With funding from New York State being held up and no end in sight, cash flow at many nonprofit organizations is getting tight. Moreover, because contracts with New York State for the fiscal year that began April 1, 2010 have not yet been registered, some traditional avenues of bridge financing are not available. To meet payroll and other emergency expenses, nonprofit Board and staff members may be considering making loans to the organization to be repaid when monies from the State begin flowing again. Before accepting a loan from a Board or staff member, the organization should consider the information below.

Questions:

1. Is it allowable for individuals to loan money to the nonprofit organization on whose board they serve?
2. Is it allowable for staff members to loan money to the nonprofit organization that employs them?
3. How is it determined that the loan is in the best interest of the corporation?
4. Does the Board of Directors need to vote on accepting the loan?
5. If the Board or staff members decide to forgive the loan, can they take a tax deduction?

Answers:

1. Is it allowable for individuals to loan money to the nonprofit organization on whose board they serve?

Yes, it is allowable for board members to loan money to the nonprofit organization on whose board they serve. However, because this is a transaction between a person with a fiduciary duty to the organization (i.e. the board member) and the organization, there is the appearance of a conflict of interest. Whenever a situation or transaction might benefit (either directly or indirectly) the personal interests of a director (for example, establishing terms for the loan or deciding when loan repayment will occur), there will exist a conflict of interest. The organization must review its conflict of interest policy to determine what steps need to be taken to determine that the loan is in the best interest of the corporation and to approve the terms of the loan.

2. Is it allowable for staff members to loan money to the nonprofit organization that employs them?

Yes, it is generally allowable for staff members to loan money to the nonprofit organization that employs them. The organization should review its personnel policies to make sure that accepting the loan is not prohibited by the policies. If the staff member is an individual “in a position of substantial authority” (for example, the Executive Director or Chief Financial Officer) then they will have a fiduciary duty to the organization, and as with the loan from the board member, there is a potential conflict of interest. The organization must review its conflict of interest policy to determine that the loan is in the best interest of the corporation and to approve the terms of the loan.
3. **How is it determined that the loan is in the best interest of the corporation?**

Accepting the loan will be considered in the best interest of the organization if the loan proceeds are needed to fund programming and the terms of the loan are the same or better than the organization would receive from an unrelated party. It is important that there is a promissory note or loan agreement that establishes the terms of loan: (i) the amount of the loan; (ii) the interest rate; (iii) the term of the loan; and (iv) how the loan will be repaid.

The organization should review its conflict of interest policy to see if it includes a process for researching fair market value of a transaction. For example, the organization could research the terms and cost of securing a loan in the same amount from a traditional lender. The Internal Revenue Service provides a sample conflict of interest policy that can offer guidance if the organization does not have its own. [http://www.irs.gov/instructions/i1023/ar03.html](http://www.irs.gov/instructions/i1023/ar03.html).

Typically, the conflict of interest policy will require that:

1) The conflict must be disclosed to the Board in writing;
2) The interested person must be excluded from any discussions by the Board of the transaction, unless responding to a request for information; and
3) The interested person must be excluded from the vote of the Board on any matter in which he or she has a conflict of interest.

Disclosure of conflicts and any action taken in response to the conflict, including noting the procedures followed in accordance with the organization’s conflict of interest policy, should be recorded in detail in the Board meeting minutes.

4. **Does the Board of Directors need to vote on accepting the loan?**

Yes, the Board of Directors should approve the acceptance of a loan from a member of the Board of Directors or a staff member. This will help evidence the fact that the financial transaction between the organization and its Board or staff member is legitimate. Additionally, under the New York Not-for-Profit Corporation Law (NPCL), an interested party transaction may be voidable by the corporation if: (i) there is no evidence that the transaction is fair and reasonable to the corporation; (ii) the conflict is not disclosed in good faith or known to the Board; and (iii) the transaction is not properly approved by a vote of the Board without counting the interested person’s vote. Depending on the facts, a director or officer who fails to make proper disclosures may be subject to a charge of breach of the duty of loyalty by the Attorney General.

5. **If the Board or staff members decide to forgive the loan, can they take a tax deduction?**

A Board or staff member can choose to forgive a debt and take a charitable deduction for the amount forgiven if there is valid evidence of an enforceable loan. For example: A board member loans money to a nonprofit organization that the organization cannot repay. For the board member to forgive the loan and take a charitable deduction for the amount forgiven, there must be a promissory note or loan agreement evidencing the obligation of the organization to repay the board member.

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