



## Suggestions for Modernizing North Carolina's Nonprofit Laws

The North Carolina Center for Nonprofits works with nonprofits serving all 100 counties of North Carolina. The Center, along with the Nonprofit Sub-Committee of the NC Bar Association's Business Law Council, has developed recommendations for several potential changes to NC Nonprofit Corporation Act (Chapter 55A of the General Statutes) and NC Charitable Solicitation Licensing Act (Chapter 131F of the General Statutes). These recommendations would modernize state nonprofit laws and make these laws more consistent with best practices for nonprofits, allowing nonprofits to operate more efficiently and to use more of their time and money for their mission-related programs, services, and activities.

The following is a summary of the recommendations from the Center and the Nonprofit Sub-Committee of the NCBA Business Law Council for changes to the nonprofit corporation and charitable solicitation statutes. We have prepared examples of legislative language for each recommendation.

**Mergers and dissolutions of nonprofits.** During the COVID-19 pandemic, a growing number of nonprofits are having difficulty maintaining the financial resources necessary to sustain their operations. As a result, there has been an increase in mergers between nonprofits and in dissolutions of nonprofits. In many situations, the merger or dissolution of a nonprofit is the most efficient way to ensure that another organization can use the nonprofit's remaining charitable assets for the best possible purposes to support communities. The current nonprofit corporation law has two limitations that can create unnecessary barriers to effective mergers and dissolutions:

1. The statute does not expressly permit mergers between unincorporated nonprofit associations (which are governed by Chapter 59B of the General Statutes) and nonprofit corporations or between nonprofits and limited liability companies (LLCs) that are treated as 501(c)(3) charitable organizations for federal tax purposes.
2. The statute generally requires nonprofits to seek review by the Attorney General of any significant transfers of assets. When a 501(c)(3) nonprofit dissolves, its board of directors has a duty to develop a plan of dissolution to protect its charitable assets by transferring them to another nonprofit. The additional review by the Attorney General often requires a dissolving nonprofit to use a significant portion of its remaining assets for legal fees rather than for charitable purposes.

*Policy solution:*

- The General Assembly could address these issues by passing legislation that: (a) expressly allows for mergers of nonprofit corporations with unincorporated nonprofit associations and with LLCs that are treated as 501(c)(3) tax-exempt entities for federal tax purposes; and (b) exempting transfers of assets of a dissolving nonprofit – if the dissolution is properly approved by the nonprofit's governing board – from review by the Attorney General. These changes were included in H.B. 732 in the 2019 session, which the House unanimously approved.

**Nonprofit annual reports.** Unlike most states, nonprofits incorporated in North Carolina do not file basic annual reports with the state. This means that many defunct nonprofits continue to exist as legal entities in North Carolina. Currently, more than 120,000 nonprofits are incorporated in North Carolina, but only

about 36,000 tax-exempt organizations file some variation of the Form 990 with the IRS. This large and growing number of defunct (but still existing) nonprofits makes oversight of the state's nonprofits more challenging and creates an opportunity for potential fraud and abuse.

*Policy solution:*

- **The General Assembly could address this issue by creating a simple, online, no-fee annual reporting requirement for North Carolina nonprofit corporations. This proposal was included as Part III of S.362 in the 2019 session, which the Senate unanimously approved.**

**Domestication of nonprofits.** In 2014, the Internal Revenue Service issued guidance explaining that tax-exempt nonprofits can change their state of incorporation without having to re-apply for tax-exempt status by following state laws for domestication of foreign nonprofits. Currently, the NC Nonprofit Corporation Act does not allow for domestication of foreign nonprofits, so nonprofits that are changing to their state of incorporation to or from another state must create a new legal entity and then merge or transfer assets from the previous entity to the new entity, and then re-apply for tax-exempt status. This process creates unnecessary costs and administrative burdens for these nonprofits.

