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Legal Alert: Should a Nonprofit Organization Incorporate in New York or Delaware?

Nonprofits operating in New York City frequently assume that they have no choice but to incorporate in New York State. However, New York is not the only option. Delaware is becoming an increasingly popular choice for nonprofits because of the potentially friendlier legal regime. Whether to incorporate in New York or Delaware is an important question that should be evaluated carefully. Nonprofits should consider all relevant facts, e.g., where it plans to fundraise and operate its programs, the organization's capacity to incur ongoing costs, and ability to navigate multiple state compliance regimes. This Legal Alert will highlight some of the key differences between the legal regimes applicable to nonprofits in New York and Delaware.

Governing Law

New York has a separate statutory regime for nonprofit corporations through the New York Not-for-Profit Corporation Law (the N-PCL) as well as an active charity oversight function under the New York State Attorney General's Charities Bureau (the Charities Bureau). Delaware, on the other hand, puts both for-profit corporations and nonprofit corporations under the jurisdiction of Delaware's General Corporation Law (DGCL) and does not have a Charities Bureau equivalent.

It is well known that most business corporations in the country, regardless of where they operate, incorporate in Delaware, largely because the DGCL is so well-developed and because it is largely adjudicated in a separate court dedicated to settling business disputes called the Delaware Court of Chancery. However, the DGCL may also afford certain advantages to nonprofits, depending on certain factual circumstances of the organization and its planned activities. If an organization's activities in New York rise to a certain threshold level, certain registration, annual disclosure and filing requirements under the N-PCL are triggered,¹ regardless of where the nonprofit is incorporated. If however, planned activity does not meet these threshold levels, mandating compliance with New York state law, the nonprofit may take advantage of the less onerous requirements of the DGCL. It is important to note that organizations incorporating in Delaware but operating in New York will need to obtain certificate(s) of authority in order to conduct programs or provide services in New York.² Additionally, in order to

¹ N-PCL §1301(a) bars foreign corporations from conducting activities in New York unless it is authorized for such activities. See N-PCL §1301(b) for a non-exhaustive list of acts on their own "which may not constitute conducting activities [by a foreign corporation]" e.g., maintaining bank accounts or defending any action or proceeding (whether judicial, arbitral or otherwise) and holding board meetings in New York.

² Foreign corporations may apply to conduct activities and enjoy the same rights and privileges granted to New York not-for-profit corporations under N-PCL §1304; however, certain program activities may require consents from local government authorities, e.g., New York City Department of Education, under N-PCL § 404.

solicit charitable contributions in New York, foreign corporations must register with the Charities Bureau under Article 7-A of the Executive Law and make annual filings.³

N-PCL vs. DGCL

Generally, the New York nonprofit regime is stricter and more comprehensive than the DGCL. For example, the N-PCL requires strict internal governance of nonprofits, including restrictions on who can serve as board chair⁴, the requirement for annual conflict of interest disclosures of board directors, officers and key persons⁵ and required regulatory approvals for actions like mergers or consolidations⁶. In addition, New York requires three initial board directors to incorporate a nonprofit⁷ and, depending on the planned activities, certain activities may require regulatory approvals from state and local city agencies with jurisdiction⁸. The N-PCL also requires additional oversight over certain events and transactions. In order for a New York not-for-profit corporation to dissolve outside of the courts, for example, it must go through a multi-step process involving the Attorney General, New York State Department of Taxation and Finance, and the New York State Department of State, as well as any other state agencies with jurisdiction over the dissolving entity.⁹ A New York not-for-profit wishing to "sell, lease, exchange or otherwise dispose of all or substantially all its assets", must either petition a state court or the attorney general for approval under N-PCL §§ 511 and 511-a. Even a change to the purpose clause in the certificate of incorporation requires approval by the Attorney General.

