

9.6 FORM OF ORGANIZATION

The most advantageous organizational form for a tenant organization depends on the size, purpose, and functions of the group. Tenant organizations range from small social groups to activist groups organized to serve as a negotiating unit for tenants in a particular project. In addition, tenant groups can be organized to receive grant monies to operate social service programs for residents. Furthermore, the organizations can be resident management corporations or entities that contract with the PHA to perform certain management functions. In many cases, local tenant organizations have joined forces to form citywide, statewide or national organizations.

The needs of tenants' groups significantly vary. Accordingly, the decision whether to incorporate and seek nonprofit, tax exempt status or to organize as an unincorporated association depends largely upon the needs and characteristics of the individual tenant organization and considerations posed by state law.²

The public housing tenant participation regulations require certain organizational components and operating methods for tenant organizations seeking official recognition and funds for tenant activities from the PHA and HUD.³ Tenant organizations need not be incorporated. However, organizations taking on direct management functions under a contract with a PHA, such as resident management corporations, must be nonprofit corporations under the laws of the applicable jurisdiction.⁴

9.6.1 Unincorporated Nonprofit Associations

Most tenant organizations begin as unincorporated nonprofit associations. This form is especially useful in the organization's early stages because it allows for a greater amount of informality in both its formation and disbanding. There are few, if any, public reporting requirements, no filing fees, and a great deal of tenant control over the officers and leaders because they are individually liable for any actions taken without authorization by the members.

As the group becomes larger and more sophisticated, however, the informal association form has limitations caused, in large part, by the risk that the association will not have legal standing under state law as an "entity" possessing legal rights and duties apart from those of its individual members.⁵ For example, at common law, an "association" cannot sue or be sued in its own name. Therefore, actions must be brought in the name of all individual members or as class actions. Today, however, in a majority of jurisdictions, statute, procedural rule or judicial decisions authorize an unincorporated association to sue and be sued in the association's name or in the names of specified association officers.⁶ More importantly, at common law, an "association" cannot buy or sell property or enter into contracts. Although a few states by statute give associations the capacity to own property,⁷ property must otherwise be held by members as joint tenants or tenants in common. Under principles of agency law, individual members may be held personally liable for torts committed or contracts entered into on behalf of the association.⁸ In addition,

¹ Note this excerpt from the last edition of NHP's "green book" has not been updated since the 2012 edition.

² See generally, HOWARD L. OLECK, NONPROFIT CORPORATIONS, ORGANIZATIONS, AND ASSOCIATIONS (6th ed. and 1998/1999 Cumulative Supplement) (Prentice-Hall 1998).

³ 24 C.F.R. §§ 964.115, 964.130 (2012).

⁴ *Id.* § 964.120.

⁵ See BRAD J. CAFTEL, NATIONAL ECONOMIC DEVELOPMENT LAW CENTER (NOW THE INSIGHT CENTER FOR COMMUNITY ECONOMIC DEVELOPMENT), COUNSELING ORGANIZATIONS IN COMMUNITY ECONOMIC DEVELOPMENT 2-1 to 2-5 (Rev. 1998).

⁶ See *Project Basic Tenants Union v. Rhode Island Mortgage and Fin. Corp.*, 636 F. Supp. 1453 (D.R.I. 1986) (tenants' union was unincorporated association with capacity to sue); H. G. Henn & M. G. Pfeiffer, *Nonprofit Groups: Factors Influencing Choice of Form*, 11 WAKE FOREST L. REV. 181, 191-92 (1975). See also FED. R. CIV. P. § 17(b) (West 2012).

⁷ See, e.g., CAL. CORP. CODE § 18105 (West 2012).

⁸ See Oleck, *supra* note 2, p. 153.

and perhaps most significantly, an association ordinarily may not alone qualify for grants from government agencies or private foundations, and may need to partner with an existing nonprofit, tax exempt corporation (often called a “fiscal agent” or “fiscal sponsor”).

