



**OFFICE OF THE CITY ATTORNEY**  
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CITY ATTORNEY

December 6, 2005

Department of Neighborhood Empowerment  
Greg Nelson, General Manager  
334-B East Second Street  
Los Angeles, CA 90012

Re: Nonprofit Corporations And Neighborhood Councils

Dear Mr. Nelson,

This letter responds to questions you have posed relating to whether Neighborhood Councils may form nonprofit corporations.

**BACKGROUND**

The Plan for a Citywide System of Neighborhood Councils sets forth the goals and objectives of the Neighborhood Council system and defines how Neighborhood Councils may become “certified” or “recognized” by the City of Los Angeles. However, the Plan also provides that “Certified Neighborhood Councils shall be as independent, self-governing, and self-directed as possible” and that the “Department of Neighborhood Empowerment [DONE] shall assist Certified Neighborhood Councils to pursue options, including, but not limited to, tax exempt status and/or non-profit incorporation, to strengthen their independence.” In part, because of this language in the Plan, questions have arisen as to whether and how Neighborhood Councils may form nonprofit corporations.

We have phrased your questions and provided answers to them as follows:

**QUESTION 1**

May nonprofit corporations be formed to support Neighborhood Councils? If so, what form should they take?

## ANSWER

Yes. The likely method of nonprofit formation would be under Section 501(c) of the Internal Revenue Code. However, care must be taken in the formation to ensure that the nonprofit maintains a separate corporate identity from the City entity. The nonprofit corporation could take the form of a "Friends of a Neighborhood Council" or some type of organization created to accept, maintain and administer funds obtained from private donations to support Neighborhood Councils.

## DISCUSSION

A nonprofit public benefit corporation "is not organized for the private gain of any person" and is organized for "public" or "charitable" purposes. Cal. Corp. Code § 5120(b). Generally, a charitable corporation is created for or devoted to charitable purposes which include "the relief of poverty, the advancement or education or religion, the promotion of health, *government or municipal purposes*, and other purposes the accomplishment of which are beneficial to the community as a whole". *Younger v. Wisdom* (1981) 121 Cal. App. 3d 683, 690 (emphasis added). As an incentive for donors, those who give to a nonprofit benefit corporation receive significant tax deductions for their contributions. Internal Rev. Code § 170.

The Internal Revenue Code lists the various types of organizations that may be exempt from federal taxation. 26 United States Code §501(c). Whether a nonprofit is able to obtain tax exempt status would likely depend upon its function and mission, and under what section of the tax code it is applying.<sup>1</sup>

Should a "Friends of the Neighborhood Council" or support-type corporation be formed, it would likely take the form of a public benefit private nonprofit corporation whose purpose would be to support the Neighborhood Council and directly benefit the community which is served by the particular Neighborhood Council. The Articles of Incorporation should specifically identify the purpose for the corporation and the ways it wishes to support the particular Neighborhood Council.

A Neighborhood council "support-type" nonprofit corporation should maintain a separate corporate identity from the City and identify the charitable or educational function it wishes to pursue in its incorporation papers. To maintain the "separate organization"

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<sup>1</sup> For example, nonprofits organized under section 501(c)(3) may not engage in lobbying activities, which includes activities to influence legislation. See, *Regan, v. Taxation with Representation of Washington* (1983) 461 U.S. 540, 76 L.Ed. 2d 129.

status, board members on the Neighborhood Council and the board members of the nonprofit corporation should not overlap.<sup>2</sup>

The City currently has a variety of nonprofit arms that serve as charitable support groups. Following the model of several City support groups may prove instructive to individuals or stakeholders who wish to form such a corporation. Examples of organizations that have formed support public benefit private nonprofit corporations include: The Greater Los Angeles Zoo Association (GLAZA) which supports the Zoo Department, the Library Foundation which supports the Library Department, and the Friends of the Observatory (FOTO) which support the Recreation and Parks Department, specifically for the Griffith Observatory, to name a few. These groups have been set up so that their Articles of Incorporation and bylaws specify their mission.<sup>3</sup>

To set up a support group, if the individuals or stakeholders desire the assistance of legal counsel, they will need to seek *private* counsel for that purpose.<sup>4</sup> However, a few general parameters should be followed to avoid the nonprofit from being treated as a City entity:

a) The nonprofit corporation should maintain a separate board of directors from the Neighborhood Council.

