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Nontax Considerations Before Incorporation

Kenneth L. Guernsey
Michael Traynor
Matthew D. Brown

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**§2.1 I. DECIDING WHETHER TO START A
NONPROFIT ENTERPRISE**

{section omitted}

**§2.2 II. THREE BASIC FORMS OF NONPROFIT
ENTERPRISES**

Historically, three basic forms of legal organization of nonprofit enterprises have been used in California: the unincorporated association (see §§2.3–2.8), the trust (see §§2.9–2.11), and the corporation (see §2.12). Most California nonprofit organizations are corporations. Although the client will ultimately decide which form best suits the needs of the enterprise, this decision should be made only after discussing with the attorney the key attributes of each of the three basic forms of nonprofit enterprises.

Major factors that usually influence the choice of legal entity are ease and cost of formation; flexibility in management and operation; capacity to make contracts, own property, and exercise other legal rights; and limitations on the directors' and members' personal liability. The importance of each factor varies, depending on the organization's intended purposes and activities.

NOTE► The [American Law Institute \(ALI\)](#) is in the process of drafting [Principles of the Law of Nonprofit Organizations](#), which will cover the legal issues raised by the organization, operation, and oversight of nonprofit organizations, with an emphasis on charities. This ALI project aims not only to describe what the law is, but also to set forth optimum principles and, where appropriate, recommendations of good practice. Attorneys considering the appropriate form of nonprofit organization may find these principles helpful.

The importance of obtaining tax-exempt status (see [chap 3](#)) precludes many nonprofit organizations from being formed as business corporations under the [General Corporation Law \(Corp C §§100–2319\)](#). Any nonprofit organization, however, that is not tax-exempt and does not anticipate the need to become so might consider organizing under this law. Business corporations are not required to operate at a profit, and if no profits are earned, income or franchise taxes are minimal. The main advantage usually is the more liberal standards of conduct afforded under the General Corporation Law.

WARNING► A business corporation that holds assets for charitable or eleemosynary purposes is, with respect to those assets, subject to supervision by the California Attorney General, who may apply the strict standards of conduct for charitable trustees (see §§2.9, 2.11) to the directors’ conduct. In this event, the less rigorous standards of conduct for directors of nonprofit corporations (see §§8.97–8.124) may be preferable.

§2.3 A. Unincorporated Association

Title 3 of the Corporations Code, governing unincorporated associations, was reorganized and revised in 2004. The term “nonprofit association” now is defined by statute as “an unincorporated association with a primary common purpose other than to operate a business for profit.” [Corp C §18020\(a\)](#). “Unincorporated association” is defined as “an unincorporated group of two or more persons joined by mutual consent for a common lawful purpose, whether organized for profit or not.” [Corp C §18035\(a\)](#). Before the enactment of [Corp C §18035\(a\)](#), courts had developed a similar definition of unincorporated association as: “(1) a group whose members share a common purpose, and (2) who function under a common name under circumstances where fairness requires the group to be recognized as a legal entity.” *Founding Members v Newport Beach Country Club, Inc.* (2003) 109 CA4th 944, 962, 135 CR2d 505, quoting *Barr v United Methodist Church* (1979) 90 CA3d 259, 266, 153 CR 322.

Groups using this form of organization are diverse, including labor unions, political parties, social clubs, religious organizations, environmental societies, athletic organizations, condominium owners, lodges, stock exchanges, veterans groups, and nonprofit corporations that have failed to make requisite filings and lose their corporate status. Like corporations, nonprofit unincorporated associations are creatures of statute. See [Corp C §§18000–21401, 24001.5](#). They are not partnerships because they lack the essential partnership attribute of carrying on a business “for profit.” [Corp C §16202](#).

Nonprofit associations may, but need not, register their names and insignia with the Secretary of State to prevent registration of any deceptively similar name or insignia or any unauthorized use of the registered name or insignia. [Corp C §§21300–21310](#).

§2.4 1. Advantages

The major advantages of the unincorporated association are the relative ease with which it can be organized, the informality with

which it can act, and the relatively fewer statutory formalities applicable to it (though recently the legislature has enacted a number of statutes concerning unincorporated associations; see §2.6). Whether oral or embodied in a constitution or in the bylaws, articles of association, or other documents, these matters, as well as the association's purposes and the rights, obligations, and authority of its members, directors, and officers, are governed by the principles of agency and contract law, by implied and express agreements among the members, and by statute and case law.

