Legal Entities & Legal Documents Used in Communities

1. **What is a legal entity?**

   An individual person, business, or organization with the legal capability of entering into a contract with an individual or legal entity. Creating a legal entity makes it possible for an organization to function like an individual person functions: entering into binding contracts for goods and services that it provides or others provide, including contracting for services provided or buying things, providing goods or services to others; borrowing money, loaning money; leasing or buying assets, selling or leasing assets. A legal entity must uphold the terms and conditions of its agreements (i.e. Bylaws with the state, contracts with others, etc.) or risk the possibility of being sued for failing to honor its contractual obligations. Having a legal entity is beneficial for and protects communities because it's how a group of people can together do all the same things that an individual person can do in terms of these activities. Examples: Homeowners Association, Limited Liability Company, 501©3 nonprofit, Housing Co-op.

2. **Three categories to choose from:**

   (1) Real Estate Entities,

   (2) Legal Entities for Securities and Stocks,

   (3) Legal Entities for Businesses. Most intentional communities use business entities, even though they're not ideal and don't quite fit.

3. **Ten reasons why intentional communities use legal entities** (and legal documents like leases, deeds, & contracts, and legal processes like easements) and **how they choose them**:

   (1) Credibility with individuals and organizations that can provide the community specific goods or services: for example, buying liability insurance, paying property taxes, getting a loan.

   (2) Liability protection for individual community members.

   (3) Ability to reduce federal income taxes, when possible.

   (4) Equity for community members.

   (5) Tax-deductible donations and exemption from taxes.

   (6) Ability to choose fellow community members (if the legal entity allows this)*

   (7) Protection of land from ecological damage and undesirable future development.

   (8) The community's intentions for its values, Mission & Purpose, and basic agreements are "official" for any lawyers or Courts that may review them in the future.

   (9) Exemption from state or county subdivision regulations.

   (10) Flexibility — can be changed easily.

   Not all communities have all these reasons or preferences. Some of these contradict each other and can't occur together. ***Also depends upon how the property is owned.

4. **Three levels for considering which legal entities to use:**

   (1) Which entities are legally recognized in your country?

   (2) Legally recognized in your state or province?

   (3) Whichever legal entities your community's lawyer researches and recommends specifically for your community, based on your group's particular intentions and needs. Not "a lawyer," but "your lawyer," the one your group has hired specifically for your community.

5. **"Liability" and "limited liability protection"**

   "Liability" - Being liable — responsible for — potentially being punished for one's actions through lawsuits, including being ordered by the Court to serve jail time or pay legal fees and/or punitive damages, fines, or having to pay money owed to creditors. Liability generally arises from actions that are illegal or that are considered wrong in the eyes of the law. Wrong

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actions could be actions or failure to act that result in damage, death, or loss to another person (or to a legal entity).

"Limited liability protection" — The protection that certain legal entities offer their founders, board members, officers, employees, and, re for-profit corporations, their shareholders.

If the legal entity is convicted of a criminal action or must repay a debt, it is responsible to perform any Court-ordered punishments or pay any Court-ordered fines, and/or is responsible to pay back its debts. However, because it has "limited liability protection" its founders, board, officers, employees, or shareholders are may not be personally responsible for any criminal wrongdoing or debts of their organization and their personal assets aren't vulnerable. They don't have to go to jail or pay fines or repay the organization's debts themselves (with exceptions regarding situations where they individually committed crimes or wrongs related to the corporation).

It's "limited" liability, not "total liability," because in some cases when a Court can show that a specific board member, officer, or employee knowingly caused their organization to break the law or take out a loan there was no possibility of repayment, that person is liable (that is, responsible) and can be subject to criminal charges or Court ordered fines or punishment. The court's actions in such a situation could be an example of what's called "piercing the corporate veil."

Some legal entities (such as a general partnership, or the two real estate entities) do not have limited liability protection. Thus a debtor or someone seeking punitive damages can sue the organization, and if they win the suit, the Court will force the people in the organization to pay the overdue bills or punitive damages out of their own personal assets.

The people in an organization with the most assets would be the most vulnerable.

6. "Corporations" and "nonprofit corporations"

"Corporation" - A legal entity that, like a person, can enter into contracts, buy and sell assets, goods, or services, borrow or lend money; make investments; hire employees; and pay taxes, etc. A corporation is considered an entity distinct from the people who own or operate it — it offers them limited liability protection. Its board members, officers, employees, and shareholders cannot be held personally responsible for the corporation's actions or debts.

In general, a corporation is created when its founders file two documents — Articles of Incorporation and ByLaws — with their state or province.

There are two kinds of corporation: for-profit (called "corporations") and nonprofit.

