Section 7

The Process and Benefits of Incorporation

Incorporation is the process of a business or nonprofit group becoming a corporation. A corporation is a legal, non-living entity – a business or nonprofit organization – that has rights and powers similar to those of people, such as the power to buy, sell and own property, engage in business transactions, and to sue and be sued. When a unit or department becomes incorporated, it does so under the laws of the state where it is located because state and local corporations are defined and regulated by state, not federal, laws. Each state has the authority to establish its own laws regarding corporations; therefore, corporate laws can vary to a degree from state to state. However, all fifty states require corporations to have articles of incorporation, bylaws, and a board of directors, and throughout the country subsidiary corporations must follow the same basic rules as entities accountable to the parent corporation.

Benefits of Incorporation

The most important benefit of incorporation is limited liability, which protects members and employees of corporations from lawsuits against the corporation or a particular member or employee of that corporation. If an incorporated organization or one of its members or employees takes an action that results in a lawsuit, the members and employees of the corporation are generally protected from being sued themselves for damages, unless the person is the primary reason the lawsuit was filed. Organizations are commonly sued when they owe a debt that they cannot or do not pay, one of its members or employees acts in a negligent way that harms someone or something, or the corporation or one of its members or employees does something improper or illegal. In most cases, innocent members and employees of an incorporated organization cannot be personally sued to cover debts and damages of the corporation.

Organizations that are not incorporated (unincorporated entities), might not have the protective benefits of limited liability. If your unit is not incorporated and one of its members incurs a debt or causes damages in her capacity as a unit member, every member of your unit could be held personally responsible. This is true even for members of the unit who had nothing to do with the action generating the lawsuit. There may be other state laws that protect members of ***un***incorporated units, but this varies by state and may not provide as much protection as the limited liability for corporations.

Other benefits of incorporation include the increased confidence that donors, government agencies, and members of the public typically have in the capability of incorporated organizations to achieve their mission and therefore may be more willing to donate. In addition, many foundations and government agencies will only give grants to organizations that are incorporated.

Limits of Legal Protection Provided by Incorporation

Although being incorporated affords some protection for members and employees from lawsuits, it does not protect the unit or department from being sued. It is important to remember that departments and units are responsible for their actions and operations, a primary reason why board members should take their legal, ethical and fiduciary responsibilities seriously. In the event that a unit or department acts negligently, owes a debt it cannot pay, or by some other action triggers a lawsuit, the national organization is not liable. In addition, improper, illegal, or unwise actions by a department or unit can result in the loss of its charter.

Costs of Incorporation

The costs to incorporate are generally surprisingly reasonable. Every ALA department is already incorporated. Units or intermediate bodies wishing to incorporate must obtain and complete the proper forms from their state government, including filing articles of incorporation, paying fees (generally these are relatively nominal), and usually filing paperwork with the state government on a yearly basis to remain incorporated. You can lose corporate status if you fail to file necessary state reports and forms after becoming incorporated. Corporate laws and regulations vary by state, so check with your state government for the exact requirements that apply in your state.

Incorporation and Tax-exemption

Incorporation is not the same as tax-exemption. Incorporation describes an organization that is a legal corporate entity. Tax-exemption is a privilege granted by both the federal government (through the IRS) and state governments because each has its own authority to tax individuals and organizations. Tax-exemption is granted to nonprofit organizations that exist to do mission-driven work that benefits the public good – the public at large or a specific group, like veterans.

Is There an Alternative for a Unit That Does Not Want to Incorporate?

There is no alternative to incorporation that affords any protection from liability to the Unit. An organization is either incorporated, or it is not. While there is no requirement for ALA entities to incorporate, the national organization strongly recommends that units and intermediate bodies handling funds do so to protect members from lawsuits. Unfortunately, even individuals and organizations who are responsible and well-intentioned may find themselves being sued. Without the limited liability protection that incorporation affords, all the members of a unit could be put at risk by the actions of one member.

Insurance: Both incorporated and non-incorporated units should purchase as much insurance as needed, based on the recommendation of an attorney or insurance advisor knowledgeable in insurance matters so that you have enough to cover any judgments based on the history of judgments in your state. It is critical to have director’s and officer’s liability insurance, fidelity insurance, and as much liability insurance as necessary. Please consult an insurance representative for details.

My Unit Has Decided to Incorporate. What Do We Do Now?