In 2004, the legislature enacted the [Nonprofit Integrity Act \(Stats 2004, ch 919\)](#), which amended the [Supervision of Trustees and Fundraisers for Charitable Purposes Act \(Govt C §§12580–12599.7\)](#) so that “unincorporated associations . . . and other legal entities holding property for charitable purposes” are now expressly covered by that Act. [Govt C §12581](#). The amendments also clarified that an unincorporated association may qualify as a trustee under the [Supervision of Trustees and Fundraisers for Charitable Purposes Act](#) if it holds property in trust under a charitable trust or it accepts property to be used for a particular charitable purpose distinct from the general purposes of the association. [Govt C §12582](#). Therefore, depending on the nature of their activities, some nonprofit associations may be subject to Attorney General supervision and the reporting requirements and other provisions of the Act. See [chap 11](#).

NOTE► In signing the [Nonprofit Integrity Act](#), Governor Schwarzenegger encouraged the legislature “to ensure the nonprofit community is not subjected to needless bureaucracy thereby potentially hampering [their] work and contributions,” and “to revisit this issue” if the bill “results in unnecessary expense to the non-profit community.” [Historical & Statutory Notes to Stats 2004, ch 919](#), following [Bus & P C §17510.5](#) (West’s Ann. 2005).

In 2005, the legislature enacted several statutory provisions concerning governance of unincorporated associations, including termination or suspension of membership, member voting, amendment of governing documents, merger, and dissolution. See [Corp C §§18300–18620](#). See also [§2.6](#).

§2.5 2. Disadvantages

There are three major disadvantages that make the unincorporated association less than desirable for most nonprofit enterprises:

- The uncertainty of the law governing the association and its members (see [§2.6](#));

- The uncertainty about the liability of association members in SLAPP suits (see §2.7); and
- The difficulty of drafting comprehensive documents that would relieve some of this uncertainty (see §2.8).

PRACTICE TIP► Depending on its purposes, it may be beneficial for an existing nonprofit unincorporated association to become a public benefit corporation (Corp C §5121), mutual benefit corporation (Corp C §7121), or religious corporation (Corp C §9121). Changing to corporate status requires authorization in accordance with the association’s rules and procedures. Corp C §§5121(a), 7121(a), 9121(a). For filing requirements and effect of the change, see Corp C §§5121(b)–(g), 7121(b)–(g), 9121(b)–(g).

§2.6 a. Uncertainty in Governing Law

California law governing unincorporated associations suffers from a degree of uncertainty because several statutory provisions define some, but not all, of the rights, duties, and liabilities of the association and its members, directors, officers, and agents. Case law fails to clarify many of the statutory gaps.

The law is clear in some areas. Courts have found that associations are entitled to general recognition as separate legal entities. See, e.g., *White v Cox* (1971) 17 CA3d 824, 827, 95 CR 259. The statutes provide that an unincorporated association may enter into contracts (see Com C §1201(28)–(30)) and “may, in its name, acquire, hold, manage, encumber, or transfer an interest in real or personal property” (Corp C §18105). An unincorporated association may sue and be sued in the name it has assumed or by which it is known. CCP §369.5(a); see also *Barr v United Methodist Church* (1979) 90 CA3d 259, 153 CR 322 (allowing suit against church that was unincorporated association under CCP §388, precursor to CCP §369.5, did not violate constitutional protections); *Jardine v Superior Court* (1931) 213 C 301, 2 P2d 756 (CCP §388 constitutionally valid). Except as otherwise provided by law, the association is liable for acts and omissions of its directors, officers, agents, and employees acting within the scope of their authority to the same extent as if it were a natural person. Corp C §18250. Associations are also included in the statutory definition of “persons” who may register and protect trademarks and service marks. Bus & P C §14204.

The law is somewhat less certain regarding the personal liability of the association’s members for debts and contractual obligations, but statutory revisions in 2004 ameliorated to a significant degree the uncertainty wrought by the prior common law in this area. Generally

speaking, “[a] member, director, officer, or agent of a nonprofit association is not liable for a debt, obligation, or liability of the association solely by reason of being a member, director, officer or agent.” [Corp C §18605](#). More specifically, a member is not liable for the association’s contractual obligation unless he or she ([Corp C §18610](#)):

- Expressly assumes personal responsibility for the obligation in a signed writing;
- Expressly authorizes or ratifies the contract, as evidenced by a writing (other than in his or her capacity as a director, officer, or agent of the association);
- Has notice of the contract and received a benefit under it;
- Executes the contract without disclosing that he or she is acting on behalf of the association; or
- Executes the contract without authority to do so.

