Formation of Nonprofit Organizations

FORMS OF NONPROFIT ENTITIES

Nonprofit Corporation

The most popular form of nonprofit—and the primary focus of this book—is the nonprofit corporation. It typically is the preferred entity because of the comprehensive statutory structure provided through a state’s nonprofit corporation act that usually is similar to the state’s for-profit corporation act. Like a for-profit corporation, the nonprofit corporation provides liability protection to its constituents (members of the board of directors, officers, volunteers, and employees) for any debts and liabilities of the corporation. In addition, nonprofit corporations, pursuant to the applicable state nonprofit corporation act, are provided broad powers.

Limited Liability Company

Limited liability companies (LLCs) can be established for a nonprofit purpose. Like nonprofit corporations, LLCs are subject to a comprehensive statutory structure. Still, they differ from nonprofit corporations in some important respects,
including the fact that an LLC must have members who have an ownership interest in the LLC. This requirement creates an issue from a tax exemption standpoint because, to date, the IRS has only recognized tax-exempt status for LLCs whose members are tax-exempt.¹

As discussed in more detail in this book, an LLC may be an attractive form of entity for a nonprofit corporation that is organizing a subsidiary because a single-member LLC is treated as a disregarded entity for federal tax purposes and need not file a separate return with the IRS.²

**Unincorporated Nonprofit Association**

An unincorporated nonprofit association often arises when a group of individuals has embarked on a nonprofit activity but has not incorporated as a nonprofit corporation or other business entity. It often is an informal organization in which the participants may not have addressed legal or organizational issues, including whether to incorporate. Examples include a garden club, a booster club, a local chapter of a state-wide or national association, a union, or a political committee. An unincorporated nonprofit association need not file a document with the secretary of state’s office in order to be established.

There can be uncertainty with respect to the rights, duties, and liabilities of the individuals involved with the unincorporated nonprofit association. This has been remedied in recent years in some states by the adoption of an unincorporated nonprofit association act that provides some basic law regarding the operation of an unincorporated nonprofit association.

Some states have adopted the Uniform Law Commission’s Revised Uniform Unincorporated Nonprofit Association Act (RUUNAA) or its predecessor, the Uniform Unincorporated Nonprofit Association Act. RUUNAA provides default governance provisions and certain liability protections for members and managers and provides more certainty than

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1. *See infra* Chapter 3, “Classification of Nonprofits with Tax-Exempt Status under Section 501(c)(3).”
2. *See infra* Chapter 3, “Classification of Nonprofits with Tax-Exempt Status under Section 501(c)(3), Limited Liability Companies.”
the common law for a limited number of legal problems. RUUNAA is intended to provide a limited set of rules and protections for small nonprofit organizations that have not chosen to elect as a nonprofit corporation.

As the activities of an unincorporated nonprofit association increase, consideration may be given to incorporating as a nonprofit corporation. Still, it may make sense in limited situations to continue the activity as an unincorporated nonprofit association such as where its activities will not present significant risk to the organization or the individuals involved.

The IRS will recognize an unincorporated nonprofit association as a tax-exempt entity, as will most state regulators, if it is sufficiently organized to operate under a set of written governing documents, typically bylaws.

**Charitable Trust**

The most common form of a nonprofit is a nonprofit corporation. This has not always been the case. In the early days of the United States, nonprofits were more often established in the form of trusts, most commonly charitable trusts. This came from the Statute of Charitable Uses adopted in England in 1601, which allowed trusts to be formed for charitable purposes. Charitable trusts can operate like nonprofit corporations.

Formation of a charitable trust does not require any filing with the secretary of state’s office, but a trust instrument still is required. The trust is formed for purposes of benefiting a nonprofit purpose. The trust has trustees who are responsible for the operation of the trust. Trustees are held to a higher fiduciary standard than corporate directors, and the default form of trustee decision-making is different, usually requiring unanimous consent.

**TYPES OF NONPROFIT CORPORATIONS**

Once it has been determined that the attorney is working with a nonprofit corporation, it is important to determine the type of nonprofit corporation: a public benefit corporation, mutual benefit corporation, or religious corporation.

Some states, such as California, recognize the differences among these types of nonprofit corporations in their statutes. Others do not expressly
recognize such classifications. Regardless of whether the applicable non-
profit corporation act uses such classifications, it is helpful to think about
the type of nonprofit corporation in these terms because the rules imposed
by the applicable state nonprofit corporation act for each type can differ.

