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Unincorporated Nonprofit Associations: Opportunities and Risks

In response to the COVID-19 pandemic, communities are eager to find new ways to deliver relief to individuals and develop solutions to widespread problems. Some of this work is being done through established nonprofit and business entities, while some is being carried out by individuals unaffiliated with any formal entity. Operating outside of an established business or nonprofit organization can promote speed and flexibility, but it can also come with increased risks to the participants, difficulty complying with charitable solicitation and tax exemption rules, and susceptibility to fraud.

This FAQ provides an overview of risks incurred by people participating in unincorporated associations. It also touches on fiscal sponsorship, incorporation, and other strategies that can be used to minimize risk and enhance legal compliance.

1. What is an unincorporated nonprofit association?

An unincorporated nonprofit association is an informal group of two or more individuals who join together for a not-for-profit purpose without creating a corporation, LLC, or other entity to do so. For example, individuals may join together to provide groceries for families impacted by the COVID-19 crisis, or run a crowdfunding campaign to help health workers obtain needed supplies. Such associations are not organized under New York's Not-for-Profit Corporation Law.

2. What are the steps to form an unincorporated nonprofit association under New York law?

Creation of an unincorporated association does not depend on compliance with any statutory provision, and there are no fees applicable. Written rules or bylaws are not required. However, the following is recommended to carry on the affairs of the organization:

- A written statement of the purpose and common goals of the association;
- Articles of association and bylaws to set out the method of operation and the designation of responsibilities of officers, as well as signing authority, to carry on the various functions of the organization;
- A budget with funding requirements;
- Retention of accurate books and records.

3. Can people who are part of an unincorporated nonprofit association be held liable for the association's activities?

Yes, the officers, directors, and members of an unincorporated association may be held personally liable for the debts and liabilities of the association if they authorize or ratify the activity. Although New York law permits lawsuits to be brought against an unincorporated association, it does not shield the individual from personal responsibility for the actions of the association.

In practical terms, this means:

- If the unincorporated nonprofit association enters into a contract, lease, or any monetary obligation, each of the members may be personally liable for breach of its terms;
- Each member may be jointly or individually responsible for payment of any judgment arising from the negligence or wrongful misconduct attributed to the association;
- The cost and availability of insurance against potential liabilities asserted against members of the unincorporated nonprofit association may be problematic given the risks associated with the form of the organization.

In contrast, officers, directors, and employees of a nonprofit corporation are generally protected from personal liability when these individuals are conducting activities on behalf of the corporation in good faith.

4. Can a donor take a tax deduction for a contribution made to an unincorporated association?

Charitable donations are tax deductible only if they are made to an organization with 501(c)(3) tax exempt status. If the organization has annual revenues over $5,000, then it must apply to the Internal Revenue Service for recognition of its tax exempt status in order for its donors to take a tax deduction.

5. Are there tax implications for members of an unincorporated association?

In addition, an unincorporated association's members may be individually liable for taxes on the association's revenues. This can happen if the association's revenues are under $5,000 and the association is not operating for strictly charitable or educational purposes, or if the revenues total more than $5,000 and the association has not obtained IRS recognition of its tax exempt status. The IRS may treat the members of the association as partners for tax purposes, meaning that each of the members may be liable for tax on a portion of the revenues.

6. Do unincorporated associations have to follow charitable solicitation rules?

Each state has its own charitable solicitation rules. New York's apply to unincorporated associations that raise $25,000 or more in a tax year for charitable purposes. Information about registration and disclosure requirements applicable to people or entities soliciting charitable funds in New York are available at https://www.charitiesnys.com/faqs_reg_new.html

7. What are some alternatives to operating as an unincorporated association?

An unincorporated nonprofit association may turn to fiscal sponsors to help carry out its mission. A fiscal sponsorship is a contractual arrangement between a person, group, or organization that does not have its own tax exempt status and a 501(c)(3) exempt organization (the fiscal sponsor). The fiscal sponsor collects tax-deductible donations on behalf of the unincorporated nonprofit association, and it may also perform certain administrative duties. For information about fiscal sponsorships, see Lawyers Alliance's "Fiscal Sponsorship FAQ," https://lawyersalliance.org/userFiles/uploads/legal_alerts/Fiscal_Sponsorship_FAQs_April_2015_FINAL.pdf. Lawyers Alliance also has a recorded webinar, "Negotiating and Understanding Fiscal Sponsorship Agreements," which can be accessed by registering at https://lawyersalliance.org/webinars/view/id/4

Alternatively, an unincorporated association can incorporate as a not-for-profit corporation and apply to the IRS for tax exempt status. Information about incorporating and seeking tax exempt status can be found in Lawyers Alliance's publication, "Getting Organized," which can be ordered at https://lawyersalliance.org/publications/list . Lawyers Alliance also has a recorded webinar, "Becoming a Nonprofit: Incorporation and Tax Exemption," which can be accessed by registering at https://lawyersalliance.org/webinars/view/id/19

8. How can an unincorporated nonprofit association find a fiscal sponsor?

An established organization with a similar mission may be willing to act as a fiscal sponsor, at least in the short term.

There are also organizations that offer fiscal sponsorship services as part of their standard activities. The following resources may be helpful in locating this type of fiscal sponsor

- National Network of Fiscal Sponsors**:** http://www.fiscalsponsors.org/
- Fiscal Sponsors Directory: https://fiscalsponsordirectory.org/

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