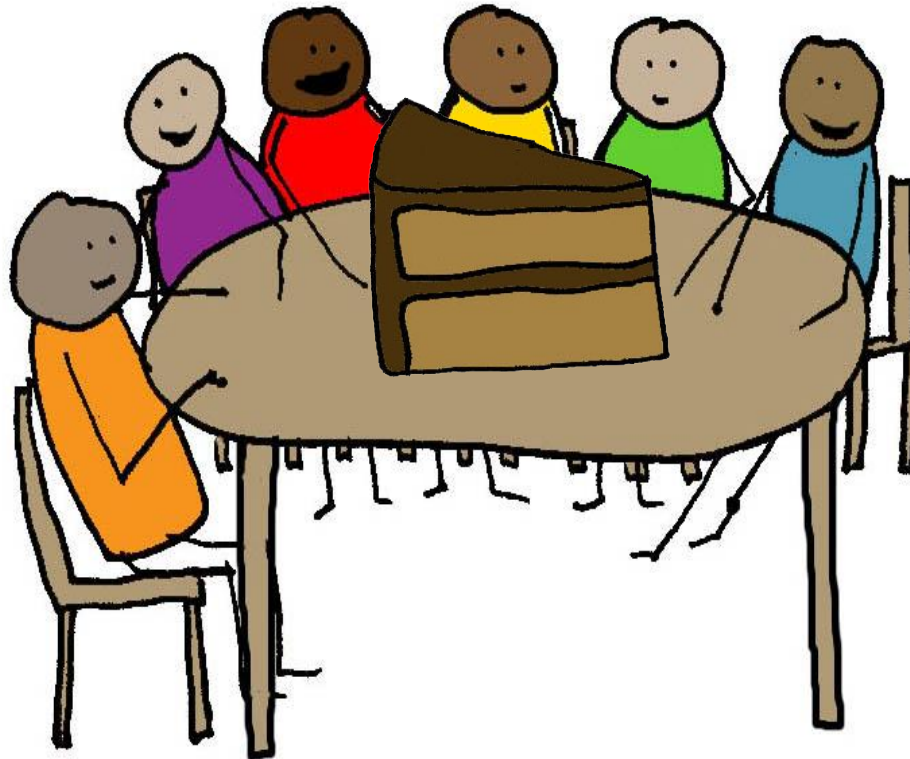


Entity Structure for Community Composters: Cooperatives, Nonprofits, For-profits, and more! Explained with the help of cake!

Note:

Many of the notes below the slides may be informative or they may be irrelevant. Some are remnants of other presentations. Read them at your own risk.



Entity structure matters
for **your compost enterprise**
and, as it turns out,
for the **whole community compost movement!**





Sustainable Economies Law Center

We support a lot of **cooperatives** and **nonprofits**...
And **SO MANY** things in between and beyond.
(We spend a lot of time in legal grey areas.)

