

Legal Structures for the Transition

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We're nourishing communities
and creating livelihoods...
That must be a
501(c)(awesome)!



1

How do we legally structure stuff like this?

Community food gardens	Local industries
Car-sharing groups	Shared commercial kitchens
Renewable energy co-ops	Ecovillages
Local currencies	Housing cooperatives
Time banks	Elder care cooperatives
Cottage foods markets	Grey water cooperatives

2

How to we get from:
People starting lots of cool projects in
our communities...

To:
Projects that will endure, become the
new commons, and make our
communities resilient?

3

Reasons to get excited about legal structure:
The more we move our economic activities
into organizations designed with equitable,
social, and cooperative goals, the more we
can transform our entire economy. The
choices we make in structuring organizations
are critical; the architecture of organizations
will, essentially, be the architecture of a new
economy.

4

Less Useful Legal Structures for the Transition

- 501(c)(3) Public Benefit Nonprofits
 - LLCs and L3Cs
 - Stock corporations
 - Benefit corporations

More Useful Legal Structures for the Transition!

- Cooperative Corporations and Associations
- Mutual Benefit Nonprofits (exempt under 501(c)(6), (7), (8), (10), (12), 528, etc)
- 501(c)(4) Public Benefit Nonprofits

5

**Doing stuff together is great!
But does it make you an entity?**

California Corporations Code 18035 (a) says:
"Unincorporated association" means an unincorporated group of two or more persons joined by mutual consent for a common lawful purpose, whether organized for profit or not.

Geee... that was perfectly clear....

But then it goes on to say that co-ownership and marriage/domestic partnership don't count:
(b) Joint tenancy, tenancy in common, community property, or other form or property tenure does not by itself establish an unincorporated association, even if coowners share ownership of the property for a common purpose.
(c) Marriage or creation of a registered domestic partnership does not by itself establish an unincorporated association.

Hmm....can you spot the grey areas?

6

Thing 1:
A person who files tax returns, can enter into contracts, open bank accounts, receive money, manage property, etc.

Thing 2:
An association that files tax returns, can enter into contracts, open bank accounts, receive money, manage property, etc.

7

Not a Thing.

8

Additional Guidance on What Is or Isn't an Entity
Treasury Regulations § 301.7701-1
Classification of organizations for federal tax purposes
 (a) (2) *Certain joint undertakings give rise to entities for federal tax purposes.* A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. For example, a separate entity exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. Nevertheless, a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes. For example, if two or more persons jointly construct a ditch merely to drain surface water from their properties, they have not created a separate entity for federal tax purposes. Similarly, mere co-ownership of property that is maintained, kept in repair, and rented or leased does not constitute a separate entity for federal tax purposes. For example, if an individual owner, or tenants in common, of farm property lease it to a farmer for a cash rental or a share of the crops, they do not necessarily create a separate entity for federal tax purposes.

9

So, you are a Thing, now what?

Should you just keep doing stuff in an ad hoc, loosey goosey way?
Maybe not, if you:

- Want the project endure even when members come and go.
 - Want to preserve the integrity of the mission.
 - Want people to put money or other resources in.
- Want to avoid the "Tyranny of Structurelessness" and have clarity transparency, and legal enforceability in how decisions are made.
- Want to be protected if someone else in the group is negligent.
 - Don't want to make the IRS mad at you.

10

Could you come under the umbrella of an entity that already exists?

- Like a homeowners association?
- A 501(c)(3) nonprofit organization?
 - That's often called fiscal sponsorship.

Note: A lot of projects in the U.S. that are fiscally sponsored would not pass muster if they applied for their own 501(c)(3) status. In that respect, the fiscal sponsor probably shouldn't host the project.

11

So...you are going to form and structure your own entity. There are three layers of considerations:

- 1. What entity to choose**
At the state level.
- 2. What tax status to obtain.**
At the federal level.
- 3. How to structure governance, operations, and financial provisions.**
At the organizational level.

12

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- 501(c)(4) Public Benefit Nonprofits

13

Is the focus to generate extra and/or passive income for anyone?

If so, try a good ol' fashioned:
Stock Corporation (includes S Corp, C Corp, Benefit Corp, Flexible Purpose Corp)
 or
Limited Liability Company (LLC)

14

If you aren't trying to get someone rich, is the focus of the benefit inward or outward?

Public benefit nonprofits
 (usually get 501c3 or c4 exemption)

V.

Mutual benefit nonprofits
 (usually get c5, c6, c7, c8, c9.....)


and

Cooperatives

15

Nonprofit corporations are like cakes

Tax exemption (like 501c3) is like the icing.



