COMMUNITY, INC.

LEGAL INCORPORATION FOR INTENTIONAL COMMUNITY

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SECTIONS	EXAMPLES
PARTNERSHIP -	ALOE, NEW SUNRISE, KERISTA
FOR-PROFIT -	DUNMIRE HOLLOW
COOPERATIVE -	ALPHA
NON-PROFIT -	SHANNON
SUB CHAPTER S & T -	OAKWOOD (MO)
IRC 501 (C) (3) -	ANANDA, HIGH WIND, SHILOH
IRC 501 (C) (2) -	HAWK HILL
IRC 501 (C) (4) & IRC 528 (HOMEOWNERS ASSOCIATIONS) -	COMMON GROUND, FRIENDS COMMUNITY BRYN GWELED, HARVEST HILLS
IRC 501 (D) -	TWIN OAKS, EAST WIND
IRC 501 (C) (6) -	FEDERATION of EGALITARIAN COMMUNITIES
COMMUNITY DEVELOPMENT CORPORATION -	NASCO, STELLE, CERRO GORDO
COMMUNITY LAND TRUST (CLT) -	INSTITUTE for COMMUNITY ECONOMICS, CLT of the SOUTHERN BERKSHIRES, SCHOOL OF LIVING

FOURTH WORLD SERVICES

INTENTIONALITY

FIRST STEPS

Intentional community generally arises from an idea or philosophy developed by one or more persons. The idea may be focused primarily upon building a cooperative lifestyle, or cooperation may be more peripheral to the association's primary tenets. Once a "community" arises, certain very persistent imperatives always arise with it. One such imperative is the need for a mutually respectful relationship, through well prepared legal documents, between the community and the larger society represented by state and federal governments.

In designing a new community, or transforming an existing one, careful attention must be given to the method of legal incorporation used. It is possible for communities to function without any legal status, or as an unincorporated association. However, this may not be secure in the long term, particularly if a substantial amount of property is involved.

The first step in organizing a community is to gain an understanding of the various forms of community in existence and how they manage their relationship to the government. The second step is for the new community to clarify its reasons-for-being and affirm a common direction. After the process of self-definition is completed, the new community may then search for the most appropriate form of association to fit, avoiding as far as possible the situation of shaping the community to fit the law. There is a substantial amount of flexibility afforded by most forms of state incorporation and Internal Revenue Code sections, and intentional communities are found under many of these different forms of legal organization.

DEFINITIONS

The distinction between intentional community and other forms of social organization is difficult to define. Essentially, there can be no legal definition for intentional community any more than there can be a legal definition for religion.

Economics provides the most convenient method for classify- ing the many different forms of intentional community in existence. The three primary classifications which will be used in this writing are "collective," "communal" and "economically diverse." These terms were chosen as they have no legal definition. The term "cooperative" is defined differently by the IRS and by the states, and that term will be used only in reference to those laws. In the classification system used here a "cooperative community" is considered to be one form of collective community, since in both all property is privately owned.

The collective community is a form of intentional community in which there is simply no common ownership of property. Members may choose to dissolve the community, divide the assets, and leave nothing behind but memories and perhaps some written records as a collective legacy. Farms owned by a minority of their residents and rented urban households are common examples of collective communities.

Communal communities, in contrast to the collective model, hold all or most of their assets in common. If the members decide to dissolve a communal community which was incorporated as a tax-exempt organization, all residual assets, after debt settlements, must be donated to a similarly incorporated organization. The "vow-of-poverty" is a feature of some communal societies. Upon taking the vow-of-poverty, all of one's assets are donated to the community and none are returned when the individual leaves.

LEGALITIES & RESOURCES

Although communities have managed to incorporate without the services of a lawyer, it is essential that good information and advice be obtained. This article may only be used as an introduction, and no guarantees may be assumed concerning the use of the information presented.

Material for the following state incorporation sections was researched in sources including, Communes Law and Commonsense: A Legal Manual for Communities, Lee Goldstein, New Community Projects, 1974 (32 Rutland St., Boston, MA), and We Own It: Starting and Managing Co-ops, Collectives, and Employee-Owned Ventures, Peter J. Honingsberg, Bernard Kamoroff, and Jim Beatty, 1982, Bell Springs Publishing, Laytonville, CA. Material for the federal tax-exemption sections (501 series) was researched from sources including the Internal Revenue Manual No. 7751, Exempt Organizations Handbook. Material for the 501 (c) (2) discussion originated from New Organizational Prospects for Community and Conservation Land Trust, Greg Galbraith, Ozark Regional Land Trust, 1984 (427 S. Main, Carthage, MO 64836. Includes actual articles, bylaws, lease agreements for the CLT). The IRC 528 information was contributed by Herb Goldstein (Common Ground Community, Rt. 3, Box230, Lexington, VA 24450). For information on Community Development Corporations, worker cooperatives and land trusts, see Severyn Bruyn and James Mecham, Beyond the Market and the

STRUCTURAL OPTIONS

Economically diverse communities are essentially a blend of both collective and communal economic arrangements within one society. Communities in which the land and perhaps some buildings and equipment are held in common, while houses, cars and bank accounts are privately owned, constitute the most common form of economically diverse community. In other communities there may be the option of some people living in a communal arrangement while other people maintain private property and income. Some of these communities provide for individuals to easily make the change between communal and cooperative arrangements while other communities employ a more formal transition process.

The collective and communal community forms may theoretically be organized under any of the four primary categories of legally recognized association on the state level; partnership, cooperative corporation, for-profit corporation and non-profit corporation. Economically diverse communities generally have more than one of these. The federal tax-exemption statutes may be used by either the communal or the economically diverse communities.

Every state has its own unique set of incorporation laws, presided over by the Secretary of State. Presiding over the federal tax laws is the Internal Revenue Service (IRS) of the Department of the Treasury and the Internal Revenue Code (IRC). The IRC relates differently to the partnership, cooperative and for-profit state laws, and the tax-exempt portions of the Code are available only to organizations which are organized as non-profit in their state. Tax-exempt determinations are granted by IRS regional offices.

Communal and economically diverse communities may take advantage of the federal tax-exemption statutes. Tax-exempt status may be relevant to some communities, since most generally exist for some form of either religious, educational or charitable purposes, and many provide benefits to people outside of the community membership.

