

# Should Your Group Incorporate?



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Center for Health, Environment & Justice

Revised 2009



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# Center for Health, Environment & Justice

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## Mentoring a Movement

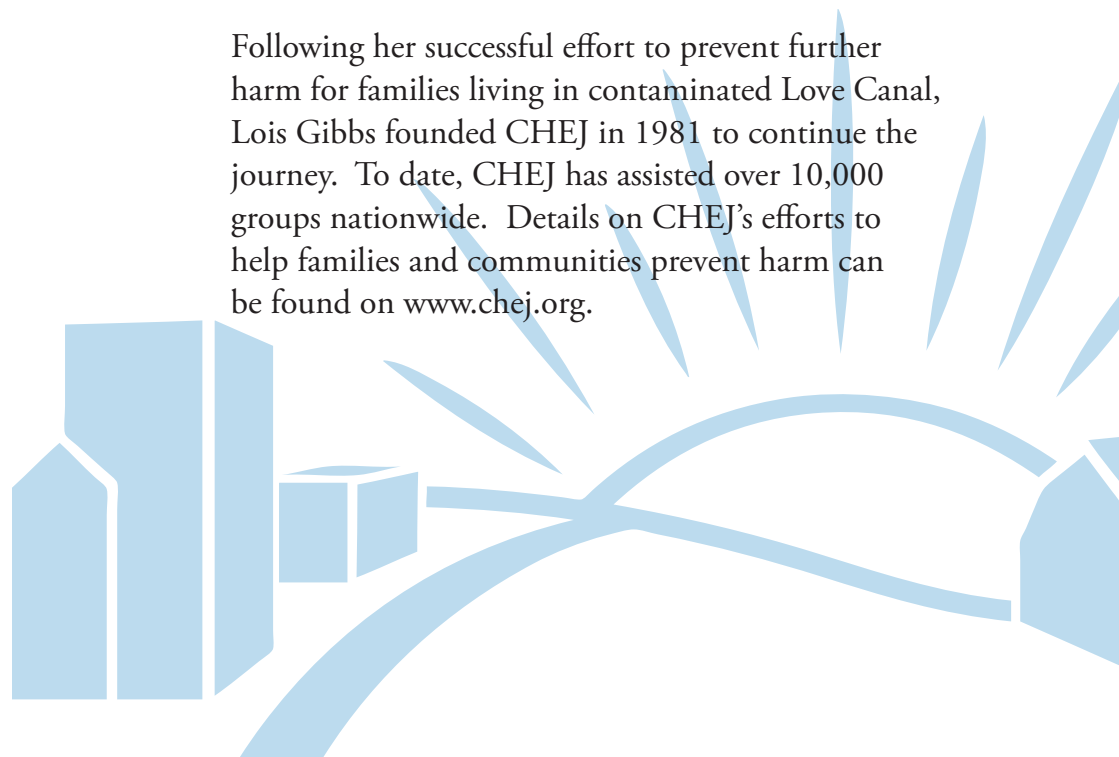
## Empowering People

## Preventing Harm

### **About the Center for Health, Environment & Justice**

CHEJ mentors the movement to build healthier communities by empowering people to prevent the harm caused by chemical and toxic threats. We accomplish our work by connecting local community groups to national initiatives and corporate campaigns. CHEJ works with communities to empower groups by providing the tools, strategic vision, and encouragement they need to advocate for human health and the prevention of harm.

Following her successful effort to prevent further harm for families living in contaminated Love Canal, Lois Gibbs founded CHEJ in 1981 to continue the journey. To date, CHEJ has assisted over 10,000 groups nationwide. Details on CHEJ's efforts to help families and communities prevent harm can be found on [www.chej.org](http://www.chej.org).







# Should Your Group Incorporate?

Whether your group should incorporate is a very important question and one that should be handled with a lot of thought and care. Before you decide to go forward and incorporate, ask yourself, “Why?” As with any other major step, you should not proceed unless you know why you are doing it and what you are getting yourselves into. This guide is intended to raise the most important issues you will need to consider and to provide you with the key information to start.

