include the name of the public benefit corporation, its purpose, and language ensuring that it is not organized for the private gain of any person and that it will comply with other applicable requirements (including, if tax exemption is desired, the requirements for tax exemption). (For sample articles of incorporation, see the “Bibliography” listings.)
- 3. Draft the bylaws of the corporation.** Bylaws set out the overall structure and basic rules for operating the corporation, including how directors and officers are elected and how the governing board operates. These rules are limited by California laws and are very important to the governance of the corporation. (See “Bibliography” for assistance on drafting bylaws.)
- 4. Draft action of incorporator and have it signed by all incorporators.** If the articles of incorporation were signed only by an incorporator and not by the initial board of directors, the incorporator needs to appoint the first board. The incorporator may also take other actions at the same time, including adopting the bylaws, appointing the officers, and authorizing the opening of bank accounts.
- 5. File federal application for employer identification number (EIN) with the IRS.** You can apply for an EIN by mail, fax, or phone, by using IRS Form SS-4 and following instructions that normally are available from the IRS’ website. See “Application for Employer Identification Number” in Chapter 4 of this Guide, and see the “Directory of Services” for listings.

**6. File a statement by domestic nonprofit corporation.** The Statement by Domestic Nonprofit Corporation is sent by the Secretary of State within 90 days of filing Articles of Incorporation. You must complete and return this statement to the Secretary of State. You will have to file this form again at least every second year during the life of the corporation.

**7. Register with the Attorney General's Registry of Charitable Trusts.** Charities must register with the Attorney General's Office within 30 days after receiving their first assets by filing Articles of Incorporation and bylaws with the Attorney General's Registry of Charitable Trusts and pay a \$25 registration fee. Organizations must renew registration and file financial reports annually thereafter.

**8. Hold first meeting of directors.** Agenda items for the first meeting typically involve organizational issues, such as adopting bylaws, electing officers, establishing a bank account, setting the accounting year and basic accounting procedures, planning a budget for the first year, and adopting procedures for safekeeping of minutes, bylaws, and other corporate records. If not meeting in person, and to the extent permitted by the organization's bylaws, the directors may take these actions by "unanimous written consent," which requires the signatures of all directors. It is important for the corporate secretary to record and keep minutes of all meetings (and unanimous written consents) of the board of directors and board committees.

**9. File application for exemption from federal income taxes with the IRS and state income taxes with the California Franchise Tax Board.** Use IRS Form 1023 for the federal income tax application and FTB Form 3500 for the state income tax application. (See Chapter 3 of this Guide.)

**10. Review the corporation's need for state and local permits and licenses and establish procedures to meet deadlines for required periodic filings with the IRS, FTB, Secretary of State and Attorney General.** This procedure is important to keep the organization in good standing and avoid the need to pay delinquency fees. (See Chapters 3 and 10 of this Guide.)

There are several books and government publications that discuss in more detail the steps for forming a nonprofit corporation. See the "Bibliography" for listings.

This Guide and the publications cited in the "Bibliography" are not a substitute for professional legal assistance. You may wish to seek the professional services of an attorney or other expert who is experienced in forming new nonprofit corporations.

## **FREQUENTLY ASKED QUESTIONS**

**Q. Is it necessary to hire an attorney to form a public benefit corporation?**

**A.** No. California law does not require that you retain an attorney to form a corporation. However, as noted earlier, there are many questions to review prior to deciding to form a public benefit corporation. An attorney who specializes in the area of nonprofit corporations could assist in this review and guide the organizers through the steps to incorporate and apply for income-tax exemptions.

Many charitable organizations cannot afford to pay the fees charged by private attorneys. There are low-cost or free legal services available to certain types of charities in some areas, although it is not always easy to find such providers who are experienced with nonprofit organizations. Consult the “Directory of Services” for listings.

**Q. What is the simplest legal form to use in creating a charity?**

**A.** The public benefit corporation is the recommended legal form for most California charities. This may not be true for religious organizations, which may find it preferable to form as nonprofit religious corporations, and for certain other types of charities, such as private foundations funded and managed by a family, which may want to consider organizing as trusts. Although there is significant paperwork involved in forming a public benefit corporation, the procedures for operation and the rights and duties of directors, officers, and members are more clearly set forth for public benefit corporations than for other forms of organization under California law. This may be very helpful during the operating life of the corporation.

**Q. How does our charitable organization obtain “tax-exempt status”?**

**A.** To obtain exemption from federal income tax as a charity, it is necessary to apply to the IRS for classification as an organization described in Internal Revenue Code section 501(c)(3). Most California charities also apply to the Franchise Tax Board for parallel exemption from California income taxes. The basic steps and the necessary application forms are described in Chapter 3 of this Guide. Free publications available from the IRS and the Franchise Tax Board include instructions on applying for tax exemptions. See the “Directory of Services” and “Bibliography” in this Guide for listings.

**Q. How do we register our charitable organization with the Attorney General?**

**A.** Registration with the Attorney General is required for newly formed California public benefit corporations and other types of charitable organizations. Organizations are required to file a copy of the articles of incorporation and bylaws, or other governing instrument, within 30 days after initial receipt of assets. Most charities registered with the Attorney General’s office must also file Form 990, 990-EZ or 990-PF annually, and all registered charities must file Form RRF-1 annually. For the forms and instructions, see the Attorney General’s Charitable Trusts website at [www.ag.ca.gov/charities/](http://www.ag.ca.gov/charities/), or contact the Registry of Charitable Trusts at P.O.Box 903447, Sacramento, CA 94203-4470. (This contact information is current as of this writing.) Also see the “Directory of Services” for the Attorney General’s Registry listing.

**Q. If a charity incorporated outside California does business or holds property here, does it have to register with the Attorney General?**

**A.** Any charitable corporation organized outside California that is doing business or holding property in this state for charitable purposes must register with the Attorney General (with the same exceptions that apply to California corporations). Such a corporation also must comply with the California Secretary of State’s requirements for qualifying to transact business in this state, which includes designating an agent for service of process here. If a non-California corporation desires exemption from California taxes, it must file applications with the Franchise Tax Board and any other appropriate state agency, as discussed in Chapter 3 of this Guide.



## Chapter 3

# APPLICATION FOR TAX-EXEMPT STATUS

Most charitable organizations in California seek exemption from income tax under federal Internal Revenue Code (IRC) section 501(c)(3) and California Revenue and Taxation Code section 23701d. These provisions generally exempt a charity from federal or state income tax on all forms of income derived from the charity's exempt purposes. Currently, individuals who itemize and corporate donors may deduct contributions to "section 501(c)(3) organizations," subject to various limitations set forth in IRC section 170.

### What Is 501(c)(3) Status

A section 501(c)(3) organization must be “*organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes.*” To qualify, an organization must satisfy an organizational test and an operational test. The *organizational test* is met if the articles of incorporation include language limiting the purposes of the organization to one or more of the exempt purposes set forth in section 501(c)(3) and do not empower the organization to engage in any substantial activities which do not further one or more exempt purposes. In addition, the organizational documents (or applicable state law) must require the organization to expressly dedicate its assets to exempt purposes in the event of a dissolution.

The *operational test* requires the organization to be engaged primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3). The test will not be met if “more than an insubstantial part” of the organization’s activities is not in furtherance of exempt purposes. Examples of impermissible conduct include diversion of charitable assets to private individuals, excessive compensation to officers and directors, and engaging in certain prohibited political activities, such as participation in political campaigns on behalf of or in opposition to candidates for public office or substantial lobbying. To obtain recognition of tax-exempt status in California, nonprofit California public benefit corporations also may be required to show that no more than 49 percent of the organization’s directors are “interested persons” or their close relatives, as defined in California Corporations Code section 5227. See Chapter 6 for discussion of “interested” directors.

### “Public Charity” or “Private Foundation”?

Organizations that qualify for exemption under IRC section 501(c)(3) will be classified by the IRS as either a public charity or a private foundation. Most organizations (with a few exceptions, such as churches) are presumed to be private foundations unless they receive a determination from the IRS that they are a "public charity." Most commonly, an organization will be classified as a public charity if it receives a certain percentage of its total support from government sources, other public charities, or a broad base of individual donors. Nonprofits should be aware that achieving public charity status based on public donations is a complex calculation and early consultation with a tax professional is strongly recommended. An organization also may avoid being classified as a

private foundation if it meets the IRS definition of a church, school, or hospital, if it relies primarily on income earned from its charitable activities (such as museums), or if it maintains a support relationship with one or more public charities or governmental entities (this relationship may be either financial or programmatic).

Classification as a private foundation carries with it several disadvantages, including a two percent excise tax on the organization's net investment income, certain limitations on the deductibility of charitable contributions by individual donors, a wide range of operational requirements and restrictions, and more burdensome reporting requirements. Private foundations are most frequently formed by a single family or corporation desiring to retain a high degree of control over operations and grants.

### **Unrelated Business Income Is Taxed**

Regardless of their classification as a public charity or as a private foundation, section 501(c)(3) organizations are subject to tax on income derived from actively conducted business activities that are not substantially related to the organization's exempt purposes. Business activities in and of themselves are not “related” to the charitable purpose just because the proceeds are used for the exempt purpose.

### **How To File For Income Tax-Exempt Status**

An organization that wishes to obtain exemption from income tax must file applications with the appropriate federal and state authorities. Obtaining a federal tax exemption under IRC section 501(c)(3) requires the submission to the IRS of Form 1023 (Application for Recognition of Exemption under Section 501(c)(3).) The application generally must be filed within 27 months from the end of the month of incorporation, together with a fee. Tax-exempt status, if granted by the IRS, will be retroactive to the date of incorporation. A similar procedure requires the submission to the California Franchise Tax Board of Form 3500 to obtain tax-exempt status in California, together with the payment of a filing fee. More information regarding the criteria and procedures for applying for federal tax exemption can be found in IRS Publication 557 (How to Apply for and Retain Exempt Status for Your Organization).

In general, IRS Form 1023 requires the organization to submit the following documents:

- a conformed copy of the organization’s articles of incorporation (or trust instrument)
- the bylaws (if a nonprofit corporation)
- Employer Identification Number (EIN) of the organization (or an application therefor on Form SS-4)
- a statement of receipts and disbursements
- a current balance sheet
- other financial information, including a proposed budget for two years in the case of newly formed organizations
- an executed copy of a consent to extend the period in which to assess tax (Form 872-C) (except in the case of a private foundation, which does not submit this form).

See also the publication “Life Cycle of a Public Charity” posted on [www.irs.gov/charities](http://www.irs.gov/charities) . This publication describes all of the interactions a charity will have with IRS throughout its life, from application to dissolution.

NOTE: Federal tax law requires that charitable organizations make available for public review at their principal offices copies of their exemption application, Form 990, 990EZ or 990PF returns for the three most recent years, and that charities also provide copies of these documents to any person who sends the charity a written request. The charity may charge reasonable copying fees and actual postage costs for mailing the documents. Individuals who have been denied access to or copies of the exemption application or Form 990 by a charitable organization may call IRS Customer Account Services at (877) 529-5500 (toll-free-number) or write to

Internal Revenue Service  
TE/GE Division Customer Service  
P.O. Box 2508  
Cincinnati, OH 45201

### **Property Tax Exemption**

The California State Board of Equalization, and the county assessors, are the administrators of the welfare exemption from property taxation (Cal. Rev. & Tax Code, § 214 et seq.). There are many requirements for obtaining a welfare exemption from property taxes. For further information, see the listing for State Board of Equalization in the “Directory of Services.”

### **Sales Tax Exemption**

A charity that sells items may be required to collect and remit to the state sales tax on goods sold. In California, there is no general exemption from sales tax for charities. Rather, a variety of narrow exemptions apply to certain charitable activities. For further information, see the listing for State Board of Equalization in the “Directory of Services.”

The law of tax-exempt organizations is highly complex, and this discussion is intended only as a broad overview of the requirements for exemption. Organizations with special problems or that need more assistance should consult the listings in this Guide under “Directory of Services” and “Bibliography,” or a private attorney or tax expert.

## **FREQUENTLY ASKED QUESTIONS**

### **Q. How long does it take to find out if our organization will be recognized as tax-exempt by the IRS?**

**A.** Generally, it takes at least three months after filing the application for recognition of exemption (Form 1023) with IRS to learn if the application has been approved. When IRS notifies you of the decision to recognize exemption from federal income tax, IRS will include instructions for annual filing of IRS Form 990, 990-EZ or 990-PF, which is required to maintain tax-exempt status. (See “Directory of Services” for IRS listings.) If the organization is classified as a public charity by reason of its public support, the IRS determination will be an advance ruling for five years with respect to the public charity status. An additional submission, on IRS Form 8734, will be required at the end of the advance ruling period.

Newly formed nonprofit organizations should not state that they have obtained recognition of tax-exempt status until recognition is granted. Once granted, the tax-exempt status is generally retroactive to the date of organization.

**Q. If IRS denies the application by our organization for recognition of income tax exemption, what can we do with the funds already donated to the organization?**

**A.** In most cases, all funds collected by a charitable organization are irrevocably dedicated to charitable purposes. Even if the organization fails to be recognized as exempt by the IRS, the funds must be used for charitable purposes, and cannot be refunded to the donors.

In special circumstances, such as where an organization was formed as a public benefit corporation by mistake, where its organizers intended it to be a mutual benefit corporation, and where all the funds received were dues from members, the organization may be allowed to terminate as a charity and refund the dues and other assets to members, rather than to charity. However, the Attorney General’s written consent must be obtained if the organization was formed as a public benefit corporation.

**Q. What are the procedures for obtaining recognition of exemption from state income tax for our organization?**

**A.** The procedures for being recognized as exempt from California income or franchise tax by the California Franchise Tax Board are similar to those for the IRS. California FTB Form 3500 must be completed and submitted to FTB. The FTB will notify the applicant of its decision on exempt status, and also send instructions for annual filing of FTB Form 199. See “Directory of Services” for FTB listing.

