

March 28, 2008
AARC Chartered Affiliates Leadership Workshop

I appreciate the privilege of being able to speak to you today. I have been associated with the AARC as its legal counsel for more than 25 years and during that period have come to appreciate the work the Association does for the respiratory care profession and the professional manner in which you accomplish your work. It is an honor to be associated with the AARC.

You are to be admired and respected for your willingness to give your time, talent and labor to enhance and better your profession without compensation or other reward. I wish I could stand before you and tell you that accepting the role of an Officer and a Director of a not-for-profit tax exempt organization is merely an honorary title, involving little personal risk or aggravation, with high professional recognition and limited time required. Sadly that is not true. Today, in our litigious society, the role of an Officer requires a high degree of active participation, requiring inquiry into management decisions and careful monitoring of investment activities, personnel and other operating policies. While this may appear to simply be common sense, it is the failure of the Officers and Directors of companies like Enron, World Com and Health South that have made the news over the last few years.

The **honor** of being elected to serve is still present or no one would ever accept all of the duties and responsibilities that come with the title. However, Officers, as well as Directors, are now being held to higher levels of accountability than ever before to maintain the trust of the constituent members they serve.

The goal of this presentation is to answer the following questions:

- (i) What distinguishes a for profit corporation from a tax exempt corporation?
- (ii) What is a Section 501(c)(6) organization and is it the same as a Section 501(c) (3) organization?
- (iii) What duties and liabilities have you implicitly assumed by agreeing

to become a director of a not for profit tax exempt association?

As a matter of **state** law the AARC is defined as a not-for-profit corporation. As a matter of **federal** law the American Association for Respiratory Care is a Section 501(c)(6) tax-exempt trade association. Not-for-profit corporation, sometimes referred to as Non profit corporations, exist to accomplish specific purposes. Whatever their purpose, however, all not-for-profit corporations must operate in compliance with (i) state and (ii) federal laws and regulations.

State Law:

The American Association for Respiratory Care was organized under the Illinois Nonprofit Corporation Act, in accordance with its Articles of Incorporation, which were accepted by the State of Illinois. A corporation's Articles of Incorporation provide the basic structure of any corporation, whether for profit or not for profit, setting forth the corporation's name, its purpose. Those persons who are charged with the responsibility of fulfilling the overall objectives of any corporation are referred to as the Board of Directors of the corporation.

Applicable state law charges the Directors of the corporation with certain responsibilities, including the responsibility to adopt Bylaws to govern the corporation. The Bylaws discuss, in detail, the management and regulation of the Corporation. The Bylaws cannot, however, contain any provision which conflicts with the provisions of the Articles of Incorporation. The Bylaws may be adopted, altered, amended, or repealed only by the corporation's Board of Directors, unless the Articles of Incorporation state otherwise.

It is the responsibility of the Board of Directors to supervise the Officers of the corporation. If committees are authorized, it is the Board of Directors who oversees the work of the committees. The officers and/or the committees may assume much of the day to day tasks of running the organization and ensuring that the corporation accomplishes the objectives set by the Board of Directors. More often than not such committees should make recommendations to the Board of Directors seeking ratification of the

Committee's recommendations.

In general, the Board of Directors first determines the overall objectives of the Corporation, then determines its direction, then sets its policies, and finally creates committees or appoints or employs personnel to implement those policies. From time to time the Board may find it necessary or helpful to re-evaluate the corporation's objectives, policies, and procedures to ensure they are consistent with the purposes for which the corporation was formed. The Board of Directors may evaluate the performance of the corporation's committees or officers to ensure they are effective in carrying out the Board's policies. In a traditional corporation where officers are elected by the Board, such officers may also be fired at the pleasure of the Board. In the case of most Chartered Affiliates, all Officers are elected and automatically serve as members of the Board of Directors.

As a matter of law the Board of Directors is responsible for all aspects of the life of the corporation: they set policy and they arrange for policy to be carried out. The Board of Directors may delegate certain authority to officers, committees, employees, or agents, but responsibility for the overall management of the corporation's affairs is retained by the Board. Certain authority may not be delegated, for example, appointing or removing members, altering the Bylaws, amending the Article of Incorporation, adopting a plan of merger, or dissolving the corporation. The provisions which allow Directors to delegate authority recognize that members of the Board may not have the time or expertise to manage personally all the activities of the organization on an ongoing basis.

Duties/Liabilities:

State law recognizes the responsibility of the Board and curbs the power of the Board by imposing standards of legal liability of the Board of Directors for their actions. The Board of Directors is solely responsible to the members of the organization. The Board of Directors has a fiduciary duty to the members of the organization who elected them. To be specific, such duties include a duty of loyalty, a duty of honesty, and a duty of care. If this trust is violated, then Directors may be personally liable for the breach. In other

words, in the case of a nonprofit corporation a Director must always act for the benefit of the Association's members.

In addition to being legally liable to the members of the organization, the Board of Directors is subject to change by vote of its members, if the members of the nonprofit corporation have been given the right to vote in the corporation's bylaws. Thus, at the annual meeting of the members, when Directors are elected, the members may exercise a measure of control over the organization by electing Directors who mirror their concerns and interests.

What do these powers and duties mean when applied to the Officers Directors of a Chartered Affiliate?

