

Leasing Issues for Tax Exempt Entities

Under the NY Not-for-Profit Corporations Law (N-PCL), an entity may qualify as either a charitable or non-charitable not-for-profit corporation if the ordinary purpose of the corporation is not for pecuniary profit or financial gain. (NY Not-for-Profit Corp. L. § 102 (McKinney)). An entity may qualify as a religious corporation under the NY Religious Corporations Law if created primarily for religious purposes. (NY Relig. Corp. L. § 2 (McKinney)). If a registered not-for-profit corporation or a religious corporation seeks to enter a real property lease as a landlord, the corporation must abide by a particular set of requirements.

The NY Not-for-Profit Corporations Law and NY Religious Corporations Law govern these situations. A good starting point considers whether the entity is registered as a not-for-profit corporation or a religious corporation, as some requirements differ between each entity. The requirements also differ depending on whether the entity is leasing out property it owns (acting as a landlord), or looking to lease property for its own use (acting as lessee).

A. Not-for-Profit Corporation

Authorization

Section 509(b) of the Not-for-Profit Corporations Law states that “[n]o corporation shall sell, mortgage, lease, exchange or otherwise dispose of its real property unless authorized by the vote of a majority of directors of the board or of a majority of a committee authorized by the board” So, in order to lease property to a tenant, a not-for-profit entity must obtain authorization for the transaction from its board of directors. For an isolated transaction involving real property, the entity must obtain authorization by “the vote of a majority of directors of the board or of a majority of a committee authorized by the board.” (§ 509(b)). However, if the transaction involves “*all, or substantially all*, of the assets of the corporation,” the entity must obtain authorization by two-thirds of the entire board or, if there are twenty-one or more members, authorization by the vote of a majority. (§ 509(b) (emphasis added)). Each entity’s bylaws may provide further voting requirements. If the not-for-profit is leasing property for its own benefit, board approval is not required, although it may be obtained as a precaution.

For a transaction involving all or substantially all of a non-charitable corporation’s assets, the board must adopt a resolution specifying “terms and conditions of the proposed transaction, including the consideration to be received by the corporation and the eventual disposition to be made of such consideration, together with a statement that the dissolution of the corporation is or is not contemplated thereafter.” (§ 510(a)(1)). If the board passes the resolution, the corporation’s members (if any) must subsequently approve it. The members may approve the transaction as specified in the board’s resolution, or the members may approve the transaction while authorizing the board to modify the terms and conditions of the transaction. (§ 510(a)(1)).

Approval

On the other hand, a charitable corporation (a Type B, Type C, or Type D with charitable purposes), must not only obtain board and member approval for a sale or lease of real property

constituting all or substantially all of its assets, but “shall **in addition require approval of the attorney general or the supreme court** in the judicial district or of the county court of the county in which the corporation has its office or principal place of carrying out the purposes for which it was formed” (§ 510(a)(3)).

To obtain Attorney General (AG) review under N-PCL § 511-a:

1. Corporation submits a draft petition to the AG before submission to the court, allowing the AG to perform a preliminary compliance review (note, this is not available to insolvent corporations)
2. The AG may require additional information while reviewing the petition
3. The AG can approve the transaction by writing “Attorney General’s Approval” on the petition

Note – this method is preferred by the Charities Bureau.

To obtain Court approval, with notice to the AG under N-PCL § 511:

1. Corporation files a verified petition with the court
2. Corporation must give AG at least 15 days’ notice before a hearing on the petition
3. The AG will grant a “no objection” endorsement on the petition if it complies with all requirements, or the AG may require the corporation to give notice to interested parties and have a hearing before the court

Both the court and the AG apply the same standard of review when evaluating a not-for-profit corporation’s proposed transaction. The court and AG consider two prongs:

1. Whether the terms of the transaction are fair and reasonable to the corporation, and
 - a. Valuation: while not explicitly required by the Not-for-Profit law, case law suggests that an independent appraiser should value the property using at least three comparable sales.
 - b. Conflicts of Interest: the court and AG consider whether an officer, director, member, employee, or other party has an interest in the transaction
2. Whether the transaction serves the purpose of the corporation or its members.
 - a. Proceeds: any proceeds obtained from the transaction must be distributed or allocated according to the corporation’s charitable purpose; they cannot be used to benefit a particular director, officer, member, etc.

Transactions involving interested parties, such as directors, officers, or members, must comply with additional requirements as stated in N-PCL § 715.

B. Religious Corporations

Authorization

Like not-for-profit corporations, the board and members of religious corporations must authorize the transaction. However, a particular religious sect may have specific quorum requirements stated in the Religious Corporations Law (for example, RCL § 134 lists requirements for corporate meetings held by Baptist Churches).

Approval

Section 12 NY Religious Corporation Law provides that “a religious corporation shall not sell, mortgage or lease for a term exceeding five years any of its real property without applying for and obtaining leave of the court or the attorney general therefore . . .” pursuant to the requirements in N-PCL § 511 and § 511-a. A specific list of churches are only required to seek court approval, and need not notify the AG. Unlike for not-for-profit corporations, court or AG approval is required *even if* the property does not constitute all or substantially all of the religious corporation’s assets. Purchase money mortgages and purchase money security agreements do not require court or AG approval.

The court and AG apply the same two-prong test to both religious corporations and not-for-profit corporations: whether the transaction is fair and reasonable and whether it serves the purpose of the religious corporation or its members. (N-PCL §§ 511(d), 511-a(c)). While most religious entities should obtain an appraisal to demonstrate the fairness of the transaction, a solvent religious corporation seeking to convey property to “another religious corporation, or to a membership, educational, municipal or other non-profit corporation” need not obtain an appraisal if the transaction is for nominal consideration. (RCL § 12(8)).

C. Other Considerations

Attorneys should be aware that several issues may arise when a not-for-profit or religious corporation engages in a real property transaction. These issues include:

1. Tax implications – such as private benefit and private inurement rules; may also incur penalties under the IRS and New York State
2. Conflicts of interest – such as when a board member or director has a financial stake in the transaction
3. Particularized requirements for public versus private charities – such as self-dealing and excess benefit transactions
4. Unrelated Taxable Business Income (UBIT)

Summary:

Entity Type	Applicable Law	Board approval required to act as landlord?	Court or AG approval required to act as landlord?	Board approval required enter lease as lessee?
Not-for-Profit Corporation: <i>non-charitable purpose</i>	NY N-PCL §§ 509–511-a	Yes	No	No*
Not-for-Profit Corporation: Type B, Type C, or Type D corporation with <i>charitable purpose</i>	NY N-PCL §§ 509–511-a	Yes	Yes, if transaction involves “all or substantially all” of corporation’s assets	No*
Religious Corporation	NY RCL § 12 NY N-PCL §§ 509–511-a	Yes	Yes, regardless of size of assets* (but – leases for less than a 5-year term do not require approval)	No*

*Bylaws of the individual entities may impose additional requirements.