Federal IRS regulations are only relevant when a business, whether community owned or otherwise, creates net income; that is gross income minus expenses. It is a common practice, particularly among non-profit businesses, to match income to expenses and thereby avoid a tax liability. This provides the luxury of not having to seek an IRS tax-exempt determination in order to reduce taxes. However, communities which seek to maximize profits through which they may fund growth in membership or standard-of-living must consider tax liabilities.

Federal tax-exempt statutes are found in the IRS Section 501 series of the Revised Code of 1954. The subsections which are applicable to community organization are 501 (c) (2), 501 (c) (3), 501 (c) (4), 501 (d), and 528. Of these, only IRC 501 (d) was created specifically for communal community. The 501 (d) code provides exemption from corporate taxes for "Religious and Apostolic Associations" which maintain a common treasury and which file a "Statement of Religious Belief," for which there is no prescribed format. IRC 501 (c) (4) is the least appropriate to communal community. It was written for "Civic Leagues, Social Welfare Organizations, and Local Associations of Employees" which promote community welfare through charitable, educational or recreational programs. Such programs must provide benefits to the community at large and not to a narrow group of recipients.

IRC 528 is another type of Homeowners Association in which there is no requirement that the association benefit anyone other than the intentional community itself and its members. This section of the tax codes may be the most appropriate for economically diverse communities. IRC 501 (c) (3) is intended for Religious, Educational, Charitable, Scientific, Literary ..." organizations, and is also most suited to some aspects of economically diverse communities. However, the IRS disallows the use of any exempt statute in cases where income inures directly to the benefit of individuals. IRC 501 (c) (2) status is a "Title Holding Corporation for Exempt Organizations" which can only exist in conjunction with a (c) (3) organization. The (c) (2)'s sole function is to hold property titles and to collect rent monies for the (c) (3) parent foundation. The (c) (2) status is particularly well suited to the land trust community design, a form of economically diverse community.

State: New Directions in Community Development, Temple University Press, 1987. For information on socially responsible investing, revolving loan funds, and profiles of existing development organizations, see Susan Meeker-Lowry, Economics As If The Earth Really Mattered, New Society Publishers, 1988. Finally, Seneca Twin Oaks and Albert Bates of The Farm contributed substantially to the first sections of this paper. My appreciations to all of the contributors. (Note: An edited version of this paper titled, "Options for Incorporation of Intentional Communities," coauthored by Albert Bates and A. Allen Butcher, appeared in the 1990/91 Directory of Intentional Communities, 1990, FIC/CPC. Paragraphs of this paper attributed to Albert Bates are from the Directory article.)

COMMUNITY, INC.: Legal Incorporation for Intentional Community **A. Allen Butcher**

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THE PARTNERSHIP

The general partnership can be thought of as a small group of individual proprietors operating a common business. As such, each partner pays taxes on one's own share of the profits, whether retained in the business or distributed to the partners, and each general partner is wholly liable for any partnership debt. Many community projects begin as partnerships, as there are no filing or other governmental fees required, and as individual tax rates are usually lower than corporate rates. Then, as the business becomes stable, and the need for limited liability is felt more strongly, incorporation is often sought.

A partnership agreement can be as simple as a verbal agreement and a handshake. In fact, if a community of some kind is formed without a formal agreement, the IRS and the courts will usually rule that the community is operating as a partnership. Even though a written partnership agreement is not required, it is wise to reduce the possibilities of future misunderstandings by documenting the intentions of the partnership, responsibilities of the partners, property rights and sharing, compensation to departing partners, and how to change or amend the agreement.

The limited partnership, unlike the general partnership, is required by law to have a written agreement and to file with the IRS. A "limited" partnership allows investors to become partners, but only their investment is at risk. Also, the limited partner can participate in management only to a small degree, otherwise the partnership may lose its limited status. Thus, there must always be at least one general partner who will assume full risk and responsibility.

Technically, anytime there is a change in the number of general partners, that organization dissolves and a new set of books is opened for the new partnership. A "continuing" partnership, however, can provide for a flow of short-term partners without a mandatory dissolution. Accounting and law firms are often organized in this manner, with a core of senior partners providing consistency while short term associates flow through. A partner can never be an employee, so the partnership would not have to pay social security or compensation, unless other persons are contracted as employees.

In structuring a collective business, the continuing partnership may be a comfortable method to provide for turnover. More committed individuals may then move into senior partner positions as they choose to accept managerial responsibilities. Although this structure worked for a community supported by a business called Cottage Industries Forestry in Colorado, the partnership structure proved problematic in the cases of Aloe Community, North Carolina and New Sunrise, Missouri. (New Sunrise became Sweetwater Community under the Ozark Regional Land Trust.) In both Aloe and New Sunrise, the land title was jointly held by several persons. When problems led to failure or transition, a final settlement of the disposition of the land was very difficult since one or more of the partners either could not be found or refused to cooperate.

A creative community design which can only be described as a partnership agreement is that maintained by Kerista Community in San Francisco. Kerista has a for-profit business, called Abacas, Inc., and two tax-exempt organizations; one scientific/educational, the other charitable/religious. One account, called "SPA," is kept separate from these corporate entities and used to manage the community's "voluntary wealth limitation" agreement. Each member is permitted to keep a certain amount of money in their personal account, with surpluses contributed to SPA and deficiencies drawn from it on a monthly basis. Apartment rents, food, auto and other living expenses are paid out of the SPA account, and surpluses are donated each month to the tax-exempt entities or to the SPA trust fund. The SPA account owns no property, it's balance is kept low, and any interest income is divided among the account partners in their personal tax reporting.

THE FOR-PROFIT CORPORATION

A corporation is a legal entity separate from its owners. In effect, the corporation is a "legal person," licensed by the state for perpetual existence despite turnover or transference of its ownership. A corporation can make contracts, accumulate assets, and sue or be sued in its corporate name. It is this latter aspect, called limited liability, that most clearly distinguishes between proprietorships or partnerships, and corporations. Directors or stock-holders of corporations are not liable to pay a debt or court judgment owed by the corporation, unless negligence of duty can be established, or the IRS is collecting. Corporations are subject to what is termed "double taxation." Corporations pay income taxes on their profits as corporate income, then taxes are paid again when profits are distributed to share holders as dividends to be declared as taxable income on their personal tax returns. Of course, there are ways to avoid these taxes.