**Q. Our charitable organization has special tax problems. Where can we find an expert on charitable tax-exempt organizations?**

**A.** The law on charitable tax-exempt organizations is very complex and quite specialized. Be certain if you hire a tax attorney or other tax expert that the person is knowledgeable about this area of tax law. You may contact any of the following for referrals to tax experts. Be sure to specify the area of expertise that your organization seeks.

- The County Bar Association referral service in your area.
- Accredited law schools in your area will usually have a tax specialist on their faculty who may be able to refer you to an attorney who specializes in tax-exempt organizations.
- Large charitable organizations in your area may be able to give you names of tax experts who have assisted their organization.

**Q. If our charity is recognized as exempt from federal and state income taxes, does the charity have to pay property tax on property it owns? Does the charity have to pay sales tax on items it sells?**

**A.** A charity exempt from income tax may still have to pay property tax and sales tax. The rules that apply to exemption from property and sales taxes are different from the rules for exemption from income tax. Contact the State Board of Equalization and the local county assessor’s office for additional information. See the “Directory of Services” listings.



## Chapter 4

# CHARITY AS AN EMPLOYER

Many charities hire employees to staff their offices, provide program services, conduct fundraising, maintain books of account, file tax forms, and provide other necessary services for the operation of the charity. The fact that a charity has “tax-exempt status” and is a nonprofit corporation does not excuse it from the same legal obligations to its employees that apply to any business corporation. This chapter describes several important legal obligations of employers.

### 1. Application for Employer Identification Number

Even if a charity does not intend to hire any employees or workers, it must still apply for an Employer Identification Number (“EIN”) with the IRS. An EIN is a nine-digit number which is assigned to entities for tax filing and reporting purposes. It is the corporate equivalent of a Social Security Number and is used by the IRS to identify the corporation’s information returns in IRS records. An entity prepares and files Form SS-4 to request an EIN from the IRS. The Form SS-4 may be obtained on the IRS website.

A charity can apply for an EIN by telephone, fax, or mail depending upon how soon the charity needs to use its EIN. A charity can receive its EIN over the telephone (and use it immediately) by calling (800) 829-4933 and providing the IRS with the information requested on Form SS-4. The IRS may request that the caller fax the SS-4 to the IRS, and will issue the EIN either over the phone or by return fax.

Alternatively, a charity can receive its EIN from the IRS via fax within four business days. In order to do this, the charity needs to complete Form SS-4 and fax it to the IRS at (215) 516-3990. The charity can also obtain an EIN through the mail, which takes about four to five weeks. Finally, the IRS website sets forth a procedure for obtaining an EIN over the Internet. Please note that these procedures for obtaining an EIN and contact information are subject to change.

### 2. Federal and State Corporate Employment Taxes

A corporation’s own tax-exempt status allows exemption from tax on the corporation’s income. As an employer, the corporation remains obligated to report any employee’s income and to make proper withholding payments to the federal and state governments. It is also responsible for depositing, paying, and reporting federal income tax, social security and Medicare taxes (FICA), and federal unemployment tax (FUTA), unless the charity is specifically exempt from the applicable requirements. Withholding requirements are strictly enforced. Failure to comply could result in penalties for the organization, its directors, and its employees. The penalty is generally equal to the tax evaded or not collected.

The following is a list of information forms and withholding returns that employers must file with the state and the federal government:

- Employee's Withholding Certificate (W-4)
- Corporation Federal Quarterly Withholding Returns (Form 941-E) and bank deposits of withheld income taxes and social security taxes
- Annual Federal Wage and Tax Statement (W-2)
- California Employer Registration Form - California Income Tax Withholding form (SE-44) - California Unemployment and Disability Insurance (quarterly)
- Annual Federal Unemployment Tax Return

Federal withholding obligations are explained in IRS Publication 15 (Circular E-Employer's Tax Guide) which may be obtained from your local IRS office or at [www.irs.gov](http://www.irs.gov).

### **3. Employee Relations**

Legally, a charitable organization is treated like any other employer. To avoid misunderstandings between the charity and its employees, directors, or officers, the charity should provide each employee with a written statement of the charity's employment policies, including any employee benefit plans, such as vacation policies, health plans, retirement or life insurance plans.

### **4. State and Federal Laws Regarding Working Conditions, Minimum Wages, Overtime Pay, and Discriminatory Hiring and Firing Practices**

Generally, public benefit corporations and other charitable organizations are subject to laws governing the terms and conditions of employment and prohibitions on discrimination to the same extent as private, business corporations. Effective January 1, 2002, the minimum wage in California increased from \$6.25 per hour to \$6.75 per hour. This minimum wage rate applies to charities that have employees. Additionally, charities are subject to the employment rules addressing overtime pay, required break periods, etc.

Charitable employers should be especially careful to classify employees correctly for purposes of exempt-from-overtime status under federal and state wage-and-hour laws. In addition, every charitable employer should institute and follow an anti-harassment policy.

Please note that religious organizations may be exempt from some of the above laws and restrictions.

### **5. Independent Contractors**

Ultimately, the IRS will decide whether the people who work for a charitable organization are employees for whom tax withholding and reporting by the employer applies, or whether they are "independent contractors" for whom these employer obligations do not apply. An employer who incorrectly classifies employees as "independent contractors" may be held personally liable for penalties and damages if the IRS disagrees with the classification. If your organization plans to work with "independent contractors," you may wish to consult an attorney or other expert about IRS guidelines for such classification.

## **FREQUENTLY ASKED QUESTIONS**

**Q. During the early years of operation, our charity had insufficient funds to pay key employees the true value of their services. Now that we have adequate revenues, can we pay our employees retroactively?**

**A.** This problem is not unusual. The answer is complicated by the law that says that charitable assets may not be distributed as “profits” or dividends to any person. Under this rule, a charity that hired an employee for a \$20,000 yearly salary (assuming that to be a fair rate for the services performed) but was unable to make those payments the first year, would be allowed later to make up the amounts due as revenues become available, because of the contractual obligation. However, if the charity had not contracted to pay the employee the “fair” price, but some lesser amount, or if, without a contract, the charity simply paid the employee what it could afford from available monthly revenues, the charity could be barred from later paying an additional “bonus” to the employee. Payment of charity funds as a gift or “bonus” to any person may be an illegal distribution of charitable assets, for which directors of the charity can be held personally liable. A person who works as a volunteer for charity has no legal right to payment of compensation from the charity. Actual expenses may be reimbursed.

**Q. Our charity has been sued by an employee for breach of employment contract and for discrimination. Will the Attorney General act as attorney to defend our charity and save us the expense of hiring a private attorney?**

**A.** No. The Attorney General acts as the attorney for the general public to protect all beneficiaries of charitable assets against fraud and mismanagement of those assets. When the Attorney General sues charity directors for fraud, the action usually seeks repayment from the directors to the charity. In other types of cases, where directors and the nonprofit corporation are sued by employees or other persons for violations of contract, for injuries, or for other civil wrongs, it is the obligation of the directors to hire an attorney to defend the corporation at the corporation’s expense.

**Q. If an employment-related lawsuit is filed against our charity, will insurance pay for the costs of an attorney to defend the corporation and its officers and directors?**

**A.** Whether the corporation can look to its insurance carrier to defend the action depends on the type of insurance coverage the corporation has purchased. When corporations are able to purchase “general liability” insurance, the insurer will usually provide an attorney to defend the corporation against a lawsuit. However, many general liability insurance policies exclude coverage for employment matters. The corporation, therefore, ordinarily should also purchase “directors and officers” insurance, which will protect these individuals from many types of civil claims, including some employment-related lawsuits. If the corporation’s employment force is large enough, it may be advisable for the corporation to obtain an employment practices liability (“EPLI”) policy. An EPLI policy usually will cover the organization and all of its officers, directors, employees, agents and subsidiaries for employment-related claims within the scope of the policy. It’s important to note that employment actions constitute a substantial percentage of the lawsuits filed against charitable corporations.

**Q. We just learned that an employee embezzled substantial funds from our charity. What can we do about it?**

**A.** Upon learning that an employee has embezzled funds from the charity, the directors have a legal duty to take reasonable steps to try to recover the funds and to refer the matter to the local District Attorney for possible criminal prosecution. The directors may have to hire a private attorney to file a civil suit for restitution against the employee. Directors must evaluate whether the prospect of recovery outweighs the probable costs of suit. The loss to charity should be reported on the Form RRF-1 filed with the Attorney General, with an attached explanation of the action taken by the directors to recover the loss.



## **Chapter 5**

# **FISCAL MANAGEMENT: BOOKKEEPING, ACCOUNTING REPORTING REQUIREMENTS**

Efficient and accurate fiscal management is very important to all charitable organizations. The directors are responsible for organizing and documenting the financial affairs of the charity. It may be useful for the charity to hire an accountant, controller, or other fiscal manager. In choosing a method of fiscal management, the needs of various users of the accounting information must be considered. There are two general categories of users: (1) internal users -- management staff, board of directors and members; (2) external users -- governmental agencies, grantmaking organizations, banks and other financial institutions.

### **Internal Controls Over the Fiscal Management System**

The goal in establishing internal controls over the fiscal management of a charity is to prevent error, fraud, theft, or mismanagement. Good internal controls safeguard charitable assets and insure reliability of financial records. Items which make up an effective control system include budgets, segregation of duties, policy and procedures manuals, clear definition of, and adherence to, set procedures for management authority, and periodic review of the control system. A system requiring two signatures on all the corporation's checks is an important control measure. Continuing cost-benefit analysis by charity managers is vital to effective operation and survival.

The charity's directors play a key role in establishing internal controls for the charity. Their approval of policies and procedures determines the fiscal management system. The minutes of the board meetings should reflect these important policies.

Many charity directors seek expert advice from a professional accountant to assist in designing and implementing the fiscal management system. Choose an accountant carefully and be specific about the charity's needs. Ask the accountant about his or her experience with other charitable organizations. Check references.

### **Preventing Internal Fraud and Theft of Charitable Assets**

Fraudulent diversion of charitable assets by employees, officers, or directors with control over those assets can occur at either the receipt or the disbursement phase. Charities may receive many donations in the form of cash and checks. The person who receives and records the cash and checks could, without proper controls, deposit those funds into unauthorized bank accounts and divert the funds to personal use, without the knowledge of other employees or directors. For this reason it is very important to separate the function of recording cash receipts from responsibility for access and control over the receipts. Assigning different people to the separate tasks of recording receipts and making bank deposits minimizes the risk of fraud.

At the disbursements level, it is important to require two signatures on all checks drawn on the charity's account. This reduces the risk of such fraudulent practices as writing checks for non-existent expenses or paying fictitious creditors or phantom grantees.

Directors should continually monitor the budget and anticipated revenue sources and amounts during the year, and compare expected revenues to the actual revenues reported during the year. Any sizable differences between expected and actual revenue should be carefully investigated by directors or designated officers to obtain a full explanation. The directors or their designee should review quarterly the charity's bank account statements, check reconciliations, and the books of account for any obvious irregularities.

Annual independent audits can help to protect against internal fraud and fiscal mismanagement. Independent audits can be expensive, however, and may be beyond the budget capabilities of small charities. A good alternative is to retain an independent accountant to conduct a review of the charity's financial statements, and issue a review report to the directors. A review is usually much less expensive than an audit, and can alert directors to serious deficiencies in the internal control system as well as possible fraud.

## **Components of an Accounting System**

A charity's accounting system should reflect accurate, understandable data that is useful in making management decisions and preparing reports. Accounting records should adhere generally to the standards of Accounting and Financial Reporting for Nonprofit Health and Welfare Voluntary Organizations, and to generally accepted accounting principles. The actual books of account to be maintained depend on the type of organization.

For example, a grant-making organization would have different accounting needs than a health clinic or museum. Generally, an organization's books of accounts will include:

### **1. General Ledger**

A general ledger consists of a number of accounts representing stored information about a particular kind of asset, liability, fund balance, revenue, or expense. Information is taken from the general ledger to prepare financial statements such as the Balance Sheet or the Income and Expense Statement. The amounts reported in the General Ledger accounts are often totals for a given time period for a class of accounts detailed in subsidiary ledgers.

### **2. Subsidiary Ledgers**

Subsidiary ledgers provide greater detail for a particular account. For example, an accounts receivable subsidiary ledger lists information on each customer's purchases, payments, and balance. The general ledger contains one figure representing the total for a period from all subsidiary ledgers for that account.

### **3. Journals**

Information from business papers is recorded in chronological order in journals. Various types of journals include:

- Sales Journal - Sales are recorded as they are made; usually all information is taken from the invoice

- Disbursement Journal - Cash or checks going out to pay for expenses, acquiring assets, making grants, are recorded
- Receipts Journal - Cash or checks coming into the organization are recorded
- General Journal - Non-repetitive types of transactions and corrections or adjustments are recorded

In addition to an accurate system for recording fiscal data, a charity needs a filing system that allows easy access to various business documents and helps the accountant when preparing periodic financial statements, tax returns, and management reports. A good fiscal management system allows you to trace any transaction from the financial reports to the general ledger, subsidiary ledgers, journals and business records.

## **Reporting Requirements to Government Agencies**

In addition to keeping financial records, the accountant may be responsible for preparing and filing reports for the charity with various government agencies. Even if your accountant does not prepare these reports for you, you should ask that a report-filing calendar be established for the charity to assist directors in complying with all the required filings. Listed below are some of the annual reporting and filing requirements that apply to most charities.