Generally, incorporation and the process of seeking tax-exempt status can be a costly, time-consuming process. It obligates you to set up a structure that needs to be carefully thought through and to meet a number of local, state and federal legal requirements, including filing more reports than most people have ever imagined.

Unless your group has some very good reasons to do it, such as planning to be in existence for several years along with the need to raise money through grants and donations that require you to be tax-exempt, then our advice is either forget it, or wait until you do have some compelling reasons for doing it.

## Why Do Groups Think They Should Incorporate?

Generally, leaders give three reasons for incorporating:

### To gain legitimacy

**Belief:** Many people feel that the best way to prove themselves and to the world that they are “for real” is to take the legal step of incorporating. All groups, when they first start out, can be considered to be an “unincorporated association.” Though this has a nice ring to it, many people feel that this isn’t enough and that they have to prove that they are somehow more than just an informal bunch of people. It’s as though you have to be ready to pull your corporate charter out of a bag and wave it around to get attention.

**Reality:** First off, this is a political, not a legal question. Generally, community organizations gain legitimacy by their actions, not by the amount or type of papers they file with the government. Nobody really cares whether you are a corporation or an unincorporated association. You can have an unincorporated group that doesn’t do anything, as well as a corporation that is very active. You can have a very active “unincorporated association,” or an incorporated, do-nothing group. What wins

your respect and POWER is what you do, not what format you've selected.

### **To protect members and Leaders**

**Belief:** Some groups incorporate because they feel this will protect their members and leaders from being sued by their opponents for the work on the issue they've taken on. A few groups incorporate in order to protect their leadership from any financial liability, to protect leaders from being personally liable for the group's debts.

**Reality:** It is true that in a corporation, the individual liability of leaders and members is limited. Generally, a leader can't be held personally liable for debts incurred by a corporation. However, there are some important exceptions. A leader who serves on a corporation's board has a "fiduciary responsibility," which means that s/he is held responsible for acting reasonably and responsibly in that role. If you and your fellow leaders don't pay attention to the corporation's finances or act irresponsibly (for example, by authorizing expenditures far in excess of the group's resources), you could be found to have violated your "fiduciary responsibility" and be held liable. The IRS says that it must get its tax money and if a group fails to do so, the board members can be held personally liable. If your group hires someone and federal withholding, Social Security or unemployment taxes aren't paid, the IRS can come after both the corporation and the individual board members, even if you didn't know that the taxes weren't being paid.

The other "protection" issue is lawsuits from your "enemies." Leaders want to incorporate to avoid being sued personally for offenses like libel and slander. This is a natural concern (though one that is usually exaggerated) for many groups engaged in tough fights with Big Business or government. The sober reality is that your enemy can sue you anyway — they'll probably sue both the group and the individual board members, plus any other individual they think was involved. You will still have to hire a lawyer and defend yourselves. Being incorporated means that your lawyer can argue (and probably win) the point that you are exempt from prosecution because you

acted as an official of the group, but you will not be protected from being sued. Incorporation simply gives your lawyer another "defense" s/he can raise on your behalf. Besides, these lawsuits against you by your "enemy" are often just harassment suits filed to get you off their backs. Unless the group or the individuals in it willingly and maliciously told lies, the odds of winning are heavily in your favor. But you still have to deal with the anxiety and initial expense, even if you are vindicated, or counter sue and win.

### **To collect donations**

**Belief:** Many leaders feel that the only way they can raise money is by being incorporated as a "nonprofit corporation."

**Reality:** You don't have to be incorporated to collect donations. Any one can give money to anyone else; it's a free country. It's just that there's no tax advantage to the donor unless the group s/he is supporting is not only incorporated, but also recognized by the IRS as a particular kind of "taxexempt" corporation (generally one that falls into the definition laid out in section 501(c)(3) of the IRS Tax Code). If your fundraising plans are generally small-scale and informal, you don't generally need to go through the extended processes of incorporation and seeking tax-exempt status. However, if you do plan to be around for a while and need to raise lots of money, you will have to solve the tax/fundraising question.