Corporations exist in a wide variety of forms, and the laws concerning them are correspondingly extensive. Some of the most complicated of these laws involve stock or securities. A for- profit corporation is started by incorporators or investors who contribute the initial assets. In return, the incorporators are the owners of the corporation, and receive stock in proportion to their contribution. The company may then issue shares of "common" stock to raise money. The more shares purchased by an individual, the greater their investment, and therefore, the greater their control of the company, since each share usually gets one vote. "Preferred" stock, however, usually pays higher dividends and does not include voting rights.[1]

It is possible for intentional communities to organize as a for-profit corporation, or simply to own one separate from the community itself. The Joint Stock Corporation, in particular, was used by many historic American communities, including the "Phalanxes" or "Unions" as the Associationist communities were called. Joint stock companies pay taxes like corporations, but are not usually allowed limited liability. Thus, they are rare today.

The joint stock, like other for-profit corporations, are particularly unsuited to community organization because shareholders with voting power typically will not live in the community, while legally exercising control over it. The fact that the business corporation is not conducive to collectivity, plus the greater amount of governmental control and regulations (and therefore expense) that for-profit corporations are subject to, indicates the inappropriateness of the business corporation to the aims of community. "Furthermore," as Lee Goldstein emphasizes in Communes Law & Commonsense, "there are no advantages in the business corporation form, including limited liability, that cannot be gained by using some other, more comfortable form of organization."[2]

Never-the-less, there is at least one intentional community organized as for-profit, that is Dunmire Hollow in Tennessee. Harvey Baker wrote about Dunmire Hollow, "our main motivation for choosing a 'for-profit' corporation was that it was possible and affordable. We went with the (almost) simplest possible charter (only adding in the voting/non-voting share distinction) and by- laws, preferring to keep the ... workings of our community outside the legal framework and system. The only real drawbacks are the $150 per year in corporate franchise and excise taxes we pay the state (which have more than doubled since we started). At this point it would be very difficult to change our structure, as it ... would bring up the subject of selling out, or somebody not getting their money back...." [3]

THE COOPERATIVE CORPORATION

For those communities that have access to a good cooperative corporation law in their state, this form of incorporation can be easy and comfortable. Every state, however, has a different cooperative corporation law, and many permit only particular types of cooperatives, since the law was usually written to accommodate only certain interests such as agricultural marketing, electric or credit union cooperatives. Some states have cooperative corporation laws which state something to the effect of: "Business activity is not restricted; cooperatives may conduct business for any legal purpose." States which permit incorporation as "cooperative" appear to provide quite adequate coverage for a small community and its support industries. There has been an effort on the part of several state cooperative associations to amend their state cooperative corporation statutes to allow all forms of cooperatives; consumer, worker, and (inadvertently) intentional community. Alpha Farm in Oregon is one example of a community organized as a Cooperative Corporation.

Cooperative corporations enjoy all benefits common to corporations, such as limited liability, perpetual existence, and tax deductible fringe benefits for member-employees. In addition, a cooperative corporation can sometimes issue non- transferable membership shares in place of shares of stock and enjoy an exemption from both the Federal Securities and Exchange Commission and the State Securities Department. It is sometimes also possible, though not advised, to incorporate in a state which has a good cooperative corporation law, then register in the community's home state as a "foreign corporation." Usually, cooperative corporations must include in their articles and bylaws provisions for observing the basic cooperative principles: Open membership, Democratic control (one-member one-vote), political neutrality, and no profit motive (limited return on share capital and patronage refunds).[4]

THE NON-PROFIT CORPORATION

Shannon Farm in Virginia is an example of a community organized as a non-profit corporation. Obtaining state non-profit status is not difficult if the basic requirements are followed, some of which are listed in the next two paragraphs. Many communities use the non-profit status for incorporating the community itself, then the partnership, for-profit or cooperative corporation is used to cover their industrial activities. The state non-profit status is also a prerequisite to obtaining tax-exempt status.

Like all corporations, the non-profit is permitted perpetual existence, the paying of wages and benefits to member-employees, limited liability, and to enter property transactions and court suits. State non-profit status exempts the corporation from paying state income taxes, employment taxes, and the franchise tax, which is a minimum state income tax imposed on corporations in some states. In return, the corporation must have bylaws, officers, board of directors, meetings and rules of procedures.

A non-profit corporation can engage in a profit making activity. The state's concern in this is not whether the corporation is breaking even or realizing a profit, but rather, the concern is in what is being done with the profits generated. A non-profit corporation may retain its profits for its own use, donate them to other non-profit corporations, or pay out its profits in wages and benefits to its member-employees, so long as these are comparable to wages and benefits payed for similar work in similar fields. The non-profit corporation may not distribute what are called, "gains, profits or dividends" as this practice is contrary to the intent of non-profit law. Further, the non-profit corporation may not issue corporate stock or certificates of ownership, but the issuing of memberships is usually optional and these memberships are usually exempt from securities and stock permit laws.[5]

Generally, if a non-profit corporation is dissolved, residual assets must be donated to another non-profit. However, in the case of Cooperative Homesteads, Inc., a revision of the ir Articles of Incorporation to a for-profit status enabled the members to split the assets. See: Stucki and Yeatman, "Community Land Trusts," 1990/91 Directory of Intentional Communities, 1990, FIC/CPC, p. 105.)

SUB CHAPTER S and SUB CHAPTER T CORPORATIONS

Sub Chapter S is a federal IRS tax code for small for-profit corporations; basically representing a hybrid between the partnership and the corporation. As with the partnership, the Sub Chapter S corporation is exempt from corporate taxes. The stockholders must pay federal income taxes on all the dividends to which they are entitled, whether or not all the profits are distributed. As with the standard corporation, the Sub Chapter S corporation will likely need to retain some of its profits for capital improvements. These retained earnings in Sub Chapter S corporations are taxable to the stockholders as non-distributed income, but in the standard corporation the stockholder pays taxes only on dividends actually received.

