

# **NONPROFIT DISSOLUTION GUIDE**

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**by**

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## **Overview**

A Pennsylvania nonprofit may voluntarily dissolve under Subchapter F (Voluntary Dissolution and Winding Up) or Subchapter H (Post-dissolution Provision for Liabilities) of the Pennsylvania Code. Most nonprofit dissolutions occur under Subchapter F because of the increased formalities, including an obligation to post security for potential claims, under Subchapter H. This guide discusses the more commonly followed procedures for voluntary dissolution set forth in Subchapter F including:

- adoption of a resolution for dissolution through members or board of directors of the organization, as applicable;
- notification to all known creditors of the organization by certified or registered mail of the intended dissolution;
- publication of notice of the intended dissolution;
- approval(s) from the Office of the Attorney General and, if required, the Orphans' Court;
- issuance of tax clearance certificates from Pennsylvania Department of Revenue and the Office of Unemployment Compensation Tax Services; and

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- filing of articles of dissolution with the Department of State, Corporation Bureau.

The legal requirements for the involuntary dissolution of a corporation are complex and any nonprofit organization provided legal notice of an involuntary dissolution should seek legal advice immediately.<sup>2</sup>

### **Voluntary Dissolution Before Operations Begin**

Before the nonprofit corporation commences operations, the majority of its incorporators or members may dissolve it by filing executed articles of dissolution with the Department of State.<sup>3</sup>

### **Voluntary Dissolution Once Operations Begin**

#### *Adoption of Plan of Liquidation and Dissolution*

For an operating nonprofit corporation, the dissolution process typically begins with the board of directors or members adopting a resolution to dissolve the organization voluntarily.<sup>4</sup> A dissolution plan that describes the intended steps to dissolve the nonprofit typically is included as well. The issue of whether the corporation should dissolve is then voted on at a regular or special meeting of the members or board of directors. Written notice of the meeting must be sent to all members of the nonprofit corporation. In a nonprofit corporation without members, the resolution is considered adopted upon approval of a majority of its board of directors. In a nonprofit organization with members, the resolution is considered adopted upon approval of a majority of members entitled to vote.<sup>5</sup>

#### *Wind-up of Operations*

For a voluntary dissolution, the wind-up of operations may commence once the dissolution plan is approved by the board of directors—it is not necessary to wait until the nonprofit is formally dissolved to start the wind-up of operations. Wind-up activities include the collection of sums owed to the nonprofit corporation, the conversion of its assets into cash and the discharge of its liabilities “as speedily as possible.” In addition, the wind-up process requires the mailing of notice of the dissolution by certified or registered mail to each creditor or claimant and each municipality in which it has a place

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<sup>2</sup> The Pennsylvania Code relating to involuntary dissolution is set forth in Subchapter G of the Pennsylvania Code (15 Pa.C.S. §§ 5981-5998).

<sup>3</sup> 15 Pa.C.S. § 5971. Articles of dissolution are filed with the Department of State using Form DSCB:15-5971.

<sup>4</sup> 15 Pa.C.S. § 5972. A nonprofit corporation with members may commence the voluntary dissolution process by a petition from 10% of its voting members recommending voluntary dissolution, by an action through a majority of its board of directors or by following any other methods for proposing or adopting a dissolution resolution provided for in the corporation’s bylaws.

<sup>5</sup> The dissolution action can be rescinded using the same procedure at any time before the articles of dissolution are filed with the Department of State. 15 Pa.C.S. § 5974(a)-(d).

of business in the Commonwealth.<sup>6</sup> The dissolution must also be advertised in a local county law reporter and in a newspaper of general circulation to provide potential creditors with notice of the dissolution.<sup>7</sup> Even after the articles of dissolution have been filed, the board of directors of the nonprofit corporation maintains authority to engage in wind-up activities.<sup>8</sup>

### *Asset Distribution*

Typically, the assets of a nonprofit corporation are considered assets committed to charitable purposes and may not be diverted from that charitable purpose without the approval of the courts.<sup>9</sup> A remaining asset may be distributed to another organization or organizations selected by the dissolving nonprofit corporation on terms that will, in the discretion of the nonprofit organization, fulfill as nearly as possible the intention of the donor.<sup>10</sup> Notice of proposed distribution of any assets of a charitable organization should be provided to the Office of the Attorney General of the Commonwealth of Pennsylvania and, if required, an order of the Orphans' Court should be obtained authorizing the distribution of any remaining assets.<sup>11</sup> The Attorney General notification should include copies of the dissolution plan and the formal approval of the plan by the nonprofit's board of directors or members.<sup>12</sup>