Generally, an "unincorporated association" can't receive "grants" from churches, foundations and other key funding sources unless (a) you are planning to become incorporated and tax-exempt, and prove to the funding source that you have a good plan to do this or (b) you have a "sponsor" or "channeling agency" that is incorporated and tax-exempt, as well as acceptable to the funding source. The Catholic Campaign for Human Development (CHD), for example, will fund community organizations engaged in social justice work if they have a "channeling agency" and a good plan for becoming independent. Some foundations, unfortunately, will not fund a group that doesn't have final approval from the IRS of its tax-exempt

application. Foundations often use this final approval as evidence of the group's maturity and stability.

One additional, but less common, reason why leaders feel they should incorporate is so that they can participate in a lawsuit in a formal way. The reality is that you don't need to be incorporated to participate in a lawsuit. The courts recognize "unincorporated associations" and will permit them to become parties to a lawsuit. There is, of course, the added question you should consider of whether any group, incorporated or not, should become formally involved in a lawsuit. In most cases, it's better for the organization to do what it does best: ORGANIZE.

Let the individuals who have the legal grievance file the suit. Leaders of an organization should weigh what the organization gains by filing a suit, as opposed to what the individuals gain, and how the lawsuit will effect their organizing.

### **The Process of Incorporation and Tax Exemption**

Being incorporated and being tax-exempt are two different procedures. You incorporate by filling out forms, and filing Articles of Incorporation and By-laws with the appropriate state agency, usually your Secretary of State's Office. Later, you file with the IRS for recognition as a "tax-exempt" corporation, usually under section 501(c)(3) of the IRS Tax code.

#### **Incorporation.**

You will need to draw up clear and detailed By-laws and Articles of Incorporation. This will require your group to carefully examine its purpose and structure. Please, resist the temptation to simply "borrow" another group's By-laws.

By-laws are your legal rules of operation and define how decisions are made. As such, they are not interchangeable from group to group and you are asking for serious trouble down the road if you adopt rules of behavior that don't fit your group and the people in it. The mechanics of incorporating with the state are otherwise pretty simple. It's the concept behind your By-laws and Articles of Incorporation that should take up time and energy.

#### **Tax-exempt Status Recognition.**

First, you must be incorporated as a "not-for-profit" corporation with your state. Then, you file for recognition as taxexempt with the IRS. There are specific forms for this, along with instructions that should be read very carefully. Again, please resist the temptation to copy some other group's paperwork, especially if they filed their papers some time ago. Include all attachments that are required in the instructions and keep your fingers crossed. Getting recognition from the IRS as a 501(c)(3) corporation has never been easy. IRS agents carefully screen applications from citizens' action groups, and often give them a lot harder time and appear to be denying applications more and more.

#### **Problems in Getting Nonprofit, Tax-Exempt Status**

The main problem in getting non-profit, tax-exempt status for most community organizations is that they describe what they plan to do (political action) in terms that the IRS interprets as forbidden activities for 501(c)(3) corporations.

That is, what some groups do is describe their organizing work in terms that the IRS reads as "lobbying" or "partisan political activity." Lobbying by 501(c)(3) corporations is severely limited and "partisan political activity" (e.g. endorsing candidates, electioneering, etc.) is prohibited. So when you say, "Our purpose is to hold our elected officials accountable..."; the IRS literally sees "Red," holds up your application, or rejects it outright.

Tax-exempt, 501(c)(3) corporations are generally expected to engage in "social, educational or charitable work". Though taxexempt groups are permitted to engage in some lobbying (provided it does not consume a "substantial" part of the corporation's resources, generally defined as 20% or less), the IRS has been giving applicants trouble if they feature this activity prominently on their initial application. Non-profit, tax-exempt groups are not allowed to spend any of their resources in endorsing or promoting candidates or getting involved in partisan political activities. If you say

anything on your application that even hints at such activities, the IRS will probably reject your application.

