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Should a Nonprofit Organization Incorporate in New York or Delaware?

Say you have a great idea for a new nonprofit organization. The planned programming will take place in New York and the organization wants to serve people who live and work in New York. The organization will also have an office in New York. Obviously, this new nonprofit should incorporate in New York State, right? Not necessarily. A nonprofit can incorporate in any state, even while operating entirely in another state. That being said, in almost all cases, a nonprofit corporation will choose to incorporate in the state where its principal place of business is located, or in Delaware for reasons noted in this alert. The nonprofit must follow the laws of the jurisdiction where it is incorporated, and qualify to do business in the state or states where it conducts business. Once a new organization incorporates in a particular state, that state's corporate law will govern the nonprofit's governance procedures.¹

While many nonprofits based in New York choose to incorporate in New York, it may be helpful for you to know that Delaware is also a good option because Delaware has a more flexible legal regime. Whether to incorporate in New York or Delaware should be evaluated carefully in consultation with an attorney. This Legal Alert will highlight the key advantages and disadvantages to incorporating in New York and Delaware.

New York's Not-for-Profit Corporation Law and Delaware's General Corporation Law

New York has a separate statutory regime for nonprofit corporations through the New York Not-for-Profit Corporation Law (the N-PCL)² 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 (known in Delaware as "nonstock") corporations under the jurisdiction of Delaware's General Corporation Law (the DGCL)³ and does not have a Charities Bureau equivalent.

Most U.S. business corporations, regardless of where they operate, incorporate in Delaware and qualify to do business in states where they conduct business.⁴ This is because the DGCL is flexible, well-established, and widely used both nationally and internationally. Disputes under it are adjudicated in a specialized court called the Delaware Court of Chancery.⁵ The Court of Chancery, which operates without a jury, is known for being flexible and efficient. While contemplating the benefits of litigating in

¹ For more details on the impact of New York and Delaware law on corporate governance, please see the Lawyers Alliance publication *Bylaws That Work*: <https://lawyersalliance.org/publications/list>

² <https://www.nysenate.gov/legislation/laws/NPC>

³ <https://delcode.delaware.gov/title8/c001/index.html>

⁴ <https://corp.delaware.gov/stats/>

⁵ <https://courts.delaware.gov/chancery/>

Delaware may not be a deciding factor for a newly-forming nonprofit, having a better understanding of the regime in both states may be more helpful to you in making your decision.

New York vs. Delaware: Delaware Advantages

Generally, the New York nonprofit regime is stricter and more comprehensive than the DGCL. For example, the N-PCL has specific rules regarding the internal governance of nonprofits, including restrictions on who can serve as board chair⁶, the requirement for annual conflict of interest disclosures of board directors, officers and key persons⁷ and a required minimum of three board members.⁸

New York requires Charities Bureau approval for actions like mergers or consolidations.⁹ The N-PCL also requires additional oversight over certain other 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.¹⁰ 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 Charities Bureau 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 Charities Bureau. Depending on the planned activities, certain activities may require regulatory approvals from state and local city agencies with jurisdiction.¹¹ All of these transactions may take substantial time and resources to complete.

Delaware, by contrast, 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.¹² In contrast to the process in New York, dissolution of a Delaware nonprofit nonstock corporation under the DGCL solely requires that the nonprofit be current on its annual tax reports. The nonprofit can then take the few relatively simple corporate actions required to dissolve upon a majority vote of its directors.¹³ 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.

⁶ 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]".

⁷ 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.

⁸ See N-PCL § 702.

⁹ See Article 9 of the N-PCL.

¹⁰ 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.

¹¹ 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.

¹² However, if the assets involved are funds that are being solicited in New York, New York state charitable solicitation laws must be followed regardless of the nonprofit's incorporation in Delaware.

¹³ DGCL §§ 275-76.

Delaware also has a simpler and speedier process of incorporation. Only one board member is required for governance of the nonprofit¹⁴ and no regulatory agency consents are required.¹⁵ 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.¹⁶

Finally, 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.¹⁷ 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.

New York vs. Delaware: New York Advantages

While the advantages of Delaware are apparent, the choice is not as clear as it may seem at first. Most importantly, compliance with New York State's regulatory requirements may be unavoidable if any significant activity or funding is planned to occur in New York 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.¹⁸ Organizations incorporating in Delaware but operating in New York will also need to obtain certificate(s) of authority in order to conduct programs or provide services in New York.¹⁹

Moreover, the stricter rules in New York exist for a reason! Donors (both government and private) may be comforted by the additional scrutiny given to charitable activities in New York. For example, a Delaware nonprofit is allowed to have only one board member, which would be illegal in New York and is not a best practice. Some funding sources or government agencies may be most comfortable giving to a New York entity and be wary of a 'foreign'-based entity, although this wariness is not widespread.²⁰

Another drawback in Delaware is the requirement to engage and maintain a "Registered Agent" whose purpose is to receive all legal documents on behalf of the nonprofit in Delaware.²¹ A Registered Agent can cost hundreds of dollars each year to maintain. There is no such requirement in New York. Delaware

¹⁴ See DGCL § 141(b).

¹⁵ 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.

¹⁶ DGCL § 101.

¹⁷ See § 1902(b) of Title 30 of Delaware Code.

¹⁸ See Executive Law Article 7-A. 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).

¹⁹ 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.

²⁰ The only example Lawyers Alliance is aware of where a government agency explicitly requires grantees to be incorporated in New York is the NYC Health and Hospitals Corporation, which requires public hospitals' 'auxiliary' fundraising entities to be incorporated in New York. Some nonprofit managers have also noted that elected officials sometimes prefer to give to entities incorporated in New York.

²¹ See DGCL § 1910.

also requires an annual report be filed with the Secretary of State, although this is a very simple document.

Conclusion

While nonprofit organizations operating in New York often choose to incorporate in New York, you may want to consider whether forming in Delaware is more suitable for your organization. You may want to consult a lawyer about your decision and if you have identified any funders you will want to make sure your funders do not have a preference about where you incorporate. Incorporating in Delaware will cost more due to the requirement to have a registered agent in the state but contrasting that with the burden of seeking government approvals for major corporate changes may make the cost of a registered agent inconsequential.

This alert is meant to provide general information only, not legal advice. For further questions or information, please contact Rafi Stern at 212-219-1800 ext. 251, rstern@lawyersalliance.org, or visit our website www.lawyersalliance.org.

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