There are a number of requirements and restrictions on the Sub Chapter S corporation, and unique relationships to other legislation such as the operating loss carryback laws. There are a set of proper filing guidelines, and no more than 20% of the corporation's income can come from royalties, rents, dividends, interest, annuities or other "passive investment income." There can be no more than 35 shareholders in the Sub Chapter S corporation, and some states do not recognize Sub Chapter S for state taxation.[6]

Sub Chapter T is an IRS code for cooperative organizations organized as state for-profit or cooperative, but <u>not</u> non-profit. Sub Chapter T corporations must be organized as the IRS defines cooperatives: 1. One-member, one-vote. 2. Primary intent must be to provide goods or services to the membership rather than making profits. 3. Any distributed earnings must be in the form of patronage refunds rather than traditional dividends. These distributed profits are exempt from corporate taxes (though taxable as individual income) and must be paid on the basis of the amount or percentage of the business or labor the member has done with the cooperative. The Sub Chapter T corporation does not pay taxes on any surplus generated by business done with members of the cooperative, only surpluses generated by business done with non-members is taxable, whether distributed or not. There are many qualifications to this section of the federal tax codes, also many states do not recognize the Sub Chapter T corporation for tax purposes.[7]

At least one community uses Sub Chapter S for its legal identity; Oakwood in Missouri. The corporation owns the land and whatever facilities or equipment is constructed or purchased in the corporation's name. All other assets are controlled by individuals. Sub Chapter S was chosen by the community in response to a crisis wherein one departing member demanded sale of the land for immediate return of that person's investment.

IRC SECTION 501 (c) (3)

There is a long list of IRS codes for tax-exempt organizations. Only a few of these codes permit an organization to receive tax-deductible donations from corporations or individuals and grants from government agencies or private foundations. This is the aspect of the IRC 501 (c) (3) determination which has caused it to be so well known, sought after, and now also more difficult to obtain. Additionally, the 501 (c) (3) organization is eligible for low mailing rates, government loans, and exemption from most forms of property tax. Religious orders that qualify under either 501 (c) (3) or 501 (d) are also exempt from Social Security, unemployment and withholding taxes.

In order to qualify under IRC 501 (c) (3), an organization must be both "organized" and "operated" exclusively for one or more purposes specified in that section; this is called the "dual test." The organizational test relates to the rules for governing an organization and its purposes stated in its articles of organization. The operational test relates to the organization's activities. Additional restrictions are that no part of the net earnings may inure to the benefit of any private shareholder or individual (other than salaries), and that no substantial part of the activities of the (c) (3)

organization (including the publishing or distributing of statements) may be for participation in any political campaign on behalf of any candidate for political office, or in attempting to influence legislation on other than an issue directly affecting the (c) (3)'s work or existence. However, individuals, so long as they are acting on their own behalf and not in the name of the exempt organization, may be involved in a political activity or may organize a separate association for that purpose. One other condition upon the (c) (3) organization is that the Articles of Organization must include a clause stating that upon dissolution, all remaining assets must be donated to another 501 (c) (3) organization.

Under the Tax Reform Act of 1969, a distinction was made between public charities and private foundations. An exempt organization loses its public status when less than one third (in most cases) of its income is realized from public sources (the "public support test" or "dual test"). Private foundations are subject to more restrictions, more taxes, and more limited tax- deductibility of donations than public charities. Of course, an exempt organization can lose its exemption altogether if it violates any of the provisions of tax-exempt law (which includes the "public service test" and "unrelated business activities" described in following paragraphs). The Revenue Service defines education as; "the instruction or training of the individual for the purpose of improving or developing his capabilities," and "instruction of the public on subjects useful to the individual and beneficial to the community," such as counseling to women on methods of home birthing and infant care.

"A charitable organization or trust must be set up for the benefit of an indefinite class of individuals, not for specific persons." Examples of purposes which are charitable in the legal sense are: "relief of the poor and distressed or of the under privileged; erection or maintenance of public buildings, monuments or works; lessening of the burdens of Government; lessening of neighborhood tensions; to eliminate prejudice and discrimination; to defend human and civil rights secured by law; or to combat community deterioration and juvenile delinquency."

Unlike education or charity, "the statutory term 'religion' cannot be defined with precision." "Religion is not confined to a sect or a ritual, as the symbols of religion to one are anathema to another." "The Supreme Court has suggested that serious Constitutional difficulties would be presented if this section were interpreted to exclude even those beliefs that do not encompass a Supreme Being in the conventional sense, such as Taoism, Buddhism, and Secular Humanism."[8]

The Revenue Act of 1950 and the Tax Reform Act of 1969 have functioned to impose limits on the exemption from taxes which organizations are permitted. Many exempt organizations operate trades or businesses which have little or no relationship to their exempt purposes aside from the need for the profits from the business to carry out such purposes.

The tax-free status of section 501 organizations enables them to use their tax-free profits to expand operations, while for-profit corporations can expand only with the profits remaining after taxes. As Congress considered this unfair competition, the above mentioned laws were enacted comprising IRC 511 through 515 defining "unrelated business taxable income." The intention of these codes is not to affect the tax-exempt status of any organization, as it is the destination, not the source of income, which is considered the ultimate test for the right to exempt status. Though most tax-exempt organizations are subject to the unrelated business taxable income codes, IRC 512 (b) (15) provides an exclusion from unrelated business taxable income carried on by a religious order or by an educational institution maintained by such an order.

Many religious or spiritual communities, of both Eastern and Western traditions are organized under section 501 (c) (3). Examples are: Ananda Ashram, New York, Providence Zen Center, Rhode Island, and many Catholic monasteries. It is also experienced that some organizations which arise as educational etc., later decide to develop a community as support for or illustration of their purposes. The High Wind Association in Minnesota, organized for appropriate technology development, and Circle Pines Center in Michigan, organized as a folk-school and conference center, are two such examples.