- (1) Reports to the Attorney General. Charities that are required to register and report to the Attorney General must file annually with the Attorney General's Registry of Charitable Trusts a copy of their Form 990, 990-PF or 990-EZ, together with Form RRF-1 ("Registration/Renewal Fee Report") and pay a fee, which is based on gross annual revenue for the preceding fiscal year. Effective 2000, the Attorney General discontinued its old report form (Form CT-2). For additional information and forms, contact the Registry by email at [www.ag.ca.gov/charities/](http://www.ag.ca.gov/charities/) or by mail at P.O.Box 944255, Sacramento, CA 94203-4470. See Chapter 8 for reporting requirements for charity raffles, which became effective in 2001.
- (2) Federal information returns of tax-exempt organizations to the IRS (Forms 990, 990-PF, 990-EZ).
- (3) California return of tax-exempt organizations to Franchise Tax Board (Form 199, Form 109).
- (4) Quarterly federal employment tax deposits (FICA) to the IRS.
- (5) Quarterly employment deposits to the California Employment Development Department.
- (6) Forms W-2 (provided to employees each year and copies filed by the employer with the federal and state governments).
- (7) Forms 1099 (provided to non-employee service providers and copies filed with the federal and state governments).
- (8) Local and state property and sales tax statements and returns.

In addition, an IRC 501(c)(3) organization must make its three most recent federal tax returns, its status application and its determination letter available for inspection by the public. (See IRS website for details.)

## **FREQUENTLY ASKED QUESTIONS**

**Q: What specific fiscal management procedure will help to protect our charity against fiscal mismanagement and embezzlement?**

**A:** Generally, fiscal management policy should provide for careful periodic review of financial records by directors and by independent accountants. Procedures such as a dual- signature requirement on all charity bank accounts, periodic review of monthly statements by the board, and an annual independent audit are highly recommended.

**Q: What if our charity cannot afford an annual independent audit or review?**

**A:** As of January 1, 2005 charitable organizations with gross revenue of \$2,000,000 or more must have independent audits and must appoint an audit committee. (Government Code § 12586, subd. (d).) At minimum, the board of directors of organizations which are below this threshold should review the charity's financial records regularly. An audit committee could be created to review the charity's finances and watch for irregularities. Low-cost accounting services may also be available. See the "Directory of Services" listings.

**Q: I was recently appointed to the board of directors of a charity, and I have discovered that the charity's records are disorganized and incomplete. I also suspect that a former director misused the charity's funds. What should I do?**

**A:** Some persons who find themselves in the situation described above simply resign from the board of directors. If a director decides to continue to serve in the circumstances described, he or she should protect against possible liability for negligence by insisting that an independent audit of the charity be conducted immediately, and that a competent person be hired to establish a proper accounting system and to maintain the corporate records. He or she should recommend at a board meeting that the board investigate the conduct of the former director and take appropriate action. He or she should make sure that recommendation is recorded in the minutes of the meeting.

Any person who suspects fiscal abuse regarding charity assets is encouraged to report the matter to the Attorney General's Charitable Trusts Section, which has investigative audit powers and may bring a civil action to recover diverted charitable assets. Any evidence of criminal activity, such as embezzlement of charitable assets, should be reported to the local police or district attorney for possible criminal prosecution.



## Chapter 6

# **DIRECTORS AND OFFICERS OF PUBLIC BENEFIT CORPORATIONS**

Every corporation must have directors and officers. Legally, a public benefit corporation (defined in Chapter 1) may operate with only one director. However, most charities operate with three or more directors, which is strongly recommended. In addition to directors, every public benefit corporation is required to have a president, a chief financial officer and a secretary. Additional officers may be appointed. The powers, duties, and liabilities of directors and officers of public benefit corporations are governed by California statutes. Directors are required to discharge their duties consistent with a fiduciary obligation to the charity. (Corporations Code section 5000 et seq.)

## **DIRECTORS**

### **Powers and Duties of Directors**

The directors of a nonprofit public benefit corporation are responsible for conducting the corporation's affairs and for exercising the powers of the corporation. Directors may delegate many of their powers to others, such as officers and employees, but the directors are ultimately responsible for all corporate decisions.

Directors may be elected (usually by members) or designated (by the board of directors or other persons). The provisions for election, resignation, removal, terms of office, quorum necessary for action by directors, action by executive committee, delegation of powers, and other important issues affecting directors are generally covered by California statutes. Provisions governing these matters should be set forth clearly in the corporation's bylaws.

### **Compensation of Directors**

Charities may not pay excessive or unreasonable compensation to their officers and employees. The board of directors or an authorized committee of the board, and the trustee or trustees of a charitable trust, must review and approve the compensation of the president or chief executive officer and the treasurer or chief financial officer to assure that it is reasonable. (Government Code section 12586.)

Most directors of public benefit corporations serve on a volunteer basis, and do not receive compensation, other than occasional reimbursement for actual expenses of attending meetings (mileage, parking fees, meal costs). However, California law permits directors to receive reasonable "compensation as a director or officer," and distinguishes such compensation from other payments to directors that raise conflict of interest questions. Reasonable compensation paid to a director or officer is not "self-dealing" and it does not impair the ability of the director to serve as a "disinterested" director in reviewing other corporate transactions. California law does not suggest what amount of compensation to a director is reasonable. That is determined on a case-by-case basis according to the particular facts and circumstances. The Attorney General audits payments to directors that are more than nominal.

Standards adopted by the Wise Giving Alliance state that trustees and directors should be volunteers and not compensated other than for expenses. Those standards are not legally binding.

## **Liability of Directors**

In general, directors of nonprofit corporations, like directors of business corporations, are usually not personally liable for the debts, liabilities or obligations of the corporation. A director's personal liability to third parties (parties other than the corporation itself) is very limited. California law on directors' liability is complicated and has been changed frequently by the Legislature.

However, a director of a public benefit corporation may be held personally liable to repay damages to the corporation itself where he has breached his duty of care or loyalty to the corporation.

### **1. Disinterested Director Who Acts in Good Faith With Reasonable Care Is Not Liable to Corporation**

A director of a public benefit corporation who performs his or her duties in good faith, in a manner the director believes to be in the best interest of the corporation, and with reasonable care and inquiry under the circumstances has no personal monetary liability to the corporation in an action based on alleged failure to discharge the director's duties. This protection against liability does not apply to a director who engages in self-dealing or who makes or receives a prohibited loan or distribution of the corporation's assets.

### **2. Volunteer Director Not Liable to Third Parties in Certain Circumstances**

Although California statutes (Corporations Code sections 5047.5, 5239) purport to protect volunteer officers and directors of charitable corporations against personal liability for monetary damages to third parties under certain circumstances, these statutes cannot prevent the filing of lawsuits against individual directors and officers of nonprofit corporations. It can be expensive for an individual director to pay an attorney to defend the director against a civil lawsuit. For this reason, it is important for directors to review the matter of "directors and officers" insurance. (See discussion under Chapter 4.) Moreover, these statutes do not protect officers or directors from liability in a lawsuit brought by the Attorney General.

### **3. Duty of Loyalty and Conflict of Interest**

#### **a. Self-Dealing Transactions: Directors May Be Liable For Damage to Corporation**

A "self-dealing" transaction is a contract, agreement, or other action affecting the assets or income of a public benefit corporation to which the corporation is a party and in which one or more of its directors has a "material financial interest." Such transactions may include payment of a salary, contract, fee, commission, or other benefit of material economic value from the public benefit corporation to one or more of its directors, or to a corporation or partnership in which a director has a material financial interest. In reviewing self-dealing transactions, the Attorney General considers a financial interest "material" to a director if it is large enough to create an appearance of conflict of interest. This is a question of fact in each case.

Self-dealing transactions between a director and the corporation on which the director serves are inherently suspect. The director's first duty of loyalty is to the corporation, and it may be difficult for

a director to carry out that duty if he or she is also looking to make a profit from transacting business with the corporation. This is one reason that California law requires that all boards of directors of public benefit corporations be composed of at least 51 percent of directors who are “disinterested” persons. “Disinterested” means that neither the director nor any member of his family is paid by the corporation to do anything other than act as a director. For example, a director who is a paid employee, or whose spouse is a paid employee, of the corporation is not a disinterested person. A majority disinterested board of directors helps to insure that the corporation is protected against unfair self-dealing transactions and other conflicts of interest.

When a self-dealing transaction is not fair to the corporation, and when the self-dealing director charges an unreasonable price or makes an excessive profit from a self-dealing transaction, the corporation suffers damage. The Attorney General and certain other persons may sue the responsible directors to recover from them the actual damage suffered by the corporation, plus interest, and in some cases punitive damages. Any damages recovered are returned to the corporation. Often the self-dealing directors and other directors responsible for the damage are removed from the charity's board.

Of course, there are cases of self-dealing where the corporation actually benefits and is treated fairly. A self-dealing transaction is legally valid if a director contracts with the corporation he serves to provide needed services at a fair price, if the terms are reasonable to the corporation, if the contract is for the corporation's benefit (not the director's benefit), if the corporation “could not have obtained a more advantageous arrangement with reasonable effort under the circumstances,” and if it is approved in advance by a majority of all the directors, not counting the vote of the interested director or directors. If the directors have all of the facts before them and in good faith find that these criteria are met, they may “validate” a self-dealing transaction and protect themselves against liability for self-dealing.

Obviously, if the “disinterested” directors do not conduct their review of self-dealing in good faith but merely as a sham to protect other directors, there would be no effective validation. In cases of fraud and collusion by the directors, all directors could be held liable for damages to the corporation.

#### **b. Director May Be Liable For Making Prohibited Loans of Corporate Funds.**

With narrow exceptions, a public benefit corporation may not make loans to its officers or directors without Attorney General approval. Directors may be held personally liable for making prohibited loans. Exceptions are allowed for certain types of loans to an officer of the corporation under specified conditions for the purchase of the officer's primary residence. However, loans to directors are never permitted. (Corporations Code section 5236.)

#### **c. Directors May Be Liable For Making Prohibited Distribution of Charitable Assets.**

A director may be personally liable for making or receiving a prohibited “distribution” of the public benefit corporation's assets. Examples of prohibited distribution include:

- transfers of corporate funds or assets to directors, officers or members without fair consideration
- payment of excessive or unauthorized salaries, non contractual benefits or “bonuses”
- improper gifts of charitable assets to individuals
- other uses of the corporate assets unrelated to carrying out the organization's charitable purposes.

## **Derivative Actions Against Directors**

Legal actions filed against directors to recover damages resulting from breach of a director's duty to the corporation are called "derivative actions." They are usually filed by the Attorney General or a disinterested director on behalf of the corporation and its charitable beneficiaries. Derivative actions against directors usually seek recovery of monetary damages from the responsible director(s) and other equitable relief. Any repayment is made to the corporation or another similar charity.

## **Statutory Transactions**

California law requires that certain transactions by public benefit corporations require either consent by or notice to the Attorney General. These transactions are treated with special attention because they significantly change the corporation. These transactions include dissolutions, mergers, sales of substantially all assets, and amendment of articles to change the form of the corporation (e.g., from a public benefit to a business (i.e., for-profit) corporation). See Chapter 10 for more detail on statutory transactions.

## **Indemnification and Insurance**

California law (Corporation Code Section 5238) allows a nonprofit charitable corporation to indemnify directors and officers for costs and expenses of civil litigation under certain circumstances. However, no indemnification, is permitted for director's fraud, acts of bad faith or unsuccessful defense of self-dealing.

Many nonprofit corporations purchase "directors and officers" insurance to provide a source of payment for these litigation costs, in addition to the corporation's own funds. Public benefit corporations may purchase indemnification insurance to protect directors from liability for most claims, but not for fraud and self-dealing.

## **Officers**

Every nonprofit public benefit corporation must have at least three officers: a president (or chairman of the board), secretary, and a chief financial officer. The officers are usually appointed by the directors. Officers' responsibilities are spelled out in the corporation's bylaws. Their duties usually include maintaining books of account, responsibility for deposits and disbursements, keeping minute books, giving required notices, and such other duties as the directors prescribe.

The duties of officers and methods for their appointment and removal should be clearly stated in the corporation's bylaws. Generally, officers are not liable to the corporation or to third parties who sue the corporation. If an officer has acted in a fraudulent or grossly negligent manner, he or she may be liable. The president or chief executive officer is generally responsible for the day to day operations of the corporation.

## **FREQUENTLY ASKED QUESTIONS**

### **Q. What criteria does the Attorney General apply in reviewing self-dealing and loan transactions that are submitted for approval to the Attorney General's office?**

**A.** The Attorney General applies the statutory criteria for determining fairness of self-dealing transactions, as set forth in California Corporations Code section 5233. Facts are reviewed to determine whether the self-dealing is for the benefit of the corporation, whether the terms are fair and reasonable to the corporation, and whether there is no better alternative available to the corporation.

In reviewing requests to approve proposed loans from a public benefit corporation to a director or officer, the Attorney General applies a standard of strict scrutiny. Unlike self-dealing transactions, which may be validated under statutory standards, most loans from a public benefit corporation to a director or officer are prohibited in the absence of Attorney General approval. In reviewing a loan transaction, the Attorney General asks whether the loan is strictly necessary to carry out the charitable program and to protect charitable assets. Additional criteria applied by the Attorney General in reviewing a loan transaction include whether better alternatives are available to the corporation, whether the terms and interest rate are fair to the corporation, and whether the loan is secured.

### **Q. The directors of our public benefit corporation, which operates a school, voted to convert it to a business corporation. Will the Attorney General approve this conversion? How long will it take to get an answer?**

**A.** The Attorney General's answer will depend upon a thorough review of all the facts. Conversion is permitted by statute if the terms are approved by the Attorney General and all of the charitable assets of the converting public benefit corporation (which are irrevocably dedicated to charitable purposes) are distributed to another charity with charitable purposes similar to the purposes of the converting corporation. The Attorney General's office looks at all material facts of a conversion to determine its fairness to the corporation. Is the value assigned to the assets of the converting public benefit corporation the true fair market value of those assets? Is an independent appraisal needed? Will the directors of the public benefit corporation become the directors and shareholders of the new business corporation? Are there self-dealing issues? Are the terms of payment or purchase of the converting corporation fair and reasonable to charity? Is the charity designated to receive the payment or purchase price a qualified IRC 501(c)(3) organization with similar purposes to the converting corporation?