"Nonprofit corporation" ("nonprofit," "not-for-profit") — A corporation (which thus offers its board members, officers, and employees limited liability protection) that is organized not to make a profit, but to benefit the public or a certain segment of the public.

No income from a nonprofit corporation may be distributed to its members, directors, or officers. It can pay its employees reasonable wages or salaries. Sometimes its officers are paid salaries too.

A nonprofit is created when its founders file two documents — Articles of Incorporation and By-Laws — with their state or province.

A nonprofit must be designated as a nonprofit when it us first created. It can only do activities permitted for a nonprofit organization, first, by the state or province in which it's created and by the IRS (or Canadian Revenue Board), and secondly, by the activities its founders describe in the ByLaws.

Like other corporations, nonprofits can also enter into contracts, borrow money and lend money, buy and sell assets, have employees, and pay taxes. They can just be a nonprofit with no special tax exemptions. If they do want special tax exemptions, they must apply for this with the Internal Revenue Service (or Canadian Revenue Board). In the US the IRS designates the nonprofits with tax exemptions with numbers starting with "5," i.e.: 501©2, 501©3, 501©4, 501d, etc.

7. "Deeds" and "Leases," "Ground Leases"

"Deed" - A document that transfers certain property rights from one person or organization — the current owner — to another person or organization — the new owner.

The most common kind of deed is an outright transfer of all rights in the property from one owner to another; i.e. "owning the property." The transferred rights include the right to change the property physically: including building on, leasing, selling, mortgaging, giving away, or leaving to one's heirs all or part of it. (Some deeds transfer only part of the property rights, like an easement, or the right to possess the property only during one's lifetime etc., but this just focuses on the kind of deed that permanently transfers absolute rights to the property.)

When someone owns property they have a deed to that property. *(Called "real property" by the law.) A deed is permanent, at least until the new owner sells the property (i.e., transfers all the same the property rights) to a new owner.

"Lease," "Ground Lease" — A document that transfers certain property rights from one person or organization (the property owner or lessor) to another person or organization (the tenant or lessee) for a designated period of time. This is called leasing the property. The lease only transfers some rights; not all the rights that are transferred by a deed.

In a "ground lease" these rights may include the right to live there, to change the property physically, to build on the property, and to remove or tear down any buildings that one has built on the property. The lessee cannot sell, mortgage, give away, or will to his or her heirs all or part of the leased property.

The lease is temporary, and exists for the length of time stated on the lease, typically from one year to 99 years. The tenant has the lease and the transferred property rights until the term of the lease ends. A lease can be renewable. Or, the owner can lease the property to a different person or organization, or sell the property to a new owner.

8. **"Contract"** — A legally enforceable promise or undertaking that something will or will not occur. Usually it's an agreement with specific terms between two or more people or organizations. A contract describes a promise to do something specific in return for something valuable, called "consideration." The "consideration" is often money. Examples: Promissory Notes. Real Estate Sales Contract. Contract to do solar installation work.

   Contracts can be either written or oral, but oral contracts are harder to prove in Court.

   In some cases a contract can consist of several documents, such as a series of letters, orders, offers, and counteroffers — a Court can interpret these as an implied contract.

   Contracts are enforceable by law, generally either by compelling one party to fulfill its agreement or by ordering that party to reimburse the other for resulting damages. But this requires that the party who wants the other party to fulfill the contact must sue the other party for breach of contract. The other party is forced by law to fulfill the contract if the Court finds the contract was breached.

   Just signing a contract doesn't accomplish its enforcement; rather, just lets both parties know enforcement can happen.

   Contract law varies greatly from state to state.

9. **Kinds of legal entities commonly used by US intentional communities:**

   (1) Community Associations:

   - Homeowners Association
   - Condominium Association
   - Housing Co-op (or Land Co-op)

   (2) Nonprofit corporations:

   - 501©3 nonprofit
   - Nonexempt nonprofit

   (3) Other:

   - Limited Liability Company (LLC)
   - Low-Profit Limited Liability Company (L3C)

NOTE: Neither a "Land Trust" or a "Community Land Trust is a entity itself, but rather legal arrangements that use one or another legal entities — often 501©3 nonprofits — to accomplish their goals, depending on the state and the intention of the trust's founders.

The requirements about deeds, leases, contracts, and different legal entities vary from state to state. Some states don't have certain legal entities.

- **Homeowners Association, Condominium Association**. See chart.

  Examples: Most cohousing communities in the US use a Homeowners Association.

  Pioneer Valley Cohousing, MA, uses a condo association. Sharingwood Cohousing, WA, uses a "air space condo" on individual members' lots for their houses.

- **Housing Co-op (or Land Co-op)** (called by LRT "Cooperative Association"). See chart.