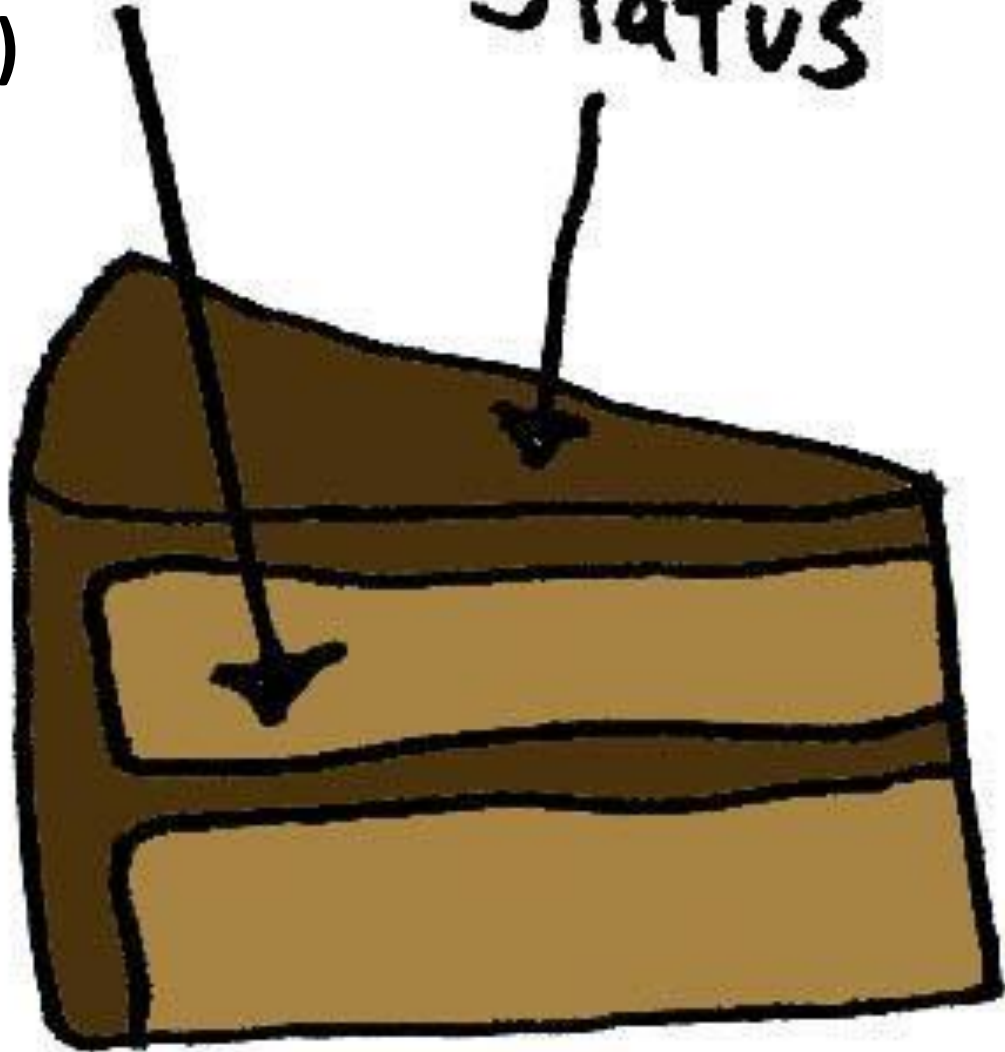


Quick poll! My compost enterprise is a:

- ☐ Sole Proprietorship (just one person owns it, no formal entity)
- ☐ Nonprofit
 - ☐ Fiscally-sponsored nonprofit
 - ☐ 501c3 nonprofit
 - ☐ 501c4 nonprofit
 - ☐ Not tax-exempt nonprofit
- ☐ Cooperative
 - ☐ Worker-owned cooperative
 - ☐ Consumer-owned cooperative
- ☐ For-profit
 - ☐ Partnership
 - ☐ Corporation
 - ☐ Benefit Corporation or Social Purpose Corporation
 - ☐ Limited Liability Company (LLC)
- ☐ It's informal or we haven't figured it out yet

Entity (State level)

Tax Status (Federal level)

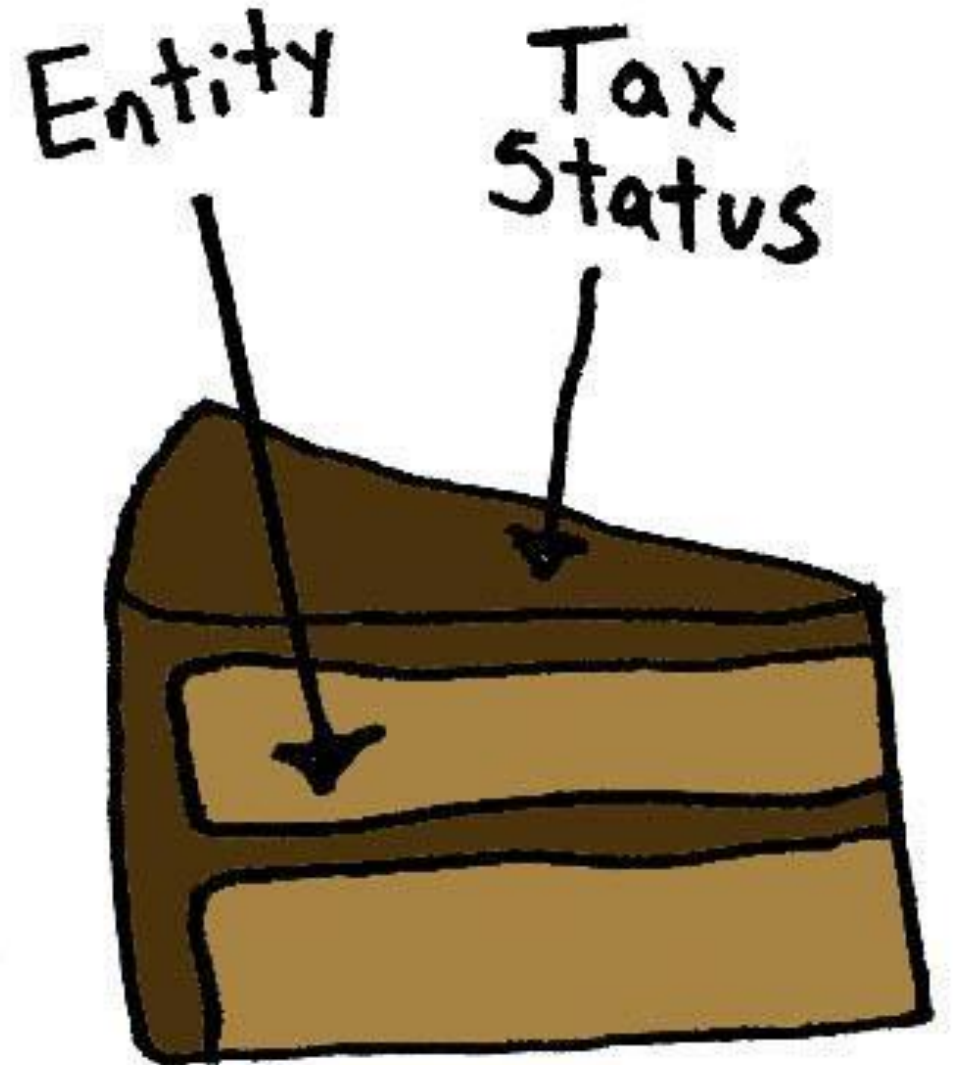
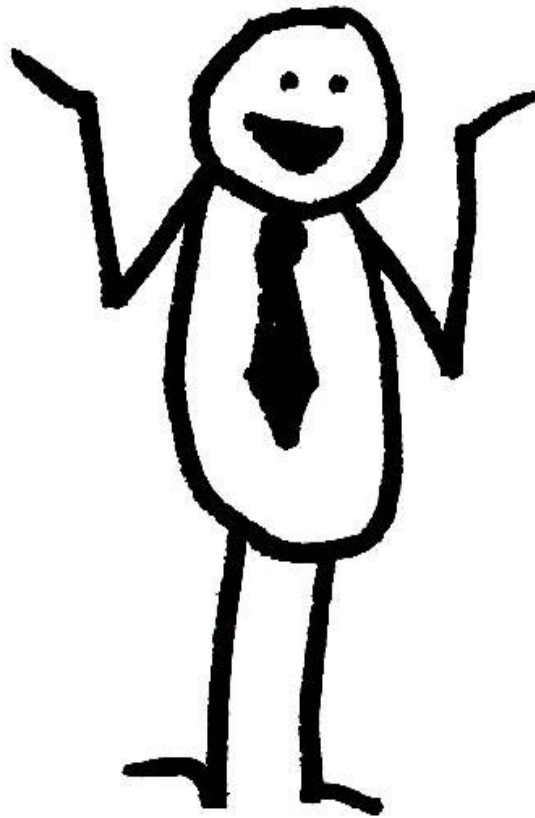