16

501(c)(3)

Purposes are limited to:

- Charitable
 - Includes relief of poor, distressed, and underprivileged.
 - Includes preservation of ecologically significant land.
- Educational
- Scientific
- Religious

Note: Sustainability and resilience, alone, are not recognized as tax exempt purposes under 501(c)(3)

Other stuff:

- It's tax exempt AND donations are tax deductible.
- Cannot operate for the private gain or benefit of any person.
- Cannot operate substantial unrelated business.

17

Why 501(c)(3)s are an awkward choice for practical projects that help to sustain us?

Stuff like:

- Community food gardens
- Car-sharing groups
- Renewable energy co-ops
- Time banks
- Shared commercial kitchens
- Ecovillages
- Housing cooperatives

The problem lies in the practical and the us.

18

A tricky legal grey area for 501(c)(3)s doing social enterprise

Personal Commercial

Growing and selling
A LOT

Charitable/Educational/Etc.

19

A tricky legal grey area for 501(c)(3)s in the sharing economy

Personal Commercial

Growing and eating
A LOT

Charitable/Educational/Etc.

20

But hooray for activities that don't fit into neat legal boxes!

Personal Commercial

What about projects that
- feed us and our communities
- generate an income
- and make the world a better place?

Charitable/Educational/Etc.

21

Communities filled with "Nanoprofits?"

Page 25 of IRS Publication 557 says that if you meet the requirements and purposes of a 501(c)(3), and if your annual gross income is less than \$5,000, then you do not need to apply for tax exemption in order to be considered tax exempt under 501(c)(3). But you still need to file the 990 Postcard each year. And you'll need to call the IRS before you file it, so they don't go "Huh?" when they receive your 990.

22

501(c)(4)s – Social Welfare Organizations

Examples:

- Some farmers markets
- Political organizations
- Local currencies and time banks

Info:

- Need to benefit a broad sector of the community, not a specific group
- Donations are not tax deductible

23

501(c)(6)s – Business Leagues

Examples:

- Business Alliance for Local Living Economies chapters
- Green Chamber of Commerce
- Bar associations
- Professional leagues
- Orgs formed to support a category of businesses (certain type of food producers, for example)

Info:

- The purpose of the organization must be to promote the common business interest of a group of persons.

24

501(c)(7)s – Social, recreational, and “other nonprofitable purposes.”

Examples:

- Gardening clubs and gardens (but not farms?)
- Boat or RV-sharing club (but not a car sharing club?)
- Shared workshops (?)
- Tool lending libraries

Info:

- **Fun is mandatory:** IRS will generally deny exemption for activities that are not sufficiently connected to or in furtherance of social, recreational, or other pleasure activities
- Section 501(c)(7) is designed to provide tax exemption to organizations that groups form for their *own* benefit, rather than for a public benefit.
- Rationale for tax exemption
- Income received from nonmember sources are taxed as unrelated business income

25

501(c)(8)s – Fraternal Beneficiary Societies 501(c)(10)s – Fraternal Societies

Info:

- There are 100,000 of them!
- (c)(8): Provide members with the payment of life, sick, accident or other related benefits
- Both types of societies must engage in “**fraternal activities**,” such as social activities, ceremonies, rituals, and so on, and an organization found to be lacking in such things will not be found tax exempt
- “The term “fraternal” can properly be applied to such an association for the reason that the **pursuit of a common object, calling, or profession** usually has a tendency to create a brotherly feeling among those who are thus engaged.”
- Must operate under a “**lodge system**” - carrying out its activities under a form of organization that comprises local branches called lodges, chapters, and the like. The local branches must be chartered by a parent organization and largely self-governing.
- **Hmm....Transition U.S. – is that a Lodge System?**

Hmm: How can we use this for the sharing economy? Mutual aid societies? 26

Section 501(c)(12) - benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, and “like organizations.”

Info:

- “Like organizations” is not a catch-all.
- **No:** A housing cooperative
- **Yes:** Funeral cooperatives, cable television cooperatives, and energy services - -
- **Maybe?** Other kinds of modern communication cooperatives (like internet service providers), personal services, grey water cooperatives, or renewable energy cooperatives?

27

Other:

- **521 and 501(c)(16) Agricultural Cooperatives**
(Marketing products or financing the crop growing operations)

- **501(d) Apostolic Associations** (Income-sharing communities)

- **528 Homeowners Associations** (to acquire, construct, manage, and maintain property...what else can we do with 528?)