Delaware does not have such an active regulatory system for its nonprofits. The Delaware Attorney General does not preapprove or review corporate transactions of its nonprofits.¹⁰ In stark contrast to the process in New York, dissolution of a nonprofit Delaware corporation under the DGCL solely requires that the nonprofit be current on its annual tax reports before the nonprofit can take the few relatively simple corporate actions required to dissolve upon a majority vote of its directors per DGCL § 242(b)(3). Registration with the Delaware Attorney General is not required and nonprofits wishing to make corporate changes such as amendments to its certificate of incorporation, mergers and dissolutions do not need state government approval.

³ See Section 172-a of the Executive Law for a list of certain categories of organizations, namely religious organizations, that are exempt from registration (posted on www.charitiesnys.com).

⁴ Under N-PCL §713, employees of a New York nonprofit cannot serve as board chair or president of the board (or hold any other title with similar responsibilities) unless 2/3 of the entire board approves such employee serving as chair; provided, that "no such employee may be considered an independent director under [Article 7 of the N-PCL]".

⁵ New York nonprofits must adopt and oversee a conflict of interest policy mandating required internal approval processes for "related party transactions" and annual disclosures of potential conflict of interest by board directors, officers and key persons. See N-PCL §715-a.

⁶ See Article 9 of the N-PCL.

⁷ See N-PCL § 402.

⁸ For example, any organization that includes among its purposes the care of foster children must obtain approval of the commissioner of the office of children and family services per N-PCL §404(b)(1). See N-PCL § 404 for all required consents.

⁹ See Article 10 of the N-PCL for the processes required for nonprofits that wish to pursue non-judicial dissolution. Per N-PCL § 1101, the attorney general may also bring a judicial action for dissolution of a New York nonprofit.

¹⁰ However, if the assets involved are funds that are being solicited in New York, New York state laws must be followed regardless of the nonprofit's incorporation in Delaware.

Other considerations

Delaware also has a simpler and speedier process of incorporation. Only one board member is required for governance of the nonprofit¹¹ and no regulatory agency consents are required.¹² Incorporation can be as quick as filing a certificate of incorporation for a nonstock exempt corporation and paying the filing fee with the Delaware Secretary of State Division of Corporations per DGCL § 101. One drawback, however, is that although the Delaware process is much simpler and quicker, a Delaware nonprofit is required to engage and maintain a "Registered Agent" whose purpose is to receive all legal documents on behalf of the nonprofit in Delaware.¹³ A Registered Agent can cost hundreds of dollars each year to maintain. There is no such requirement in New York.

Other regulatory simplicities of the Delaware system for nonprofits include automatic exemptions from various state and local taxes for nonprofits that are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.¹⁴ In New York, 501(c)(3) nonprofit organizations must separately apply for state and local tax exemptions for corporate franchise taxes, property taxes and sales taxes. Additionally, all New York nonprofits are required to submit annual filings with the New York Attorney General on the state-specific CHAR 500 form, whereas Delaware nonprofits conducting activities in Delaware simply file a copy of its federal Form 990 with the Delaware attorney general. It is clear that the New York regime for not-for-profit corporations is more burdensome than Delaware's from a regulatory perspective. However, compliance with New York State's regulatory requirements may be unavoidable if any significant activity or funding is planned to occur in New York City or elsewhere in the state. A nonprofit incorporated in Delaware that solicits funds or is "conducting activity" in New York will fall under the New York regime, creating duplicative reporting requirements. Nonprofits incorporating in Delaware will be subject to less regulatory oversight and greater ease of corporate changes, such as dissolution, but should also consider the ongoing annual expense of maintaining a Registered Agent if incorporated in Delaware.

This alert is meant to provide general information only, not legal advice. For further questions or information, please contact Ciarra Chavarria at 212-219-1800 ext. 228, cchavarria@lawyersalliance.org, or visit our website www.lawyersalliance.org.

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¹¹ See DGCL § 141(b).

¹² It should be noted, however, that a Delaware nonprofit that plans to run programs in New York coming under regulatory purview of New York agencies (e.g., the Department of Education for organizations with certain educational missions), the relevant agency consent(s) will still be necessary as part of its application for authority to conduct activities in New York.

¹³ See DGCL § 1910.

¹⁴ See Section 1902(b) of Title 30 of Delaware Code.