What *really* gives flavor to our enterprises?

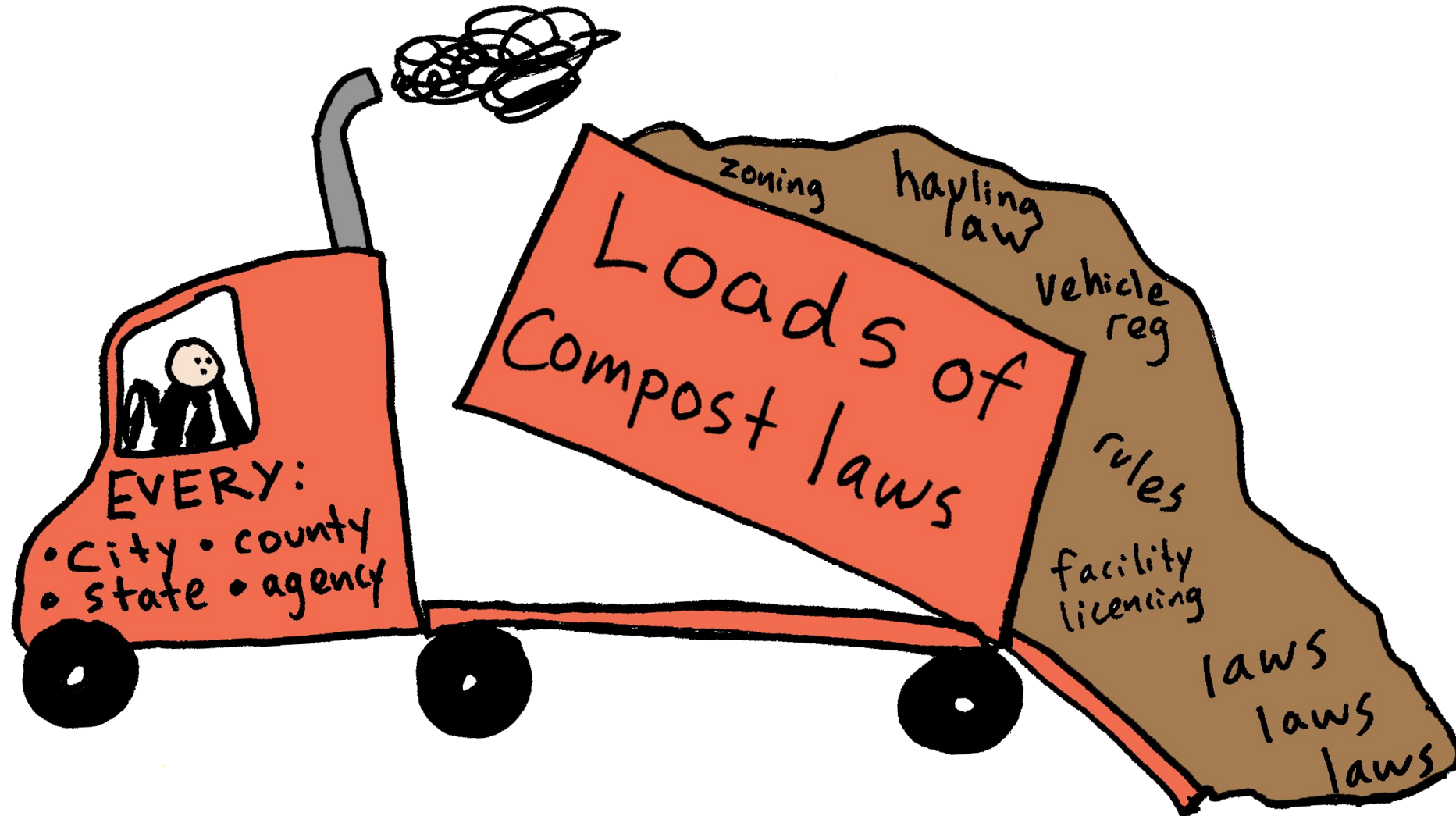


But everything I'm about to say about entity and tax status is still important because....