*Policy solution:*

- **The General Assembly can address this issue by adopting a form of the domestication provision in the Model Nonprofit Corporation Act.**

**Number of nonprofit directors.** Currently, North Carolina law allows nonprofit corporations to operate with only one board member. A single-member board can make it impossible for a nonprofit to take action on matters if the board member has a conflict of interest. It is also inconsistent with nonprofit best practices guidelines (e.g. the Center's *Principles & Practices: Best Practices for North Carolina Nonprofits* recommends that nonprofits have at least five board members) and with the Model Nonprofit Corporation Act (adopted by many other states), which requires nonprofit corporations to have at least three board members.

There are two situations where it may be reasonable for nonprofits to have a single board member:

1. A foundation that was established by a single individual or family may be able to operate effectively with only one board member; and
2. In some circumstances when nonprofits are going out of business, board members resign while the nonprofit is winding up business and it is difficult to recruit new board members for the dissolving nonprofit.

*Policy solution:*

- **The General Assembly can address this issue by requiring North Carolina nonprofits to have at least three board members with limited exceptions for private foundations and for nonprofits with vacancies in board positions.**

**Electronic voting.** The NC Nonprofit Corporation Act allows nonprofits' boards of directors and members to take actions outside of meetings by unanimous written consent. Under the current statute, nonprofits must include language in their articles of incorporation or bylaws opting in to electronic voting if they want to allow directors or members to use email or other means of electronic transmission for these types of votes. During the COVID-19 pandemic, some nonprofits discovered that their governing documents did not include this "opt-in" language and have had difficulty taking action when members or boards have been unable to meet in person.

*Policy solution:*

- **The General Assembly could replace the current “opt in” provisions for use of email for actions by unanimous written consent with “opt out” language.**

**Reimbursement of board members, officers, and members.** The NC Nonprofit Corporation Act prohibits nonprofits from distributing money or property to its board members, officers, or members. There is an exception from this prohibition for reasonable payments to board members, officers, or members for services they render for the nonprofit. However, the language is unclear about whether this type of reasonable reimbursement is an exception from the statutory definition of a prohibited “distribution” and whether a committee of the board can authorize this type of payment.

*Policy solution:*

- **The General Assembly can add clarifying language to remove this ambiguity from the statute.**

**Charitable solicitation license exemption for small nonprofits.** Currently, the state charitable solicitation statute exempts certain small nonprofits from licensing requirements if they have less than \$25,000 in contributions annually and do not compensate anyone for fundraising. The \$25,000 threshold was established when the Internal Revenue Service (IRS) had a threshold of \$25,000 in annual expenses for filing Form 990 (the annual information return for tax-exempt entities). Because the IRS threshold is now \$50,000, some small nonprofits need to have charitable solicitation licenses – and spend significant time completing paperwork and preparing financial statements – even though they are exempt from basic filing requirements from the IRS.

*Policy solution:*

- **The General Assembly can bring the charitable solicitation licensing exemption into conformance with current federal tax standards by raising this threshold from \$25,000 to \$50,000. This change was included in H.B. 732 in the 2019 session, which the House unanimously approved.**

**Notarization requirements for charitable solicitation licenses.** Currently, the state charitable solicitation licensing law requires nonprofits to have charitable solicitation licensing applications and renewals notarized each year. The notarization requirement creates an extra burden for nonprofits in completing their charitable solicitation licensing documents and does not provide any additional public protection. During the COVID-19 pandemic, many nonprofits have found it difficult to have documents notarized.

*Policy solution:*

- **The General Assembly can eliminate an unnecessary burden by removing the notarization requirement for charitable solicitation licensing paperwork from the statute.**

**Automatic extension of charitable solicitation filing deadlines.** The statutory deadline for filing charitable solicitation licensing applications and renewals was established to be consistent with the deadline for nonprofits’ filing their Forms 990 with the IRS. This makes sense since nonprofits must include their 990s with their charitable solicitation filings each year. The IRS currently allows nonprofits to receive an automatic six-month extension of this filing deadline. The charitable solicitation statute only allows for a three-month automatic extension, and further extensions may be made at the discretion of the NC

Secretary of State. Practically, this creates situations where some nonprofits are unable to file their charitable solicitation paperwork in a timely manner if their Forms 990 have not yet been completed.

*Policy solution:*

- **The General Assembly can address this issue by revising the filing deadline provisions in the charitable solicitation licensing statute to allow for identical automatic extensions to those provided by the IRS.**

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