The review of facts and legal analysis required for the Attorney General's decision to approve or disapprove a corporate conversion may take from two weeks to several months, depending on the facts and complexity of the transaction and the workload of the Attorney General.



## Chapter 7

### **MEMBERS IN A PUBLIC BENEFIT CORPORATION**

California law does not require a public benefit corporation to have members. Any public benefit corporation may create classes of members and offer membership to individuals or corporate entities. Depending on the bylaws, members may be vested with significant voting and other statutory rights, or they may simply be donors who enjoy honorary membership without voting or statutory rights.

Members with legal rights under California statutes are created when a public benefit corporation's articles of incorporation or bylaws give its members the right to vote for directors or to vote the manner in which the charity's assets will be disposed upon dissolution or merger. California law gives certain other rights to those "voting members" including:

- the right to inspect certain corporate records
- the right to elect and remove directors
- rights to receive notice of meetings
- the right to sue the directors in derivative actions, or third parties on behalf of the corporation, under certain circumstances and subject to specified limitations
- other rights spelled out in the statutes and in the corporation's bylaws

Classes of voting members cannot be abolished by the directors without consent from the voting members.

Many public benefit corporations have "honorary members" who receive a form of "membership" recognition in return for their donations or services. Honorary members do not have voting rights or statutory rights and should not be confused with voting members.

Members, as such, are not personally liable for the debts, liabilities or obligations of the public benefit corporation. A member is not liable for the actions of directors, unless a member personally benefitted from an unfair self-dealing transaction, prohibited distribution of corporate assets, or other improper action.

### **FREQUENTLY ASKED QUESTIONS**

#### **Q. What is the difference between honorary and statutory members?**

**A.** Unlike the honorary members, statutory members are given legal rights to protect their membership interests. They are allowed to inspect corporate records, attend meetings, and have other privileges outlined earlier in the chapter. Honorary members are usually contributing donors who do not have legal rights as members. Consult the bylaws of your organization to determine your status.

**Q. I am a member of a public benefit corporation. My request to attend meetings of the board of directors and inspect the corporations, financial records has been denied by the directors. What are my rights? Can I sue?**

**A.** Statutory members have legal rights to receive annual reports, to inspect and copy corporation records, and to exercise their voting rights set forth in the corporation's articles or bylaws. These rights can be enforced in civil court actions. Members are entitled to notice and have rights to attend membership meetings. Generally, members do not have statutory rights to notice of or attendance at board of directors meetings.

**Q. Are public benefit corporations subject to the open meeting requirements under California law?**

**A.** No. Legislative bodies, school districts, and governmental entities and their subsidiaries are subject to the open meeting requirements. Most charities do not fall into these categories. Some charitable organizations may be considered "government entities" because of substantial government funding or government agency affiliation. If you believe a charity is closely affiliated with a government agency, contact that government agency to ask about your rights to attend the charity's meetings under the open meetings requirements.

**Q. I am a donor to a charity. Can I obtain the charity's financial statement?**

**A.** Yes. IRS Forms 990, 990-EZ or 990-PF, filed by the charity with IRS and with the Attorney General's Registry of Charitable Trusts, are public records. IRS regulations require charities to make these records available for inspection by any person. Some charities with gross revenue of \$2 million are required by California law to have independent audits performed and make the audited financial statements available for inspection. (See Govt. Code section 12586(e)(1).)

**Q. I am a statutory voting member of a charity and would like to use the charity's mailing list to send out information. Am I entitled to use the mailing list?**

**A.** Yes, with limitations. The mailing list of your charity is considered a valuable corporate asset, and the value diminishes if the list is distributed. California law provides specific procedures for member mailings through a "blind" use of the list. Your information is mailed out without disclosing the contents of the list to any person. The charity cannot refuse your mailing request based on the content of your message, so long as your mailing is reasonably related to your rights as a voting member of the charity.

**Q. The directors of a public benefit corporation wish to abolish the class of voting members because the members are threatening to sue the directors. Is this possible?**

**A.** It will be very difficult. Classes of voting members cannot be abolished without their consent. Nor can their rights as voting members be changed without proper notice, due process, and their consent.

All charities must raise funds to survive. Most charities rely on various income sources, including public support, government funding, and private foundation grants to sustain their operating budgets. Some charities collect fees for services they provide as part of their charitable programs.



## Chapter 8

### **CHARITY FUNDRAISING**

Every year in California, individuals contribute billions of dollars in response to charity fundraising appeals. Some of the most popular fundraising techniques used by charities include: (1) direct in-person requests for donations by volunteers at homes and offices, (2) direct mail or telephone solicitation, (3) newspaper and magazine advertisement and, (4) sales of tickets to special events or sales of products. Some charity solicitors are paid for their efforts by the charity or by a commercial fundraiser hired by the charity, while others work as volunteers. Whichever method is used, the charity and the fundraiser must comply with various federal, state, and local requirements.

The federal tax laws on deductibility of charitable contributions by donors have an impact on charitable solicitation. IRS guidelines require that taxpayers must show that the amount claimed as a deductible gift to charity exceeds the fair market value of any benefits received. The IRS guidelines require that charities spell out in their solicitations the market value of dinners, etc., and list deductible and non-deductible sums separately.

Most public charities do their own fundraising, using their own employees, paid consultants or volunteers. Fundraising methods include direct mail, telemarketing, advertising, raffles, and direct appeals. These fundraising costs should be reported by the charity on its Form 990 as salaries, consulting fees, printing, postage, and other miscellaneous costs. Some California cities and counties require that charities obtain a license prior to conducting charity fundraising within their jurisdiction.

A few charities hire outside businesses to raise funds in the charity's name. These businesses are called "commercial fundraisers for charitable purposes" and "fundraising counsel," and are regulated by the Attorney General.

A commercial fundraiser is defined as any individual or entity who, for compensation, solicits funds for charitable purposes, or who receives or controls funds as a result of solicitation for charitable purposes. Commercial fundraisers are required to disclose their identity as such prior to solicitation and must disclose their fundraising expenses and ratios upon request by a person who is solicited. (Government Code section 12599.)

A fundraising counsel is defined as a person who, for compensation, plans, manages, or consults on charitable solicitation in California. (Government Code section 12599.1.)

California law requires disclosure of certain information at the time a charity solicitation is made. To prevent fraud and unfairness in charity solicitation, a solicitor should provide correct information identifying the charity and the charitable program that will benefit from the contribution.

## California's Charity Solicitation Disclosure Law

If a charitable solicitor tells the person who is being solicited that the donation will be used for a particular charitable purpose, then the charity has a fiduciary duty to use the donation for that purpose. (Business and Professions Code section 17510.8)

California law requires commercial fundraisers for charitable purposes and fundraising counsel to register annually with the Attorney General, pay an annual fee, and file annual financial reports on charitable solicitation activities conducted during the preceding year. Commercial fundraisers are legally required to disclose their identity as such prior to solicitation and must disclose their fundraising expenses and ratios upon request by a person solicited. (Government Code section 12599; *People v. Orange County Charitable Services*, 73 Cal.App.4th 1054 (1999)).

There must be a written contract between a commercial fundraiser and a charity for each solicitation campaign, event or service. That contract must contain certain information which is set forth in Government Code section 12599, subdivision (i), including the fundraiser's fee. The contract must also disclose any proposed payments to secure any person's attendance at or sponsorship of a charity fundraising event, and must contain a provision allowing the charity to cancel the contract without cost or penalty for 10 days after the contract is executed.

A commercial fundraiser must file a notice with the Attorney General's Registry of Charitable Trusts no less than 10 working days prior to commencing each solicitation campaign, event or service. (Notices of solicitations for victims of emergency hardship or disasters must be filed no later than the commencement of solicitation.) The notice must include certain information which is set forth in Government Code section 12599, subdivision (h).

No person may act as a commercial fundraiser if that person, any officer or director of that person's business, any person with a controlling interest in the business or any person whom the commercial fundraiser employs to solicit for compensation, has been convicted of a misdemeanor or felony arising from a charitable solicitation. (Government Code section 12599, subd. (l).)

A commercial fundraiser may not solicit in California on behalf of a charity unless that charity is registered or is exempt from registration with the Attorney General's Registry of Charitable Trusts. (Government Code section 12599, subd. (m).)

Fundraising counsel are also required to file a notice with the Attorney General before commencing any service for any charity, and to have a written contract with each charity for whom they perform services, allowing the charity to cancel the contract without cost or penalty for 10 days after the contract is executed. (Government Code section 12599.1.)

Charities and commercial fundraisers shall not misrepresent the purpose of a charitable organization or the nature or purpose or beneficiary of a solicitation. A charity must exercise control over fundraising activities conducted for its benefit, may not employ any commercial fundraiser or fundraising counsel who is not registered with the Attorney General and may not raise funds for any other charity which is required to register with the Attorney General unless that charity is so registered. (Government Code section 12599.6.)

The above is merely a summary of some of the more important provisions pertaining to charitable fundraising. Any charity or other person or organization who intends to engage in charitable solicitation should first review carefully all the provisions of Government Code sections 12599-12599.7.

Additional information about charitable fundraising is contained in the Attorney General's Guide to Charitable Solicitation and the Attorney General's annual Report on Charitable Solicitation by Commercial Fundraisers. Both publications are available on the Charitable Trusts website ([www.ag.ca.gov/charities/](http://www.ag.ca.gov/charities/)) and may be obtained from the Attorney General's Public Inquiry Unit at P.O. Box 944255, Sacramento, California 94244-2550. Commercial fundraisers for charitable purposes who plan to solicit in California may obtain registration and reporting forms with instructions on the Attorney General's Charitable Trusts website or may request them in writing from the Registry of Charitable Trusts, P.O. Box 903447, Sacramento, California 94203-4470.

### **City and County Ordinances**

In addition to federal and California laws regulating charity solicitation, many cities and counties in California require licensing, registration and financial reporting as a condition to charitable solicitation within their jurisdiction. For a complete list of more than 200 cities and counties that have solicitation ordinances, consult the link to CEB, Advising California Nonprofit Corporations, on the Attorney General's website.

### **Choosing a Fundraiser for Charity**

There are many competent and honest fundraisers who contract their services to charities. There are several ways to locate a reputable charity fundraiser. Contact prominent charities in your area (especially colleges, hospitals, and cultural organizations) for their recommendations; contact your local community fund for referrals; contact the professional fundraisers association in your area for assistance. See the "Directory of Services" for listings.

When selecting a professional fundraiser or fundraising counsel, always ask for references and check them carefully. Ask for proof of registration with the Attorney General's Office. Make sure your charity's rights and obligations are clearly spelled out in a written contract. (See provisions of Government Code section 12599, subd. (i) for required provisions and Model Contract on the Attorney General's website.) Clarify the fundraiser's rights to fees and payment of expenses, and try to get a fundraiser's bond as security. Cash controls and banking procedures for funds collected should be carefully planned to insure that charity directors maintain control.

Unfortunately, some charities have lost thousands of dollars in contributions because of fraud or incompetence by their fundraisers. Directors who are negligent in their dealings with a charity fundraiser could be held personally liable for the resulting loss to the charity.

Large charitable organizations with sufficient operating budgets often hire their own "development officers" as salaried employees, to serve as fundraising experts and to plan and carry out the charity's fundraising programs. Many cultural and educational institutions rely on their directors and members to contribute volunteer fundraising assistance.

Generally, except where expressly permitted (as in the case of charity bingo and raffles), private lotteries and raffles are illegal when they involve payment of value for a chance to win a prize. A lottery or raffle is illegal if it contains the elements of prize, consideration and chance. It is a crime in California to conduct an illegal lottery or raffle.

### **Charity Bingo, Raffles, and Illegal Gambling**

Certain tax-exempt organizations are authorized by state law and local ordinance to raise money from bingo, provided that: (1) the proceeds are used only for charitable purposes, (2) the games are conducted by volunteer members of the organizations, (3) no salaries are paid with bingo proceeds, (4) there is no commingling of bingo money with any other funds, (5) the organization conducting bingo holds a valid license issued by the city or county in which bingo is played.

Charity bingo start-up costs range from a few hundred dollars to many thousands of dollars. Proper planning by directors is essential to insure profitable, cost-effective, and legal games. Every charity must comply with the local charity bingo licensing requirements before operating charity bingo games. Charities must account to local licensing authorities for all bingo proceeds.

Raffles conducted by nonprofit organizations for charitable purposes are lawful under California law which took effect in 2001. (Penal Code section 326.6.) Ninety percent of raffle revenue must be used for a charitable purpose or program. Charitable organizations must register with the Attorney General's Registry of Charitable Trusts prior to conducting a raffle and must annually report the results of any raffles conducted. Registration and reporting forms may be obtained from the Registry of Charitable Trusts by mail or from the Charitable Trusts website.

Charity auctions of donated goods and other occasional sales and bazaars to raise funds for charity are permitted.

### **A Word to Donors: How to Protect Yourself Against Charity Solicitation Fraud**

The BBB Wise Giving Alliance ([www.give.org](http://www.give.org)) and the Council of Better Business Bureaus (CBBB) ([www.bbb.org](http://www.bbb.org)) publish guidelines for public donors and suggest basic steps that may protect against fraud. Some of the suggestions are:

1. Do not give cash to a stranger. Do not make a cash donation to any person who solicits you in the name of charity, unless you know the person and know with certainty that he or she is authorized to collect for the organization named.
2. Take the time to learn about the charitable organizations you support. You can read summaries about many charities published by CBBB and the Wise Giving Alliance, or review public files on most charities at the Attorney General's Registry of Charitable Trusts, or on the Attorney General's Charitable Trusts website. Many charitable organizations will send you a written financial statement and description of their programs. IRS regulations now require that charitable organizations provide to donors upon request copies of their 990s for the three most recent years, together with a copy of the application for exempt status. (See the Directory of Services for listings for CBBB, Wise Giving Alliance, the Attorney General's Registry of Charitable Trusts and additional sources of information.)

