



Nonprofit Unincorporated Associations vs. Nonprofit Corporations: Choosing the Right Corporate Structure

Organizations often grow from networks of people who have common values and ideas. Such mission-driven networks eventually will need to decide whether their organization could benefit from a more formal structure. When making this decision, consider the following:

- Will the group exist for a long time or just to work on a short term issue?
- Will the group want to raise money to fund operations?
- Will the group want to lobby or engage in political activity?
- Does the group want to receive donations and grants?
- Will the group engage in activities that could expose members to liability?

Even if the group will exist only for a short time, a more formal structure may provide guidance as to who will arrange meetings, who should be designated to speak for the group, how decisions will be made, and who is authorized to sign checks or collect money.

Unincorporated Association:

The simplest form for a new organization is an unincorporated association. It is informal, allows flexibility if goals or needs change, and it comes with little cost.

Forming a nonprofit association has very few requirements. Texas law defines a nonprofit association as an “unincorporated organization...consisting of three or more members joined by mutual consent for a common, nonprofit purpose.” The Texas Business Organizations Code (Code) chapter on [Unincorporated Nonprofit Associations](#) provides no guidance on how to establish an unincorporated nonprofit association. Tex. Bus. Org. Code [Ch. 252](#). The organization is not a filing entity, meaning that it is not required to file a Certificate of Formation or Articles of Association with the Texas Secretary of State. Chapter 252 sets forth two *optional* filing requirements: 1) a statement of authority to transfer an estate or interest in real property and 2) to appoint an agent to receive service of process. Although there is no state filing requirement, the association must file formation documents if it plans to seek federal tax-exempt status. Bylaws are usually adopted by associations to define governance issues.

The Code does not mandate registration or organizational requirements, but nonprofit associations *are* required to keep “correct and complete” account records for at least three years after the end of each fiscal year and must make that information available to the members of the association. The Texas Attorney General’s office is authorized to inspect and make copies of records and other documents to monitor and investigate compliance with state law.

Although many of the differences between nonprofit unincorporated associations and nonprofit corporations are addressed in the Code, other factors come into play when choosing between the two structures. The single major benefit of an unincorporated association is that it is unhindered by the strict organizational, reporting, and registration requirements of nonprofit corporations. This informality will be lost, however, if the organization decides to seek federal tax-exempt status. Organizing as an unincorporated nonprofit association therefore benefits organizations that are small, do not plan on receiving much money, whose activities are mostly internal, and whose transactions with outside parties are limited. If the organization anticipates growth, wishes to pursue tax exempt status and engages in many outside transactions, becoming a nonprofit corporation is probably the best option.

The following illustrate some similarities and differences between nonprofit corporations and unincorporated associations:

Formation, Records, and Reporting Requirements:

The Code governs the formation of nonprofit corporations. It sets forth requirements for the number of directors, voting rights of directors and members, meeting procedures, notice requirements for meetings, the officers, and their duties. A nonprofit corporation must file a [Certificate of Formation](#) with the Secretary of State. If the goal is to become tax-exempt, additional language is required in the State filing. See [IRS Pub. 557](#).

Nonprofit corporations may be organized for any lawful purpose, but to qualify for tax exemption the purposes are more limited, such as religious, charitable, and educational. Once formed, a nonprofit corporation has the right to perpetual existence as long as it complies with the law.

In addition to formation requirements, Texas law mandates that nonprofit corporations meet certain requirements for record keeping and reporting. The corporation must keep “correct and complete” books and account records and minutes of all board, committee, and member proceedings and keep a record of the names and addresses of voting members. This information is to be made available to members upon written demand. If the corporation raises more than \$10,000 a year, it must maintain full and correct financial records for each transaction in accordance with generally accepted accounting practices, and the board must prepare an annual report of the corporation’s financial activity. Financial activity reports must be filed with the IRS at the close of each fiscal year.