**Public Benefit Corporation**

Most nonprofits are public benefit corporations (also called “charitable
corporations”). These entities normally will qualify for tax-exempt status
under Internal Revenue Code section 501(c)(3) or 501(c)(4) as charita-
table or social-welfare organizations. Examples of the types of entities that
fall into this category include libraries, museums, hospitals, and schools.
Oftentimes, a public benefit corporation provides a service or product to the
public that generally is not offered by a for-profit enterprise. The nonprofit
may have a membership, but many public benefit corporations do not have
members because most state nonprofit corporation laws allow nonprofits to
be governed by only a board of directors without members. The activities
of this type of nonprofit typically are available to the public in general.

**Mutual Benefit Corporation**

A mutual benefit corporation is formed primarily to serve the members of
the nonprofit corporation as opposed to the general public. Many of the
attributes of a mutual benefit corporation are similar to those of a for-profit
entity, and in some ways the members of a mutual benefit corporation look
more like shareholders with regard to certain governance rights. Still, an
important distinction is that members of a mutual benefit corporation do
not have the right of distribution from the corporation. Examples of mutual
benefit corporations include homeowner associations, chambers of com-
merce, trade associations (such as state bar associations and the American
Bar Association), fraternal organizations, veterans organizations, and
country clubs and other social clubs. Many mutual benefit corporations
establish their tax-exempt status under section 501(c)(6) or 501(c)(7).

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3. A nonprofit “public benefit corporation” is not to be confused with a
Delaware “public benefit corporation,” which is a type of for-profit benefit
corporation.
Religious Corporation

A religious corporation is similar to a public benefit corporation but is set up for religious purposes. For constitutional and policy reasons, however, nonprofit corporation acts will provide religious corporations with more flexibility in structure and operations than public benefit corporations.

Other Types of Nonprofit Corporations

Some states have additional categories of nonprofit corporations such as consumer cooperatives.

ORGANIZATIONAL DOCUMENTS

Organizational documents differ depending on the type of nonprofit organization created. With a nonprofit corporation, it is necessary to have articles of incorporation, typically filed with the state’s secretary of state office, and bylaws. With a charitable trust, it is necessary to have a trust instrument or other document that defines the type of entity and how it functions. A limited liability company has articles of organization or a certificate of organization, typically filed with the secretary of state, and an operating agreement. For an unincorporated association, it is helpful to have a written document, often in the form of bylaws or other form of governance agreement.4

Nonprofit Corporation—Articles of Incorporation

In order to create a nonprofit corporation, it is necessary to file articles of incorporation with the state secretary of state’s office together with the applicable filing fee. Such document establishes the existence of the nonprofit corporation. Some provisions of the articles are similar to for-profit corporation articles of corporation, whereas other provisions are unique to nonprofit corporations.

4. RUUNAA contemplates the unincorporated nonprofit association will have “governing principles” in the form of an agreement between the members that governs the purpose and operation of the association and the rights and obligations of its members and managers.
Mandatory Provisions

The provisions contained in articles of incorporation will vary depending upon the state of incorporation in accordance with the requirements imposed by the state nonprofit corporation law. As a result, reference to the state nonprofit corporation act is essential in preparing the articles.

Some common mandatory requirements include the following:

- **Name.** A nonprofit corporation must have a name that is distinguishable from other legal organizations incorporated in the same state. In many states, a nonprofit corporation is not required to include in its name the word “corporation,” “incorporated,” “company,” “limited,” or any abbreviations thereof.

- **Purpose Clause.** This is an important part of the articles of incorporation. If the nonprofit is to have tax-exempt status under Internal Revenue Code section 501(c)(3), the articles of incorporation must limit the purposes of the nonprofit to one or more exempt purposes permitted under section 501(c)(3). A state nonprofit corporation act may impose other requirements on what must be stated with regard to the purposes of the nonprofit.