It means the Board of Directors of your Chartered Affiliate is in charge of your Society and ultimately answers to the members of the Society for its actions. As a result, Directors of a Chartered Affiliate have a fiduciary duty to manage the affairs of the Society so that its property will be used for the purposes for which it was entrusted to the Chartered Affiliate. As mentioned before, a director is a fiduciary and must act solely for the benefit of members of the Chartered Affiliate in scrupulous good faith and candor. A fiduciary duty is the highest form of a legal duty owed by one person to another. These **fiduciary duties** can be summarized as follows:

1. Duty of Loyalty -- The duty of loyalty for a Director requires that he or she not exploit their Society's opportunities, or misuse inside information, or cast a vote on a matter in which a Director has an adverse interest.
 - (a) Doctrine of Corporate Opportunity: Where a business opportunity is in line with the Chartered Affiliate's activities, and is one in which the Chartered Affiliate has a legitimate interest or expectancy, the opportunity belongs to the Chartered Affiliate. A Director who diverts the opportunity and embraces it as his own will be considered a constructive trustee for the benefit of the Chartered Affiliate and will be required to hold all of the profits and benefits received from that opportunity for the benefit of the Chartered Affiliate.
 - (b) Use of Inside Information: Moreover, a Director who acquires

special knowledge or information by virtue of his fiduciary relationship with their Chartered Affiliate is not free to exploit that knowledge or information for his or her own personal benefit. Just as a trustee has no right to retain for himself the profits yielded by property placed in his possession but must account to his beneficiaries, a Director of a Chartered Affiliate who is entrusted with, or obtains potentially valuable information, may not appropriate that asset for his or her own use. A Director may also be held accountable if he or she discloses such information to another person who then gains an advantage over members of the general public or over the Chartered Affiliate and its members.

- (c) **Conflicts of Interest:** A conflict of interest is defined as any situation in which a Director has a direct or indirect outside personal interest which has the potential of being contrary to the best interests of the Chartered Affiliate. It is not possible to describe all the specific circumstances and conditions that might be considered conflicts of interest. Any question that might arise with regard to potential conflicts should be discussed with the Board of Directors. In order to guard against Conflicts of Interest I worked with Jill Jacoby in 1986 to develop a Conflicts of Interest Statement and Questionnaire.

In the event any Director of a Chartered Affiliate should have any direct or indirect interest in, or relation with, any individual or organization which has entered, or proposes to enter, into any transaction with the Association, such Director must notify the Board of Directors of such interest or relationship and must thereafter refrain from discussing or voting on the particular transaction in which he has an interest. This Director must also refrain from otherwise attempting to exert influence on the Society, its officers, Board of Directors or employees, to affect its decision to participate or not to participate in such an actual or proposed transaction. These types of transactions include, but are not limited to, transactions involving:

- i. The sale, purchase, lease or rental of any property, supplies or other asset(s) between a Director and the Association;
- ii. Employment or the rendition of services;
- iii. The award of any grant, contract or subcontract; or
- iv. The investment or deposit of any funds of the Association.

When and if the particular transaction is discussed in a meeting, the minutes of that meeting must reflect that a disclosure was made by the interested Director. Furthermore, a Director must not in any direct or indirect manner compete with the Chartered Affiliate or secretly act on behalf of creditors.

2. Duty of Care -- The duty of care requires that a State Society's Directors exercise reasonable care and good faith in carrying out their responsibilities. A Director should exercise the same care and skill which an ordinarily prudent person would exercise under similar circumstances in his or her own personal affairs. By accepting the office, Directors implicitly undertake to give their best judgment to the State Society, and may be held liable for negligent or unauthorized acts.

Board Member Checklist:

1. Have I read the State Society's Bylaws and do I understand them?
2. Do I understand the State Society's organizational structure as a matter of law?
3. Do I understand the tax issues relating to a tax exempt organization, and do I understand the consequences for non-compliance?
4. Do I attend Board meetings regularly?
5. Do I participate in Board meetings I attend?
6. Do I read and understand the Minutes of the meetings of the Board of Directors, even when unable to attend?
7. Do I attend Committee Meetings, participate in the Committee meetings I attend, and read and understand the Minutes of the

- Committee meetings even when unable to attend?
8. Do I timely complete my assigned responsibilities?
 9. Do I understand the Association's budgeting process?
 10. Do I understand the State Society's financial condition and financial statements?
 11. Do I ask questions if I do not understand the policies or procedures I hear?
 12. Do I avoid the substance or appearance of Conflicts of Interest?
 13. Do I read the State Society's publications and understand them?
 14. Do I know who is the State Society's Registered Agent?
 15. Do I know who has signature authority over the State Society's bank accounts?
 16. Do I know who is responsible for filing the State Society's Form 990 with the Exempt Organization's Division of the Internal Revenue Service and do I know whether such return was timely filed?
 17. Do I know if the Board has proper:
 - A. Legal representation
 - B. Accounting representation

Tax Considerations:

As a matter of federal law the American Association for Respiratory Care is a Section 501(c)(6) tax-exempt trade association. To be specific Treasury Regulation 1.501(c)(6)-1 defines a trade association as an association of persons having some common business interest, the purpose of which is to promote such common interest and **not** to engage in a regular business of a kind ordinarily carried on for profit. In effect a trade association is intended to furnish its members with information which will permit them to operate more efficiently and more effectively.

Contributions to a Section 501(c)(6) organization are not defined in Section 170 of the Internal Revenue Code as a tax deductible charitable contribution. Section 501(c) of the Internal Revenue Code confers tax exempt status on 26 different kinds of organizations, but only contributions to

a Section 501(c)(3) organization are defined as tax deductible charitable contributions.

Even though an organization has filed a Form 1024, Application for Exempt Status, with the Exempt Organizations Division of the Internal Revenue Service, and received a favorable determination letter, it is not completely free of the requirements of the Internal Revenue Code. The organization must still (i) meeting certain annual filing requirements and (ii) pay certain taxes and penalties.

Other Discussion Topics:

- Unrelated Business Income Tax
- Penalties for Failure to File Form 990
- Judicial Committee