The case of Shiloh Community in Oregon, points out the importance of the unrelated business taxable income provision of the (c) (3) statute. The tax court ruled that Shiloh's rehabilitation program of finding jobs for former drug users, street people, and others and contributing their income to their 501 (c) (3) corporation was a practice unrelated to Shiloh's exempt purpose. The tax court claimed that Shiloh owed additional corporate taxes plus interest for every year beginning in 1977. Most of Shiloh's assets were sold to pay the IRS bill. If Shiloh had formed a separate for-profit corporation to operate its businesses, allowable deductions would have created minimal tax liabilities. [9]

There are a number of issues involving the application of the 501 (c) (3) tax status to intentional community. The Catholic monaastic orders have the most experience with this, much of which is available in the periodical called, Catholic Law Review. Albert Bates of The Farm reports that a number of Catholic orders have evolved into joining the social security system by having members work as employees, paying social security taxes for the minimum amount of time necessary to qualify for retirement benefits, then drop the employee status for membership in the tax-exempt organization.[10] As noted in the 501 (d) section, legal precedents exist establishing that organizations which do not pay wages or salaries for labor need not pay social security taxes.

IRC SECTION 501 (c) (2)

This section of the tax codes was enacted to help 501 (c) (3) and other exempt organizations to overcome several obstacles to holding and managing their property. Title holding companies are useful devises to limit liability, facilitate administration, and increase borrowing power.

IRC 501 (c) (2) exempts from Federal income tax corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to a parent organization which itself is exempt. This statute does not specify the relationship that must exist between the title holding corporation and the exempt organization it feeds. However, an exempt organization receiving support from a title holding company must exercise some control or ownership over the title corporation. Such control insures proper distribution. Some examples of the necessary control are; owning the voting stock of the title holding company, possessing the power to select nominees to hold the voting stock, appointing directors, etc. Although rare, a (c) (2) corporation may have multiple parents; such organizations as mutual funds, however, are not permissible. A (c) (2) corporation may be treated as being organized and operated for the purposes of its parent corporation if the (c) (2) corporation pays its net income to the exempt parent, and the (c) (2) organization and its parent file a consolidated income tax return.

IRC 501 (c) (2) prohibits the engagement in any business other than holding title to property and collecting income therefrom. Although renting real estate is a business under certain circumstances, it is the type of operation that IRC 501 (c) (2) was designed to allow. Additionally, a (c) (2) organization may invest in stocks and bonds and passively collect the income therefrom. However, permissible investment activities are distinguished from the active "business" of security trading. Holding a royalty interest in oil or mineral production rights falls within the IRC 512 (b) (2) exclusion from the definition of "unrelated business taxable income," and would be a permissible source of income. On the other hand, holding a working interest in such property would not fall within the IRC 512 (b) (2) exclusion, and would be an impermissible source of unrelated business income for a (c) (2) corporation. The rental of personal property, unless leased with realty, has consistently been treated as the conduct of trade or business, and would be subject to unrelated business income tax (IRC 511) if received regularly by an exempt organization. The leasing of vehicles would be impermissible, for example. Incidental, ancillary, or unrelated income producing activities such as refreshment stands or catering services operated by the title holding corporation on the premises of leased real property may be carried on without jeopardizing the corporation's exempt status, if the income received is treated as unrelated business taxable income as detailed in the IRC 512 statutes.

The Community Land Trust movement (see the CLT section), which is generally organized through the 501 (c) (3) Code, has found that the title holding corporation is particularly helpful in carrying on its programs of protecting the integrity of natural resources, and of keeping land and housing accessible to low income people. As the IRS may decide that a (c) (3)'s practice of collecting rent from land held in stewardship for community activities of work and residence does not constitute a charitable public benefit, the 501 (c) (2) corporation's ability to limit its parent 501 (c) (3)'s exposure to conflicts with the IRS may be extremely valuable.

Greg Galbraith wrote in <u>New Organizational Prospects for Community and Conservation Land Trust</u>, that community land trust (CLT) ..."organizations include community and neighborhood associations, low income housing advocates, farmland preservationists, and environmental and conservation groups. But (if,) while holding and leasing land pursuant to their purposes,.. the lease income from such properties is arbitrarily judged by the IRS to be a significant part of the organization's activities, it may cause the organization to lose its status. So where the IRS 501 (c) (3) status may seem to be most appropriate and useful to the CLT, it becomes less feasible with a substantial expansion of CLT activity."[11] Therefore, the 501 (c) (2) Title Holding Corporation may be helpful to any CLT development strategy. Specific advantages of the use of the title holding corporation are: that leasing land for homesites or houses and apartments is less likely to be recognized by the IRS as an unrelated business (possibly resulting in a loss of exempt status) if the land is under a 501 (c) (2) holding company, and that the (c) (2) helps a small (c) (3) with a high proportion of income coming from 'rent' to meet the 1/3 - 2/3 public support test.[12]

Hawk Hill Community Land Trust was the first CLT organized as a title holding corporation under the Ozark Regional Land Trust.

IRC SECTION 501 (c) (4)

This section of the IRS codes grants tax exemption to civic leagues or organizations not originated for profit but operated exclusively for the promotion of social welfare, the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. The (c) (4) organization, as with all the 501 series, can not engage in partisan politics.

The regulations describe the promotion of social welfare as promoting in some way the common good and general welfare of the people of the community, such as bringing about civic betterment and social improvements. While an exact delineation of the boundaries of a "community" contemplated by section 501 (c) (4) is not possible, the term as used in the section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit thereof.

As the preceding paragraphs imply, IRC 501 (c) (4) applies to a broad range of activities including civic leagues, social welfare organizations and local associations of employees. Within that range is included organizations called Homeowners' and Tenants' Associations.

Homeowners' and tenants' associations are two types of organizations which aid in defining the emerging concept of social welfare and the concomitant principle of community benefit. The common areas or facilities owned and maintained by the (c) (4) organization such as roadways and parklands, sidewalks and street lights, must be for the use and enjoyment of the general public. Where the homeowners' association's activities primarily rebound to the benefit of private individuals, exemption will ordinarily be precluded.

IRC SECTION 528

Homeowners' and tenants' associations are fairly widespread in our country, and for the most part the people involved in these organizations do consider themselves to be part of a "community." Condominiums are incorporated as either 501 (c) (4) (or 528) organizations yet only rarely are these considered intentional communities. One such example is Friends Community in Massachusetts. Other examples of communities structured as Homeowners Associations include Stelle, Illinois, Bryn Gweled, Pennsylvania, and Harvest Hills, Missouri. Common Ground Community in Virginia is one community which is using the IRC Section 528. Herb Goldstein of Common Ground (Rt3 Box 230, Lexington, VA 24450) wrote the following material on the application of IRC 528 for intentional communities.