The relatively narrow scope of the statute represents a repudiation of the broader and somewhat vague principle announced in prior court decisions that a member who *impliedly* authorized or ratified the contract could be liable. [Comment to Corp C §18610](#). Termination of membership does not relieve a person of an obligation incurred as a member before termination. [Corp C §18310\(b\)](#).

The Corporations Code contains a corresponding section providing that a director, officer, or agent of a nonprofit association is not liable for the association’s contractual obligation unless he or she ([Corp C §18615](#)):

- Expressly assumes responsibility for the obligation in a signed writing;
- Executes the contract without disclosing that he or she is acting on behalf of the association; or
- Executes the contract without authority to do so.

The common law alter ego doctrine applicable to a corporation and its shareholders also applies to a nonprofit association and “a member or person in control of [the] association.” [Corp C §18630](#). None of the statutory liability provisions limits application of the [Uniform Fraudulent Transfer Act \(UFTA\)](#) (CC §§3439–3439.12). [Corp C §18640](#).

A member’s personal liability for torts is even more uncertain than his or her personal liability for contractual obligations. Even if an association is sued in its own name and faces liability as a separate entity, individual members who consented to or participated in the

association's acts or omissions may be personally liable under theories of joint, several, or joint and several liability. See [CCP §369.5\(b\)](#) (requiring service of process on member in his or her individual capacity before liability can be assessed).

Precisely what degree of consent or what kind of involvement might expose a member to tort liability is far from clear. For example, *Davert v Larson* (1985) 163 CA3d 407, 209 CR 445, held that tenants in common who delegated control and management of the real property to the owners' association were not immune from common-area tort liability to third parties. Subsequently, however, the legislature provided tenants in common immunity from common-area tort liability as long as the association maintains general liability insurance at a statutorily prescribed level. See [CC §1365.9](#). In contrast to *Davert v Larson*, the court of appeal in *Cody F. v Falletti* (2001) 92 CA4th 1232, 112 CR2d 593, held that members of a subdivision association were not liable for a tort injury on property in which they possessed only a limited access easement interest, not a full ownership interest. In a different factual scenario, the court in *Steuer v Phelps* (1974) 41 CA3d 468, 472, 116 CR 61, held that members of a church association who authorized an individual to drive the association's car may be personally liable for the driver's negligence under the doctrine of respondeat superior.

In 2005, the legislature added a statutory provision addressing tort liability. It provides that a member, director, officer, or agent of a nonprofit association is liable for injury, damage, or harm caused by an act or omission of the association or a director, officer, or agent of the association if he or she ([Corp C §18620\(a\)](#)):

- Expressly assumes liability for injury, damage, or harm caused by particular conduct and that conduct causes the injury, damage, or harm;
- Engages in tortious conduct that causes the injury, damage, or harm; or
- Is otherwise liable under any other statute.

Note that this statutory provision "provides a nonexclusive list of existing grounds for liability, and does not foreclose any common law grounds for liability." [Corp C §18620\(b\)](#). The legislation was motivated, at least in part, to "provide guidance to a layperson" regarding tort liability. [34 Cal L Rev'n Comm'n Recommendations 257 \(2004\)](#). But because the statutory grounds for liability are not exclusive, and common law liability is not foreclosed, [Corp C §18620](#) may simply codify the uncertainty that the legislation was intended to clarify.

LEGISLATIVE NOTE► Existing law does not provide a standard of care for a director of an unincorporated association, which leaves a director unsure of his or her duties and potential liability. The California Law Revision Commission proposed legislation that “would fill the gap in existing law by adding a default standard of care for a director of an unincorporated association . . . based on existing standards applicable to similar entities, whether incorporated or unincorporated.” [34 Cal L Rev’n Comm’n Recommendations 231 \(2004\)](#). The legislature declined to enact this standard of care in 2005, although it may revisit the issue in the future.

Another area of uncertainty stems from the lack of express statutory authority giving officers, directors, or members of an unincorporated association implied or apparent authority to act for it. Under general agency principles, an association’s officers and directors must have express or clearly implied authorization or express subsequent ratification of acts performed as agents of the association. This restriction may be a disability when dealing with banks and other organizations that require a clear indication of an agent’s authority. This uncertainty has been alleviated to some extent for real property transactions. See [Corp C §§18115, 18120](#).

In response to the uncertainty fostered by the hodgepodge of common law and state statutes governing unincorporated associations throughout the United States, the National Conference of Commissioners on Uniform State Laws (NCCUSL) drafted the [Uniform Unincorporated Nonprofit Association Act \(UUNAA\)](#) and recommended its enactment in all states. See [UUNAA](#), Prefatory Note (1992, 1996). The California Law Revision Commission recommended against adopting the [UUNAA](#) in California because it “would unsettle existing law without providing significant substantive benefit.” [33 Cal L Rev’n Comm’n Reports 729, 734 \(2003\)](#). The Commission has recommended other revisions to California law governing unincorporated associations, some of which the legislature has enacted.