- **Irrevocable Dedication of Assets.** If the nonprofit is to have tax-exempt status under section 501(c)(3), it is necessary to include a provision that prohibits the assets of the corporation from being used to benefit an individual, and instead to use them for the charitable purposes of the corporation. It also is necessary to include a provision that identifies the disposition of the assets upon dissolution of the entity to ensure that the assets will be used for a charitable purpose even after the corporation ceases to operate.5 Nonprofits seeking other forms of exempt status generally must demonstrate only noninurement of benefits to the

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5. For mandatory provisions for organizations organized exclusively for one or more section 501(c)(3) purposes, see 26 C.F.R. §§ 1.501(c)(3)-1(b)(1)(i) and 1.501(a)(3)-1(b)(1)(iv)(4). I.R.S. Publication 557, Tax-Exempt Status for Your Organization, contains samples of language that will meet the organizational test.
members and managers, with the possible exception of liquidating distributions.

- **Registered Agent.** It is necessary to include a provision that identifies the registered agent for service of process along with the address of the registered agent. A nonprofit corporation always must have a registered agent in place. For some nonprofits, the registered agent will be a volunteer of the organization. It is important to ensure that a replacement registered agent is substituted in the event this volunteer ceases to be involved with the organization. A nonprofit corporation can be administratively dissolved for failure to file its annual or biennial report, which typically is sent to the registered agent. If the volunteer is no longer involved in the organization, it is possible that the report will not be submitted, and an administrative dissolution will occur.

- **Incorporator.** It often is necessary to include the name and address of one or more incorporators of the nonprofit corporation. The role of incorporator is similar to that in a for-profit corporation. The individual is responsible for signing and filing the articles of incorporation and convening an organizational meeting or otherwise getting the first board of directors appointed unless the initial board of directors is identified in the articles of incorporation.

- **Other State Requirements.** There may be other types of information required to be included in the articles of incorporation. For instance, in California and states that have adopted the ABA Revised Model Nonprofit Corporation Act, it is necessary to identify the type of nonprofit (i.e., public benefit, mutual benefit, or religious). In states that have adopted the ABA Model Nonprofit Corporation Act, Third Edition (MNCA) (which replaced the Revised Model Nonprofit Corporation Act), it is necessary to describe any “designated body” that has been assigned powers that otherwise rest with the board of directors. In addition, some states require that the nonprofit identify in the articles of incorporation whether it has any members.
Optional Provisions

State nonprofit corporation acts often allow for the inclusion of permissible provisions. In terms of the nonmandatory provisions in the articles of incorporation, the following may be included:

- **Initial Board of Directors.** The names and addresses of the initial members of the board of directors can be identified in the articles of incorporation. The inclusion of this type of information can be helpful as it allows the board to convene the organizational meeting (as opposed to the incorporator). Some nonprofits desire to minimize public information on the members of the board of directors. As a result, they may opt not to identify the board members in the articles of incorporation (because it is publicly available from the state secretary of state’s office). Still, states often will require annual or biennial reports to be filed with the secretary of state’s office that identify one or more of the directors of the nonprofit. Such documents are also public record. Further, this information will be furnished when the organization files for its exempt status. Another reason not to identify the directors in the articles of incorporation is that, unless eliminated by future amendments, their names will remain in the articles long after they have ceased serving as directors.

- **Elimination/Limitation of Liability of Directors.** In some states, including those that have adopted the MNCA, a provision may be included in the articles of incorporation that eliminates or limits the liability of a director to the corporation or its members for money damages.\(^6\)

- **Indemnification.** Similarly, some states, including those that have adopted the MNCA, allow for the most expansive indemnification rights only if a provision is included in the articles of incorporation.

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6. The MNCA provides an “automatic” liability shield for directors of a charitable corporation. MNCA § 8.31(d). For directors of a noncharitable nonprofit corporation, the articles of incorporation must include the liability shield language in order for directors to be protected from liability to the nonprofit and its members. MNCA § 2.02(c).
• **Management of Nonprofit.** It is possible to include provisions in the articles of incorporation addressing the management and regulation of the nonprofit corporation.

• **Defining, Limiting, and Regulating Powers.** A provision can be included in the articles of incorporation that describes the powers and limitations of the corporation, its board of directors, members, and any class of members.

• **Membership Differences.** A provision can be included that describes the characteristics, qualifications, rights, limitations, and obligations for each class of members. The management of the nonprofit; the description of any powers and limitations of the corporation, its board of directors, members, and any class of members; and any membership differences also can be addressed in the bylaws, which may be a more proper document to address these topics.

• **Amendments to Articles of Incorporation.** A provision can be included that describes the process under which the articles of incorporation may be amended. In multi-level organizations and organizations with an outside sponsor, it is common to include a provision in the articles of incorporation requiring approval of the superior organization or sponsor of any amendments to the articles of incorporation or bylaws.