"Homeowners Association" as defined in section 528 should not be confused with the requirements of a "homeowners Association" under section 501 (c) 4. The latter allows tax-exemption only if the organization promotes the common good and general welfare of a broad general community on an unrestricted basis. This requirement to "promote social welfare" is judged by IRS standards and may be impossible to meet, whereas under 528 there are no requirements that the association benefit anyone other than the intentional community itself and its members.

Section 528 is also unlike any other tax-exempt classification in that the organization does not apply to the IRS for recognition but instead elects on an annual basis to file an 1120-H tax return. The disadvantage of electing to file an 1120-H is that non-exempt function income, after allowable expense deductions plus a $100 specific deduction, is taxed at a rate of 30%. (The legislative history reveals that Congress set the rate at 30% in 1980 because it estimated that this was the medium tax bracket of members of Homeowners Associations. Now that other tax rates have been lowered, there is good cause to lobby Congress to lower this rate as well.) If the corporation can eliminate all non-exempt function income in excess of deduction it will have no tax liability.

For an intentional community to qualify to elect tax-exemption under section 528 it must meet certain requirements, or "tests". Membership in the organization is generally restricted to the owners or tenants of the residences or lots, and membership in the organization is required as a condition for ownership.

To meet the organizational test, some intentional communities may qualify under condominium provisions, but most would technically be called a "residential real estate management association," organized to administer and en-

force covenants, and to manage and maintain association property or other common areas. The magic phrase that the IRS would look for in an organization's articles of incorporation is that it is "organized solely for the purposes of acquisition, construction, management, maintenance, and care of association property." Since these terms have a broad legal meaning your by-laws can define and embellish in its preamble or purpose section your community's commitment to achieving equality, social change, respect for the earth, etc.

One "operational test" which must also be met has to do with sources of income. At least 60% of the association's gross income must consist of membership dues, fees, or assessments. This "minimum of 60% gross income from exempt function purposes" cannot include a fee charged to some members for a special service not provided to others.

The second "operational test" is that at least 90% of the association's expenditures must be in furtherance of its exempt purposes.

There are additional rules as to what may be done with money left over at the end of the year, or "overassessment." These may be returned to the members, applied to the following year's assessments, or kept for capital improvements, but apparently this surplus is not tax-exempt if it is accumulated for future maintenance costs. Careful year-end bookkeeping is required.

Although section 528 was not written specifically for intentional communities, it is applicable to groups where members own their homes (it can apply to common roof condominium arrangements as well). It works for Common Ground in Virginia, which has 80 acres including 15 2-acre lots which members lease from the community for the purpose of building a home. The rest of the land and the community buildings, ponds, and gardens are held in common. Members pay a monthly assessment to the community.

Albert Bates adds that " 'Association property' may even include property owned privately by members, provided that the private property exempted affects the overall appearance of the community, the owner agrees to keep up the appearance, and there is an annual pro rata assessment of all members to maintain the property. An example of association property would be tennis courts and swimming pools ... meeting places or retreats. Those used exclusively by the association would be exempt. Those leased to non-members would no longer qualify as 'association property'." (For reference see "Legalities and Resources" section of this paper.)

See: IRS Publication 588 ("Tax Information for Homeowners Associations"), Form 1120-H (U.S. Income Tax Return for Homeowners Associations) and its instruction sheet #2281-10. See Also: Internal Revenue Regulations, Section 1.528-1 et seq.; BNA's Tax Management Inc. 408 2d, pgs A-46 et seq.; and Legislative History, Miscellaneous Revenue Act of 1980 - P.L. 96-605 [1980 U.S.C.C. & A.N. 7307 et seq.].

IRC SECTION 501 (d)

The 501 (d) exempt status is a little used statute intended for communities which hold a common treasury and which may engage in business for the common benefit of the membership. In 1976 only about sixty communities used this statute, half of them Hutterite. The statute was originally instituted in the Revenue Act of 1936 for the Shakers and organizations like them, thereby providing the only formal legal classification for communal organizations unaffiliated with a traditional religious organization.

IRC 501 (d) provides exemption for a religious or apostolic association or corporation if: (a) it has a common or community treasury, even if it engages in business for the common benefit of its members; and (b) the members include in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for the year. Any amount included in the gross income of a member is to be treated as a dividend received.

In general, the type of organization exempt under IRC 501 (d) is one organized for the purpose of operating a communal religious community where the members live a communal life following the tenets and teachings of the organization. All of the organization's property is owned in community. Each member, upon joining completely surrenders to the organization all property which he or she owns, and, upon leaving the organization, is entitled to no part of the group assets. The activities often consist of farming and manufacturing. The income of the organization goes into a community treasury and is used to defray operating expenses and the cost of supporting and maintaining the members and their families.

Being only rarely used, the 501 (d) status is still untested in several legal respects. One unresolved issue involves the question of the amount of income from other than community owned businesses which may be contributed to the 501 (d) treasury. The Fellowship of Hope, Indiana failed to receive 501 (d) determination for this reason. "The basis for IRS denial has been that we were not 'substantially' sup-

ported through internally operated business. ... It is the percentage of ‘outside’ income vs. the ‘internally generated’ income that needs to meet this definition of ‘substantial.’ So far we have not been able to get IRS to say exactly what percentage meets this definition.”[13]

Two other issues have been resolved due to an IRS challenge aimed at Twin Oaks Community, Virginia. First, the issue of Twin Oaks’ non-payment of social security taxes was resolved when a Circuit Court Ruling precedent was cited which established that organizations which do not pay wages or salaries for labor need not pay social security taxes.

