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Charitable Organizations: Non-Profit Dissolutions and Mergers in the Wake of COVID-19

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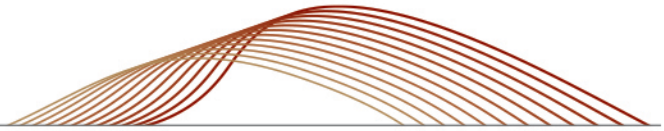
INTRODUCTION

The COVID-19 pandemic has wreaked havoc on numerous aspects of our societal well-being, having created a profound impact on the economic sustainability of many non-profit corporations. We can expect many non-profits to face new challenges in the months ahead, a number of which may impair their ongoing economic viability. Many non-profits conduct in-person fundraising events and hold large in-person conferences and will need to assess their options. Further, opportunities for non-profits to provide essential services while social distancing measures are in place may be limited. Given the innumerable challenges this crisis has presented, some non-profits may be considering whether to dissolve entirely or to merge with another entity in the near future.

In the case of a dissolution, a non-profit typically seeks out the approval of the state's authorities by filing the documentation required to dissolve the entity. The documentation and procedures required for initiating a dissolution varies among states. Approval to dissolve in each state is typically contingent upon the successful "wind-up" of the non-profit's matters, namely satisfying any outstanding debts and distributing any remaining assets in keeping with state and federal requirements.

Under a non-profit merger, the "acquiring" entity takes ownership of all agreed upon assets, including all real and intellectual property of the "acquired" non-profit. The acquiring entity also assumes responsibility for any debts, liabilities, contractual obligations, litigation claims (present claims and potential future claims) and any other encumbrances of the acquired non-profit.

The procedures for dissolution and merger of non-profits are similar in most states, requiring authorization by the non-profit's board of directors, development of a plan of dissolution, payment of liabilities and distribution of assets, coordination with state authorities and notification to the IRS. To illustrate, this article provides a brief overview of the process in New York and California.



DISSOLUTION OF NOT-FOR-PROFIT CORPORATIONS IN NEW YORK

Before filing a petition to dissolve a not-for-profit corporation in New York, the Board of Directors of the corporation (and any other applicable governing body) must approve a plan of dissolution. The necessary documentation and procedures will depend on whether or not the corporation has assets and if it has been granted tax-exempt status. Note that if there are any remaining assets, such assets must be distributed in a manner that is consistent with (i) federal and state law, (ii) the corporation's bylaws or articles of incorporation and (iii) the plan of dissolution.

The next step is to file the plan of dissolution and a proposed certificate of dissolution for approval with the New York State Attorney General's Office ("NY AG"). In parallel, the entity should submit a completed "Request for Consent to Dissolution" form from the New York State Department of Taxation and Finance, which may require submitting additional documentation.

After approval is received from NY AG, the corporation has 270 days to carry out its plan of dissolution, including distribution of assets (if applicable), payment of liabilities and winding up of the corporation's activities. After the corporation's assets have been fully distributed, the corporation must prepare a final financial report showing no assets or liabilities.

Once consent is received from the NY AG and the New York Department of Taxation and Finance, both the certificate of dissolution and consent should be filed with the New York State Department of State.

DISSOLUTION OF NON-FOR PROFIT CORPORATIONS IN CALIFORNIA

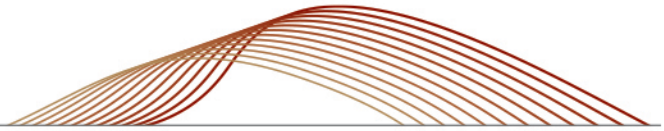
Before filing a petition to dissolve a non-profit corporation in California, the corporation should consult the Articles of incorporation and Bylaws to determine any dissolution restrictions and who must approve dissolution.

Once the dissolution plan is adopted, a Certificate of Election to Wind Up and Dissolve should be filed with the Secretary of State. However, if approval to dissolve was unanimous, a majority can sign a Certificate of Dissolution.

After filing the appropriate certificate with the Secretary of State, the corporation should notify any creditors and claimants. If the notice includes a deadline for claim submission, the deadline must be at least 120 days from the date of notice. After this deadline, the corporation can pay any debts.

Next, the corporation must create a plan for distribution of assets, and seek a waiver of objections from the California Attorney General's Office ("CA AG"). A dissolving public benefit or religious corporation must obtain approval from the CA AG before distributing any surplus assets. Additionally, any mutual benefit corporation that holds assets in a charitable trust must obtain approval from the CA AG before distributing those assets.

Once the distribution plan is approved, the corporation must distribute remaining assets in accordance with the plan. After distribution of assets, the corporation should pay any final taxes and file final returns.



Next, the corporation should file the Certificate of Dissolution as well as the CA AG's waiver letter with the Secretary of State.

Once the corporation receives a certified copy, it can be sent to the Registry of Charitable Trusts at the CA AG along with a financial report showing that all assets were distributed.