§2.7 **b. Uncertainty Concerning Liability In SLAPP Suits**

Members belonging to a nonprofit association that attempts to influence governmental action on issues of public significance, such as environmental and development matters, face the threat of “Strategic Lawsuits Against Public Participation” (SLAPPs) brought by the people whose activities the association opposes. See generally [Pring & Canan, SLAPPs: Getting Sued for Speaking Out \(1996\)](#).

Although California has an anti-SLAPP statute that offers some protection (see [CCP §§425.16–425.18](#); *Briggs v Eden Council for Hope & Opportunity* (1999) 19 C4th 1106, 81 CR2d 471; *Drum v Bleau, Fox & Assocs.* (2003) 107 CA4th 1009, 132 CR2d 602), members of associations suffer more uncertainty about their ultimate liability than do participants in enterprises using the corporate form.

§2.8 c. Difficulty of Drafting

Drafting a comprehensive constitution or other governing document can be a formidable task, given the numerous rights, obligations, and procedures to be defined and the absence of clear statutory norms. Short, simple documents (or even no documents) may be used, but this approach inevitably leaves key issues to be resolved by mutual agreement or by reference to ill-defined common law principles.

§2.9 B. Charitable Trust

Trusts are essentially property management devices in which one or more persons (the trustee or trustees) holds legal title to the trust property, subject to an equitable obligation to use or hold it for the benefit of charity or of another person (the beneficiary). See [Restatement \(Third\) of Trusts §2 \(2003\)](#). On charitable trusts, see [Drafting California Irrevocable Trusts, chaps 18, 18A \(3d ed Cal CEB 1997\)](#). On charitable foundations, see [chap 19](#).

California's [Trust Law \(Prob C §§15000–19403\)](#) applies to charitable trusts that are subject to the Attorney General's jurisdiction, to the extent that the Trust Law does not conflict with the [Supervision of Trustees and Fundraisers for Charitable Purposes Act \(Govt C §§12580–12599.7\)](#). [Prob C §15004](#). Except to the extent modified by statute, the common law of trusts applies. [Prob C §15002](#).

When involved in general activities that do not involve investment or management of trust assets, a trustee must use “reasonable care, skill, and caution under the circumstances then prevailing that a prudent person acting in a like capacity would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument.” [Prob C §16040\(a\)](#). A similar, but more detailed, standard of care applies when a trustee is investing or managing trust assets. See [Prob C §§16040, 16047](#). For comparison, see, *e.g.*, [Corp C §5240](#), which establishes, for public benefit nonprofit corporations, an investment standard of avoiding speculation, looking to the permanent disposition of the funds, considering probable income and safety of the corporation's capital, and complying with any additional standards imposed in the

articles, bylaws, or expressed terms of an instrument or agreement under which the assets were contributed to the corporation.

California's standard for trust investment and management largely follows the Restatement (Third) of Trusts approach, so that a trustee's decisions are "evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust." See [Prob C §16047](#); [Restatement \(Third\) of Trusts: Prudent Investor Rule §§227–229 \(1992\)](#).

A trustee may not use or deal with trust property for the trustee's own profit and may not take part in any transaction in which the trustee has an adverse interest. [Prob C §16004\(a\)](#). These statutory duties may be modified in the trust instrument. [Prob C §§16040\(b\), 16046\(b\)](#).

Despite any provision in the trust instrument or in California law, a trust that is a private foundation as defined in [IRC §509\(a\)](#) (see [§1.12](#)) must not (see [Prob C §§16101–16102](#)):

- Engage in any act of self-dealing as defined in [IRC §4941\(d\)](#);
- Retain any excess business holdings as defined in [IRC §4943\(c\)](#);
- Make any investments in a manner that would subject the trust to tax under [IRC §4944](#);
- Make any taxable expenditure as defined in [IRC §4945\(d\)](#); or
- Distribute its income for each taxable year at a time and in a manner that will subject the trust property to tax under [IRC §4942](#).

In addition to the specific statutory provisions discussed above, many other Probate Code provisions address trustee duties, powers, and liability to beneficiaries and other persons. See generally [Prob C §§16000–16504, 18000–18005](#).

NOTE► A California nonprofit charitable corporation may be appointed as a trustee if certain statutory requirements are met. [Prob C §15604](#).