**These are words
policymakers and
regulators understand!**

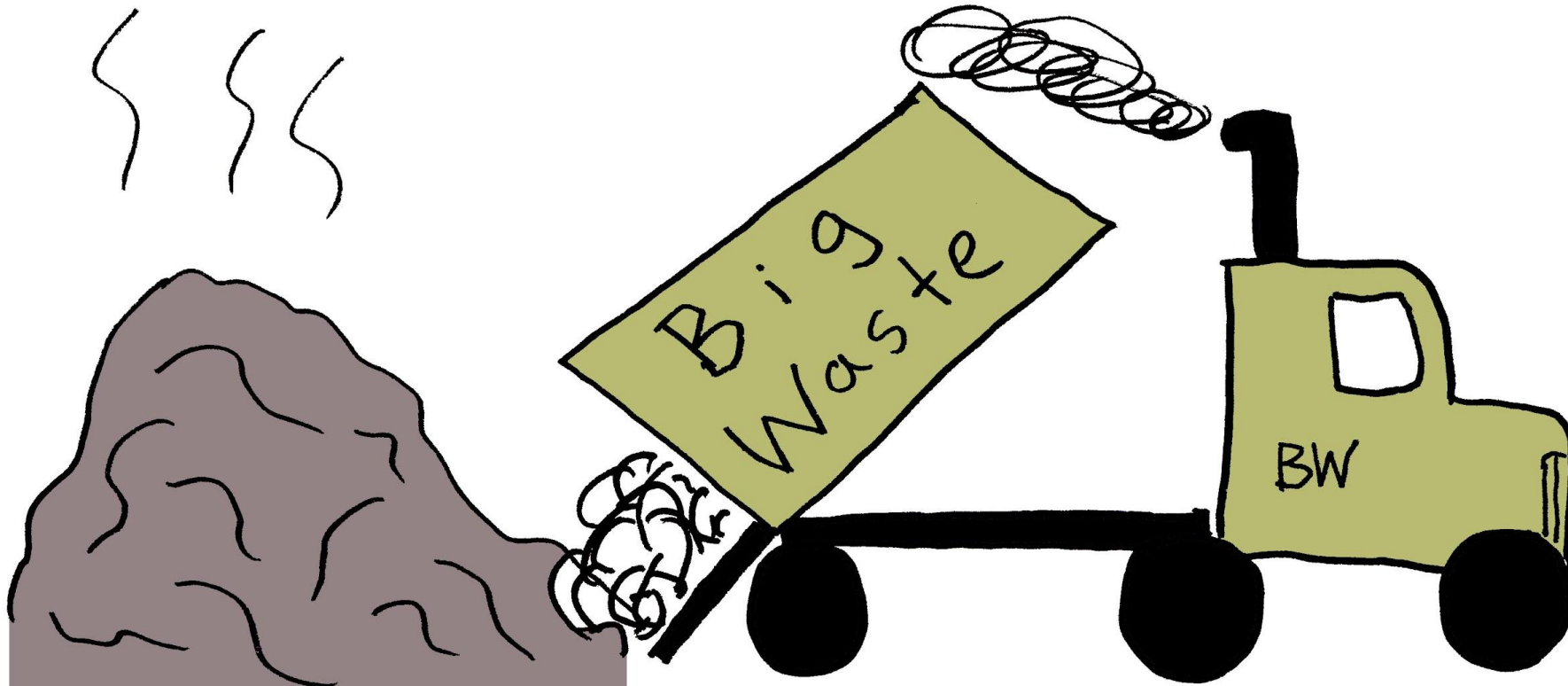


Compost policy is being made RIGHT NOW!



YIKES! The trend is to make laws that privilege LARGE-SCALE waste haulers and facilities.

- Burdensome licensing and regulatory requirements intended for large scale operations
 - Exclusive contracts (monopolies) for big haulers.



We can ask policymakers to give certain kinds of compost enterprises:

- **Exemptions** from some regulations and hauling restrictions
- Public **funding** and **preferential contracting**