28

Is it time for a 501(c)(30)?

Entities formed for the purpose of pooling funds, sharing assets, and managing projects, such as:

- A car sharing club
- Community garden
- Renewable energy cooperative
- Etc.

Anyone have a buddy in Congress?

29

Tax exemption might not matter, if you operate at cost. But it’s the state minimum taxes that’ll get ya.

- In California, there is an \$800/year minimum franchise tax for corporations (including nonprofits that aren’t tax exempt) and LLCs.
 - There are a few additional exemptions, including for agricultural cooperatives.
 - That’s another piece of legislation worth writing! Create exemptions for all kinds of cooperatives!
- In Oregon, I think the minimum tax is only \$150, which creates a more open climate for starting organizations.

30

And those newfangled kinds of entities?

Benefit Corporations

- MUST operate for public benefit
- Must report on general public purposes and specific purposes, and measure them using 3rd party standards.

Flexible Purpose Corporation

- ALLOWS directors to consider one or more specific purposes beyond financial value, with requirements to report on their accomplishment of these specific purposes.


Social Purpose Corporation

- Required to create general social benefit but are not told what that has to be or how to achieve it.
- Have the additional flexibility to name a specific benefit, should the founders or initial shareholders desire to hold themselves to a higher standard.
- A third important aspect of the SPC, in addition to the general social purpose requirement and specific purpose option, is that, once established in the articles of incorporation, social purposes of the SPC may only be altered, amended, or eliminated by a two-thirds majority of the shareholders

31

B Corp is not a type of corporation. It's a kind of certification.

But certifications are pretty cool too.



Like:

- Living wage certification
- Green business certification
- Fair trade certification
- Organic certification
- Union certification
- Not animal tested certification

32

Another New Kind of Entity

Low-Profit Limited Liability Company (L3C)

Charitable: The Company significantly furthers the accomplishment of one or more charitable or educational purposes and the Company would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.

Not aimed at making a profit: No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

No lobbying, etc: No purpose of the company is to accomplish one or more political or legislative purposes

It's all about the Program Related Investments (PRIs) from foundations.

33

If our communities are to be filled with locally owned businesses that create stable livelihoods and don't sell out when they get successful....how should they be structured?

- Cooperatives!
- Or sole proprietorships without employees!

34

Cooperatives are present as:

Values and Practices (the cooperative principles):	Legal Structure	Legal Entity
<ul style="list-style-type: none"> • Open, voluntary membership • Democratic governance • Limited return on equity • Surplus belongs to members • Cooperation between cooperatives • Concern for community 	<ul style="list-style-type: none"> • LLC or corporation set up like a cooperative • Nonprofit Mutual Benefit Corporation • Nonprofit Public Benefit Corporation 	<ul style="list-style-type: none"> • Cooperative Corporation • The only entity that can legally use the word "cooperative" in its name.

35

Cooperatives have a special tax status!

Thanks to **Subchapter T** of Internal Revenue Code!

- "Dividends" don't get taxed twice: Net profits distributed to members are tax deductible to the cooperative
- Only if you are operating on a "cooperative basis," which means: distributions of net profits are based on the "quantity or value of business done with or for such patron." Distributions to patrons not made in proportion to business done with the cooperative cannot qualify as patronage refunds.

RurDev.USDA.Gov has lots of resources explaining all this.

36

Organizational Structure and Operations: The Real Teeth

- Composition and election of governing body
- Spheres of decision-making, management, and operations
- Procedures for meetings and decision-making
- Voting rights
- Financial provisions: how money and other resources flow into and out of the entity
- How people come and go from the entity
- Conflict of interest policies
- Procedures for amending governing documents
- Dissolution of the entity



37

Participatory Governance

If we want a world full of organizations that benefit the greatest number of people, we need to meaningfully involve the greatest number of people in governance.

38

Three Things I Realized About Governance

Whoa! It's all about governance!



39

Thing #1:

Everyone participating in governance of organizations and enterprises is key to ensuring that the economy provides for everyone.

How do you ensure your grocery store will make decisions that benefit workers?



40

Put the workers in charge!!



Now, how do you ensure your grocery store will make decisions that benefit workers, food producers, farmers, AND customers?



42



Thing #2:
Organizations of in a resilient economy will be fueled **less by big money incentives...**

...and **more by individual inspiration, engagement, enjoyment, and meaningful social connection.**

This mandates that we involve everyone meaningfully in governance.