Understand the rules and follow them. You must tell the truth. If you really do intend to spend a substantial amount of your group's resources doing things that the IRS restricts or forbids, then maybe 501(c)(3) is not for you and you should look at other forms, such as staying an unincorporated association, forming a 501(c)(4) corporation or a "political action committee (PAC)." As discussed earlier, these forms change the way you raise funds. If on the other hand, your purpose is education and other permissible activities for 501(c)(3) groups, SAY SO. Just don't use your application for 501(c)(3) recognition as a soapbox—the IRS examiner may not agree with your political principles.

### Other Things To Consider

When you incorporate, you are taking on obligations that must be attended to. You will have to file papers with the state to protect your incorporation status every year. You will probably have to file a number of financial papers as well, as your new corporation starts collecting and spending money. If you file for IRS tax-exempt status, there are more papers to file as well. There will be deadlines to meet or else you will find yourself subject to paying penalty fees. At every step along the way, from your first application, through all of your reports, there are fees to be paid.

Further, by incorporating, you will have to formally adopt rules of operation (by-laws or a constitution) and will have to obey them. This is not a bad thing, but it means a change from the days when you could operate as an informal group of friends and neighbors, accountable to no one but each other.

You will also have to start keeping good records, even if you have very little money to spend. All of this could be a very positive change, especially if your group plans to be around for a while. But ask yourselves, "Do we need to be incorporated to do what we need to do?"

### Forms, Forms, Forms

As stated earlier, be prepared to fill out federal and state forms.

The IRS has a handy reference guide Publication 557, *Tax-Exempt Status for Your Organization* that discusses the rules and procedures for organizations that seek to be recognized for an exemption under section 501(c)(3). To apply for recognition by the IRS of exempt status as an organization described in 501(c)(3) of the Code, you must fill out the IRS Form 1023, *Application for Recognition of Exemption*. The application must be complete and accompanied by the appropriate user fee.

Forms that are required to be included with your application:

- Form 8718, User fee for Exempt Organization Determination Letter Request.
- The organization will also need to request an employer identification number using Form SS-4, *Application for Employer Identification Number*, (even if the organization does not have any employees).
- Articles of Incorporation (and your Certificate of Incorporation, if available from your state)
- By-Laws

Once Incorporated financial forms you will need to submit to the IRS Form 990 or Form 990-EZ on an annual basis. Organizations, except for churches, their integrated auxiliaries, and public charities whose annual gross receipts are normally less than \$5,000, do not have to report to the IRS, unless they notify the IRS that they are applying for recognition of 501(c)(3) status.

Generally, tax-exempt organizations must file an annual information return. Tax-exempt organizations that have annual gross receipts not normally in excess of \$25,000 are not required to file the annual information return. Tax-exempt organizations, other than private foundations, must file Form 990, *Return of Organization Exempt From Income Tax*, or Form 990-EZ,



### Short Form Return of Organization Exempt From Income Tax.

Form 990-EZ is designed for use by small taxexempt organizations and nonexempt charitable trusts. An organization may file Form 990-EZ, instead of Form 990, only if (1) its gross receipts during the year were less than \$100,000, and (2) its total assets (line 25, Column (B) of Form 990-EZ) at the end of the year were less than \$250,000.

### **Related Chej Guidebooks and Factpacks**

*Fight to Win: A Leaders Manual*, by Lois Gibbs, CHEJ

*User's Guide To Lawyers: How to get them to work for you so you're not working for them.*, by CHEJ

*Reprints: Legal Corner*, by Ron Simon

*How to Deal With a Proposed Facility*, by CHEJ

Research Guide for Leaders, by CHEJ

“CHEJ is the strongest environmental organization today – the one that is making the greatest impact on changing the way our society does business.”

*Ralph Nader*

“CHEJ has been a pioneer nationally in alerting parents to the environmental hazards that can affect the health of their children.”

*New York, New York*

“Again, thank you for all that you do for us out here. I would have given up a long time ago if I had not connected with CHEJ!”

*Claremont, New Hampshire*



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