• **Religious Organizations.** Religious organizations may have fidelity clauses to a particular creed or denomination.

From a drafting standpoint, it often is best to include only those provisions that are mandatory and those permissive provisions that may provide additional protection to the nonprofit or its directors and officers and cannot be included in the bylaws. A main reason for such recommendation is that the articles of incorporation is a public document that requires amendments to be filed with the secretary of state’s office, whereas the bylaws—a document typically referenced more frequently by an organization and its directors and officers—can be amended without a filing with the secretary of state’s office. Another reason is that articles of incorporation typically are harder to amend than bylaws. In order to avoid unnecessary conflict, it is best not to cover the same subject matter in both the articles of incorporation and bylaws. Of the permissive
provisions listed, however, a nonprofit always should consider including in the articles of incorporation those permitted under state law to limit liability of the directors and provide maximum indemnification protection to the directors and officers.

Nonprofit Corporation—Bylaws

The bylaws are a governance document of the organization that is not filed with any secretary of state’s office. Depending on the state of incorporation, however, they may need to be provided to the state attorney general. They also may need to be included in an exemption application filed with the IRS depending on the exemption form used.

The bylaws contain a description of the basic powers, rights, duties, and limitations of the members (if there are members), the board of directors, and the officers. To the extent the nonprofit corporation has members, the bylaws often is the document used to describe important aspects of membership.

The bylaws are important to the governance of the organization for two reasons. First, the bylaws set forth the rules of governance of the organization, including the steps required for member action and board of director action to be effective. Second, many nonprofit corporation acts contain “default” provisions that will control unless different terms are set in the articles of incorporation or bylaws. As a result, to the extent the organization would like to be subject to rules that differ from the default rules, it is important to address those rules in the bylaws. Given this importance, the attorney must give careful attention to those documents. To the extent there are inconsistent provisions in the articles of incorporation and bylaws that overlap, the provisions in the articles of incorporation will control.

Some organizations, particularly older ones, have both a constitution and bylaws as separate documents. This is somewhat more common in unincorporated associations. In that case, the constitution contains the more important provisions not included in the articles of incorporation and should be harder to amend than the bylaws. In general, the more modern thinking is to have one combined document. Regardless of what they are called, and whether they rest in one document or two documents, they are “bylaws” under most states’ nonprofit corporation laws.
Sources to Consider When Drafting Bylaws

For guidance on preparing or reviewing bylaws, helpful resources include:

- applicable state nonprofit corporation act;
- applicable state charitable solicitation laws;
- the Internal Revenue Code;
- sector-specific legal requirements, e.g., a federally qualified health center is required under federal regulation to have a certain minimum number of board members, which would be addressed in the bylaws; and
- state liability shields/volunteer limitation of liability laws.

Subject Areas Covered in Bylaws

Members

As discussed above, nonprofit corporations may have members, but in most states they also may forgo members.\(^7\) In addition, the concept of “member” and the rights of a member will differ among nonprofit corporations. State nonprofit corporation acts typically treat an individual or entity that has the ability to elect one or more directors or has other voting power with regard to significant matters as a “member” under the act. This is important because the act often will provide certain rights to members.

Some kinds of nonprofit organizations, such as those associated with performing arts, public interests, or the needs of special or vulnerable populations, often have a group of individuals and/or entities that are referred to as “members” that do not have the ability to elect directors or vote on other significant matters. They may have member benefits relating to nonprofit organization’s activities, such as special access to discounts in admissions, tickets, or promotional items. Without such voting rights, they typically are not considered “members” under a nonprofit corporation act. A nonprofit might have “special access”-type members as a means to recognize donors or derive revenue by creating a sustainable group of individuals.

\(^7\) This is not the case in Delaware where members are required for all nonprofit corporations.
or others who support participation in the organization’s mission. In such circumstances, these members often will have only those rights that are set out in the articles of incorporation and bylaws with no reference to the applicable state nonprofit corporation act. The bylaws should make clear that these “members” have no voting rights.

Many states recognize delegate assemblies as an intermediate body between the members and board of directors. For such organizations, the members may have only the right to elect delegates who, in turn, elect directors. If that is the case, the bylaws must be drafted carefully to ensure that the individual members do not inadvertently retain statutory rights of members.