MERGER OF NOT-FOR-PROFIT CORPORATIONS IN NEW YORK

In New York, every merger or consolidation of a not-for-profit charitable organization must be approved by the NY AG and/or a New York State court. If approval from the NY AG is sought, it may also determine that court review of a particular petition is appropriate, for example, if there is opposition to or complaints about the merger from members of a constituent corporation or the public.

In addition to securing approval of the NY AG or the applicable court, merging and consolidating corporations must secure the approval or consent of their boards of directors, and any other applicable governing body.

Before submitting the petition, the first step in a merger is the adoption of a plan of merger or consolidation, which should be approved by the boards of directors and applicable governing bodies of each corporation proposing to merge. The plan should identify the merging entities and set forth the terms and conditions of the merger.

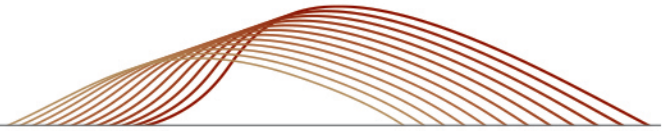
After the plan of merger or consolidation is approved, a certificate of merger or consolidation in accordance with applicable law must be signed on behalf of each constituent corporation.

Corporations that are required to be registered with the NY AG's Charities Bureau must comply with the applicable registration and annual financial reporting requirements prior to the merger or consolidation.

Once the plan is approved internally and the certificate of merger or consolidation is prepared, the parties to a proposed merger must prepare a joint affidavit, signed on behalf of both corporations, or a verified petition to the NY AG or the Court seeking approval of the merger, accompanied by a number of documents and exhibits including the plan, corporate approvals and constitutive documents. The NY AG may request additional documents and information needed in order to review the petition. If the petition is made to the Court, it must be accompanied by a proposed order of the Court.

Upon completion of the review of the petition for approval of the plan and certificate of merger or consolidation, the NY AG may provide approval of the petition.

If the NY AG does not approve the petition or there are other parties that object to the merger and wish to be heard by the Court, application must then be made to the Court, on notice to the NY AG



and any other appropriate parties, for an order approving the merger. If the Court finds that the applicants have complied with provisions of law applicable to mergers, and that the interests of the constituent corporations and the public interest will not be adversely affected by the merger, it will grant an order approving the plan and certificate of merger.

After the applicable court or the NY AG has approved the merger, the certificate of merger must be must be filed with the New York State Department of State, together with the written approval of the NY AG or the court order of approval, as applicable. In addition, the surviving corporation must file a certified copy of the certificate with the county clerk of each county in which the office of a constituent corporation, other than the surviving corporation, is located, and with the office of the recording officer in each county in which real property of a constituent corporation, other than the surviving corporation, is situated. A copy of the certificate of merger must also be filed with the Office of the NY AG.

A merger becomes effective upon the filing of the certificate of merger by the Department of State, or on a later date, as stated in the certificate of merger, which may not be more than 30 days after such filing.

MERGER OF NON-FOR PROFIT CORPORATIONS IN CALIFORNIA

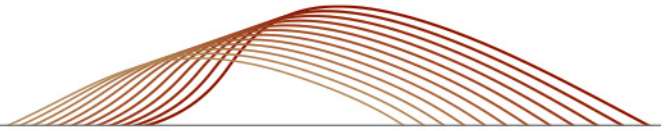
In California, mergers generally require written consent of the CA AG. However, depending on the type of non-profits that are merging, a merger may occur without written consent. For example, a non-profit categorized as a public benefit corporation under California law may merge with another public benefit corporation or a religious corporation without written consent of the CA AG.

Generally, an agreement of merger should be approved by the boards of the merging non-profits. This agreement generally includes details such as the terms and conditions of the merger; amendments to the articles of the surviving non-profit, amendments to the bylaws of the surviving (or acquiring) non-profit to be effected by the merger, name and place of incorporation of each constituent non-profit, which of the constituent non-profits is the surviving entity, etc.

The principal terms of mergers should also be approved by members and any persons whose approval is required by the respective articles of each non-profit. Each non-profit shall also provide a certificate signed and verified by the chair of the board, the president or any vice president and by the secretary, the chief financial officer, the treasurer or any assistant secretary or assistant treasurer.

Non-profit mergers will also generally require 20 days' prior notice to the CA AG along with a copy of the proposed agreement of merger. When a non-profit merges, the CA AG requires that it first distribute all of its assets to another charity with the same or similar purposes. Applications will generally include a letter signed by an attorney or a director of the non-profit setting forth the proposed action, copy of the resolution authorizing the proposed action, board meeting minutes, financial statements, and articles of incorporations.

After the necessary approvals, the Agreement of Merger and officers' certificates should be filed with the Secretary of State. More information regarding specific merger requirements are discussed in California Corporations Code sections 6010 et seq. for public benefit corporations, sections 8010 et



seq. for mutual benefit corporations, section 9640 for religious corporations; and sections 12530 et seq. for general cooperative corporations.

DISCLAIMER

The information in this article is not a substitute for legal advice from an attorney but has been drafted to provide guidance to those preparing applications to dissolve, merge or consolidate not-for-profit corporations.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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