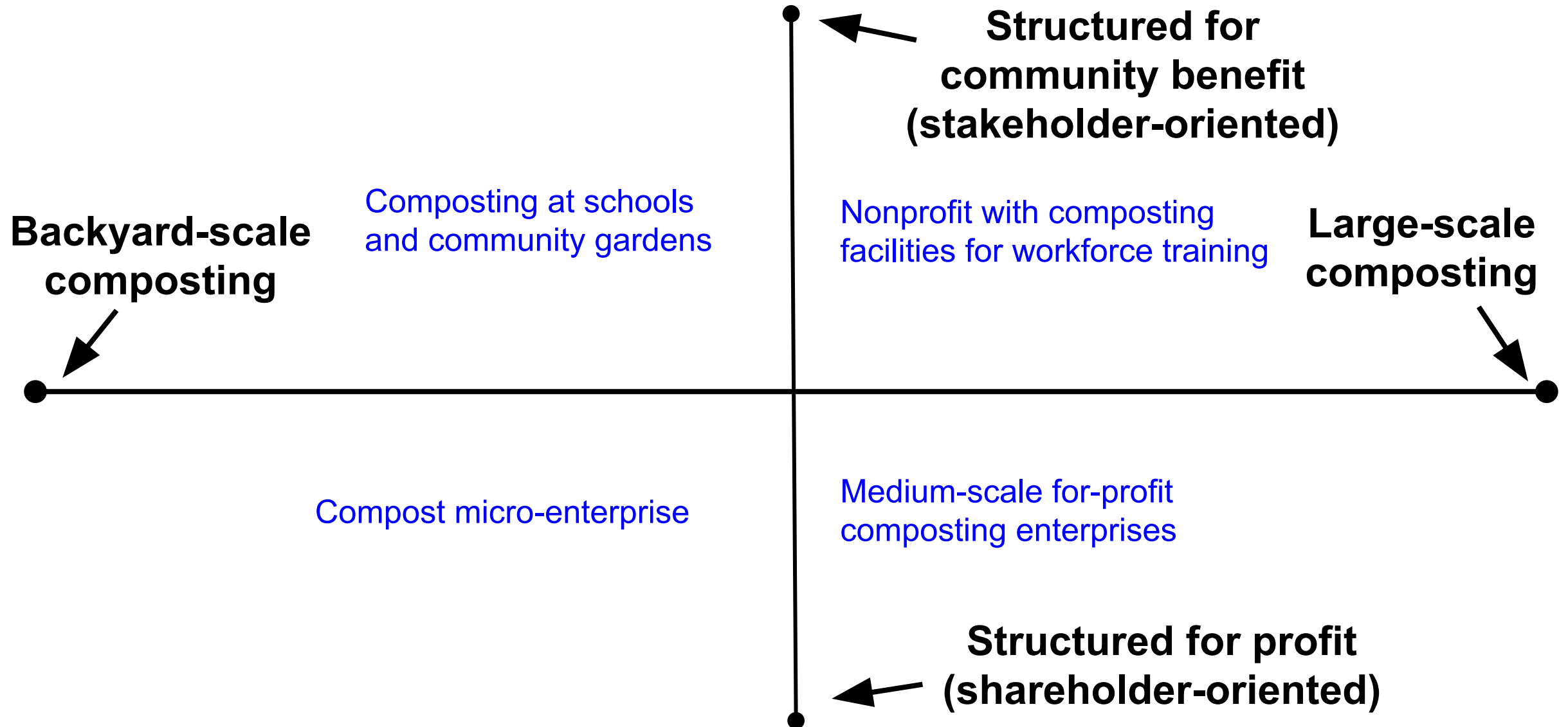
...on the basis of their:

- Small size
- Composting methods and practices
- Entity structure oriented toward public benefit (nonprofits and cooperatives)



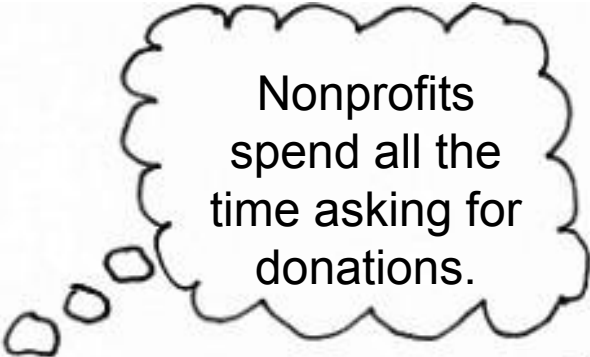
There's not much else in the way of objective criteria....or is there?

Size and entity structure:

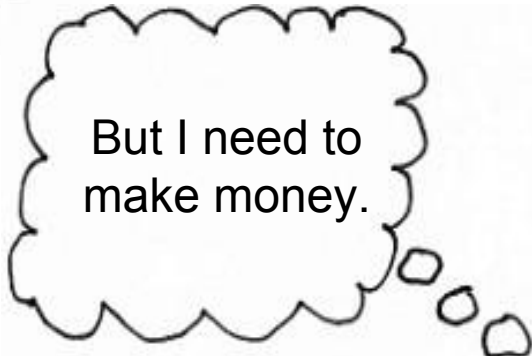


Two key points:


1. A major determinant of your entity structure for a compost enterprise may be the potential to gain policy advantages.
2. So you might need to challenge your preconceptions about nonprofits and cooperatives, like:




Nonprofits
spend all the
time asking for
donations.



But I need to
make money.



Cooperatives
spend all their
time in
meetings.



I don't want a
Board of
Directors to be
my boss.