§2.10 **1. Advantages**

Charitable trusts are favored in the law. They are not subject to the rule against perpetuities ([Prob C §21225\(e\)](#)) and will not be allowed to fail for lack of a trustee ([Restatement \(Third\) of Trusts §§31, 34 \(2003\)](#)) or for lack of a detailed plan of execution (*Estate of Butin* (1947) 81 CA2d 76, 183 P2d 304). To qualify for this preferred status, a trust's purposes must be exclusively and clearly charitable, and its beneficiaries must be either the public (or some definite class or part

of the public) or institutions devoted to the public welfare. *Estate of Graham* (1923) 63 CA 41, 218 P 84.

The major advantage of a charitable trust or foundation is that it can be established and operated relatively quickly and inexpensively, without having to comply with as many statutorily required formalities as the corporate form of organization. For example, under the [Supervision of Trustees and Fundraisers for Charitable Purposes Act \(Govt C §§12580–12599.7\)](#), although both charitable trusts and charitable corporations that meet a certain revenue threshold must comply with several of the same financial reporting and auditing requirements, trusts are relieved of the obligation to establish and maintain an audit committee.

The best application of the charitable trust form is probably in the family foundation, which may allow the family to retain control while permitting certain tax benefits. Another important advantage of the charitable trust is that the founder has authority to name the trustee or trustees.

If the grantor intends that the organization simply invest its endowment and make distributions for charitable purposes, a trust may be preferable to a public benefit corporation. If the trust form of organization is chosen, the trust instrument should carefully identify successor trustees. This careful identification avoids the need to go to court to appoint a successor, allows the grantor to exercise control over the direction of the trust, helps maintain continuity of charitable purpose, informs existing trustees of the consequences of resigning, and, if a court must someday decide whom to appoint as trustee, guides the court as to the characteristics of trustees the grantor originally intended. The trust instrument should give trustees the power, in their absolute discretion, to form a charitable corporation and transfer all the assets of the trust to it.

§2.11 **2. Disadvantages**

Charitable trusts must be registered with the Attorney General's Registry of Charitable Trusts and are subject to the Attorney General's continuing supervision. See generally [Supervision of Trustees and Fundraisers for Charitable Purposes Act \(Govt C §§12580–12599.7\)](#); [Attorney General's Guide for Charities \(1988\)](#); [Bell & Bell, Supervision of Charitable Trusts in California, 32 Hastings LJ 433 \(1980\)](#).

In a proceeding involving a charitable trust, the Attorney General must be given at least 30 days' notice before a hearing on a petition filed under [Prob C §17200](#). [Prob C §17203\(a\)\(3\)](#). The Attorney General may file a petition in an action involving a charitable trust

under [Chapter 3 of the Probate Code \(Prob C §§17200–17211\)](#) when a trustee’s liability for breach of trust is at issue. [Prob C §17210](#).

When a client is considering organizing a nonprofit charitable enterprise as a trust, the initial focus should be on the intended activities. The trust may be an appropriate vehicle if the organization is primarily intended to hold, manage, or distribute property, but it is seldom appropriate if the organization intends to engage in other types of activities. If the organization is to have members’ or community involvement, input from members or the community may be inconsistent with trustee control and duties under the [Trust Law \(Prob C §§15000–19403\)](#) and the [Uniform Prudent Investor Act \(Prob C §§16002\(a\), 16003, 16045–16054\)](#). A public benefit or religious corporation may be preferable in such a situation.

§2.12 C. Corporation: Advantages and Disadvantages

The corporate form of organization offers one major advantage over the two alternatives discussed above: It is a recognized and well-understood legal entity governed by relatively clear statutory norms in such important areas as permitted activities, director and member liability and indemnification, director standards of conduct, and internal governance. Potential disadvantages of incorporation include certain built-in costs of formation, the need to observe corporate formalities, and (for some organizations) the burden imposed on directors by statutory standards of conduct. Except for small clubs or similar organizations and passive charitable foundations, these disadvantages are usually outweighed by the substantial advantages of the corporate form.

III. CHOOSING THE RIGHT TYPE OF NONPROFIT CORPORATION

A. Public Benefit, Mutual Benefit, and Religious Corporations

§2.13 1. Basis for Classification

Most California nonprofit corporations fall within one of three major classifications: public benefit, mutual benefit, or religious. In addition to the [Nonprofit Corporation Law’s](#) general provisions ([Corp C §§5000–5080](#)), each type of nonprofit corporation is governed by a separate, self-contained part of that law, known respectively as the [Nonprofit Public Benefit Corporation Law \(Corp C §§5110–6910\)](#), the [Nonprofit Mutual Benefit Corporation Law \(Corp C §§7110–8910\)](#), and the [Nonprofit Religious Corporation Law \(Corp C §§9110–9690\)](#).