In certain circumstances, the nonprofit organization must obtain the approval of the courts to distribute its remaining assets. For example, if the value of the remaining assets exceeds \$100,000, an order of the Orphans' Court specifying the disposition must be applied for and obtained.<sup>13</sup> Similarly, a court order must be obtained where the proposed distribution diverts the asset from the object to which it was

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<sup>6</sup> 15 Pa.C.S. § 5975(b); 15 Pa.C.S. § 5977(b)(8). Proofs of the publication should be kept with the corporate records of the corporation and should not be submitted to the Department of State. For nonprofit corporations with a place of business in Philadelphia, notice should be addressed to: City of Philadelphia, Municipal Services Building, 1401 J.F.K. Boulevard, Public Services Concourse, Philadelphia, PA 19102.

<sup>7</sup> 15 Pa.C.S. § 5975(c). A public notice in the *Legal Intelligencer* can be placed here:

[http://www.law.com/jsp/pa/specials.jsp?p=public\\_notices#order](http://www.law.com/jsp/pa/specials.jsp?p=public_notices#order).

<sup>8</sup> 15 Pa.C.S. § 5978(a). Pennsylvania law does not impose stricter standards of care or duty on directors during the winding-up process. 15 Pa.C.S. § 5978(a).

<sup>9</sup> 15 Pa. C.S. 5547(b); 15 Pa.C.S. § 5976(b).

<sup>10</sup> 20 Pa.C.S. § 7740.3(b); *see also* 15 Pa. C.S. § 5547(b). Additional limitations may apply if there are pre-existing restrictions on the transfer and/or utilization of the asset. For example, if the dissolving entity is a 501(c)(3) corporation, the assets must be distributed to another 501(c)(3) organization to preserve favorable tax treatment of the original gift and/or obtain favorable tax treatment upon the dissolution distribution. *See, e.g.*, 26 C.F.R. § 53.4941(d)-2 (addressing specific acts of self-dealing).

<sup>11</sup> *See* Pa. O.C. Rule 5.5. Note that in a nonprofit organization with members, remaining assets may be distributed to the members in equal portions. 15 Pa.C.S. § 5975(c); however, statutory requirements regarding court approvals and distribution recipients would apply. *See, e.g.*, f.n. 8; f.n.9, f.n. 13, f.n. 14.

<sup>12</sup> If the charity was received by will or trust the Attorney General must be notified pursuant to the Orphan's Court Rules. *See* Pa. O.C. Rule 5.5.

<sup>13</sup> 20 Pa.C.S. § 7740.3(e); 15 Pa. C.S. § 5547(b).

donated, granted or devised. If the remaining asset value upon dissolution is less than \$100,000, the assets may be distributed upon termination to the charitable organizations selected by the nonprofit with the consent of the Attorney General.<sup>14</sup> Under the Commonwealth Attorneys Act, the Attorney General may intervene in any action involving charitable bequests.<sup>15</sup>

## Formal Dissolution & Tax Filings

### *State Tax Filings*

Tax clearance certificates must be obtained from the Department of Revenue and from the Office of Unemployment Compensation Tax Services of the Department of Labor and Industry evidencing payment of all taxes and charges payable to the Commonwealth of Pennsylvania.<sup>16</sup> Obtaining clearance takes a significant amount of time: the application process commonly takes twelve to eighteen months and the Department of Revenue issues certificates only after final tax returns have been filed. The clearance certificates must be obtained before the articles of dissolution may be filed with the Pennsylvania Department of State.

### *Articles of Dissolution*

The articles of dissolution are filed with the Secretary of the Commonwealth, along with the filing fee and any government approvals required for the dissolution.<sup>17</sup> The articles of dissolution cannot be filed until all liabilities of the nonprofit have been discharged or adequately accounted for; all of the assets of the nonprofit have been distributed; and required tax clearance certificates have been obtained.<sup>18</sup> The articles of dissolution should set forth the following information:

- name of the nonprofit and address of its registered office;
- names and addresses of its directors and officers;
- the manner in which the proposal to dissolve voluntarily was adopted by the nonprofit;

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<sup>14</sup> 20 Pa.C.S. § 7740.3(e).

<sup>15</sup> 71 P.S. §§ 732-101-732-208, § 732-204(c).