When a nonprofit corporation has “members,” it is important to set forth in the bylaws various member-related provisions. The following terms are especially important if the corporation has members with voting rights, but some provisions also are useful with a nonvoting membership. These include the following:

- **Qualification/Selection.** The bylaws should address how an individual or entity becomes a member of the nonprofit corporation. This may involve reference to another document, such as a membership application or policy document, but there should be some criteria for determining membership.

- **Classes of Members.** To the extent the organization will have more than one class of membership, the bylaws should provide a description of the different classes of membership and their respective rights, qualifications, and expectations.

- **Dues.** In the event there are dues requirements imposed on members, a general reference to this point should be included. Under many nonprofit corporation acts, the liability of a member to pay dues continues even after the individual or entity is no longer a member with regard to dues owed prior to termination of the membership. Some nonprofits find it helpful to include a provision in the bylaws making this point clear in order to avoid a dispute with a former member who has unpaid dues.

- **Member Representatives.** For nonprofit corporations that allow for members that are entities (as opposed to individuals), the bylaws should include a provision addressing the process for
a member to designate a representative to act on the member’s behalf in the governance of the organization.

- **Termination/Suspension.** State nonprofit corporation acts often recognize the ability of a nonprofit corporation to terminate or suspend a member, and some of these acts include procedures for such action. The bylaws should include a description of the general grounds for termination and suspension as well as the process for such action. Otherwise, the organization may lack any clear way to remove members. In addition, if a person remains on the membership list after ceasing any involvement in the organization, it may be difficult to meet the quorum requirements.

- **Resignation.** A description of how a member may resign from the nonprofit corporation can be helpful to avoid any confusion if there is ever a desire for a member to cease to be part of the organization.

- **Reinstatement.** Nonprofit corporations often will permit the reinstatement of a member who meets certain requirements. The reinstatement criteria and process can be addressed in the bylaws or in another document approved by the board.

- **Membership Transfers.** In some states, it is possible for members in certain types of nonprofits, such as mutual benefit corporations (e.g., country clubs), to sell their membership back to the nonprofit corporation or to transfer their membership to another individual or entity. To the extent this type of transfer is permissible (and the nonprofit wants to allow for transfers), a provision can be included in the bylaws to address the process.

- **Annual/Regular/Special Meetings.** Especially with members that elect directors or vote on other important matters, it is important to have provisions in the bylaws that address how members take action. The primary means for taking action is through annual, regular, or special meetings of the members. The bylaws should address how annual, regular, and special meetings may be called.

- **Written Consents and Ballot Voting.** Many state nonprofit corporation acts permit members to take action by written consent and/or ballot voting instead of holding an annual, regular, or special meeting. Some states and the MNCA permit such action to
be taken with less than unanimous consent/vote.\textsuperscript{8} To the extent the nonprofit corporation desires to allow for member consents or ballot voting, the bylaws can set forth the procedure for obtaining consents and/or ballots, and the minimum vote that is necessary for action to be deemed taken by the members. In many states, electronic consents and ballots are permissible, which can be addressed in the bylaws.

- **Proxies.** Many state nonprofit acts include default provisions allowing members to vote by proxy. Few membership organizations actually use proxies on a regular basis. If the organization does not want to permit the use of proxies, the bylaws should clearly prohibit them. If proxies are permissible, it is recommended the board of directors adopt a policy on recognition of proxies.

- **Notices to Members.** The bylaws should address the requirements for notice to members about meetings. Many state nonprofit corporation acts permit electronic notices (which might be accomplished via e-mail) if certain conditions are met. Publication of notice also may be permissible in the organization’s regular membership magazine or newsletter.

- **Waiver of Notices.** The process for allowing members to waive any required notices should be addressed in the bylaws.

- **Quorum.** The bylaws should include a requirement on the minimum requirements necessary to have a quorum for a meeting of the members. State nonprofit corporation acts often provide a great deal of flexibility to the organization in determining satisfactory quorum. As a result, in some states, the quorum can be very low, such as the number of the members that show up for a meeting. This can be beneficial for nonprofits with large memberships that find it difficult to have members attend meetings; however, it also can give power to a small group of people who show up for the member meetings. As a result, careful consideration must be given to determining the appropriate number of members for quorum purposes.