Three general cake categories:



**Public
Benefit**

Most 501(c)(3)s,
charitable and social
welfare nonprofits

Stock corporations,
LLCs, Benefit corps,
Social purpose corps



**For Shareholder
Profit**



**Mutual
Benefit**

Cooperatives and
mutual benefit
nonprofits



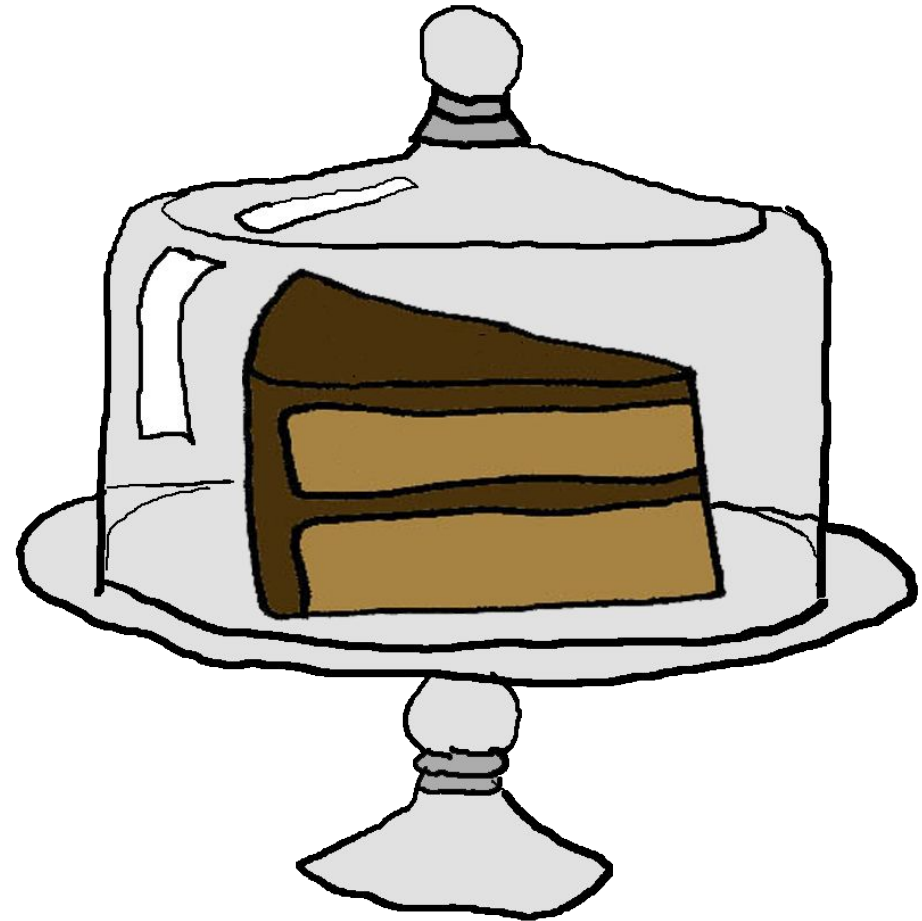


Poof!
A Partnership!

Some folks want to limit liability. What does that mean?

It doesn't mean your
enterprise is protected
from getting sued*...

*Get insurance for that.



It means that you, as an individual will be shielded from liability....uh, maybe.



