

Public charities must heed dissolution guidelines

by jennifer.gallop

Published: February 2nd, 2011



Massachusetts public charities such as health care organizations, schools, foundations and churches may decide to cease operation because of a variety of factors. In recent years, economic pressures, dwindling membership and/or deteriorating facilities each have played a role in industry consolidation.

In the past, officers of a public charity may have considered walking away rather than going through a proper dissolution process. Indeed, many defunct charitable organizations and even some public charities are noncompliant with the registration and/or annual filing requirements as posted on the attorney general's website.

Now, effective as of Jan. 1, significant penalties can be imposed against an officer or agent for failure to register and report to the attorney general in a timely manner. See Chapter 165 of the Acts of 2010, An Act Further Regulating Public Charities (the "act,"

Sections 1 and 3). The longer an organization waits to come into reporting compliance, the more the officers and directors are exposed to potential public enforcement action.

New reforms

The AG's Non-Profit Organizations/Public Charities Division is charged with ensuring that charitable assets are managed appropriately during a wrap-up process. The NPO Division has sometimes encouraged organizations on the brink of closure to merge with another entity, such as the entity likely to succeed to its assets, rather than dissolve.

That was because, more often than not, charitable organizations did not have the financial and human resources, including active board involvement, to shepherd what could often be a lengthy, complicated and sometimes costly dissolution process, one requiring both attorney general and judicial approval.

But merger is not always an available option due to successor liability concerns and cultural differences between the organizations, among other factors.

As part of the NPO Division's efforts to reform and update the public charities laws, significant changes to the statutorily mandated dissolution process were recently implemented under Section 10 of the act (amending G.L.c. 180, §11A, effective July 19, 2010), which were meant to simplify procedures and enhance compliance.

The law now permits corporations with no remaining net assets to dissolve through an administrative dissolution petition filed with the NPO Division, and without Supreme Judicial Court approval. Section 11A(c).

The provision only applies, however, for organizations that never operated or received any funds, currently have no remaining funds, or will have no remaining funds or property or a negative fund balance after payment of liabilities, including the costs associated with wind-up and dissolution, even where there will be debts and liabilities that will remain unpaid.

The act also authorizes the SJC to adopt rules permitting a similar administrative dissolution process for public charities with remaining net assets below a threshold, as determined by the SJC. Section 11A(d). Until such time as the SJC acts, however, all public charities with remaining net assets of any amount must still seek AG assent and SJC approval thereafter.

Attorney general offers guidance

In response to the act, the NPO Division released new guidance in October 2010 substantially revising the process for dissolving public charities. The step-by-step instructions contain model documents, forms and FAQs for dissolving charitable organizations both with and without assets.

One new change affecting all charities subject to annual filings (i.e., excluding churches), of which both attorneys and accountants should take note, is that a new Form PC-F (final) must be filed to determine whether or not there will be remaining net assets. Where an organization's liabilities are greater than its assets, the Form PC-F requires that the organization provide a list with the names of any creditors and amounts due.

The Form PC-F also requires detailed information concerning any amounts paid to a related party (including in-kind gifts). In addition, information is required as to whether and how any restrictions were removed from donor-restricted funds.

The new steps to dissolve a charitable organization without remaining net assets under the attorney general's "Dissolution Guidance" are as follows:

- Confirm compliance with all registration and annual filing requirements, including annual reports and Form PC for each of the last four years. Or, if the organization is exempt, prepare an alternative financial report summarizing the last three years' of financial activities for submission (noncompliance for periods prior to the applicable three/four years is ignored and waivers may be granted for current noncompliance in the NPO Division's discretion);
- Take the required board action in accordance with legal and bylaw notice and voting requirements for dissolution, and obtain an officer's certificate attesting to the action and its adequacy;
- Complete the new Form PC-F; and
- Prepare the administrative dissolution petition.

The administrative petition must address the following requirements: (i) indicate why the public charity is dissolving; (ii) state compliance with registration and reporting requirements; (iii) affirm appropriate dissolution procedures followed; (iv) confirm all funds were used to support, and/or were disbursed consistent with, the organization's mission, and (v) acknowledge that the attorney general's approval of the dissolution does not operate to waive or release any financial liabilities to third parties that might otherwise exist. In addition, other relevant circumstances should be detailed.

When assets remain

The NPO Division provides guidance on the alternative financial report, and a sample officer's certificate of vote and administrative petition are included in the Dissolution Guidance. After the final notice of dissolution is received from the Attorney General's Office pursuant to the process; the charitable organization should notify all appropriate federal and state agencies, including the secretary of state, Internal Revenue Service, Department of Revenue, and other state and regulatory agencies with whom the organization has business.

The different steps under the Dissolution Guidance for public charities with remaining assets are as follows:

1. After confirming compliance with registration and filing requirements, board action must delineate if assets being transferred are restricted or unrestricted, and provide that the entity to which assets are transferred have a charitable purpose similar to that of the dissolving organization and agree to use the assets in accordance with the dissolving organization's purpose;
2. After the Form PC-F is completed, a judicial dissolution complaint, motion for interlocutory order and order must be submitted to the NPO Division for the attorney general's assent before filing with the SJC; and
3. After the organization transfers the assets in accordance with the SJC's order, the NPO Division's assent is also required for the final dissolution filing: an affidavit of compliance confirming the asset transfer(s), affidavit(s) of receipt indicating the type of assets, value and date of receipt of

the transfer(s) and the motion for entry of judgment.

Even with the newly simplified process, the Dissolution Guidance makes clear that the NPO Division still encourages public charities to spend all of their remaining funds in accordance with their organization's mission and not to inappropriately expend remaining assets and dissolve on their own.

A charitable organization that generally makes grants may make a final grant of all of its assets, less those needed to fund the expenses of dissolution, in order to qualify for the administrative dissolution process. However, where there is material change in the asset use or modification of donor restrictions, a cy pres petition may be needed.

Further, when a public charity chooses to sell or transfer assets for less than fair market value, the organization may be required to file a petition with the SJC (single justice session for Suffolk County), following the principles articulated in *Massachusetts Charitable Mechanic Ass'n v. Beede, et al.*, 320 Mass. 601 (1947).

The attorney general also released new Section 8A(c) guidance regarding the process that a public charity must follow if it wishes to transfer all or substantially all of its assets and materially change the nature of its activities, which often proceeds a dissolution. See also "Public Charities Alerted to Guidelines on Asset Transfers," *Massachusetts Lawyers Weekly*, Nov. 22, 2010.

Considering the increased compliance obligations placed on officers and directors of public charities under the act, counsel should inform board members of their obligation to ensure that organizations do not cease existence in an inappropriate manner.

The attorney general's Dissolution Guidance is a significant step in assisting charitable organizations to suspend their activities legally.

Jennifer Gallop is a partner at Krokidas & Bluestein in Boston where she practices in the areas of health care, non-profit and administrative law. She is a member of the Attorney General's Non-Profit Organizations/Public Charities Division Advisory Committee and participated in the 8A Advisory Group.

Complete URL: <http://newenglandinhouse.com/2011/02/02/public-charities-must-heed-dissolution-guidelines/>