For a fledgling group with limited purposes and funding, the above limitations of an association probably will not outweigh the advantages. Although the association form allows informality in organization and reorganization, because of the legal uncertainties and funding limitations mentioned above, it is usually crucial that the group has articles of association and bylaws, which serve as the association’s private “law.”⁹ Some groups will combine their articles and bylaws into one document called the “constitution and bylaws” or simply “bylaws.” The authority of officers is limited to what is contained in the bylaws and articles of association or expressly or impliedly conferred upon them by the members. Thus, bylaws protect individual members and outline rules for the functioning of the organization.

9.6.2 Associations Contracting with Incorporated Groups

Many government and private foundation grants can be made only to government agencies or nonprofit, tax-exempt corporations. Instead of incorporating, seeking tax exemption, and directly applying for funds, a tenant organization can indirectly receive funding through an existing grant-eligible entity (sometimes called a “fiscal agent”), such as the PHA or an incorporated community group.¹⁰ For example, a PHA or incorporated community group enters into an agreement with a grantor agency or foundation, and the tenant organization enters into an agreement with the PHA/incorporated group to perform some or all of the tasks required by the funding source. This approach, however, is not advisable on a long-term basis or in all situations because of the lack of autonomy of the tenant organization. It does have some advantages, however, for a fledgling group that is not ready to incorporate, apply for tax exemption, apply for funds, and account for their expenditure. In addition, this method may be advisable for a group awaiting confirmation of nonprofit, tax-exempt status.

9.6.3 Nonprofit Corporations

When a tenant organization begins to engage in more complex activities and starts seeking substantial outside funding, the group may want to incorporate. Many funding sources prefer or require grant recipients to be organized in corporate form. In addition, incorporating offers the advantage of protecting individual members from personal liability for their actions on behalf of the organization.

The major difference between a corporation and an association is that a corporation is treated as an “entity” separate and distinct from its members. A corporation has the capacity to own property and enter into contracts in its own name. Thus, generally, members cannot be held personally liable for corporate actions. Furthermore, the corporation can sue and be sued, and it can usually appear in court only through an attorney. State statutes and a large body of case law govern the operation and organization of corporations.

Disadvantages of the corporate form include the necessity of complying with formalities of public filings, making periodic reports to an appropriate entity (usually the state’s Secretary of State and/or Attorney General and perhaps state and federal tax agencies), and the payment of filing fees. Therefore, incorporating and applying for tax-exempt status require more initial and continuing effort than is usually demanded by the “unincorporated association” form. If a tenant group decides to incorporate, then it will need the assistance of an attorney and may request assistance from its local Legal Services program or pro bono counsel.¹¹

Formation of a Nonprofit Corporation. Since the formation of corporations is governed by state law, a tenant organization wishing to incorporate must comply with the unique statutory requirements—for

⁹See Henn & Pfeifer, *supra* note 6. See also HUD Handbook 4381.5 REV-2, *supra* note **Error! Bookmark not defined.**, App. 9, Model By-laws for a resident organization.

¹⁰See 42 U.S.C.A. § 1437z-6 (West 2012).

¹¹In some cases, in-house counsel for corporations have a pro bono commitment to help nonprofits.

example, the form of the articles of incorporation—of the applicable state. To be exempt from state and federal income taxes, certain “boilerplate” clauses must also be included in the articles of incorporation, limiting the activities of the corporation. Bylaws should be tailored to the requirements and internal management needs of the individual tenant organization.¹²

Certain other requirements must generally be met for incorporation. An agent for service of process must be identified and registered to facilitate service of legal process on the corporation. The minutes of the first meeting should be drafted and the first meeting held to adopt the bylaws, elect officers, and take other specified corporate actions.¹³

In most states, an organization may become incorporated and receive both its federal and state tax exemptions for less than \$1,000 in registration and filing fees.¹⁴ Some states require corporations to pay minimum state franchise taxes of several hundred dollars unless tax-exempt status is first obtained. Thus, obtaining tax-exempt status may be immediately crucial to groups considering or planning incorporation.