3. Be assertive on the telephone. If you receive an unsolicited telephone call that asks for a charitable donation, tell the caller you would like to first read about the organization and its programs. Ask the caller to mail you any available literature about the organization and say that, should you decide to contribute, you will mail a check directly to the organization. Be firm.

4. To protect against theft, make all your charitable contributions by check payable to the charity, or use employee withholding programs.

5. Ask every charity solicitor who solicits you for money how your gift will be used for the charity's programs. Ask also about fundraising costs. Is the solicitor's response to your questions clear and direct, or evasive? It might surprise you to learn that many "telemarketing" campaigns are very costly. A very small portion of a donation made in response to telephone solicitation may ultimately reach the charity. If the solicitor refuses to answer your questions or tries to intimidate you into making a gift, protect yourself and hang up.

6. If you suspect dishonesty or fraud in any charitable solicitation, report the incident to your local law enforcement agency, and to the Better Business Bureau. You may also report the problem to the Attorney General's Registry of Charitable Trusts.

## **FREQUENTLY ASKED QUESTIONS**

**Q. I have been solicited for a charity that sounds like it does good work. How can I find out if this charity is legitimate?**

**A.** It may be difficult. If you are not already familiar with the organization, ask for information and financial reports from the charity. You may find useful reports about the charity have been prepared by the Better Business Bureau (BBB) or the Wise Giving Alliance; see Directory of Services for contact information. In order to solicit California donors, the charity must also be registered with the Attorney General (unless exempt) and should have financial reports on file with the Attorney General. Those reports may be accessed on-line at the Attorney General's charitable trusts website. Check also with any government agencies that the solicitor tells you are supporting the charity. There is really no way for a donor to insure that a charity is "legitimate" without doing a great deal of research. If you've never heard of the charity, and if the solicitor uses high pressure tactics, be very cautious!

**Q. We are professional charity fundraisers. Do we have to register with the Attorney General before we start a fundraising campaign in California?**

**A.** Yes. Prior to soliciting any charitable donations, a commercial fundraiser must register with the Registry of Charitable Trusts on a form provided by the Attorney General, pay a fee of \$350, and obtain a \$25,000 bond. The commercial fundraiser must renew that registration and bond annually and pay a fee of \$350. A commercial fundraiser must also file an annual financial report with the Attorney General accounting for funds collected during the preceding year.

Registration or licensing may also be required in various California cities and counties. There are more than 200 cities and counties that require charity fundraisers to comply with local licensing and disclosure requirements. See the Attorney General's website for a listing of local jurisdiction requirements.



## **Chapter 9**

# **MISCELLANEOUS CHARITABLE TRUST OVERSIGHT: TRUSTS, PROBATE, RELIGIOUS CORPORATIONS**

The Attorney General’s oversight jurisdiction extends to all forms of charities. In operating some types of charities, the fiduciary duties of a trustee may be different than they are for directors of a public benefit corporation.

### **Trusts**

A trust is a legal obligation with respect to property that is created by a written instrument—either a will (“testamentary trust”) or a trust agreement executed by a living person (“inter vivos trust”). When a trust is created for charitable purposes, the trustee must register and report to the Registry of Charitable Trusts, and the Attorney General has oversight jurisdiction over the trust. The Attorney General may audit the trust and may file civil actions against trustees for damages caused by their breach of duty to the charitable trust and its beneficiaries.

Generally, trustees are held to a high duty of loyalty and reasonable care in managing trust assets and discharging the trust purposes. Court permission is needed to terminate or modify a charitable trust.

### **Probate**

When a will or trust provides a gift for charitable purposes but fails to name a specific charitable organization to receive it, the Attorney General's office will defend the charitable gift on behalf of all public beneficiaries. Usually this occurs in a legal proceeding called a will contest or a trust contest where the heirs or friends of the person who made the will or trust challenge the charitable gift. In addition to defending the charitable gift, the Attorney General assists the court in identifying the appropriate charity or charities to receive the gift.

Notice must be given to the Attorney General of any probate proceeding involving a will that makes a charitable bequest or creates a charitable trust. Notice must be given to the Attorney General of the filing of any court petition concerning a charitable trust. (Probate Code section 17203(c).)

California law requires a trustee to serve notice on the Attorney General when a revocable trust becomes irrevocable for any reason, if the trust is a charitable trust. (Probate Code section 16061.7.) A court has no jurisdiction to terminate or modify a charitable trust unless the Attorney General is a party to the proceeding. (Government Code section 12591.)

### **Religious Corporations**

The Attorney General’s charitable oversight role with respect to religious corporations is very restricted. The Attorney General’s office does not have the same investigative or enforcement powers over religious corporations that it has over public benefit corporations and charitable trusts. (Corporations Code section 9230.)

With very limited exceptions, the Attorney General's enforcement powers may be used only if the directors of a religious corporation engage in criminal activity or conduct a public, fraudulent solicitation for "secular" purposes. As to most other harmful actions by directors of religious corporations, including self-dealing, improper distribution of a religious corporation's assets, and gross mismanagement, the Attorney General does not have the legal authority to file a derivative civil action on behalf of the religious corporation. Only the directors of the religious corporation or, in some cases, the corporation's statutory voting members, may file a civil action to correct these types of abuses.

A religious corporation is required to obtain court or Attorney General approval for the distribution of its assets upon dissolution of the corporation. (Corporations Code section 9680.)

## **FREQUENTLY ASKED QUESTIONS**

### **Q. How can I set up a trust?**

**A.** Consult an attorney. The procedure for setting up a trust and the applicable laws are complicated. For a simple bank trust account, consult a bank officer.

### **Q. I am a member of a church and I am concerned about fiscal mismanagement of church funds. Will the Attorney General investigate this?**

**A.** No. The Attorney General has no civil jurisdiction over directors of religious corporations in matters of breach of duty. If you are a statutory voting member of your church, you may wish to contact a private attorney about possible civil action to correct fiscal mismanagement. If you have evidence of serious fraud and fiscal abuse by a director, you may wish to contact the IRS.

### **Q. I am a member of a homeowners' association and am concerned about gross mismanagement of our funds. Will the Attorney General investigate this?**

**A.** No. A homeowners' association is usually a mutual benefit corporation; it is not a charity. The Attorney General's office has no jurisdiction over mutual benefit corporations, unless they control a charitable trust fund. You may wish to retain a private attorney to review your legal rights and remedies.

### **Q. I am a trustee of a charitable trust created to provide financial assistance to needy students. I would like to change the trust purpose to fund environmental projects. Can I do this legally?**

**A.** Probably not. The law of charitable trusts requires that trusts created for specific charitable purposes be carried out for those stated purposes, unless it becomes illegal, impossible, or impracticable to do so. This rule is known as the *cy pres* doctrine. To change the charitable purposes set forth in the trust document, the trustee must file a civil court action asking the court to apply the *cy pres* doctrine to change the trust purposes. The burden of proving impossibility, etc. is on the trustee and is very difficult to meet. If the trustee files a *cy pres* action without a reasonable factual basis to claim impossibility, etc., the trustee may be held liable for the resulting costs to the trust. Notice of all *cy pres* actions by charitable trustees must be given to the Attorney General.



## **Chapter 10**

# **THE ROLE OF THE ATTORNEY GENERAL IN OVERSEEING CHARITIES**

Various government agencies take actions that affect the status and operations of charitable organizations. The IRS and the California Franchise Tax Board initially determine whether an organization qualifies for exemption from federal and state income taxes. At any time during the operating life of a charity, IRS or Franchise Tax Board may audit the organization to determine its liability for taxes, penalties, or revocation of tax-exempt status.

The role of the Attorney General in overseeing California charities is different from that of the IRS and Franchise Tax Board. The Attorney General represents all the public beneficiaries of charity, who cannot sue in their own right.

All charities must register with the Attorney General, except for schools, religious organizations, hospitals, licensed health care service plans, governmental entities, regulated cemetery corporations and committees as defined in Government Code section 82013 that file statements pursuant to Government Code section 84200 et seq. Every charity that is required to register must file with the Attorney General a copy of its articles of incorporation or other governing instrument within 30 days after it initially receives property. (Government Code section 12585.)

The Attorney General investigates and audits charities to detect cases in which directors and trustees have mismanaged, defrauded, or wrongfully diverted funds from the charity. If these improper actions by directors have resulted in a loss of charitable assets, the Attorney General may sue the directors to recover from them the missing funds. The funds recovered by the Attorney General are returned to charity.

The California Attorney General has a specialized unit, the Charitable Trusts Section, that carries out the Attorney General's charity enforcement program. The Charitable Trusts Section is comprised of the Legal and Audits Unit and the Registry of Charitable Trusts. The functions of each of these components of the Charitable Trusts Section are described in more detail below.

### **The Registry of Charitable Trusts**

The Attorney General's Registry of Charitable Trusts maintains the public files containing financial reports for all of California's registered charities. Reports are accessible on the Attorney General's website ([www.ag.ca.gov/charities](http://www.ag.ca.gov/charities)). In addition, the Registry maintains a current index and a computer printout of all registered California charities.

Most charities must file annual financial reports with the Attorney General's Registry of Charitable Trusts. These reports must be filed by all public benefit corporations and charitable trusts, unless

they are exempted by statute. Currently, hospitals, schools, and churches are exempt from the annual filing requirements. The Attorney General uses IRS Forms 990, 990-PF and 990-EZ as reporting forms. Registered charities are required to file a copy of their Form 990, 990-EZ, or 990-PF on an annual basis with the Registry, as well as with the IRS. Also, effective 2000, the Registry of Charitable Trusts implemented an additional report form (Form RRF-1), which must be filed by all registered charities, together with a fee that is based on gross annual revenue for the preceding year. To obtain the RRF-1 form and instructions from the Registry, write the Registry or use the Attorney General's website.

The Attorney General may assess late fees for late filing of registration and financial reports (Government Code section 12586.1) and may revoke or suspend registration for statutory violations (Government Code section 12598(e)(1)).

Any person wishing to review a public file for any registered California charity should contact the Registry of Charitable Trusts for further information.

The Registry staff provides general information about registration and reporting to persons seeking assistance. The Registry also takes complaints from individuals about charity mismanagement and forwards the information to the Legal and Audits Section for action. A complaint form (Form CT-9) is used to document public complaints and may be obtained on the Attorney General's website or by writing to the Registry.

Every charity that is required to file reports with the Attorney General and that has gross revenue of \$2,000,000 or more (excluding grants from and contracts for services with government entities for which the government entity required an accounting for the funds received) must do the following: (1) prepare annual financial statements, using generally accepted accounting principles, that are audited by an independent certified public accountant, and make those statements available upon demand to the Attorney General and to members of the public; and (2) if it is a corporation, have an audit committee appointed by the board of directors.

The audit committee shall not include any members of the charity's staff, including the president or chief executive officer and the treasurer or chief financial officer. The audit committee shall recommend to the board the retention and termination of the independent auditor and shall confer with the auditor to satisfy its members that the financial affairs of the corporation are in order. (Government Code section 12586.)

### **Charitable Trusts Legal and Audits Unit**

The Legal and Audits Unit is staffed by attorneys and investigative auditors. This unit receives information from many sources about fiscal abuse, fraud, and mismanagement by charity directors and trustees, conducts civil investigations and audits of alleged charity abuse, and files civil court actions against directors to recover diverted charitable assets. It also reviews and acts upon mergers, sales of assets, self-dealing, loans, corporate conversions, dissolutions, and amendments of articles by public benefit corporations.

Charitable Trusts Legal and Audits Section staff are located at the Attorney General's offices in San Francisco, Los Angeles and Sacramento. (See the "Directory of Services" for listings.)

## **Scope of the Attorney General's Charitable Trusts Legal Enforcement Program**

It is the job of the Attorney General's Charitable Trusts Section to detect and to correct charity fiscal abuse. The Attorney General may audit a charity at any time to determine if the directors or trustees are carrying out the charitable trust purposes in a lawful manner. (See Corporations Code section 5250, and Government Code sections 12588 and 12598.)

Some of the problems frequently investigated by the Attorney General's Charitable Trusts Section include:

- self-dealing transactions by directors of public benefit corporations, or by trustees of charitable trusts
- loans by a public benefit corporation to a director or officer
- losses of charitable assets through speculative investments
- excessive amounts paid by a public benefit corporation or charitable trust for salaries, benefits, travel, entertainment, legal and other professional fees
- sales of charitable assets or conversion of public benefit corporations to “for profit” status (authorized by statute under restricted conditions) at a price that is unfair to the charity
- illegal use of charitable funds
- diversion of charitable trust funds from their intended purpose
- false or misleading solicitations of charitable donations

Generally, the Attorney General's Charitable Trusts Section does not take action on matters involving internal labor disputes, contested elections of directors, and disagreements between directors and members over policy and procedures. Nor does the Attorney General become involved in most legal actions between charities and third parties over contracts or torts. However, notice to the Attorney General of some of these actions is required by statute.

## **Attorney General's Charitable Trusts Section Investigative Procedures**

The Attorney General receives complaints about charity fiscal abuse from many sources--other government agencies, directors and employees of charities, reporters, donors, users of services, and from charity financial reports and information returns. After screening, substantive complaints are referred to the audit staff. The assigned auditor will normally schedule a correspondence or a field audit to review documents and conduct interviews. Usually, notice of an audit is sent in writing by the Attorney General's staff to the executive director of the charity at least one week prior to the intended date of audit.