To ensure that the nonprofit corporation (a private and separate entity from the City) is not confused with the Neighborhood Council, a separate board of directors should be maintained. This will also avoid potential Brown Act issues if there are duplicate board members, particularly if a quorum of the Neighborhood Council were to be on the board of the nonprofit corporation.

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<sup>2</sup> As the citywide system of Neighborhood Councils is currently structured, only groups of individuals or unincorporated associations are "certified" as a City entity.

<sup>3</sup> For example, GLAZA's purpose provides that it is a "means of assisting and aiding the City of Los Angeles, California, in establishing, developing, operating, caring for and maintaining the Los Angeles Zoo" and specifically allows it to accept gifts. Articles of Incorporation, Revised, 4/17/86. Similarly, FOTO's specific purpose is to "solicit contributions, and to arrange for fund raising programs for the benefit of Griffith Observatory, Los Angeles, California". Articles of Incorporation, 12/18/78.

<sup>4</sup> Because the nonprofit corporation would not be a City entity, separate legal counsel would need to be obtained with non-City funds to seek further advice on how to establish a nonprofit corporation, including tax counsel to ensure that a Neighborhood Council's lobbying activities would not implicate the nonprofit's ability to obtain a tax exemption.

b) The impetus for the creation of the nonprofit corporation should come from private individuals or stakeholders.

To avoid being subject to the Brown Act, the nonprofit corporation should not be created by the Neighborhood Council. Indeed, in *Epstein v. Hollywood Entertainment Dist II Business Improvement Dist.* (2001) 87 Cal. App. 4th 862, 873, the court held that a nonprofit corporation which the city was involved in creating was subject to the Act. In *Epstein*, a business improvement district (BID) was formed by private business people. However, because the City of Los Angeles created the system which allowed for the districts to be formed, the court found that the City was involved in the creation of the BID. As such, the BID, although a private entity, became subject to the Brown Act. The best way to avoid this inadvertent result would have the impetus for the formation of a nonprofit corporation arise from non-board member individuals and stakeholders.<sup>5</sup>

## QUESTION 2

May a Neighborhood Council use its own public funds to pay for incorporation fees or any other fees necessary to set up the support nonprofit corporation?

## ANSWER

No.

## DISCUSSION

Neighborhood Councils are currently authorized to spend money on two things: 1) for the "functions, operations, and duties of being a certified neighborhood council, includ[ing] . . . meeting and office space, office equipment, computers, supplies, and communications, such as the costs associated with newsletters, postage, or printing written materials; and 2) neighborhood improvement projects. Los Angeles Administrative Code § 22.810.1(g). An expenditure of public funds to establish a private corporation would not be considered an authorized expenditure.

In addition, to avoid being inadvertently subject to the Brown Act, the nonprofit corporation should not receive any funds *from* a Neighborhood Council (although it may donate monies *to* a Neighborhood Council) *and also* have a board member who is

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<sup>5</sup> While the board should not take action initiating and/or creating the nonprofit corporation, it is our view that it may discuss whether it wants to accept the benefits of a nonprofit corporation without that discussion implicating the status of the nonprofit corporation.

appointed by the Neighborhood Council on its governing body.<sup>6</sup> Government Code § 54952(c)(1)(B). In *Epstein, supra*, the court found that a nonprofit corporation that was brought into being by the City “in order to exercise authority that may lawfully be delegated by the elected governing body to a private corporation,” triggered the Brown Act. While a charitable nonprofit corporation established to support Neighborhood Councils would not likely be delegated any authority held by the City, it is not clear how a court would view the creation of a nonprofit corporation with public funds. Much might depend on the Articles of Incorporation and its purpose.<sup>7</sup>