The second issue resolved in the Twin Oaks case (87 T.C. No. 72) was that a 501 (d) organization need not require its members to make a vow-of-poverty. Members may take with them when they leave all personal property they joined the community with, and may also accumulate other personal property not earned by community businesses and not contributed to the communal treasury. The Court held that, “The terms ‘common treasury’ or ‘community treasury,’ as used in section 501 (d), I.R.C. 1954, refer to the communal operation of the religious or apostolic organization itself and do not impose a requirement that all members who join such religious or apostolic organization must take a vow of poverty and irrevocably contribute all of their property to the religious or apostolic organization.”[14]

Although the 501 (d) statute is the first on any governmental level specifically designed for communal organization, great care must be taken in its use. As Twin Oaks’ tax lawyer stated, “I believe that the Internal Revenue Service still maintains an internal bias against 501 (d) organizations which do not have a vow of poverty. In saying this, however, I must point out that I have not made any inquires or seen any IRS publications which support my feelings that a bias exists.” [15]

Albert Bates adds that 501 (d) corporations have no restrictions on their political activity. They can lobby, support candidates, and publish "propaganda." Upon dissolution, assets of the corporation may be divided among the members as far as federal law is concerned. However, state law generally requires that assets remaining after payment of liabilities should be given to another not-for-profit corporation. (For the Albert Bates reference see "Legalities and Resources" section of this paper.) Note that Cooperative Homesteads, Inc. avoided this restriction placed on non-profits by first changing their Articles of Incorporation to a for-profit status. (See: Stucki and Yeatman,"Community Land Trusts," 1990/91 Directory of Intentional Communities, 1990, FIC/CPC, p 105.)

IRC SECTION 501 (c) (6)

The Federation of Egalitarian Communities (FEC: Twin Oaks, East Wind, Sandhill, etc.) chose to incorporate as a 501 (c) (6) organization as the Federation exists primarily to benefit its own member organizations. Currently the primary FEC program placed under the (c) (6) is a mutual medical disaster fund. Industrial support, technical assistance, revolving loan fund, advertising/recruitment and other Federation programs will also be able to continue to develop under this form of incorporation.

The 501 (c) (6) statute privides tax-exemption for business leagues, chambers of commerce, real estate boards, boards of trade, and professional football leagues. The regulations define a business league as an association of persons, trusts or corporations having a common business interest, whose purpose is to promote the common business interest and not to engage in a regular business of a kind ordinarily carried on for profit.

THE COMMUNITY DEVELOPMENT CORPORATION

A community development corporation (CDC) is a legal entity organized to develop projects intended to meet the economic, physical, and/or social needs of a community. The CDC may be the best central organizing institution for promoting local autonomy, especially in conjunction with an educational program stressing self-management. The goal of the CDC is "to share the common wealth among all the members (of society) in a humanizing way that rejects the racism, sexism, and classism characteristic of the capitalist market and the state."[16]

The community development corporation is a direct product of the civil rights movement. The CDC strategy plans for the community to develop its organizations and political strength in order to attract outside financial and technical aid on terms that the community can accept. Only an organized community can insist that government, corporate and private funds are committed to the community according to priorities set by the community.

As an institutional design created by urban economic planners, the CDC represents a change in focus in the ongoing war on poverty from redistribution programs such as welfare and unemployment programs carried on by state and federal agencies, to a new concentration upon encouraging greater private-sector involvement in urban revitalization through job creation. Title VII of the Economic Opportunity Act of 1964 and the Community Reinvestment Act of 1977 created the concept of the CDC, permitting them to be organized as either state non-profit or for-profit. The choice of structure determines both the source of funds that the CDC is eligible to work with, and the recipients eligible to receive project revenues.

A number of organizations now use the CDC design, although its original intent was to provide a means to encourage banks and other financial institutions to participate in activities that would otherwise be prohibited to them. The Federal Reserve System encourages bank holding companies "to take an active role in the quest for solutions to the nation's social problems... (through) equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas."[17] There are three ways a bank and a CDC can work together; a bank can form a CDC, buy an existing CDC, or join one in a co-operative venture.

The National Cooperative Bank in Washington D.C. is one of various development organizations advocating the transformation of businesses created by CDCs into worker owned businesses. Instituting employee stock ownership plans (ESOPs) or worker cooperatives (ownership and control) is a means of maintaining local control of the business while freeing CDC funds for further community investment. CDCs "can help to strengthen their community's economic infrastructure from the bottom up ... (and) make ideal intermediaries to avert plant closings with employee buyouts or nurture new business start-ups."[18]

The Community Development Credit Union (CDCU) represents the adoption of the CDC concept by the Credit Union movement. In addition to business development, CDCs and CDCUs are investing in low income housing projects. As federal rental subsidies have become more scarce, some CDCs are acting as land trusts, retaining title to land while leasing it to the home buyer. The lease often contains resale restrictions limiting the price upon resale of the house or condominium in order to eliminate speculation and to maintain the home's low-income affordability.[19]

Resale restrictions are also practiced in "limited-equity housing cooperatives," which serve a social concern, as opposed to "market cooperatives" which permit private profit taking as co- op members are permitted to sell at whatever price the market will support.

The Campus Cooperative Development Corporation (CCDC) was formed in 1987 by North American Students of Cooperation (NASCO) and the National Cooperative Business Association (NCBA), to provide technical assistance and financial aid (a revolving loan fund is planned) to groups interested in starting or expanding campus-based housing cooperatives. The development corporation works to market the cooperative concept to student governments, university administrators, and campus activists. [20]

The Stelle Community Development Cooperative is possibly the first CDC created by and for an intentional community. SCDC is a for-profit CDC, as required by Illinois law, organized for industrial, residential, agricultural, cultural and educational purposes. [21]

Cerro Gordo Community in Cottage Grove, Oregon also formed a for-profit CDC to obtain land use and other approvals, financing, install utilities, and sell home sites. The CDC will register Cerro Gordo shares to give shareholders more flexibility in buying and selling their Cerro Gordo investments. In addition, Cerro Gordo includes a cooperative consisting of residents and home owners, and The Town Forum which carrys on communicaton with residents and non-resident suporters. (From: CATALYST: Economics for the Living Earth, Vol. VIII, No. 1, Winter/Spring 1991. CATALYST, Box 1308, Montpelier, VT 05601.)

The basic premise of the land trust movement is that land,

water, air and the ecosystem existing within these elements are natural creations independent of human energy. Our relationship to the earth is best conceived as a stewardship for, rather than dominion over Earth's resources. As our culture has viewed land as a commodity, the resulting abuse of land has diminished its ability to support life in some places, and in other places people are prevented from access to land to live on.