After the audit is completed, an audit report is sent to a deputy attorney general who evaluates to determine if further investigation or corrective action is warranted. The deputy attorney general will normally contact the corporation's directors and/or their counsel to discuss the problems identified.

Corrective action often includes a demand for restitution to charity. The directors may be required to repay monetary damages caused to the public benefit corporation by their breach of duty. The directors may have to pay restitution out of their personal funds if they are not covered by insurance. If the diverted funds can be traced to a particular individual other than the directors, that individual may be held liable as a “constructive trustee” of the funds. Directors may be asked to resign, or to take steps to remove other directors from positions of conflict of interest in cases of self-dealing, fraud and gross mismanagement. Improved accounting procedures and an independent audit may be required.

Initially, the Attorney General's legal staff may attempt to resolve cases of charity fiscal abuse through private negotiations with the directors and their counsel. If agreement cannot be reached, the Attorney General may file a civil court action seeking damages and other equitable relief against the directors. Civil court actions tend to be long and costly for all parties. If the Attorney General is successful in the case, the damages recovered are returned to the charity that was injured. If the charity is defunct, a successor charity will be designated by the court to receive the funds. The Attorney General is permitted to recover attorney fees, audit expenses, and expert costs in successful charitable trust enforcement actions.

Often, reporters call the Attorney General's Charitable Trusts Section to learn whether a particular charity is being investigated. The Attorney General's office does not confirm that an investigation is in progress. Investigations are confidential, and the Attorney General's office does not discuss any details of an investigation. Once a court action is filed, the legal papers filed in court become public records.

### **Notice to Attorney General or Consent by Attorney General Required for Specific Corporate Transactions**

California law requires that directors of public benefit corporations either give written notice to, or obtain consent from, the Attorney General before taking certain actions that will have a significant impact on the corporation and its assets.

A public benefit corporation must give advance written notice to the Attorney General before the corporation engages in a voluntary dissolution, a merger, or a sale or transfer of all or substantially all of the corporation's assets.

The charitable corporation may not dispose of its assets upon dissolution without either the advance written consent of the Attorney General or the approval of the court. The certificate of dissolution filed with the Secretary of State must have attached to it a certificate of the Attorney General either waiving objections to the proposed distribution of the corporation's assets or confirming that the corporation has no assets. (Corporations Code section 6615.)

Directors may give written notice to the Attorney General of self-dealing transactions. Such notice has the effect of shortening the statute of limitations for bringing a civil action to challenge self-dealing.

A public benefit corporation must obtain prior written consent from the Attorney General before making a loan to a director or officer, with certain exceptions for residential loans. Court approval may be sought as an alternative.

Directors must obtain prior written consent from the Attorney General before amending the articles of incorporation of a public benefit corporation to convert it into a business or a mutual benefit corporation, and before merger of a public benefit corporation with a business or mutual benefit corporation.

Where a public benefit corporation converts or merges into a business or mutual benefit corporation, the Attorney General requires that it first distribute all of its assets to another charity with the same or

similar purposes. Without the prior written consent of the Attorney General a public benefit corporation may only merge with another public benefit corporation or religious corporation or foreign nonprofit corporation whose articles of incorporation provide that its assets are irrevocably dedicated to charitable, religious or public purposes.

California law requires that any public benefit corporation that operates or controls a “health facility” (as defined in Health and Safety Code section 1250) provide written notice to and obtain the written consent of the Attorney General prior to any sale or transfer of ownership or control of a material amount of the assets of the corporation to a for-profit corporation or to a nonprofit public benefit or mutual benefit corporation. (Corporations Code sections 5914-5925.) Regulations concerning these transactions are contained in Title 11 California Code of Regulations, section 999.5 and may be found in the “Publications” section of the Attorney General’s website. “Health care service plans” are not hospitals or “health facilities.”

“Health care service plans” are not hospitals or “health facilities.” Health care service plans are regulated by the Department of Managed Healthcare, not the Attorney General. (Corporations Code section 10821. See *Van de Kamp v. Gumbiner*, (1990) 221 Cal.App.3d 1260.)

The following chart cites the applicable statutes and the procedures to be followed for notice to or consent by the Attorney General.

**1. VOLUNTARY DISSOLUTION** (30 days, prior notice or waiver of notice by the Attorney General)

Public Benefit Corporation (Corporations Code sections 6615 and 6716.)

Mutual Benefit Corporation (holding assets subject to charitable trust) (Corporation Code sections 8716 and 7238.)

Religious Corporation (Corporation Code section 9680.)

**2. MERGER** (20 days, prior notice to the Attorney General)

Public Benefit Corporation (Corporation Code section 6010.)

Mutual Benefit Corporation (holding assets subject to charitable trust) (Corporations Code sections 8010 and 7238.)

Religious Corporation (Corporation Code section 9640.)

**3. SALE OR DISPOSITION OF ALL OR SUBSTANTIALLY ALL CORPORATE ASSETS**  
(20 days, prior notice to the Attorney General)

Public Benefit Corporation (Corporation Code section 5913.)

Mutual Benefit Corporation (holding assets subject to charitable trust) (Corporation Code sections 7913 and 7238.)

Religious Corporation (Corporation Code section 9633.)

Any California nonprofit corporation applying to the Attorney General for waiver of notice or approval of voluntary dissolution, merger, or sale of assets pursuant to the sections of the Corporations Code listed above, should submit to the Office of the Attorney General the following information:

- A letter signed by an attorney for the corporation or director of the corporation setting forth a description of the proposed action
- A copy of the election to dissolve, agreement of merger, or other resolution of the board of directors authorizing the proposed action
- A copy of the corporation's current financial statement
- Copies of the corporation's articles of incorporation, if not already on file with the Registry of Charitable Trusts, and copies of the articles of incorporation of any other corporation that is a party to the proposed action
- In large, complex sales the Attorney General may request an independent appraisal or other evidence that the sale price and terms are fair to the corporation

#### **4. SALES OR TRANSFERS OF ASSETS BY PUBLIC BENEFIT CORPORATIONS OPERATING HEALTH FACILITIES**

(Corporations Code sections 5914 and 5920)

Attorney General approval is required for sales or transfers of assets or corporate control by public benefit corporations that operate or control healthcare facilities. (See Corporations Code sections 5914 and 5920 and Title 11 California Code of Regulations, section 999.5.) This regulation is accessible on the Attorney General's Charitable Trusts website.

#### **5. CONVERSION OF PUBLIC BENEFIT CORPORATION (TO MUTUAL BENEFIT, RELIGIOUS OR BUSINESS CORPORATION)**

(Corporation Code section 5813.5.)

Directors are not permitted to convert a public benefit corporation that has any assets to any form of proprietary corporation (e.g. a business, mutual benefit, or a cooperative corporation) until they have received the prior written consent of the Attorney General. The Attorney General requires certification that all charitable assets will be transferred to another charity as a condition to consent.

Any public benefit corporation applying to the Attorney General for approval of corporate conversion should submit the following information to the Attorney General:

- A letter signed by an attorney for the corporation or signed by a director of the corporation setting forth a description of the proposed action and the material facts concerning the proposed action
- A copy of the resolution of the board of directors authorizing the proposed action, and board meeting minutes reflecting discussion of the proposed action
- A copy of the corporation's current financial statement
- Copies of the corporation's articles of incorporation, if not already on file with the Registry of Charitable Trusts, and copies of the articles of incorporation of any other corporation that is a party to the proposed action
- Any independent appraisals of the value of the public benefit corporation that are available. (In complex transactions involving conversion of a large public benefit corporation, the Attorney General usually requires independent valuation appraisals or other evidence that the transaction

is fair and reasonable to the public benefit corporation.)

- A statement of the plan for distribution of the assets of the public benefit corporation to a qualified charitable organization, or for payment by the directors or purchasers of the public benefit corporation of the fair market value of the corporation to a qualified charitable organization

## **6. SELF-DEALING TRANSACTIONS** (Corporation Code section 5233.)

If directors of a public benefit corporation opt to submit a self-dealing transaction to the Attorney General, either to give notice or to seek approval, they should submit the following information to the Attorney General's Office:

- A letter signed by an attorney for the corporation or signed by a director of the corporation setting forth a detailed description of the self-dealing transaction, the extent to which any director has a material financial interest in the self-dealing transaction, and all material facts concerning the self-dealing transaction
- A copy of the corporation's current financial statement
- A copy of the articles of incorporation of the corporation and any amendments, if not already on file with the Registry of Charitable Trusts
- A copy of the bylaws of the corporation and any amendments, if not on file with the Registry of Charitable Trusts
- Copies of all minutes of meetings of the Board of Directors or committees of the Board of Directors that reflect any discussions or evaluations of the self-dealing transaction
- If not covered above, a letter signed by the interested director setting forth a description of the director's material financial interest in the self-dealing transaction, listing all material facts concerning the transaction and all facts disclosed by the interested director to the Board of Directors concerning the transaction

The Attorney General may require submission of additional information by the corporation and its directors in order to complete analysis of the self-dealing transaction.

These written materials should be mailed to the Office of the Attorney General that is located nearest to the corporation's principal office. See "Directory of Services."

## **7. LOANS TO DIRECTORS, OFFICERS** (Corporations Code section 5236.)

Directors who seek the Attorney General's consent to a loan from a public benefit corporation to a director or officer of the corporation should follow the same procedures set forth for self-dealing transaction approval requests to the Attorney General, described earlier in this chapter.

## **FREQUENTLY ASKED QUESTIONS**

**Q. Our board of directors will submit several public benefit corporation transactions to the Attorney General's Office for approval, including a transfer of assets transaction, a self-dealing matter and a loan to a director. What documentation is needed to support our requests for approval and how long will it take to receive an answer from the Attorney General?**

**A.** The preliminary documentation required by the Attorney General's Office for reviewing public benefit corporation transactions is set forth in regulations, which are summarized earlier in this chapter. Additional documentation may be requested by the Attorney General, depending on the type and complexity of the transaction. All transactions are reviewed to determine if they are for the benefit of the charity and are fair and reasonable to the charity. Self-dealing, loans and conversion to business corporation transactions are carefully scrutinized by the Attorney General for any potential damage to charity. See Chapter 6 for further discussion of Attorney General's review of self-dealing, loans, and corporate conversion. The time required for the Attorney General's Office to complete a review of a public benefit corporation transaction varies from two weeks to several months, depending on the facts and complexity. It generally takes more time to review self-dealing, loans, and corporate conversions than other transactions. Attorney General review of sales and transfers of assets by nonprofit public benefit corporations operating health facilities is subject to time limits set forth in Corporations Code sections 5914 and 5920.

**Q. I have information about fiscal mismanagement of a charity by its directors. Can I lodge a complaint about this with the Attorney General without revealing my identity?**

**A.** Yes. Many complaints about fiscal abuse of charitable assets are received by the Attorney General's office from directors, officers, and employees of charities who fear loss of their position or job if the directors learn that they complained to the Attorney General. Anonymous complaints will be accepted and reviewed by the Attorney General's Charitable Trusts Section.

**Q. When the Attorney General's Charitable Trusts Section conducts an audit and investigation of a charitable organization, does it make public the results of the investigation?**

**A.** No. However, the Attorney General notifies the directors of the charity under review of any corrective action that is indicated by the audit, and seeks voluntary compliance by the directors prior to considering court action. If a civil court action is filed by the Attorney General to enforce charitable laws, all legal papers filed with the court become public documents, absent a court order to the contrary.

**Q. Our charity has a \$200,000 surplus for the current year. How should the directors invest this surplus?**

**A.** Directors are required to make prudent investments of charitable assets under their control, and are permitted to rely on the advice of investment experts if it is reasonable to do so under the circumstances. Directors may be held personally liable for imprudent investments that result in losses to the charity. Directors may also be liable for lost earnings on surplus funds left in a non-interest-bearing account.

**Q. Our public benefit corporation has insufficient funds to pay creditors and the directors have therefore decided to dissolve the corporation. What are the legal obligations of the directors in winding up the corporation?**

**A.** It is the legal duty of directors of a public benefit corporation after commencing dissolution proceedings to continue the affairs of the corporation to the extent necessary to wind up the corporation's business and dispose of its remaining assets, if any, and to carry out contracts and to collect, pay, compromise, and settle debts and claims for or against the corporation. Failure to carry out these duties may subject the directors to personal liability. In extraordinary cases where there are substantial charitable assets at risk and the directors refuse or are unable to take action to protect the corporation, the Attorney General may in his discretion ask the court to appoint a receiver to take responsibility for operating or winding up the corporation. The receiver is usually paid from the remaining charitable assets.

# **A SUMMARY OF IMPORTANT CALIFORNIA STATUTES AND CASES THAT APPLY TO NONPROFIT CORPORATIONS AND CHARITABLE TRUSTS**

The California Legislature has enacted hundreds of statutes that apply to nonprofit corporations and directors and to charitable trusts and trustees. Appellate courts have issued many opinions that also affect these nonprofit corporations and trusts. This summary includes some of the most important of these laws that relate directly to the Attorney General's charitable trust enforcement role.

## **I. NONPROFIT CORPORATIONS (Public Benefit, Mutual Benefit, Religious Corporations)** (Corporations Code section 5000 et seq.)