Steps to Take in General	*EXAMPLE:* Steps to Take in Indiana
1. Contact your department headquarters to see if it has assisted other units in becoming incorporated, and/or has helpful information.	1. Contact the Indiana Auxiliary Department Headquarters to see if it can help or has any information to provide.
2. Contact authorities in your state's government for information and obtain the necessary paperwork. States vary, but likely sources of assistance include the secretary of state, attorney general, and/or department of revenue.	2. The State of Indiana requires that organizations desiring to incorporate to: A. File articles of incorporation with the Secretary of State; filing fee is $30 B. File form NP-20A with the Department of Revenue to obtain a tax ID number and exemption from state sales tax. No charge Forms can be downloaded from their websites or contact them by phone to request paper copies. Employees in these offices should be able to answer questions.
3. Consider consulting a licensed legal professional with experience in nonprofit law in your state. You may be able to obtain these services for free on a *pro bono* basis, or pool your funds with other units to share the cost of professional legal advice. An online search typing in the words: "incorporating nonprofit in ____ (enter the name of your state)" may provide helpful information.	3. You can find lawyers in the public directories; be sure to ask if they specialize or at least have experience with nonprofit law in your state. You can also do a web search for lawyers in your state; www.martindale.com is one example of a website that can help you locate lawyers in your state experienced in particular types of law.
4. Read the directions and complete the required paperwork thoroughly. Pay the necessary fees.	4. In Indiana, the only thing an organization has to do to become incorporated is complete two (2) forms and pay $30 (step 2). The forms are relatively short and easy to complete.
5. Once you become incorporated, most states will require you to file additional paperwork every year to stay incorporated; otherwise, you may lose your incorporation and other privileges, such as state tax-exemption. Know these requirements and be sure your department/unit files any upkeep paperwork on time.	5. In Indiana, the following forms are required each year: A. "Business Entity Report" must be filed with the Secretary of State, cost: $10 in the mail or $6 for online submission. B. NP-20 must be filed with the State of Indiana Department of Revenue. There is no fee, but a department/unit that fails to file this form annually will lose state sales tax-exemption.

Section 8

Comparing ALA Incorporated Entities to Unincorporated Entities

	Incorporated Entities: Units, Districts (possibly) and Departments	**Unincorporated Associations (UAs): <u>Not</u> <u>Recommended</u> for any ALA entity.**
Liability	Generally, members are not responsible for debts or damages incurred by the incorporated unit/department or any of its members. While an incorporated unit/department may be sued to recover debts and damages, if they were incurred through legal action and with proper board oversight in accordance with bylaws, members generally cannot be held liable to pay these debts and damages. Example: A corporation is sued by naming the corporation as the defendant. The corporation officers and governing board (DEC) may also be named because as fiduciary officers they have a high duty to the corporation and must avoid perceived conflicts of interest and bear liability of the corporation.	Members of UAs may be held personally liable—meaning their personal funds may be seized—to pay for debts or damages incurred by the unit or any of its members acting in a capacity as a member of the unit. State laws MAY or MAY NOT provide certain protections to members of <u>un</u>incorporated entities, such as good Samaritan laws and certain levels of limited liability. Check your state laws. An unincorporated association is sued by naming every member as a defendant.
Governance	Corporate law requires corporations to have bylaws, follow generally accepted parliamentary procedure, and have a board of directors. The national organization also requires all chartered units, regardless of incorporation, to have and faithfully follow Constitution and Bylaws similar to its own. Disregarding Constitution and Bylaws can be grounds for charter revocation and possible legal action.	Though not incorporated, chartered units that are UAs are required to have and faithfully follow Constitution and Bylaws similar to those of the national organization. Disregarding Constitution and Bylaws can be grounds for charter revocation.

Comparing Incorporated Entities to Unincorporated Entities in the ALA *...continued*		
	Incorporated Entities: Units, Districts (possibly) and Departments	***Un*incorporated Associations (UAs): Not Recommended for any ALA entity.**
Separate Legal Entity?	Incorporated units/departments are separate legal entities from their members. Incorporated units/departments have the power as legal entities to independently own, buy and sell property, sue and be sued, and have bank accounts. If an incorporated unit, district, or department is sued, the members of that group generally are NOT liable for debts and damages.	State laws vary, but typically, UAs are not separate legal entities from their members like corporations. Typically they cannot own, buy or sell property, sue or be sued, or have a bank account. Usually members of UAs do not have the protection of limited liability. Additional protections for members of UAs may be available but may require additional paperwork. In terms of the ALA, each chartered unit/department IS a separate, autonomous legal organization, an independent, but subordinate, entity, regardless of incorporation.
Tax-Exempt Status	All chartered groups are eligible for exemption from federal taxes under the national organization's group exemption number, regardless of incorporation. Maintaining federal tax-exemption is conditional on filing some version of the IRS Form 990 annually (e.g. 990-990N, 990T). State tax laws vary. Many states grant exemption from state taxes to nonprofits that are also exempt from federal taxes. Check your state laws.	All chartered groups are eligible for exemption from federal taxes under the national organization's group exemption number, regardless of incorporation. Maintaining federal tax-exemption is conditional on filing some version of the IRS Form 990 annually (e.g. 990, 990N, 990T). State tax laws vary. Many states grant exemption from state taxes to those nonprofits that are also exempt from federal taxes. Check your state laws.
Why Choose	Significant assets, members are active in the community, actively engaging in planning or holding events, conducting significant business, all have the potential to generate debts and damages—even if unintended—and therefore incorporation is strongly recommended for the protection of members and employees. All departments are strongly encouraged to incorporate, regardless of other factors.	Though being a UA may require less paperwork, UA status is not recommended. The paperwork required for incorporation is generally not overly demanding and the danger of personal liability of members in the case of a lawsuit is too great of a risk to take. The national organization strongly recommends that all separate legal entities in the ALA – units, districts/counties where they are separate entities, and departments -- incorporate.