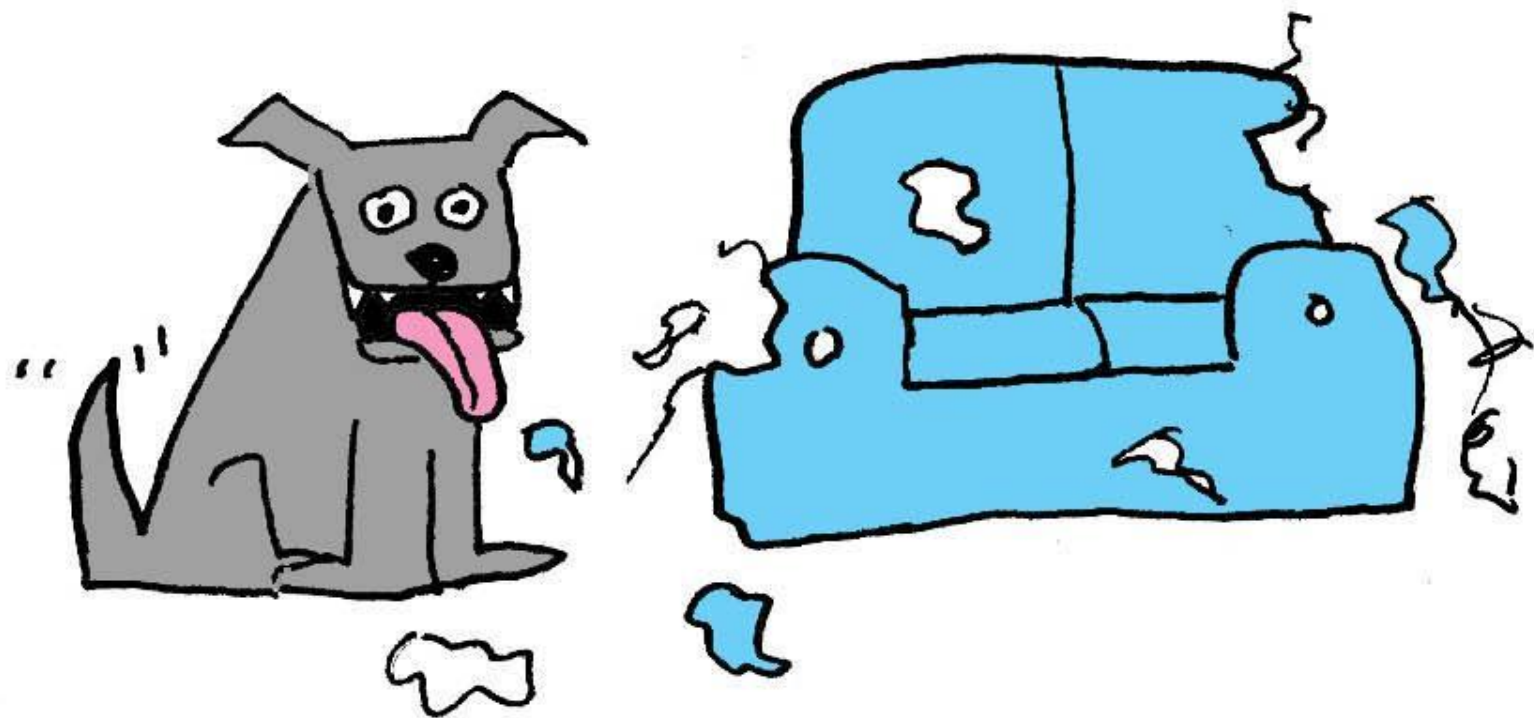


Corporations
and things
with "LL"
provide a
liability
shield

Debts your firm owes

Harm your firm causes







Debt you guaranteed

Your negligence or malpractice

LLC: Limited Liability Company

Benefits (compared to corporations) include:

- Fewer formalities
- Simpler documents
- You likely don't need to treat yourself and other owner-managers like an employee

Corporations

Common types (it varies from state-to-state):

General Corporation or Stock Corporation

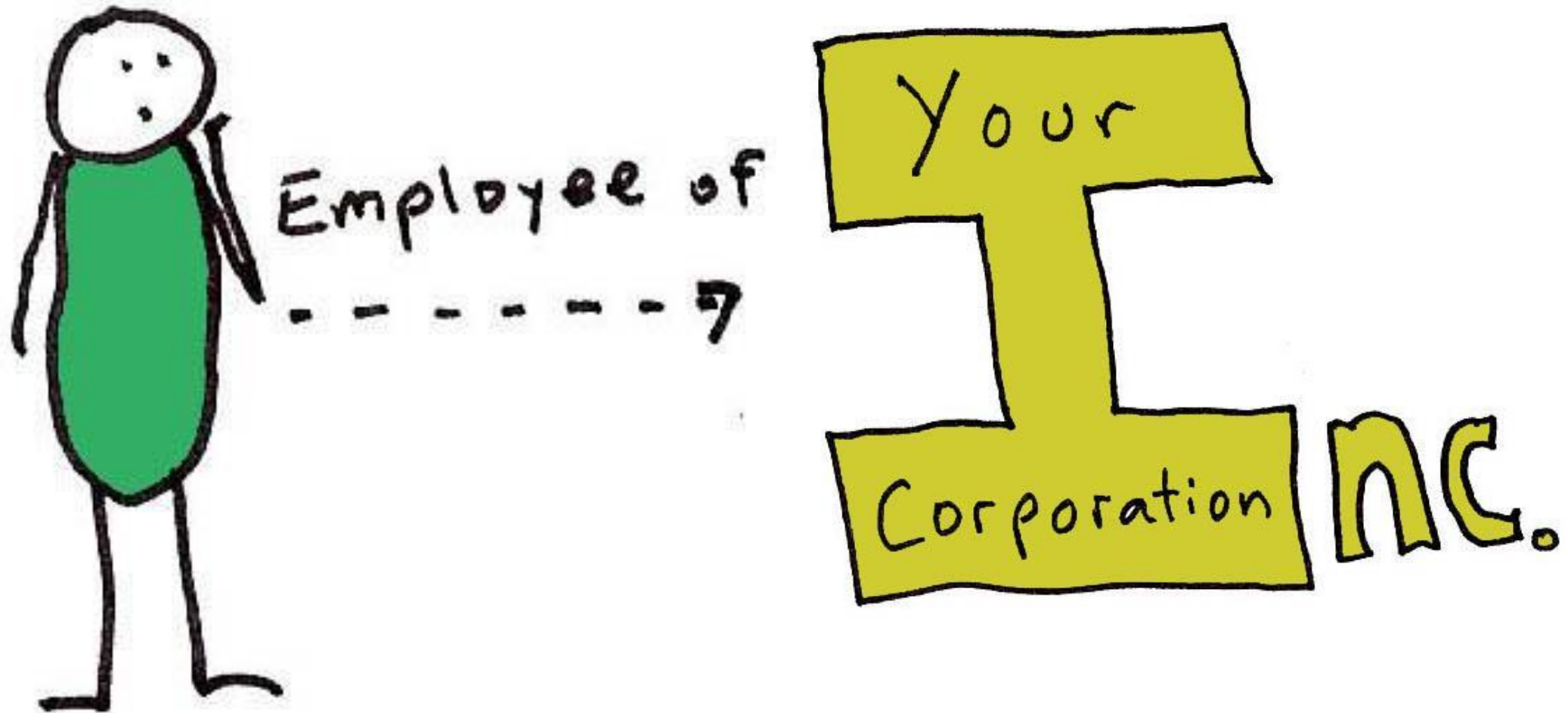
Benefit Corporation or Social Purpose Corporation

Nonprofit Public Benefit Corporations

Nonprofit Mutual Benefit Corporation

Cooperative Corporation

Do you want to be an employee?