  Examples: Urban Soil Terra Urbana, a legal entity used by Los Angeles Ecovillage, CA;

  FROG Housing Co-op, a legal entity used by Eco Village at Ithaca, NY.

- **501©3 nonprofit** - See chart. Example: Emerald Earth Sanctuary, CA.

- **Nonexempt nonprofit** - An organization used to do something or own something with limited liability protection but no intention to make a profit or to seek tax exemptions, as nothing would be taxed. The founders create a nonprofit in their state and don't seek any tax-exemption status with the IRS (thus it's "non-exempt").

  Examples: Abundant Dawn Community, VA; Eco Village at Ithaca Village Association (one of several legal entities used by Eco Village at Ithaca, NY).

- **"Limited Liability Company (LLC)"** — See chart. A legal entity for businesses that is not a corporation but still offers limited liability protection and a tax advantage over corporations (called "pass through" taxation). An LLC is considerably more flexible than a corporation re how much money each member can put in, and how decisions are made.

  Unlike a corporation, it's not legally required to keep minutes, hold meetings, or make resolutions. However, the tax advantage is only beneficial to individual LLC members if they are in a 15% or lower income tax bracket (which is the same as the corporate tax rate).

  If a community organized as an LLC any community members with middle-class incomes, the tax rate would likely be almost twice the corporate rate.

  BIG DISADVANTAGE: The joining fee or membership fee of any new member joining is treated by the IRS as taxable income — even if the money is spent immediately for community infrastructure development. So if the community is getting new members it loses money because of these taxes.

  Examples: Sowing Circle Community, CA (owns land leased to OAEC).

- **Low-Profit Limited Liability Company (L3C)** — A legal entity for businesses that offer limited liability protection and operates with a stated goal of achieving a social benefit while making a profit as a secondary goal.

  It was created to bridge the gap between nonprofit and for-profits, allowing people to support — by investing money in — socially beneficial, for-profit ventures but with simplified tax requirements by the IRS (compared to the requirements of 501(D3 nonprofits) for "Program Related Investments."

  Thus is can have the same kinds of goals as a 501©3 nonprofit, make a profit, and have some income tax advantages, as compared to an LLC or for-profit corporation (but not as many tax advantages as a 501©3 nonprofit. It's partway between. (Don't know of any communities using this legal entity; it's new.)

Four Kinds of Legal Entities Communities Commonly Use to Own Property

Homeowners Association, Condo Association	Housing Co-op, Land Co-op	L.L.C. (Limited Liability Company)	501©3 Nonproft
Created for housing developments, so people can own their own individual homes or apartments and share ownership in the common property. Most cohousing communities⊗ use this.	People own shares in the housing co-op and have a lease to their housing unit or apartment. (Or, people own shares in the land co-op and have a lease to their lot & house.)	Created as an alternative to "S" Corporations for small businesses - it's simpler and easier to use than a corporation.	The tax-deductible nonprofit.
Pros: (1) Limited liability protection. (2) Money collected for buying, developing, building, repairing, maintaining, or managing property is not taxable. To qualify for this tax break, the community must spend 90% of its money on these things, and collect 60% of its money for these things.	**Pros:** (1) Limited liability protection. (2) You can choose your members. (3) The IRS doesn't consider the fee a new member pays when they buy in as taxable "profit" as with an LLC. (4) If you need a bank loan, you might get one from the National Co-op Bank.	**Pros:** (1) Limited liability protection. (2) Easy to set up. (3) Unlike a corporation, has special tax advantages (members are not taxed twice). (This benefit is not usually relevant for communities, though, who wouldn't have shareholders and dividends.)	**Pros:** (1) Limited liability protection. (2) Can receive tax-deductible donations. (3) Exempt from county property taxes and federal income tax. (3) Can be used to create a Land Trust or Community Land Trust.
Cons: If you don't get the percentages right, the IRS taxes you like a corporation. i.e. Earthaven paid $9,000 in taxes one year. ⊗ Cohousing residents can't choose their members because they sell housing units on the open market, not because they own their shared property as a Homeowners Assoc.	**Cons:** Regular banks often don't loan to housing co-ops, and the National Co-op Bank (which lately isn't loaning much money to housing co-ops anyway) chargers higher-than-normal interest on loans.	**Cons:** (1) The IRS considers the money a new member pays when they buy into the community as taxable "profit." So a new member's joining fee is taxed!	**Cons:** (1) Elaborate & time-consuming to set up and maintain. (2) If the community disbands the founders don't get their property purchase and development money back, but must donate the organization's property and assets to another 501(c)3 nonprofit. (3) Some people (those who want equity, families with children), tend to not join, seeking instead a community where they can have equity. (4) The community tends to attract many young people having adventures and uninterested in equity. So the community can have higher than normal turnover as its young people move on.