

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 900 (Reyes)
Version: February 17, 2021
Hearing Date: June 15, 2021
Fiscal: No
Urgency: No
JT

SUBJECT

Charitable trusts

DIGEST

This bill requires a trustee holding assets subject to a charitable trust to give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of all or substantially all of the charitable assets.

EXECUTIVE SUMMARY

Existing law establishes two means of regulating charitable trusts. The Probate Code imposes fiduciary duties upon trustees to ensure that assets are properly managed. Additionally, the Attorney General is vested with significant oversight of charitable assets, including the authority to bring not only an action against a person who misuses charitable assets, but also an action seeking to stop the disposal of charitable assets. In tandem, these statutory schemes are intended to deter and remedy fraud and self-dealing. However, without forewarning of major liquidations of charitable assets, the Attorney General is limited to prosecuting malfeasance after it has occurred.

To enable the Attorney General to proactively carry out these responsibilities, this bill requires a trustee holding assets subject to a charitable trust to provide written notice to the Attorney General 20 days before disposing of all or substantially all of the charitable assets. This mirrors provisions applicable to nonprofits under the Attorney General's supervision. The bill is supported by the California Judges Association and the California Nonprofits Association. Proponents argue the bill provides the Attorney General with key information and harmonizes related provisions in the law.

The California Bankers Association opposes the bill unless it is amended to define "substantially all" precisely so that trustees can comply with certainty. They recommend defining the phrase to mean 75 percent or more of the assets.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Provides that the Attorney General is the chief law officer of the state with broad duties to see that the laws of the State are uniformly and adequately enforced. (Cal. Const., art. V, § 13; Gov. Code § 12510.)
- 2) Establishes the Supervision of Trustees and Fundraisers for Charitable Purposes Act under the supervision of the Attorney General. (Gov. Code §§ 12580-12599.8.)
 - a) Provides for regulation of charitable corporations, unincorporated associations, trustees, and other legal entities holding property for charitable purposes, commercial fundraisers for charitable purposes, fundraising counsel for charitable purposes, and commercial covertures. (Gov. Code §§ 12581.)
 - b) Vests the primary responsibility for supervising charitable trusts in California, for ensuring compliance with trusts and articles of incorporation, and for protection of assets held by charitable trusts and public benefit corporations, in the Attorney General, and provides that the Attorney General has broad powers under common law and California statutory law to carry out these charitable trust enforcement responsibilities. (Gov. Code § 12598(a).)
- 3) Requires the Attorney General to maintain a registry of charitable corporations, unincorporated associations, and trustees subject to the Act and of the particular trust or other relationship under which they hold property for charitable purposes. (Gov. Code §§ 12584.)
- 4) Requires, generally, every charitable corporation, unincorporated association, and trustee subject to the Act to file with the Attorney General periodic written reports, under oath, setting forth information as to the nature of the assets held for charitable purposes and the administration thereof by the corporation, unincorporated association, or trustee, in accordance with rules and regulations of the Attorney General. Requires the Attorney General to make rules and regulations as to the time for filing reports, the contents thereof, and the manner of executing and filing the reports. (Gov. Code § 12586(a), (b).) Exempts corporate trustees subject to the jurisdiction of the Commissioner of Financial Institutions of California or to the Comptroller of the Currency of the United States. (*Id.* at (a).)
- 5) Defines a “charitable trust” as an organization described under the federal Internal Revenue Code provision governing charitable trusts. (Prob. Code § 16100(a); 26 U.S.C. § 4947(a)(1).)

- 6) Provides that during any period when a trust is deemed to be a charitable trust, the trustee must distribute its income for each taxable year, and principal if necessary, at a time and in a manner that will not subject the property of the trust to tax under the Internal Revenue Code. (§ 16101.)
- 7) Prohibits the trustee, during any period when a trust is deemed to be a charitable trust, from any of the following activities, as defined in the Internal Revenue Code:
 - a) engaging in self-dealing;
 - b) retaining any excess business holdings;
 - c) making any investments in such manner as to subject the property of the trust to tax; or
 - d) making any taxable expenditure. (§ 16102.)

This bill requires a trustee holding assets subject to a charitable trust to give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of all or substantially all of the charitable assets.