The three types of nonprofit corporations differ from one another primarily in their purposes, the way their assets may be distributed, and the extent to which they are subject to statutory or administrative regulation:

- **Public benefit corporations** may be formed for public or charitable purposes, may not make any distribution of corporate assets to members at any time, and are subject to extensive governmental regulation and supervision.
- **Mutual benefit corporations** may be formed for any lawful purpose, may make distributions of corporate assets to members on dissolution (but not before), and are subject to less stringent state regulation and supervision.
- **Religious corporations** may be formed primarily or exclusively for religious purposes, may not make any distribution of corporate assets to members at any time, and are subject to less stringent governmental control and supervision.

A corporation's classification often relates to its purposes. Incorporated charitable organizations such as foundations, community chests, and hospitals are often organized as public benefit corporations. Societies, fraternal orders, trade and homeowners' associations, clubs, and similar organizations conducted for their members' benefit are often organized as mutual benefit corporations. Churches, seminaries, and other religious organizations are often organized as religious corporations. If the organization's purpose is religious, then it can be a religious corporation, even if it is a hospital, school, or other organization that could also be formed as a public benefit corporation. In fact, many nonprofit hospitals were formed by churches and continue to be religious organizations. Foundations may also be either religious or public benefit corporations, depending on their purpose.

PRACTICE TIP► To be a religious organization, the organization must have a religious purpose, even if the purpose is evidenced by activities that are also commonly carried on by public benefit corporations. For example, a private school that has as its purpose raising children in a particular faith and inculcating religious values would qualify as a religious organization; a school that has no statement of faith and focused only on education would not.

Some overlap occurs among the three main types of nonprofit corporations. For example, a corporation with religious purposes could organize as a public benefit corporation, although it would be unlikely to do so because public benefit corporations have less

freedom in the management of their affairs and face more extensive Attorney General supervision than religious corporations. See *McKeon v Mercy Healthcare Sacramento* (1998) 19 C4th 321, 329, 79 CR2d 319, overruled on other grounds in *Silo v CHW Med. Found.* (2002) 27 C4th 1097, 1110, 119 CR2d 698. Similarly, a corporation with public or charitable purposes seeking to avoid the relatively strict standards of a public benefit corporation could be formed as a mutual benefit corporation if its assets were not irrevocably dedicated to charitable, religious, or public purposes—if, e.g., the articles of incorporation permitted distribution of the assets to members on dissolution or if the articles did not provide for distribution. This is also unlikely to occur because the corporation would be ineligible for a charitable income tax exemption, and, as to any assets held in charitable trust, it would be regulated much as if it were a public benefit corporation. [Corp C §§7238, 7240](#).

PRACTICE TIP► Some clients representing religious groups may wish to consider forming a corporation sole ([Corp C §§10000–10015](#)) as an alternative to a religious corporation. See [§2.17](#).

PRACTICE TIP► An advantage to incorporating as a religious corporation rather than as a public benefit corporation is that a claim for punitive or exemplary damages can be pleaded against a religious corporation only by permission of the court on the basis of a finding that the plaintiff has established evidence substantiating that the plaintiff will meet the clear and convincing standard of proof under [CC §3294](#). [CCP §425.14](#).

§2.14 2. Table: Comparison of Some Aspects of Public Benefit, Mutual Benefit, and Religious Corporations

The attributes of public benefit, mutual benefit, and religious corporations are discussed in detail in later chapters of this book. The following table provides a quick-reference summary and comparison of the three types of nonprofit corporations in a few key areas.

TABLE: COMPARISON OF PUBLIC BENEFIT, MUTUAL BENEFIT, AND RELIGIOUS CORPORATIONS

	PUBLIC BENEFIT CORPORATION	MUTUAL BENEFIT CORPORATION	RELIGIOUS CORPORATION
1. Purposes	Any public or charitable purpose. Corp C §5111 .	Any lawful purpose, except that a corporation whose assets are irrevocably	Primarily or exclusively religious purpose. Corp