<sup>16</sup> A tax clearance certificate may be obtained by filing an Application for Tax Clearance Certificate Form REV-181. The application may be obtained on Commonwealth of Pennsylvania Department of Revenue website, [www.revenue.state.pa.us](http://www.revenue.state.pa.us) or by calling (717) 783-6055. The fiscal code governing tax clearance certificates may be found at [www.revenue.state.pa.us](http://www.revenue.state.pa.us).

<sup>17</sup> See Form DSCB: 15-5977.

<sup>18</sup> 15 Pa.C.S. § 5977. In cases where the assets of the nonprofit corporation are insufficient to discharge its liabilities, the articles of dissolution may be filed once all the assets have been fairly and equitably applied, to the full extent possible, to the payment of its liabilities.

- a statement that all liabilities have been discharged and the assets of the nonprofit are sufficient to discharge its liabilities;
- a statement that all the remaining assets of the nonprofit have been distributed;
- a statement that no actions or proceedings are pending against the nonprofit in any court, or that adequate provision has been made for the satisfaction of any judgment or decree that may be obtained against the nonprofit in each pending or proceeding action; and
- a statement that the required notice was sent to each known creditor and claimant and to each municipality in which the nonprofit has a place of business in the Commonwealth.<sup>19</sup>

The date the articles of dissolution are filed is the official date of dissolution. On the that date, the existence of the nonprofit ceases and a two-year statute of limitations commences for parties to bring an action against the nonprofit and assert claims against assets distributed in dissolution.<sup>20</sup> The dissolved nonprofit continues to exist for the purpose of winding up its affairs; prosecuting and defending actions or proceedings by or against it; collecting and discharging obligations; disposing of and conveying its property; and collecting and dividing its assets for the winding up of the corporation—processes that can take a significant amount of time. Taking into account all of the other procedural steps, a reasonable time frame from the decision to dissolve to filing articles of dissolution is eighteen to twenty-four months.

### ***Federal Tax Filings***

If the nonprofit organization is exempt from the payment of federal taxes, it must inform the Internal Revenue Service whether it intends to terminate operations and if its assets are to be transferred.<sup>21</sup> The organization must also set forth a description of any transferred assets, any transaction fees, the asset distribution date and the assets' fair market value along with disclosure(s) if an officer, director, trustee, or key employee of the entity is, or is expected to be, involved in the successor or transferee organization be it in governing, controlling, or having a financial interest in the other organization.<sup>22</sup> The dissolving entity must also provide certified copies of its articles of dissolution, its plan of dissolution and the formal authorization of the dissolution.<sup>23</sup> A nonprofit organization typically

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<sup>19</sup> 15 Pa. C.S. § 5977(b).

<sup>20</sup> 15 Pa.C.S. § 5979(a)(2); 20 15 Pa.C.S. § 5977(c).

<sup>21</sup> Tax-exempt organizations other than private foundations file a final Form 990, 990-EZ or e-Postcard (990-N), depending on the organization's gross receipts and assets.

<sup>22</sup> Disclosures are made in Schedule N (Liquidation, Termination, Dissolution, or Significant Disposition of Assets) of the forms listed in the prior footnote.

<sup>23</sup> For example, an organization that has a calendar year tax period and terminates at the end of the calendar year must file the final return by May 15th of the year after the year in which the termination occurs. If the same organization terminates on August 31, it must file the return on or before the 15th day of the fifth month (i.e., four months and fifteen days) from the date on which the termination occurs.

prepares the appropriate federal tax form before filing its articles of dissolution and submits the final form after the articles are filed.

### *Resources*

Information regarding the dissolution of nonprofit corporations and other fundamental change transaction is set forth in *The Review Protocol For Fundamental Change Transactions Affecting Health Care Nonprofits*.<sup>24</sup> For general guidance regarding the laws governing charitable organizations in the Commonwealth of Pennsylvania, consult *The Handbook for Charitable Nonprofit Organizations*.<sup>25</sup>

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<sup>24</sup> Originally, the Office of the Attorney General originally issued this protocol as a guide for attorneys and staff in the Charitable Trusts & Organizations Section to review fundamental change transactions affecting nonprofit, charitable health care entities, the Attorney General has endorsed the applicability of the principals set forth in the protocol to any nonprofit corporation engaged in a fundamental change transaction, including those that undertake a voluntary dissolution.

<sup>25</sup> The handbook may be viewed online at the following website address:  
<http://www.attorneygeneral.gov/uploadedfiles/consumers/nonprofitbooklet.pdf>. Inquiries regarding charitable organizations may be directed to the Office of the Attorney General at (717) 783-2853.