\textsuperscript{8} See, e.g., MNCA § 7.04.
• **Voting Rights.** It is important for bylaws to address any difference in voting rights among members if a difference exists. Otherwise, the general rule is that there is one vote per member. Some nonprofit corporation acts permit cumulative voting. If a nonprofit corporation is to allow for cumulative voting, it is important to include a provision in the articles of incorporation or bylaws.

• **Conduct of Meetings.** The general procedural rules for holding a meeting can be a helpful provision included in the bylaws in order to avoid a dispute that may arise during a meeting. There are no prescribed rules with regard to how a meeting is to be held; as a result, a nonprofit can have a great deal of flexibility in determining the actual rules for the meeting. Typically, it is not a good idea to include extensive procedural rules in bylaws. It usually is better, as such rules are needed, to authorize the members or the board to approve rules of order. In organizations with large membership meetings or delegate assemblies with significant power, it might be useful to adopt a meeting guide (sometimes called a parliamentary authority) in the bylaws.

• **Fundamental Transactions.** In many states, the bylaws may contain provisions establishing higher than normal voting requirements for fundamental transactions (e.g., amendments to articles of incorporation and bylaws, mergers, sale of assets, and dissolutions) than the statutory minimums.

**Election or Appointment of Directors**

To the extent there are members with voting rights, the directors often are elected by such members. Many state nonprofit corporation acts are flexible, however, and can allow directors to be elected or appointed by members, delegates, the directors themselves, some other party, or a combination of the foregoing.

• **Members.** The most common means for election of directors in a membership organization is through a vote of the members. To the extent there is a large membership, the election of directors may present challenges for the nonprofit corporation due to
difficulties in managing membership meetings and votes. As a result, ballot voting by mail or electronic transmission can be an important consideration.

- **Delegates.** Delegates may be part of the governance of a non-profit corporation where there is a large membership and it is necessary to centralize the governance of the organization (or director election) to a smaller group of individuals. Large religious organizations and trade organizations often use delegates. For these organizations, the bylaws frequently allow a delegate assembly to elect directors and set broad policy directives for the organization.

- **Directors.** A common form of election is where the directors elect their successors. In some states, this type of an election can take place even when there are members. One justification for having directors elect their successors is that the directors are likely to be the most knowledgeable with regard to the operations and needs of the organization (as compared to the members who may be less engaged with the organization). A drawback to allowing the directors to elect their successors is that the power is limited to a narrow group of people. A board that is elected in this manner is sometimes called a “self-perpetuating” board.9

- **Ex Officio.** An individual may automatically be deemed a member of the board of directors by virtue of the position the individual holds within the nonprofit corporation or elsewhere.10 For example, it is possible that the president or chief executive officer, an employee of the organization, might automatically be a member of the board of directors. Unless otherwise specified in the bylaws, *ex officio* directors have the same rights to vote as any other director. If the bylaws define someone as an “*ex officio* nonvoting director,” that person should not be counted for quorum purposes.

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9. In cases where there is a self-perpetuating board, it often is helpful to have a nominating committee charged with seeking out new board members with diverse viewpoints and experiences.

10. Sometimes, outsiders are *ex officio* members. For example, the president of a college might, by virtue of the position, serve as a member of the board of the alumni association.
• **Appointment by Third Parties.** A nonprofit corporation can provide in its bylaws that one or more directors are elected or appointed by a third party that may not otherwise have a role in the governance of the organization. For example, a nonprofit established to benefit a city may give the right to appoint a director to a city representative.

**Board of Directors**

An important part of the bylaws is the description of the powers and duties of the board of directors of the nonprofit corporation. The areas that should be covered in the bylaws include the following:

• **Selection.** The manner in which the members of the board of directors is elected or appointed should be set forth in the bylaws. As described above, nonprofit corporations typically have a great deal of flexibility in who will be involved in electing or appointing the directors.

• **Types of Directors.** State nonprofit corporation acts generally contemplate one class of directors, all of whom have certain duties (including the duty of care and the duty of loyalty) and rights—primarily in the form of a voting on matters. As noted above, it is possible an individual may be a director by virtue of that person’s position in the corporation itself or in another organization. This is often referred to as an “*ex officio*” director. To the extent the bylaws provide for an *ex officio* director, it is important to expressly state whether such individual has voting rights. As indicated above, if silent on issue, the *ex officio* director has the same voting rights as other directors.