### **A. Formation**

1. Article of Incorporation; filed with Secretary of State (two copies for public benefit corporations). (Corporations Code section 5120.)
2. Statement of names and addresses of officers and of agent for service of process; filed with Secretary of State. (Corporations Code sections 6210, 6212, 8210, 8212, 9660.)
3. Franchise Tax Board Exemption Application. (Revenue & Taxation Code section 23701d.)
4. IRS Tax Exemption Application, IRS Form 1023.
5. Registration with Attorney General's Registry of Charitable Trusts. (Government Code section 12580 et seq.)
6. Welfare Exemption; application filed with State Board of Equalization and county assessor. (Revenue & Taxation Code section 214.)
7. License to Issue Securities; filed with California Department of Corporations. (Corporations Code sections 25000-25804.) (This is rarely used by charities.)
8. Sales Tax Permit; issued by State Board of Equalization.
9. Health Care Service Plans (Knox-Keene licensed), subject to licensing and regulation by California Department of Managed Health (Health & Safety Code section 1340 et seq.; Corporation Code sections 10820, 10821.)
10. Registration of political lobbyists with California Secretary of State, pursuant to the Political Reform Act. (Government Code sections 82039 and 86101.) (This is rarely used by charities.)

### **B. Reporting to Government Agencies**

1. Returns of Organizations Exempt from Tax. Franchise Tax Board Forms 199, 109 (unrelated business income); IRS Forms 990, Schedule A; 990 EZ; 990-PF (private foundation); 990-T (unrelated business income)

2. Registration and reporting to California Attorney General's Registry of Charitable Trusts. (Government Code sections 12580 and 12596; Corporations Code section 6324.)

C. Operating the Corporation (areas subject to state regulation)

1. Public Benefit Corporations

a. Directors and Officers:

Disinterested directors, the 51 percent rule. (Corporations Code section 5227.)

Prohibition against secretary and chief financial officer serving concurrently as the president or the chairman of the board. (Corporations Code section 5213.)

b. Standard of Conduct Owed by Director to Corporation under the Corporations Code:

Section 5230. Duties and liabilities of directors

Section 5231. Good faith; standard of care; liability to the corporation

Section 5232. Election; selection; duties of directors

Section 5233. Self-dealing transactions by directors; liability; procedures for validating

Section 5234. Mutual directors; voidability of contracts

Section 5235. Compensation of directors; liability for unreasonable amount

Section 5236. Loans, guarantees to directors; financing residence of officer permitted

Section 5237. Prohibited loans, guarantees; liability of directors

Section 5238. Indemnification of directors, officers

Sections 5239, 5047.5. Volunteer director's limited personal liability to third party for negligence

c. Investment Standards. (Corporations Code sections 5240-5241.)

Uniform Management of Institutional Funds Act. (Probate Code sections 18,500-18508.)

d. Attorney General's Charitable Trust enforcement powers to correct breach of trust, asset diversion, mismanagement of charitable assets, fraud. (Corporations Code sections 5250, 5223; Government Code sections 12588, 12598.)

e. Investigations and actions by Attorney General. (Corporations Code section 5250; Government Code sections 11180-11191.)

f. Actions by others; rights of members (Corporations Code sections 5056, 5710, 5142, 5233, 6323); authorized number of corporate members (Corporations Code section 5036.)

g. Required corporate records, reports to directors and members. (Corporations Code sections 6320-6324.)

h. Inspection of corporate records. (Corporations Code sections 6330-6338.)

2. Mutual Benefit Corporations. Subject to same rules as to its charitable assets as a public benefit corporation. (Corporations Code sections 8324, 7135, 7238.)

### 3. Religious Corporations

a. Standards of conduct for directors of religious corporations. (Corporations Code sections 9240-9251.)

b. Limited enforcement powers of Attorney General over religious corporations. (Corporations Code section 9230.) The Attorney General may sue for a court determination that a corporation is not properly qualified or classified as a religious corporation. (Corporations Code section 9230(b).)

c. Advance written notice to Attorney General required for mergers (Corporations Code section 9640); dissolutions (section 9680); and sales or transfer of all or substantially all assets (section 9633).

d. Disposition of Assets (Dissolution, Sale or Transfer of Assets; Merger); Changes in Corporate Purposes or Status (Amendment of Articles; Conversion).

(1) Dissolution (voluntary; waiver of notice). (Corporations Code sections 6716, 8716, 9680.) Involuntary Dissolution (Corporations Code sections 6510, 6519.)

(2) Sale or transfer of substantial assets. (Corporations Code sections 5913, 7913, 9633.) (20 days advance notice to Attorney General)

(3) Merger. (Corporations Code section 6010, 8010, 9640.) (20 days advance notice to Attorney General required before public benefit corporation merges with public benefit or religious corporation. Other mergers require prior Attorney General consent.)

(4) Amendment of articles of incorporation. (Corporations Code sections 5813.5, 5820.)

(5) Change of corporate status from public benefit to mutual benefit or business. If corporation has assets, written consent of Attorney General required; if no assets, 20 days notice to Attorney General required. (Corporations Code section 5813.5.) Charitable trust not abrogated by amendment of articles. (Corporations Code section 5820.)

(6) Procedures for obtaining Attorney General's approval, waiver or notice, and for giving formal notice are set forth in regulations adopted pursuant to the California Nonprofit Corporation Law, Title 11 California Code of Regulations, sections 999.1-999.4. The instructions are summarized in Chapter 10 of this Guide.

## II. TRUSTS FOR CHARITABLE PURPOSES (Testamentary and Inter Vivos Trusts)

A. Definition of "charitable" trusts is broader than tax exempt status. *Lynch v. Spilman*, (1967) 67 Cal.2d 251.

B. Creation of trusts. ( Probate Code sections 15200- 210; Civil Code sections 2223-2224.) *Smith v. The James Irvine Fdn.*, (9<sup>th</sup> Cir. (Cal.) 1968) 402 F2d 772; *In re Los Angeles County Pioneer Society*, (1953) 40 Cal.2d 852.

C. Notice to Attorney General in probates involving charitable interests. (Probate Code section 8111.) *Estate of Zahn*,(1971) 16 Cal. App.3d 106.

D. Trustee’s standard of care and duty of loyalty; self-dealing strictly prohibited; investment standard; liability of trustees (Probate Code sections 16002, 16004, 16463-465, 16440, 16100-16105); *People v. Larkin*, (N.D. Cal.1976) 413 F. Supp. 978.)

E. Termination and modification of trusts, *cy pres* doctrine (Probate Code sections 15408-410, 17206.); deviation from terms of trust regarding making or retention of investments (Corporations Code section 5241); *Estate of Loring*, (1949) 29 Cal.2d 423.

F. Trustee fees and accounting. (Probate Code sections 15680-85, 16062-16064.) *Estate of McLaughlin*, (1954) 43 Cal.2d 462.

G. Registration and reporting by trustees for charitable purposes to Attorney General. (Government Code sections 12580-12599.7.)

### **III. REGISTRATION AND FINANCIAL REPORTING TO CALIFORNIA ATTORNEY GENERAL**

A. Registration (articles of incorporation and bylaws) and periodic financial reporting; extended reporting periods for small charities; exemptions from registration and reporting. (Government Code sections 12580-12599.7.)

### **IV. CHARITABLE SOLICITATION REGULATION**

A. Statutes pertaining to charitable solicitation

1. Statewide disclosure requirements for solicitations and sales for charitable purposes; exemptions, enforcement. (Business and Professions Code sections 17510- 17510.7.)
2. Prohibition against false representations, fraudulent advertising. (Business and Professions Code sections 17500-535; 17200-208; Penal Code section 532(d).)
3. Business and Professions Code section 17510.8 codifies the fiduciary relationship between a charitable solicitor and the person solicited.
4. Business and Professions Code sections 17510.9-17510.95, requires that a disclosure document be filed with the Attorney General by charities that collect in excess of 50 percent of annual revenue and over \$1 million in California and spend more than 25 percent of their revenue on “non-program activities.” This information is provided to the public by the Attorney General.

B. Local governmental regulation of charitable solicitation. See listing on Attorney General's website.

C. Charity bingo (Penal Code sections 319, 326.5.)

D. Charity raffles (Penal Code section 320.5.)

## V. MISCELLANEOUS CASES

A. Attorney General's charitable enforcement jurisdiction. *People v. Cogswell*, (1896) 113 Cal. 129; *Holt v. College of Osteopathic Phys. & Surgeons*, (1964) 61 Cal.2d 750; *Lynch v. Spilman*, (1967) 67 Cal.2d 251; *Hart v. County of Los Angeles*, (1968) 260 Cal.App.2d 512; *Mosk v. Summerland Spiritualist Assoc.*, (1964) 225 Cal.App.2d 376.

B. Payment of "bonuses" to charity volunteers prohibited. *Queen of Angels Hospital v. Younger*, (1977) 66 Cal.App.3d 359.

C. Rights of voting members of public benefit corporations. *KQED, Inc. v. Hall*, (1982) 135 Cal. App.3d 951; *Ferry v. San Diego Museum of Art*, (1986) 180 Cal.App.3d 35.

D. Standing to sue public benefit corporations. *Hardman v. Feinstein*, (1987) 195 Cal.App.3d 157; *In re Veterans' Industries*, (1970) 8 Cal.App.3d 902; *Holt v. College of Osteopathic Phys., etc.* (1964) 61 Cal.2d 750; *San Diego, etc. Boy Scouts of America v. City of Escondido*, (1971) 14 Cal. App.3d 189; *Estate of Beryl Buck, Mental Health Association v. Marin Community Foundation, et al.*, (1994) 29 Cal.App. 4th 1846; and *City of Palm Springs v. Living Desert Reserve*, (1999) 70 Cal. App.4th 613. On relator status, see Title 11, California Code of Regulations, sections 1-11.

E. Constitutional limits on charitable solicitation regulations. *Village of Schaumburg v. Citizens*, (1980) 444 U.S. 620; *Sec. of State v. Jos. Munson* (1984) 467 U.S. 947; *Riley v. Nat. Fed. of the Blind No. Carolina* (1988) 487 U.S. 781; *Illinois ex rel. Madigan v. Telemarketing Associates, Inc.*, (2003) 538 U.S. 600.

F. Discrimination by nonprofit organizations in violation of state laws and federal tax provisions. *Bob Jones University v. U.S.* (1983) 461 U.S. 574; *Roberts v. United States Jaycees*, (1984) 468 U.S. 609; *Board of Directors etc. v. Rotary Club of Duarte*, (1987) 107 S.Ct. 1940; *Isbister v. Boys Club*, (1985) 40 Cal.3d 72; *New York State Club Association v. City of New York* (1988) 108 S.Ct. 2225.

G. Liability of directors for negligence. *Francis T. v. Village Green Homeowners Assn.*, (1986) 42 Cal.3d 490.

H. Liability of trustees and constructive trustees for self-dealing, diversion of charitable assets; duty to account. *People v. Larkin*, (1976) 413 F.Supp. 978; *Purdy v. Johnson*, (1917) 174 Cal. 521.

I. Cy Pres doctrine and modification of charitable trust purposes. *Estate of Gilliland*, (1974) 44 Cal. App.3d 32; *Estate of Loring*, (1946) 29 Cal.2d 423; *Estate of Mabury*, (1976) 54 Cal.App.3d 969.

J. Religious Organizations Defined; Extent of First Amendment Protections to Activities of Religious Organizations; Qualification for “Religious Purpose.” *United States v. Seeger*, (1965) 380 U.S. 163; 53. *Malnak v. Yogi*, (3rd Cir., 1979) 592 F.2d 197; *Lemon v. Kurtzman*, (1971) 403 U.S. 602; *De La Salle Institute v. United States*, (N.D. 1961) 195 F.Supp. 891; *Queen of Angels Hospital v. Younger*, (1977) 66 Cal.App.3d 359; *Holv Spirit Ass'n., etc. v. Tax Commission*, (1982) 435 N.E.2d 662; *Africa v. Pennsylvania*, (1982) 662 F.2d 1025; *Universal Life Church, Inc. v. United States*, (E.D. Cal. 1974) 372 F.Supp. 770; *Church of Scientology of California v. C.I.R.*, (9<sup>th</sup> Cir. 1987) 823 F.2d 1310.

K. Political Activities and Lobbying. *Regan v. Taxation with Representation of Wash.*, (1983) 461 U.S. 540.

L. Fraudulent charitable solicitation. *Illinois ex. rel. Madigan v. Telemarketing Associates, Inc.*, (2003) 538 U.S. 600; *People of the State of California v. Orange County Charitable Services*, (1999) 73 Cal.App. 4<sup>th</sup> 1054.

## **DIRECTORY OF SERVICES**

This Directory of Services has been compiled to assist charitable organizations in locating government agencies, low-cost legal services, and technical assistance resources that provide useful information. Some of the agencies listed may be able to refer interested persons to other, more specialized services for particular problems.

### **I. Government Agencies**

IRS (Federal tax exemption and reporting compliance)

(877) 829-5500

<http://www.irs.gov/>

California Franchise Tax Board (California tax exemption)

(916) 845-4171

<http://www.ftb.ca.gov/>

California Secretary of State (Filing articles of incorporation, Annual Statement of Officers)

(916) 653-6814

<http://www.ss.ca.gov/>

Name Availability Unit

(recorded information on how to obtain)

(916) 657-5448

California Board of Equalization (Property taxes and sales taxes)

(800) 400-7115

<http://www.boe.ca.gov/>

California Employment Development Department (California payroll taxes)

(888) 745-3886

[www.edd.ca.gov](http://www.edd.ca.gov)

California Attorney General's Office Listings:

Los Angeles: Charitable Trusts Section

Office of the Attorney General

300 South Spring Street, Room 1702

Los Angeles CA 90013

San Francisco: Charitable Trusts Section

Office of the Attorney General

455 Golden Gate Avenue, Suite 11000

San Francisco CA 94102-7004

Sacramento: Charitable Trusts Section  
Office of the Attorney General  
1300 I Street  
P.O. Box 944255  
Sacramento CA 94244-2550

Registry of Charitable Trusts  
P.O. Box 903447  
Sacramento CA 94203-4470

California Attorney General's Charitable Trusts website:  
[www.ag.ca.gov/charities/](http://www.ag.ca.gov/charities/)

Public Inquiry Unit: Telephone: (916) 322-3360 or 1-800-952-5225  
(for copies of publications)

## II. Legal Services

**A. Legal Aid Societies.** Local chapters in many counties may provide low cost legal services to qualifying organizations. Usually at least three main factors are considered to determine if the organization qualifies for low cost legal aid: (1) the income level of members or targeted service beneficiaries (Is it below the federal poverty level?); (2) the assets of the members (Are they relatively low?); and (3) and the type of services provided by the organization. Charities that serve the needs of low-income individuals are usually given priority. If an organization meets the above criteria, it may receive either direct legal services or referral to another agency. See your local telephone directory for listings of Legal Aid Societies.