	PUBLIC BENEFIT CORPORATION	MUTUAL BENEFIT CORPORATION	RELIGIOUS CORPORATION
		dedicated to charitable, public, or religious purposes and that must distribute its assets to similar organization on dissolution cannot be a mutual benefit corporation. Corp C §7111 .	C §9111 .
2. Members	Corporation may, but need not, have one or more classes of statutory members and may refer to others as “members” if desired. Corporation may specify qualifications for membership (including fees), rights of members, and transferability of memberships. Corp C §§5310–5354 .	Same as public benefit corporation. Corp C §§7310–7354 .	Same as public benefit corporation. Corp C §§9310–9353 .
3. Distributions to Members	No distribution may be made to members. Corp C §5410 . Creditors, directors, members, or Attorney General (AG) may recover improper distributions on behalf of corporation. Corp	Distributions to members are permitted only on dissolution or, subject to limitations, in connection with repurchase or redemption of memberships. Corp C §§7410–7414 . Nonconsenting	No distributions may be made to members. Creditors, directors, or a specified minimum number of members may recover improper distributions on corporation’s

PUBLIC BENEFIT CORPORATION	MUTUAL BENEFIT CORPORATION	RELIGIOUS CORPORATION
C §5420.	creditors may recover improper distributions from recipients who had knowledge of facts indicating impropriety on corporation's behalf. Corp C §7420.	behalf. Corp C §9610.

{remainder of section omitted}

§2.15 B. Some Other Types of Nonprofit Corporations

In addition to the three major types of nonprofit corporations recognized in California (see §§2.13–2.14), several minor types of nonprofit corporations are recognized under California law (see §§2.16–2.18) for special purposes. It is also possible to operate a foreign nonprofit corporation in California (see §2.19). The following sections briefly discuss some of these other types of nonprofit corporations.

§2.16 1. Cooperative Corporations

A cooperative corporation (Corp C §§12200–12704) is a special type of corporation that may be formed for any lawful purpose, but it must be organized and must conduct its business primarily for the mutual benefit of its members as patrons of the corporation. Corp C §12201. The law authorizing such corporations is primarily intended to apply to consumer cooperatives and cooperatives formed for the purpose of recycling or treating hazardous waste, but it also applies to other cooperatives that elect to incorporate under it. Corp C §12200. The corporate earnings, savings, or benefits must be used for the members' general welfare and must be proportionately and equitably distributed to them, based on their patronage of the corporation. Corp C §§12201, 12451. If the client wants to offer the members limited patronage refunds or dividends during operations, the cooperative corporation may be the best choice. On most other points, the law is similar or identical to the law governing mutual benefit corporations.

§2.17 2. Corporations Sole

The corporation sole is a special nonprofit corporation that can be formed by the presiding officer of a religious denomination, society, or church to manage its affairs. This type of corporation is governed by [Corp C §§10000–10015](#). Examples of corporations sole are the Catholic Church and the Episcopal Church. See *Berry v Society of St. Pius X* (1999) 69 CA4th 354, 81 CR2d 574, which discusses the origination and purposes of corporations sole, and the requirements for amending their articles of incorporation.

For a religious group whose ruling authority is centralized in one individual, the corporation sole may be preferable to the religious corporation, because it is subject to fewer governmental controls. Compare [Corp C §§10000–10015](#) with [Corp C §§9110–9690](#).

§2.18 3. Other Special Purpose Corporations

Except where noted, the following special purpose corporations are referred to in the [Nonprofit Corporation Law](#) and, in some cases, governed in part by special statutory provisions:

- **Societies for the prevention of cruelty to children and animals** are subject to the [Nonprofit Public Benefit Corporation Law](#) as well as special provisions on formation and operation. [Corp C §§10400–10406, 14500–14503](#).
- **Port and terminal protection and development corporations** are subject to the [Nonprofit Mutual Benefit Corporation Law](#) as well as special provisions on participation by public agencies. [Corp C §§10700–10703](#).
- **Nonprofit medical, hospital, or legal services corporations** are subject to the [Nonprofit Public Benefit Corporation Law](#) or the [Nonprofit Mutual Benefit Corporation Law](#), depending on the corporation's purposes, as well as special provisions on formation and operation. [Corp C §§10810–10841](#).
- **Chambers of commerce, boards of trade, mechanics' institutes, and similar organizations**, if organized with capital stock, are subject to the [General Corporation Law](#); if organized without capital stock, they are subject to the [Nonprofit Mutual Benefit Corporation Law](#). [Corp C §12000](#).
- **Fish marketing associations and corporations**, which are subject to the [Fish Marketing Act](#) ([Corp C §§13200–13356](#)), even though deemed to be nonprofit ([Corp C §13203](#)), are governed by the [General Corporation Law](#) except where it is inconsistent with express provisions of the [Fish Marketing Act](#). [Corp C §13204](#).