COMMENTS

1. Notice requirement to assist the Attorney General's oversight of charitable assets

"Historians tell us that the spring floods of Oregon's mighty Columbia River have wrought many changes in the lives of men. It could hardly be expected, however, that the rampaging river's destruction of a partially completed race track near Portland would launch California upon its program of actively overseeing its charitable organizations. Such was indeed the case. It was from the Portland newspapers that then Attorney General Brown first learned of the existence of a charitable trust which operated the jockey club at a San Francisco Bay Area race track. Coupled with this intelligence was the unwelcome news that the funds of this charitable trust had been invested in an ill-fated and speculative venture into horse-racing on the banks of the Columbia River. Many thousands of dollars rightfully belonging to California beneficiaries of that trust rode the waves of the flood-swollen Columbia far out to sea."¹

This infelicitous event led to the eventual adoption of the Supervision of Trustees and Fundraisers for Charitable Purposes Act (Gov. Code 12580 et seq.; Stats. 1959, Ch. 1258), which requires the Attorney General to oversee charitable trusts in California (Gov. Code § 12598). As the California Supreme Court noted: "Beneficiaries of a charitable trust, unlike beneficiaries of a private trust, are ordinarily indefinite and therefore unable to enforce the trust in their own behalf. Since there is usually no one willing to assume the burdens of a legal action, or who could properly represent the interests of

¹ Wallace Howland, *The History of the Supervision of Charitable Trusts and Corporations in California* (1966) 13 UCLA L. Rev. 1029, 1029-1030.

the trust or the public, the Attorney General has been empowered to oversee charities as the representative of the public, a practice having its origin in the early common law.” (*Holt v. College of Osteopathic Physicians & Surgeons* (1964) 61 Cal.2d 750, 754 [citations omitted].) The Attorney General has broad powers under common law and California statutory law to carry out these charitable trust enforcement responsibilities. (Gov. Code § 12598.)

As a general matter, charitable trusts operating in California must register with the Attorney General and file annual financial reports listing revenues and expenditures. (Gov. Code §§ 12584, 12586.) These reports are used by the Attorney General to investigate and litigate cases of charity fraud and mismanagement by trustees and directors of charities. Additionally, the Probate Code sets forth specific duties applicable to trustees of charitable trusts, including the provision of certain notices (§ 1209 [any notice required to be given to the State of California]; § 16061.7 [key events related to revocable trusts]) and requirements relating to the management of trust assets to ensure compliance with federal tax laws, including a prohibition on self-dealing (§§ 16101 & 16102). These provisions collectively establish a statutory scheme for the regulation of charitable trusts.

This bill requires a trustee holding assets subject to a charitable trust to give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of all or substantially all of the charitable assets. This mirrors provisions applicable to nonprofit public benefit corporations and nonprofit religious corporations. (Corp. Code §§ 5913, 9633.) There, as here, the information provided in the notice enables proactive enforcement action, including legal action to halt malfeasant disposal of charitable assets.² This bill harmonizes these modest, longstanding transparency requirements among similarly situated entities subject to the Attorney General’s oversight.

The author argues:

This legislation is long overdue, and essential to ensuring that bad actors are unable to engage in self-dealing transactions. California charities should not be allowed to bypass the simple act of giving notice when making large transfers. Current California law is inconsistent, as it requires public benefit corporations to give advance notice to the Attorney General, but not charitable trusts. AB 900 will make the law consistent and equitable.

² According to the author, the Attorney General’s Office has investigated several matters involving self-dealing trustees in recent years. (*See, e.g. People of the State of California v. Bishop* (Super. Ct. Napa. County, 2014) No. 26-65141 [action to remove the trustees of the Jean Schroeder Education Trust and to recover real property that was improperly sold to the trustee].)

2. Support

The California Association of Nonprofits writes:

Under existing California law, charitable trusts and nonprofit public benefit corporations must register with and report information to the AG. Nonprofit public benefit corporations are also required to give notice to the AG when the corporation plans to sell, lease, convey, or transfer substantially all of its assets. Existing law does not currently create a comparable notification requirement for charitable trusts.