**B. National Economic Development & Law Center.** 2201 Broadway, Suite 815, Oakland, CA 94612. Telephone: (510) 251-0600. If a charitable organization is organized primarily to serve economic development projects, the Center may be able to assist it with legal services. The Center is funded by various government and private sources to help nonprofit organizations that serve low income persons. [www.nedlc.org](http://www.nedlc.org)

**C. Regional Legal Clinics and Referral Services.** The services listed below may provide free legal services to qualifying nonprofit organizations or refer them to other agencies. Some of the listed services have income or service restrictions.

**San Francisco Lawyer's Committee for Civil Rights of the San Francisco Bay Area.** 131 Steuart St., Suite 400, San Francisco, CA 94105. Telephone: (415) 543-9444 (serves organizations that provide assistance to low-income persons) - [www.lccr.com](http://www.lccr.com)

**Bar Association of San Francisco's Volunteer Legal Services Program.** 465 California St., San Francisco, CA 94104. Telephone: (415) 989-1616 - [www.sfbar.org/vlsp](http://www.sfbar.org/vlsp)

**California Lawyers for the Arts.** Fort Mason Center Bldg. C, Room 255, San Francisco, CA 94123. Telephone: (415) 775-7200 (referral service for various arts organizations only) - [www.calawyersforthearts.org](http://www.calawyersforthearts.org)

**Bet Tzedek.** 145 S. Fairfax, Suite 200, Los Angeles, CA 90036. Telephone: (323) 939-0506 - [www.bettzedek.org](http://www.bettzedek.org)

**San Diego Volunteer Lawyer Program.** 1333 7th Ave., San Diego, CA 92101. Telephone: (619) 231-8585: (same eligibility requirements as Legal Aid Societies. Services are limited to organizational and operational problems of charitable groups. Needs will be assessed and referral made to other services.) - [www.sdcb.org](http://www.sdcb.org)

### **III. Management and Operations Assistance**

#### **A. Nonprofit Management**

**Training Center for Nonprofit Management.** 606 South Olive Street, Suite 2450, Los Angeles, CA 90014. Telephone: (213) 623-7080 - [www.cnmsocal.org](http://www.cnmsocal.org)

**CompassPoint Nonprofit Services,** 706 Mission St., San Francisco, CA 94103. Telephone: (415) 541-9000. [www.compasspoint.org](http://www.compasspoint.org)

**California Association of Nonprofits, Inc.** 520 South Grand Avenue, Suite 695, Los Angeles, CA 90071. Telephone: (213) 347-2070. [www.canonprofits.org](http://www.canonprofits.org)

**National Council for Nonprofit Associations** - [www.ncna.org](http://www.ncna.org)

**Independent Sector** - [www.independentsector.org](http://www.independentsector.org)

**BoardSource** - [www.boardsource.org](http://www.boardsource.org)

**National Center for Charitable Statistics (NCCS)** - [www.nccsdataweb.urban.org](http://www.nccsdataweb.urban.org)

**Philanthropic Research, Inc. (Guidestar)** - [www.guidestar.org](http://www.guidestar.org)

**Internet Nonprofit Center** - [www.nonprofits.org](http://www.nonprofits.org)

**United Way.** Many local United Ways offer management and technical assistance programs for interested charitable organizations. Charities do not have to be funded by United Way to participate in these training programs. For additional information, contact the United Way in your area.

#### **B. Fundraising Research and Training**

**The Foundation Center.** 312 Sutter Street, Suite 606, San Francisco, CA 94108. (415) 397-0902:

(Self-help library on grants, fundraising techniques, and corporate philanthropy. The library is open to public free of charge.) - [www.fdncenter.org/sanfrancisco](http://www.fdncenter.org/sanfrancisco)

**California Community Foundation Funding Information Center.** 445 South Figueroa Street, Suite 3400, Los Angeles, CA 90071. Telephone: (213) 413-4130 (resources for nonprofits listed on website) [www.calfund.org](http://www.calfund.org)

**The Grantsmanship Center.** P.O. Box 17220, Los Angeles, CA 90017. (213) Telephone: 482-9860 (offers training in searching for grants, writing grant proposals and negotiating with funding sources) [www.tgci.com](http://www.tgci.com)

### **C. Account Training**

**Clearinghouse for Volunteer Accounting Services.** 920 Hampshire Road, Suite A-29, Westlake Village, CA 91361. Telephone: (805) 495-6755. (Volunteer accountants provide assistance to small IRC 501(c)(3) organizations. Services range from technical assistance on tax filing reports, financial reports, budget and cash-flow projections, internal control systems-data base management and installation to evaluation and revision of accounting systems. The clearing house will review audits or assist in placing a volunteer accountant on the charity's board of directors.) - [www.cvas-usa.org](http://www.cvas-usa.org)

### **D. Assistance for Foundations and Other Philanthropic Programs**

**Northern California Grantmakers.** 625 Market Street, 15<sup>th</sup> floor, San Francisco, CA 94105. Telephone: (415) 777-4111. (Northern California Grantmakers is a membership association of foundations, corporations, and other grantmakers. It works to improve cooperation and communication among grantmakers, to improve the field of philanthropy.) - [www.ncg.org](http://www.ncg.org)

**Southern California Grantmakers.** 350 South Figueroa Street, Suite 270, Los Angeles, CA 90071. Telephone: (213) 680-8866. (a membership association of foundations and corporate giving programs. Its purpose is to increase the effectiveness of private foundations and corporations in Southern California. It offers educational and training programs for grantmakers, carries out research on selected philanthropic issues, and provides direct assistance to individual grantmakers.) - [www.socalgrantmakers.org](http://www.socalgrantmakers.org)

## **IV. Charitable Solicitation and Fundraising**

### **A. Information for Donors About Charities**

BBB Wise Giving Alliance  
The Council of Better Business Bureaus  
4200 Wilson Boulevard, Suite 800  
Arlington, VA 22203-1804  
(800) 575-GIVE  
[www.bbb.org](http://www.bbb.org)  
[www.give.org](http://www.give.org)

American Institute of Philanthropy  
3450 North Lake Shore Drive, Suite 2802E  
P.O. Box 578460  
Chicago, Illinois 60657  
(773) 529-2300  
[www.charitywatch.org](http://www.charitywatch.org)

Federal Trade Commission  
[www.ftc.gov](http://www.ftc.gov)

GuideStar (national database of tax-exempt charities)  
[www.guidestar.org](http://www.guidestar.org)

## **B. Registration with Local Government Agencies**

Many California cities and counties have passed charitable solicitation ordinances to protect their citizens against fraudulent solicitation. These ordinances may require charities and charitable fundraisers to register, certify their tax exempt status, obtain a license to solicit, and file accountings of fundraising proceeds. Most California counties and large cities maintain a charitable solicitation licensing office. It may be a separate department or part of the police or sheriff's department. All current solicitation licensing offices are listed in the book published by Continuing Education of the Bar, *Advising California Nonprofit Corporations*. See the Attorney General's website for link.

## **BIBLIOGRAPHY**

### **FREE PUBLICATIONS; INSTRUCTIONS FOR APPLICATIONS FOR TAX-EXEMPT STATUS; EMPLOYMENT TAXES AND REGULATIONS; SALES TAX; PERMITS**

These publications may be obtained from the federal or state governmental agencies listed below or downloaded from the Internet. See also the “Directory of Services” section in this Guide, or consult your local telephone directory for the nearest location of the governmental agency office.

#### **FEDERAL GOVERNMENT SERVICES**

IRS - Charitable Organizations

[www.irs.gov/charities/charitable/index.html](http://www.irs.gov/charities/charitable/index.html)

#### **STATE GOVERNMENT SERVICES**

California Franchise Tax Board

[www.taxes.ca.gov/exemptbus.html](http://www.taxes.ca.gov/exemptbus.html)

Employment Development Department

[www.edd.cahwnet.gov/](http://www.edd.cahwnet.gov/)

State Board of Equalization

[www.boe.ca.gov](http://www.boe.ca.gov)

### **II. BOOKS AND OTHER PUBLICATIONS ON GENERAL ORGANIZATION OF NONPROFIT CORPORATIONS, MANAGEMENT OF BOARD AND STAFF, FISCAL MANAGEMENT, FUNDRAISING ISSUES, DUTIES AND LIABILITIES OF DIRECTORS**

*THE FOLLOWING PUBLICATIONS DO NOT NECESSARILY REPRESENT THE VIEWS OF THE ATTORNEY GENERAL AND ARE ONLY PROVIDED AS A RESOURCE*

**Advising California Nonprofit Corporations**, 2<sup>nd</sup> ed. (California Continuing Education of the Bar, 2003)

**Better Business Bureau Wise Giving Guide** (A quarterly publication from the Better Business Bureau Wise Giving Alliance, [www.give.org/index.asp](http://www.give.org/index.asp))

**Governance for Nonprofits: From Little Leagues to Universities: A Summary of Organizational Governance Principles and Resources for Directors of Nonprofit Organizations**

(American Society of Corporate Secretaries and The National Center for Nonprofit Boards)

<http://www.ascs.org/governnfp/index.shtml>

Anthony & Hazlinger, **Management Control in Nonprofit Organizations**, 7<sup>th</sup> ed. (McGraw-Hill/Irwin, 2003)

O'Connell, **The Board Member's Book**, 3<sup>rd</sup> ed. (The Foundation Center, 2003)

Wolf, **Managing a Nonprofit Organization in the Twenty-First Century** (Simon & Schuster, 1999)

DeKuyper, **Trustee Handbook, a Guide to Effective Governance for Independent School Boards**, 7th Edition, 1998 (National Association of Independent Schools)

### **III. PRACTICAL GUIDEBOOKS FOR USE IN INITIAL INCORPORATION AND APPLICATION FOR TAX-EXEMPT STATUS**

(contain forms and step-by-step checklist)

Caftel, **Forming a Nonprofit, Tax-Exempt Charitable Corporation**, (National Economic Development and Law Center) <http://www.nedlc.org/716.pdf>

Connors, **The Nonprofit Handbook - Management** (Wiley 2000)

Mancuso, **The California Nonprofit Corporation Kit**, 3<sup>rd</sup> Ed. (Nolo Press 2001)

Mancuso, **How to Form a Nonprofit Corporation in California**, 9<sup>th</sup> Ed. (Nolo Press 2000)

Edie, **First Steps in Starting a Foundation**, 5<sup>th</sup> Ed. (Council on Foundations, Washington, D.C. 2002).

### **IV. PRACTICAL GUIDES FOR FUNDRAISING, BUDGET, AND ACCOUNTING CONCERNS**

Gross, **Financial and Accounting Guide for Not-for-Profit Organizations**, 6<sup>th</sup> Ed. (John Wiley & Sons, Inc. 2000)

Seltzer, **Securing your Organization's Future: A Complete Guide to Fundraising Strategies**, rev. ed. (The Foundation Center, San Francisco, CA 2001)

### **V. LEGAL TREATISES**

These books contain a detailed overview of charitable corporations and foundations, with emphasis on history, tax laws and regulations, and corporation and trust law. These books are recommended for attorneys and persons with some legal education. These publications are available in most public law libraries.

**Advising California Nonprofit Corporations**, 2<sup>nd</sup> Ed. (Continuing Education of the Bar 2003)

Ballantine & Sterling, **California Corporation Law**, Vol. III, Charitable Trusts (LexisNexis 2003)

Fisch, Freed & Schacter, **Charities and Charitable Foundations, Supp. 1990-91** (Lond Pub., 1974)

Hopkins, **The Law of Tax-Exempt Organizations**, 8<sup>th</sup> Ed. (John Wiley & Sons 2003)

Oleck, **Nonprofit Corporations, Organizations and Associations**, 6th Ed. (Prentice-Hall 1994)

Scott, **The Law of Trusts**, 4th Ed. (Little, Brown & Co. 1987)

## **VI. BOOKS ON PRIVATE FOUNDATIONS, INCLUDING LISTINGS OF GRANTMAKING FOUNDATIONS IN CALIFORNIA**

**The Foundation Directory** (Foundation Center, annual)

**Foundation Finder**, (Foundation Center, updated monthly)

<http://fdncenter.org/funders>

Nielsen, **The Golden Donors: A New Anatomy of the Great Foundations** (Transaction Publishers 2002)

## **VII. LAW REVIEW ARTICLES ON REGULATIONS OF CALIFORNIA NONPROFIT CORPORATIONS**

Each article cited below contains an analysis of a specific area of concern to nonprofit corporations and charitable trustees, as indicated in the title. Articles include several footnotes with citations to court decisions, articles and statutes. These articles may be found in most public libraries.

Abbott & Kornblum, **Jurisdiction of the Attorney General Over Corporate Fiduciaries Under the New California Nonprofit Corporation Law**, 13 U.S.F. Law Review 753 (1979)

Bell, **Supervision of Charitable Trusts in California**, 32 Hastings Law Journal 433 (1980)

Schwarz & Hutton, **Recent Developments in Tax Exempt Organizations**, 18 U.S.F. Law Review 649 (1984) and 19 U.S.F. Law Review 299 (1985)

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