- **Small business development corporations** that come under the California [Small Business Financial Development Corporation Law](#) (Corp C §§14000–14099) are subject to special provisions of that law on purpose, formation, and operation, and are subject to the [Nonprofit Public Benefit Corporation Law](#) except where it is inconsistent with express provisions of the [Small Business Financial Development Corporation Law](#). Corp C §14051.
- **Mutual water companies** may be formed under either the [Nonprofit Mutual Benefit Corporation Law](#) or the [General Corporation Law](#). If formed under the General Corporation Law, they are subject to special provisions on quorum requirements and cumulative voting. Corp C §§602(a), 708(d). In either event, they are subject to special provisions on scope of operation and transfer and assessment of shares. Corp C §§14300–14303.
- **Corporations for charitable or eleemosynary purposes** are subject to the [Nonprofit Public Benefit Corporation Law](#) or the [Nonprofit Religious Corporation Law](#), depending on whether the purpose is charitable or religious. Corp C §10200 (limited in application to corporations in existence on December 31, 1979).
- **Agricultural nonprofit cooperative associations** are provided for in [Food & A C §§54001–54294](#). They are subject to the General Corporation Law, rather than the Nonprofit Corporation Law, except when it is inconsistent with the relevant provisions in the Food and Agricultural Code. [Food & A C §54040](#). Three or more natural persons may form such an association to market the products of its members, to supply machinery to its members, or to finance these activities. [Food & A C §54061](#). The association may then enter into marketing contracts that require the members to sell products exclusively through the association. [Food & A C §54261](#). See [McTigue-Floyd, *Agricultural Cooperative Law: A Selective Bibliography*, 10 San Joaquin Agricultural L Rev 53 \(2000\)](#).

The foregoing list is not exhaustive. See, e.g., [Ins C §§10970–10976](#) (for fraternal benefit societies), [Ins C §§11400–11407](#) (firemen’s, policemen’s, and peace officers’ benefit and relief associations).

§2.19 4. Foreign Nonprofit Corporations

Foreign nonprofit corporations are expressly exempt from the statute making California law applicable to foreign business corporations having activities and shareholders in California. [Corp C §2115](#). Therefore, a foreign nonprofit corporation may apparently look

to the law of the state in which it is organized for rules on management, standards of conduct, distributions, and similar matters. For illustrative rules, see the [Model Nonprofit Corporation Act \(1987\)](#). This exemption seems to suggest that some of the rigors of complying with California's [Nonprofit Corporation Law](#) (*e.g.*, the director "self-dealing" provisions) could be avoided by incorporating in another state, but as a rule this is probably not the case.

If a foreign corporation does any business or holds any property in California for charitable or eleemosynary purposes (other than religious purposes), it is subject to the [Supervision of Trustees and Fundraisers for Charitable Purposes Act](#) ([Govt C §§12580–12599.7](#)), which requires that reports be periodically filed with the California Attorney General and gives the Attorney General power to investigate the corporation's affairs to verify compliance with its stated purposes and with the terms of any charitable trusts it has assumed. This power is broad enough to allow the Attorney General to prosecute for violations of applicable fiduciary standards. The fiduciary standards applied would probably be the strict California standards for charitable trustees. See [Prob C §§16000–16105](#). Although these standards have been expressly made inapplicable to directors of California nonprofit corporations ([Corp C §§5230\(b\), 7230\(b\), 9240\(b\)](#)), directors of foreign nonprofit corporations have no such exemption. A pertinent exclusion from the Act's coverage is a charitable corporation organized and operated primarily as a religious organization, educational institution, hospital, or a health care service plan licensed under [Health & S C §1349](#). [Govt C §12583](#).

In addition, foreign nonprofit corporations transacting intrastate business must qualify to do business and designate an agent for service of process in California in the same manner as foreign business corporations. [Corp C §§6910, 8910](#); see [Corp C §§2100–2117](#). They must also establish exempt status with the Franchise Tax Board. There is a qualification fee (\$30) for filing the statement and designation of agent for service of process by "a foreign, nonprofit, nonstock corporation, and of a foreign corporation organized for educational, religious, scientific, or charitable purposes, and not issuing shares." [Govt C §12186\(e\)](#).

There is seldom any advantage but there may be several disadvantages for a California group to organize in another state as a nonprofit corporation. There may also be choice of law and corporate governance issues, beyond the scope of this chapter, if the other state permits greater limits on liabilities of or broader indemnities to directors and officers than California law permits.

§2.20

**IV. SALES OF MEMBERSHIPS UNDER
CORPORATE SECURITIES LAW**

{section omitted}