The land trust movement approaches both of these issues through creating common ownership structure to hold land in public trust. Land conservation trusts (LCTs) preserve natural land with unique features or life forms, and agricultural land to assure its future productive ability through lease restrictions favoring organic or permaculture programs. Robert Swann of the E. F. Schumacher Society estimates that there are about 700 conservation trusts in the U.S. with over fifty new trusts established each year. [22]

Community land trusts (CLTs) lease apartments, houses or homesites to people, thereby preventing land speculation by providing long term affordability of housing. Community land trusts combine housing options, including individual and multi- family, non-profit rental, co-ops and others, with each other and with commercial activities, open spaces, community gardens and parks all in a neighborhood-wide development program. Julie Orvis of the Institute for Community Economics offers the estimate that as of 1989 there were 52 operating urban CLTs with 1,100 housing units in the U.S., and 38 more just forming.[23]

The founders of the community land trust movement in the U.S., principally Ralph Borsodi and Bob Swann, intended for the term "community" in this case to refer to all those who support the common ownership of particular parcels of land by their involvement in the community land trust organization. The trust's elected board of directors would be chosen from among this group. Thus, the majority of the board would not be residents of the land held by the trust organization. This, Borsodi and Swann felt, would be the best assurance available in the American legal system that the organization would maintain the intention of holding land under common ownership in perpetuity. The experience has been that residents of the land could at any time decide to dissolve the land trust, sell it and keep the proceeds as private property when there are no non-residents on the board of directors to keep the organization focused upon its original intent of common land ownership. (For an example of a "land trust" which was dissolved, see the discussion about Cooperative Homesteads, Inc. by Jubal Stucki and Artie Yeatman in "Community Land Trusts," 1990/91 Directory of Intentional Communities, 1990, FIC/CPC, p. 105.)

The CLT is a democratically structured corporation with a board of trustees elected by its open membership, usually including outside public-interest representatives as well as community residents. Title to land is held in perpetuity with appropriate use determined in public planning and zoning processes, and with leases given to individuals or groups upholding the trust's purposes. The trust may aid the leaseholders in arranging financing, organizing labor, and providing technical assistance in development projects. While lease holders do not own the land they use, they may own the structures upon it through purchase or construction, making them available to their heirs. If they leave and terminate their lease, they may sell to the trust, or to other individuals, often at original cost plus consideration of improvements and inflation. Some CLTs also permit the removal of privately built and owned improvements.

In the section on 501 (c) (2) organizations we discussed the Ozark Regional Land Trust's use of the title holding corporation for managing land trust land, and in the Community Development Corporation section we reviewed the low-income housing development strategy which functions as a land trust. In addition we may view three other land trust programs sponsored by the E. F. Schumacher Society, Institute for Community Economics, and the School of Living.

The E. F. Schumacher Society aided the development of the Community Land Trust of the Southern Berkshires and the Fund for Affordable Housing with the idea that "in the long term if a Community Land Trust is able to control a fair proportion (perhaps 10%) of the land in the larger community, it might be in position to act as a stabilizer of land value and also be in position to have a strong influence on local public policy relative to the land and particular zoning laws." [24]

The Institute for Community Economics (ICE) founded by Ralph Borsodi and Robert Swann (and originally named the International Independence Institute) developed the community land trust model from influences including; the village development movement initiated by Gandhi in India, Israel's Jewish National Fund which owns most of that country's productive land, Native American philosophy and the American Civil Rights movement. ICE provides educational material, financial and technical assistance to CLTs, revolving loan funds (RLFs), limited equity housing co-ops and other programs promoting equitable access to land, housing and capital. [25]

Ralph Borsodi also founded the School of Living (SoL), which today supports a regional land trust. The SoL land trust design combines the view of Ralph Borsodi with the ideas of Henry George. [26] Borsodi believed that material objects must be classified as either "property" or "trusterty," affirming that only those items which come into existence

through human labor may be morally owned. George's contribution resulted in the plan of the regional land trust taxing the use of land separate from the value of the property upon it. Such a design may affirm community influence over the use of land, a natural resource to be held in public trust, while providing for private property as the right of ownership based upon human initiative.

The School of Living's land trust program shares the same long range goals as ICE and other CLT organizations, and differs only in the consideration of the lease fee for use of land trust land. Whereas some CDCs, CLTs (such as ICE) and some other communities may place resale restrictions upon houses and other property, such that it remains available to low income persons in the future, the SoL land trusts add a surcharge onto the lease fee. This fund is then available for purchasing additional land to place under trust, or to otherwise benefit the community. The effect is that SoL's growth is partially self-funding while ICE and other land trusts have no internal capital generation programs.

The more significant difference between these two formulas, however, is that the ICE program restricts economic activity for a social good (affordability of housing), while the SoL program taxes land according to community priorities (which may be affordable housing, park land, industry or other). ICE's program, and others like it, addresses only the housing issue, while the SoL design is a much more broad social program.

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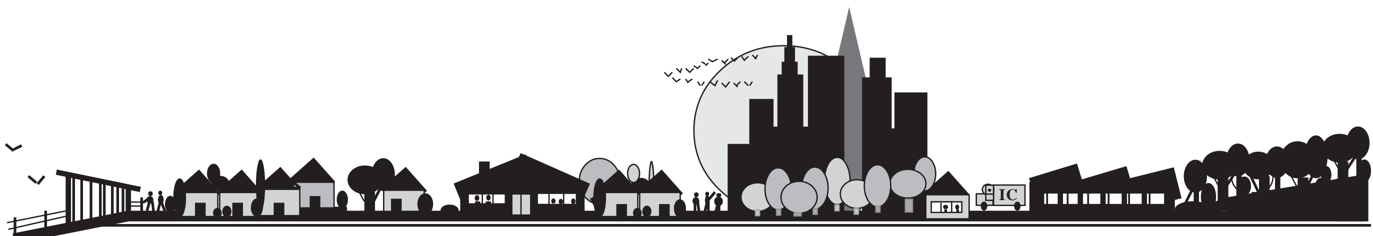

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