44

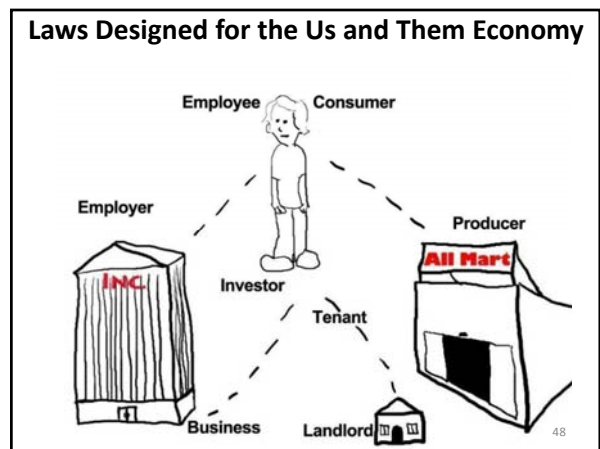


Thing #3:
Without participatory governance, a lot of what we do in the sharing economy is **ILLEGAL!**

Too many legal hoops!

Health & Safety Fire Code Labor Laws Zoning And a Whole Lot More...

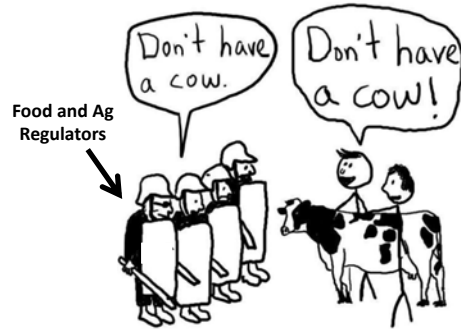
47



Laws that protect consumers



But what if the producers and the consumers are the same group of people?



Laws that protect workers



But what if the **employers** and **employees** are the same group of people?



Laws that protect investors



But what if the business and the investors are the same group of people?



#1: Make Governance Happen Here and Here!

↓ ↓

55

#2: Give Governance Models Some Legal Teeth

Need to be quite specific about stuff like:

- Procedures for decision-making, **AND**
- Spheres of decision-making, management, and operations
 - Committees, Circles, Spheres, Managers, etc.
- Composition and election of governing bodies/committees, etc.
- Place, time, process for meetings
- Process for giving notice and creating agendas
- Voting rights
- Procedures for amending governing documents
- Conflict of interest policies

56

#3: Documents can't look like this:

57

#4: Meetings can't feel like hell.

58

#5: Get trained. Learn the system. Practice it. Grow to love it.

59

Check out Holacracy and Sociocracy

- Highly structured meetings!
 - Not loosey goosey stuff like "we'll discuss it with the goal of reaching consensus."
 - Designed to give everyone a voice without taking up too much time and space.
 - Different meeting processes for different purposes (governance, strategy, tactical, elections, etc)
- Every proposal can always be revisited (holacracy)
 - Which allows groups to always move forward without making HUGE plans and commitments.
- Appointing people to multiple "roles," not single positions (holacracy)
- Semi-autonomous realms of authority
 - But with "double linking" to a general circle, allowing for communication and feedback across circles

60

**Design Principles for Governing Sustainable Resources
from Elinor Ostrom**

<http://www.environmentmagazine.org/Archives/Back%20Issues/July-August%202008/ostrom-full.html>

1. *Clearly defined boundaries.* The boundaries of the resource system, such as irrigation systems or fisheries, and the individuals or households with rights to harvest resource units are clearly defined.
2. *Proportional equivalence between benefits and costs.* Rules specifying the amount of resource products that a user is allocated are related to local conditions and rules requiring labor, materials, and/or money inputs.
3. *Collective-choice arrangements.* Many of the individuals affected by harvesting and protection rules are included in the group who can modify these rules.
4. *Monitoring.* Monitors, who actively audit biophysical conditions and user behavior, are at least partially accountable to users and/or are users themselves.

61

5. *Graduated sanctions.* Users who violate rules-in-use are likely to receive graduated sanctions (depending on the seriousness and context of the offense) from other users, officials accountable to these users, or both.

6. *Conflict-resolution mechanisms.* Users and their officials have rapid access to low-cost, local arenas to resolve conflict among users or between users and officials.

7. *Minimal recognition of rights to organize.* The rights of users to devise their own institutions are not challenged by external governmental authorities, and users have long-term tenure rights to the resource.

8. *Nested enterprises (for resources that are parts of larger systems).* Appropriation, provision, monitoring, enforcement, conflict resolution, and governance activities are organized in multiple layers of nested enterprises.

62