Some nonprofits desire to have classes of persons they refer to as directors who do not have all of the rights of “regular” directors. This may include former directors who the nonprofit corporation would like to have stay engaged with the organization. Some titles used for these individuals include “honorary directors” and “advisory directors.” Given the legal responsibilities imposed on regular directors, and in order to avoid any confusion, it is recommended nonprofits avoid the use of a “director” title to refer to
these individuals. Regardless of whether the person is called a “director,” it is important to make clear in the bylaws the rights and responsibilities of these individuals.11

- **Number.** The bylaws should set forth the specific number of directors. Alternatively, many state nonprofit corporation acts permit a nonprofit to identify a range of the number of directors who might serve at any given time with the exact number to be set by the board or otherwise.

- **Tenure/Terms.** In general, director terms can be one year or multiple years. It is important to identify the length of the terms in the bylaws. For a larger board of directors, consideration should be given to permitting staggered terms. A main benefit of staggered terms is continuity. A corporation opting to have staggered terms typically will divide the total number of directors into groups. For example, a board of 15 directors might divide the directors into three groups (generally equal in number), with one group elected each year for a term of three years. Unlike the situation with for-profit corporations, which generally are required to identify staggered terms in the articles of incorporation, a nonprofit corporation often may provide for staggered terms in the bylaws. Some nonprofits provide for a set term of years that cannot be exceeded without at least a one-year gap in service. Term limits can be helpful for a variety of reasons including addressing attendance problems and ensuring that the board has engaged members and is not dominated by one of two people. Term limits, if desired, should be clearly provided in the bylaws.

- **Qualifications.** The minimum qualifications (if any) of the directors should be described in the bylaws. In a membership organization, the bylaws often require that a director be a member.

- **Resignation and Removal.** The bylaws should set forth the rules relating to the resignation and removal of directors. Resignation typically may occur with written notice to the president or

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11. Some states authorize “alternative directors” when the elected or appointed directors cannot attend meetings. This may be useful for representative boards where some directors are appointed by third parties.
secretary of the nonprofit corporation. Removal normally can be effected through the same means by which the director was elected, i.e., if the members elected the director, the members may remove the director. Some state nonprofit corporation acts permit the board of directors to remove a director regardless of who elected or appointed the director.

- **Regular/Special Meetings/Notices.** The bylaws should address how regular and special meetings are called and the notice requirements. To the extent the nonprofit corporation contemplates electronic meetings, such as meetings held via conference call, it is important to note such permissibility in the bylaws.

- **Order of Business.** It is important for the bylaws to describe how the order of business of the board of directors meetings will be handled. Although some nonprofits will utilize formal rules, such as the special board rules in Robert’s Rules of Order, such rules are not statutorily required. In addition, for most nonprofits, formal rules may prove to be too cumbersome because they do not have large deliberative bodies. The bylaws can identify some simple rules of procedure or empower the board or an officer (such as the chair) to determine the rules.

- **Quorum.** It is important to describe the quorum necessary to hold a director meeting and to allow voting. It is common for state nonprofit corporation acts to provide that the “default” quorum is a majority of the directors. Such acts generally restrict nonprofit corporations from having a quorum that is less than one-third of all directors.

- **Voting.** The required number of votes necessary for board action to be deemed taken should be described in the bylaws. To the extent the bylaws are silent, the “default” provision in the state nonprofit corporation act—which typically is majority vote of those present—will govern. This means that abstentions at a board meeting count as “no votes.” Some nonprofits find it important to impose a greater-than-majority vote on some matters. This often is called a “supermajority” vote. If desired, it would be important to identify in the bylaws the matters requiring such a vote and the minimum number of votes to meet such a “supermajority” requirement.
• **Written Consent of Directors.** Many nonprofit corporation acts permit directors to take action via written consent in lieu of holding a meeting. Such consents typically must be signed by all of the voting directors in order to be effective. There are a few states that allow for consents or e-mail voting to be something less than unanimous. As a result, it is important to check the applicable nonprofit corporation act.

• **Electronic Communications/Action.** Most nonprofit corporation acts permit electronic notices as well as electronic action (via written consent). A provision in the bylaws expressly permitting this type of communication can be helpful.

• **No Proxies.** Sometimes nonprofit corporations want to permit directors to submit proxies for votes to occur at the board of directors meeting. Although proxies may be permissible at the member level, they are not permissible for board action in many states.

