

00-072

**INSURANCE: CONTINUING CARE PROVIDER, ETC.**

**CORPORATIONS: VIRGINIA NONSTOCK CORPORATION ACT.**

**Resident of continuing care retirement community is not prohibited from serving as director on facility provider's board of directors. Fact that individual is resident of continuing care retirement community is not automatic compromise of his good faith judgment nor is it tantamount to personal interest in transaction. Resident's personal interest in transaction would not necessarily void transaction so long as material facts of his interest are made known to board. Fact that director is resident who may receive reasonable compensation for goods or services does not equate to inurement which would affect federal tax exempt status of facility.**

The Honorable Emily Couric  
Member, Senate of Virginia

The Honorable Paul C. Harris and Mitchell Van Yahres  
Members, House of Delegates

September 25, 2000

You ask whether § 13.1-870 of the *Code of Virginia* prohibits a resident of a nonprofit continuing care retirement community ("CCRC") from serving as a voting member on the facility's board of directors. You also ask whether allowing such a resident to serve as a director is considered inurement under the Internal Revenue Code which would jeopardize the facility's tax exempt status.

A continuing care "facility" is a place "in which a person undertakes to provide continuing care to an individual."<sup>1</sup> The majority of these facilities are owned by nonprofit organizations.<sup>2</sup> Chapter 49 of Title 38.2<sup>3</sup> sets forth various statutes regarding certain requirements of the provider of such facility, including registration by the provider with the State Corporation Commission,<sup>4</sup> the filing of disclosure statements,<sup>5</sup> and mandatory provisions of a resident's continuing care contract.<sup>6</sup> Nothing in Chapter 49, however, addresses the composition or the duties of a CCRC provider's board of directors.<sup>7</sup>

Chapter 10 of Title 13.1, §§ 13.1-801 through 13.1-944, governs Virginia nonprofit corporations, including matters related to the boards of directors of such corporations. With respect to directors serving on the board of directors of a nonprofit corporation, § 13.1-870(A) provides that "[a] director shall discharge his duties as a director, including his duties as a member of a committee, in accordance with his good faith judgment of the best interests of the corporation." Additionally, § 13.1-871 addresses director conflicts of interests and states that "[a] conflict of interests transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect personal interest."<sup>8</sup> Notably, § 13.1-871(A) specifically provides that such a transaction is not voidable solely because of the director's interest in the transaction, providing the material facts of the transaction and the director's interest were disclosed or known and the transaction was approved, authorized, or ratified by the board,<sup>9</sup> and the transaction was fair to the corporation.<sup>10</sup>

It is my opinion that nothing in the language of either § 13.1-870 or § 13.1-871 would prohibit a resident of a CCRC from serving as a director on its provider's board of directors. The mere fact that an individual is a resident of the CCRC is certainly no automatic compromise of his good faith judgment nor is his residency at the facility tantamount to a personal interest in a transaction.<sup>11</sup> Even assuming that the individual did have a personal interest in a transaction before the board, such interest would not necessarily void the transaction so long as the material facts of his interest were known or disclosed.<sup>12</sup>

Regarding the issue of inurement, an organization exempt from income taxation under § 501(c) of the Internal Revenue Code will lose its tax exempt status if any part of the organization's net earnings "inures to the benefit of any private shareholder or individual."<sup>13</sup> This inurement prohibition "is generally directed at payments that are made to shareholders or individuals for purposes other than as *reasonable* compensation for goods or services."<sup>14</sup> The singular fact that a director is a CCRC resident, and there is no indication that he is receiving unreasonable payments therefor, does not equate to inurement within the meaning of this section.<sup>15</sup>

Accordingly, it is my opinion that a resident of a CCRC is not prohibited from serving as a voting member of the CCRC provider's board of directors.<sup>16</sup>

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<sup>1</sup>Section 38.2-4900.

<sup>2</sup>See Comments, *Continuing Care Retirement Communities: A Promise Falling Short*, 8 Geo. Mason L. Rev. 47, 53 n.24 (1985).

<sup>3</sup>Sections 38.2-4900 to 38.2-4917.

<sup>4</sup>See § 38.2-4901.

<sup>5</sup>See §§ 38.2-4902 to 38.2-4904.

<sup>6</sup>See § 38.2-4905.

<sup>7</sup>Note that § 38.2-4910(A) provides that "[r]esidents shall have the right of self-organization"; § 38.2-4910(B) mandates that the provider's board of directors "shall hold meetings at least quarterly" with residents of the facility for discussion of issues related to the facility. There is no language in this statute, however, which indicates that it is the exclusive means for resident representation before the board.

<sup>8</sup>Section 13.1-871(A).

<sup>9</sup>Section 13.1-871(A)(1).

<sup>10</sup>Section 13.1-871(A)(3).

<sup>11</sup>Compare §§ 2.1-639.2 and 2.1-639.31 (defining "personal interest" as "financial benefit or liability").

<sup>12</sup>See § 13.1-871(A); see also § 13.1-691(A) (governing director conflict of interests of stock corporations and containing parallel language to § 13.1-871(A)).

<sup>13</sup>See I.R.C. § 501(c)(3) (West Supp. 2000).

<sup>14</sup>[2000] 9 Stand. Fed. Tax Rep. (CCH) ? 22,609.026, at 41,689-90.

<sup>15</sup>Compare *Tauber v. Commonwealth*, 255 Va. 445, 499 S.E.2d 839, *cert. denied*, 525 U.S. 965 (1998) (discussing matter involving inurement wherein hospital issued bonds to doctors serving on hospital's board of directors in exchange for demand notes and did not enforce collection of such demand notes).

<sup>16</sup>Note that the election of any director to the board must be in accordance with all applicable corporate law.