Tax Exempt Status:

Both nonprofit associations and nonprofit corporations may apply for and receive recognition of tax-exempt status from the IRS. The requirements are the same for any organization seeking tax-exempt status under IRC Section 501(c)(3), whether a trust, corporation, or association. The organization must obtain an [Employer Identification Number](#), submit a [IRS Form 1023 Application](#) that includes an exempt purpose, a detailed narrative description of the organization’s activities, financial data, its articles of organization (and bylaws, if a corporation) and other documents as required or requested. The articles of association or incorporation documents must contain certain language as suggested in [IRS Publication 557](#). Churches and other organizations having gross annual receipts of \$5,000 or less are not required to apply to the IRS for tax-exempt status.

Although an organization may be recognized as tax-exempt, it may have to pay taxes unrelated business income, that is, income unrelated to its exempt purpose. For both nonprofit corporations and nonprofit associations, unrelated business income will be taxed at corporate income tax rates.

Liability:

As a legal entity, members of a nonprofit corporation and its Board of Directors are protected in these roles from personal liability for breaches of contract or tortious acts or omissions of the corporation. Board members may still be liable for individual acts, however. The Code provides similar protections for nonprofit associations: members are not liable for a breach of the association’s contract or for a tortious act or omission merely because the person is a member.

The Code provides detailed guidance on indemnification of directors of the nonprofit depending on the nature and outcome of the lawsuit. A nonprofit corporation may not indemnify a director that engaged in willful or intentional misconduct or that received an improper personal benefit. It must, however, indemnify a director against reasonable expenses in a lawsuit filed against the director if the outcome of the lawsuit favors the

director. Partial indemnification may be available to a director who is not wholly successful if the director acted in good faith and reasonably believed the conduct was within the best interests of the corporation. Indemnification may also be available for defense against criminal prosecution if the director had no reason to believe his or her conduct was unlawful. The Code does not set forth similar indemnification provisions for nonprofit associations. If the association wants these provisions, it must take affirmative steps to create and impose them.

The Charitable Liability and Immunity Act (Tex. Civ. Prac. & Rem. Code §84) allows volunteers that serve charitable organizations some measure of immunity from civil liability under certain circumstances. Under the Act, a “charitable organization” is any corporation, foundation, community chest, or fund that is exempt from federal income tax through IRC 501(c)(3) or (c)(4). If the organization or nonprofit association is not exempt under IRC Section 501(c)(3) or (c)(4), immunity applies only if it is a bona fide religious, charitable, educational, etc. organization. Additionally, it must not participate in any political campaign, must receive one-third of its financial support in any given year from private or public gifts, grants, contributions, or membership fees. In short, volunteers for unincorporated associations may still be subject to personal liability if the unincorporated association fails to meet these funding requirements.

Powers as a Legal Entity:

A corporation, by definition, is an organization formed by state law that acts as a “person” to carry on business or other activities. The corporation has the power to sue or be sued, purchase, lease, acquire, hold, and transfer property in its own name, make contracts, or be named as a beneficiary.

The Code confers nonprofit associations with powers similar to those of corporations. A nonprofit association may sue or be sued, can acquire, hold, and transfer an estate or interest in real or personal property, and can be the beneficiary of trusts, contracts, or wills.

Conclusion:

The level of formality of a group formed for a common goal or purpose depends upon many factors – anticipated longevity, its activities, funding needs, and organizational flexibility. If the nonprofit organization needs to raise money from outside sources to operate, incorporation is the best choice. Donors, grantors, businesses and the IRS are familiar with tax-exempt nonprofit corporations over the less formal unincorporated associations. Without incorporating, a nonprofit association cannot apply for tax exempt status from the IRS and therefore cannot collect tax-deductible donations. Incorporation with the Texas Secretary of State is required before an organization can apply to be a tax-exempt nonprofit.

The benefit to being a nonprofit unincorporated association is the informality and flexibility in the formation and administration of the organization. Smaller local organizations, such as music or religious clubs, may prefer an unincorporated association structure if they do not have the financial or human resources to obtain and maintain nonprofit incorporation requirements, have limited transactions with third parties, and the organization’s revenues are small.

Texas Community Building with Attorney Resources (CBAR)

4920 N. IH-35, Austin TX 78751

Tel: (512) 374-2712, Fax: (512) 447-3940

www.texasbar.org, Email: texasbar@trla.org