• **Compensation.** Although most nonprofits do not compensate their directors, it generally is permissible to provide reasonable compensation for board service. To the extent a director is to receive compensation, it is advisable to include a provision in the bylaws that permits such compensation.

• **Committees.** Board committees can be important to the governance of the nonprofit corporation. These committees, with certain limited exceptions, can be a delegated board authority or serve in an advisory capacity. Many nonprofits will include detailed descriptions of the standing board committees (and their responsibilities) in the bylaws. A drawback to having a detailed description is the likelihood that the committees end up not complying with the bylaw requirements because they develop their own process for operation over time. As a result, sometimes a less-is-more approach with regard to committee descriptions may be better. Bylaws can include a more general or “big picture” description about the rights and duties of the board to create committees. Many nonprofit organizations use board resolutions, committee charters, or other documents that describe the specific duties of each committee, rather than provide a detailed description (or even the names) of all committees. To the extent any such committees are delegated review or approval powers that would
otherwise be the responsibility of the board, the board should adopt and revise, from time to time as appropriate, such charter or similar document. This type of document should be easier to change over time than the bylaws. It is important to review state law on composition and permitted activities of committees. Committees with power to act in place of the board generally must consist entirely of board members whereas advisory committees can be made up of non-board members.

**Officers**

Whereas the board of directors is given authority to set policies and determine the general direction of the nonprofit corporation, the officers are expected to implement the decisions of the board of directors and oversee the day-to-day activities of the nonprofit corporation. State laws vary on specific requirements to have a particular “named” officer. Most organizations typically have, at a minimum, a president and/or chair, secretary, and treasurer. The officers of the nonprofit should be described in the bylaws along with their rights and responsibilities.

In addition, the bylaws should describe how officers are selected. In most cases, the board of directors selects the officers; however, in some nonprofit organizations, the membership select the officers. It is important to clarify whether officers are volunteers (often with set terms) or employees (who typically serve at the pleasure of the board, subject to an employment contract).

**Other Subject Areas**

Other common subject areas addressed in bylaws include the following:

- **Receipt and Disbursement of Funds.** A bylaw provision describing the officers and other representatives in the nonprofit corporation with the authority to receive and disburse funds is important for helping establish such authority to third parties (such as banks and other lending institutions) that are conducting business with the nonprofit corporation.

- **Corporate Records and Reports.** State nonprofit corporation acts often provide rights to members and directors to have access
to certain corporate records. The bylaws can set forth these rights and must do so if it wishes to modify the rights (to the extent permissible under state law).

- **Amendment of Bylaws.** The process for amending the bylaws should be addressed in the bylaws. Otherwise, the amendment process will “default” to the state nonprofit corporation act.

**Policies, Board Resolutions, and Charters**

Other important board governance documents include policies, charters, and board of director resolutions. Various governance policies are discussed in more detail in Chapter 4, *Governance Matters*, Board Policies. The board of directors might pass a “standing” resolution that addresses areas that are not specified in the bylaws. An example is a resolution setting forth by dollar thresholds the authority of officers to make binding commitments on behalf of the organization. In addition, as discussed above with regard to committees, charters can describe various aspects of committees, such as their purposes and authority, which are not set forth in the bylaws. All of these documents generally are changed more frequently than bylaws, and by having them separate from the bylaws, it is not necessary to comply with the bylaws’ amendment requirements to make changes.

**Organizational Meeting/Written Consent**

Upon incorporation of a nonprofit corporation, it is necessary for the organization to take certain organizational steps. This can be accomplished through an organizational meeting called by the incorporator or the initial board of directors if an initial board of directors is identified in the articles of incorporation. The organizational meeting also can be accomplished through a written consent of the incorporator and/or initial board of directors. The meeting/consent should cover the following:

- election of board of directors and officers;
- adoption of the bylaws of the corporation;
- appointment of any committees;
• approval of establishment of any checking or bank accounts;
• approval or authorization to proceed with the filing of an application for tax-exempt status;
• adoption of a corporate seal (if any);
• designation of the accounting year (if not identified in the bylaws);
• approval of payment of incorporation expenses;
• continuing authorization for state informational filings and state and federal tax filings;
• designation of principal office location;
• approval of filing of any applications for necessary licensure;
• approval of acquisition of insurance;
• adoption of policies; and
• release of incorporator from any further duties and liabilities.

If the incorporator is involved with the organizational meeting, the incorporator generally elects the directors, and then the directors proceed with approving the other organizational items.