This notification requirement allows the AG to monitor transactions for possible self-dealing. But without a comparable notification requirement for charitable trusts, donors to charitable trusts remain vulnerable to possible self-dealing by unscrupulous trustees. Donor giving is vital to the wellbeing of the nonprofit sector, and if donors lose confidence in the mechanisms of giving, nonprofits, and the communities they serve, will suffer.

The California Judges Association writes:

Far too often the Attorney General, who is charged with supervision of charitable trusts, and other interested parties find out about disposition of all or substantially all of the charitable assets of a trust well after that disposition. This lack of knowledge poses severe logistical and statute-of-limitations problems for the Attorney General.

AB 900 adds a new requirement that a trustee holding assets of a charitable trust give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers or otherwise disposes of all or substantially all of the charitable assets. We believe this bill will help the Attorney General in their oversight of charitable trusts and will help the court in determining the statute of limitations period as well.

3. Opposition

The California Bankers Association writes:

We are not opposed to the underlying objective of the measure. Rather, our requested amendments are intended to help trustees comply with the law. Our primary concern is the lack of definition for “substantially all.” While we understand that “substantially all” may be used elsewhere in the California code, its undefined usage elsewhere fails to provide

guidance for trustees who are struggling to understand what “substantially all” means in this context and who need to know when their legal obligation to provide notice arises.

Further, we believe that the lack of a definition for “substantially all” elsewhere shouldn’t discourage the Legislature from defining it in this instance. In fact, AB 900 provides an opportunity to improve upon previous law by more clearly stating statutory obligations. We also understand that the Attorney General’s office informally advises non-profit public benefit corporations relative to their compliance with Corporations Code Section 5913 that 75 percent or more should be considered substantially all. Accordingly, our requested amendment aligns with the informal guidance provided to those that may have a notice obligation under Section 5913.

They request the following amendments to the bill:

A trustee holding assets subject to a charitable trust as defined in subdivision (a) of Section 16100, shall give written notice to the Attorney General at least 20 calendar days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of all or substantially all of the charitable assets. For purposes of this section, “substantially all” means selling, leasing, conveying, exchanging, transferring or otherwise disposing of 75 percent or more of the charitable assets based on the current fair market value of the charitable assets at the time of providing notice pursuant to this section.

The phrase “substantially all” is an undefined term of art used throughout the codes. Similar provisions using this phrase that apply to nonprofits have been on the books since the 1970s³ and do not appear to have caused substantial compliance problems.⁴ Furthermore, from an enforcement perspective, there is arguably virtue in some degree of imprecision. If the phrase is defined to mean exactly 75 percent or more of the assets, a trustee could avoid the notice requirement by selling a fraction less (assuming the market value is readily ascertainable). Using a generally understood, longstanding term of art gives the Attorney General’s office flexibility to execute its duties in a range of situations. Finally, the cost of compliance is minimal: in borderline cases, a trustee can err on the side of caution by simply providing written notice.

³ Chapter 567 of the Statutes of 1978 added Corporations Code section 5913 (nonprofit public benefit corporations). Chapter 724 of the Statutes of 1979 added Corporations Code section 9633 (nonprofit religious corporations). As enacted, both provisions required written notice to the Attorney General 20 days before disposing of all or substantially all of the assets.

⁴ There is no published case addressing the meaning of the phrase in either statute.

SUPPORT

California Association of Nonprofits
California Judges Association

OPPOSITION

California Bankers Associations

RELATED LEGISLATION

Pending Legislation: AB 488 (Irwin, 2021) would create a regulatory framework that requires charitable fundraising platforms and platform charities to, among other things, register with the Attorney General, submit reports about their activities, and make certain disclosures. The bill is pending in this Committee.

Prior Legislation:

Chapter 724 of the Statutes of 1979 added Corporations Code section 9633, which requires nonprofit religious corporations to give the Attorney General written notice 20 days before disposing of all or substantially all of its assets.

Chapter 567 of the Statutes of 1978 added Corporations Code section 5913, which requires a nonprofit public benefit corporation to give the Attorney General written notice 20 days before disposing of all or substantially all of its assets.

PRIOR VOTES:

Assembly Floor (Ayes 54, Noes 15)
Assembly Judiciary Committee (Ayes 9, Noes 2)