Regardless of whether a Neighborhood Council board member serves on the nonprofit corporation board, a court might find that monies spent towards funding the establishment efforts of the corporation by the Neighborhood Council—even if subsequently reimbursed by the nonprofit corporation—would be deemed to be a city effort in its creation. To avoid the unintended consequences of *Epstein, supra*, and the application of the Brown Act to the nonprofit corporation it is best not to funnel any public money into its creation.

Finally, to maintain the separate corporate identity to ensure that the nonprofit corporation is not viewed as a form of a city entity, no public funds should be transferred to the nonprofit or to any private individuals creating the nonprofit from the Neighborhood Council. *In re Siegal* (1977) 3 FPPC Ops. 62. In this opinion, the Fair Political Practices Commission set forth a four-part test to determine whether an entity is a governmental agency. The four criteria that must be considered are:

- (1) Whether the impetus for formation of the entity originated with a governmental agency;
- (2) Whether the entity is substantially funded by, or its primary source of funds is, a government agency;
- (3) Whether one of the purposes for which the entity was formed is to provide services or undertake obligations which public agencies are legally authorized to perform and which, in fact, they traditionally have performed; and

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<sup>6</sup> There is an exception to this general requirement if the nonprofit corporation is to be set up as a Section 509 (a)(3) “publicly supported organization” where the nonprofit corporation is to be supported by governmental agencies. However, until the Neighborhood Council Public Purposes Grant Program is adopted, Neighborhood Councils may not give funds to nonprofit organizations unless they are implementing a specific board approved (and DONE authorized) neighborhood improvement project.

<sup>7</sup> For example, since the City of Los Angeles has inherent authority to fund raise, a court could find that the creation by a Neighborhood Council of a nonprofit “Friends of the X Neighborhood Council” corporation to raise money for the Neighborhood Council, is “a delegation of authority to the nonprofit corporation that the City otherwise could exercise.” *Epstein, supra*. at 862.

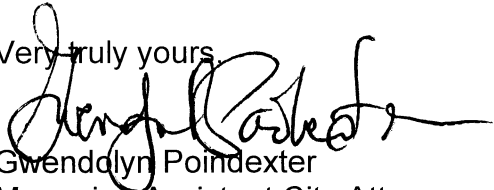
(4) Whether the entity is treated as a public entity by other statutory provisions.

Under the FPPC opinion, all four prongs need not be met in order to determine that an entity is a governmental agency. However, if the board of a neighborhood council takes formal action to create a nonprofit corporation and/or uses public funds for its creation, prongs (1) and (4) will likely be met.<sup>8</sup> Thus, the better practice is to avoid spending any public funds at all to support the creation of a nonprofit corporation.

## CONCLUSION

Because the City is contemplating the adoption of a "Donations Ordinance" to allow Neighborhood Councils the ability to accept donations from private sources, the benefits of having a nonprofit support corporation are unclear. Before considering whether to accept the benefits of a nonprofit support arm, Neighborhood Councils should carefully assess whether they actually need this vehicle to assist them in their advisory role. However, should a Neighborhood Council desire to have this type of support group, the formation of a nonprofit support-type organization along the model that currently exists to support several City Departments would be a viable option.

Should you have any further inquiries regarding this matter, please do not hesitate to contact this office.

Very truly yours,  
  
Gwendolyn Poindexter  
Managing Assistant City Attorney  
Neighborhood Council Advice Division  
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<sup>8</sup> As noted, the entity would likely be deemed a legislative body under the Brown Act if the Neighborhood Council takes action to "create" the nonprofit corporation. Should the entity be treated as a governmental entity, the members of the nonprofit corporation would become subject to the conflict of interest rules of the Political Reform Act.