Tax-Exempt Status. A nonprofit corporation organized and operated exclusively for charitable and/or educational purposes may qualify for exemption from federal and state corporate income taxes.¹⁵ The Internal Revenue Service has ruled that under certain circumstances, a tenant organization qualifies for Section 501(c)(3) exemption if it is operated exclusively for “charitable purposes.” In general, to be considered as operating for charitable purposes, a tenant organization must serve or benefit a “charitable class” of persons, such as the poor and distressed, and only incidentally benefit others. For example, an IRS ruling for the Massachusetts Tenants Union, a statewide tenant organization, states in pertinent part as follows:

[B]y providing information and technical assistance to local tenant groups in public housing projects regarding the rights and responsibilities of tenants and the effect of existing laws and regulations concerning public housing, and by representing such groups before state and Federal housing authorities, the [statewide tenant] organization is aiding individuals whose income is too low for them to obtain decent, safe, and sanitary housing. Such activities can be expected to result in improved living conditions, fair rental and lease agreements, and more knowledgeable tenants. The cumulative effect of the organization’s activities is the relief of the poor and distressed within the meaning of § 501(c)(3)-1(d)(2) of [Treasury Regulations under § 501(c)(3) of the Internal Revenue Code]. Accordingly, it is operated exclusively for charitable purposes and qualifies for exemption from federal income taxes under § 501(c)(3) of the Internal Revenue Code.¹⁶

A Section 501(c)(3) tax exemption offers significant advantages to a tenant organization wanting to operate its own programs. Certain federal and state grant programs, such as HUD block grant program funds, are available only to tax-exempt organizations. Most private foundations also have similar restrictions. Tax-exempt status will shield the organization from federal and state income taxes, except for income tax on the profits from business activity not related to carrying out the organization’s charitable purpose.¹⁷ Moreover, exemptions from other state and local taxes, such as sales tax, may be available, as well as eligibility for reduced bulk-mailing rates from the United States Postal Service.

To qualify for tax-exempt status, however, the tenant organization must comply with certain limitations on its activities. For example, “Section 501(c)(3) organizations” may not support or oppose candidates for elected public office, and are restricted, but not prohibited, in their efforts to influence

¹²See Oleck, *supra* note 2, p. 702.

¹³Insight Center for Community Economic Development (formerly known as the National Economic Development Law Center), *Model Incorporation and Tax Exemption Documents for California Non-Profits* (2008) available at <http://www.insightcced.org/publications/legalpubs.html>.

¹⁴The federal tax exemption filing fee is \$850, except that for organizations with anticipated revenues equal to or less than \$10,000 per year the fee is \$400.

¹⁵See 26 U.S.C.A. § 501(c)(3) (West 2012).

¹⁶Rev. Rul. § 75-283, 1975-2 C.B. 201.

¹⁷See 26 U.S.C.A. § 511 (West 2012).

legislation.¹⁸ The organization is subject to scrutiny by federal and state government agencies to ensure that assets are used for stated charitable purposes. Continued exemption is not assured, and if the purposes or activities of the organization materially change, the exemption may be revoked. Finally, if the tenant organization normally receives more than \$50,000 in receipts during its taxable year, it must file an annual federal information return.¹⁹ Tenant organizations that receive \$50,000 or less must file an e-postcard.²⁰ Additional reporting requirements may be imposed by the state where the organization is located.²¹

If the restrictions on influencing legislation for Section 501(c)(3) tax-exempt organizations are too constraining or are so vague as to cause concern, tenant organizations may elect to be covered by the provisions of Section 501(h).²² By such an election, the tenant organization's tax-exempt status is not threatened by the use of a portion of its activities for influencing legislation, so long as the organization's direct and grassroots lobbying expenditures do not exceed a fixed dollar amount which is calculated as a percentage of its total expenditures.²³ Lobbying expenditures are reported on the organization's annual federal information return.

¹⁸*Id.* § 501(c)(3).

¹⁹Rev. Proc. § 83-23, 1983-1 C.B. 687; 26 C.F.R. § 1.6033-2(a) (2012).

²⁰26 C.F.R. § 1.6033-6 (2012).

²¹*See* Insight Center packet on incorporation and tax-exemption at *supra* note 13.

²²26 U.S.C.A. § 501(h) (West 2012).

²³*Id.* § 4911 (tax on excess expenditures to influence legislation). *See also Counseling Organizations In Community Economic Development, supra* note 5.