Other considerations:

Cost:

\$800/year in California
for a limited liability
entity like a corporation

Formalities:

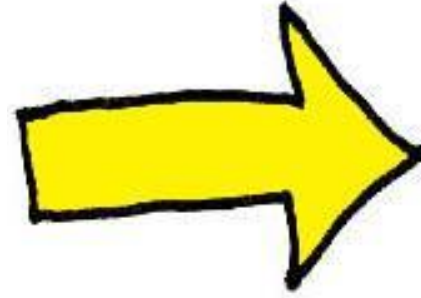
- Notice
- Meetings
- Minutes
- Records



It's a
Certification.

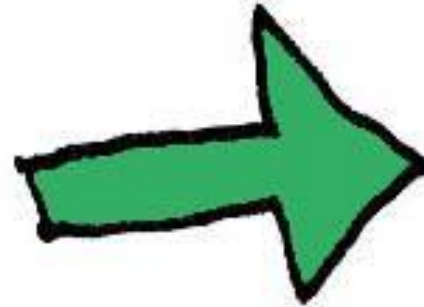


1. Cake:
Form the entity
(i.e. corporation, LLC)
or register it
(partnership)

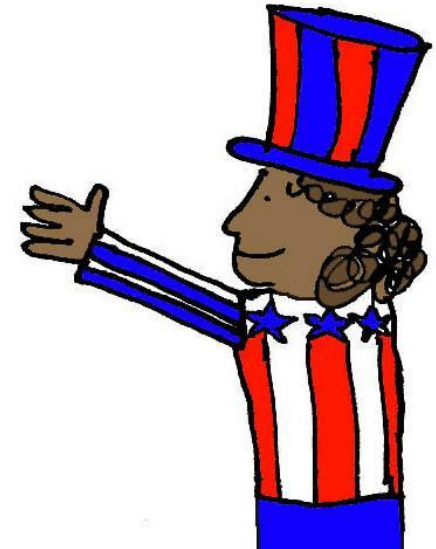


Secretary
of State

2. Icing:
Choose tax status



IRS (Aunt Sam)



Tax categories:

501(c)(3) - charitable, etc.

501(c)(4) - social welfare

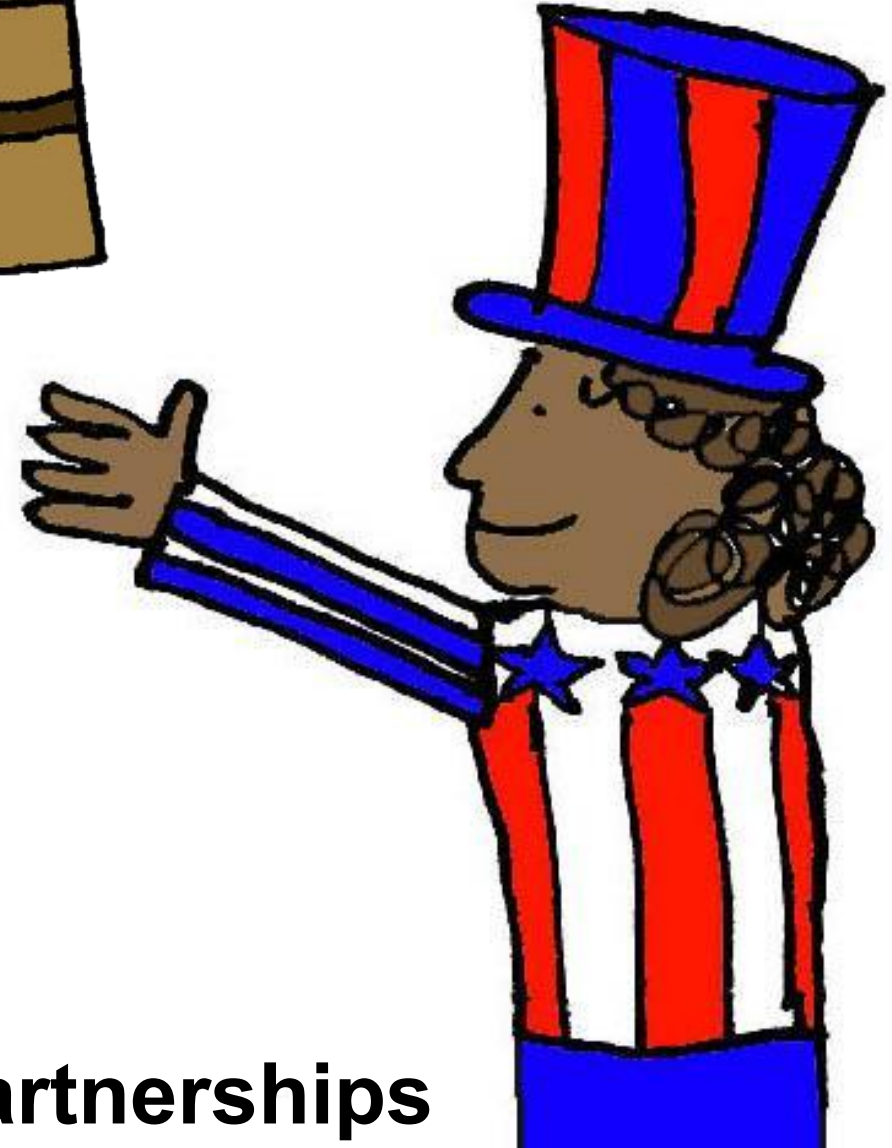
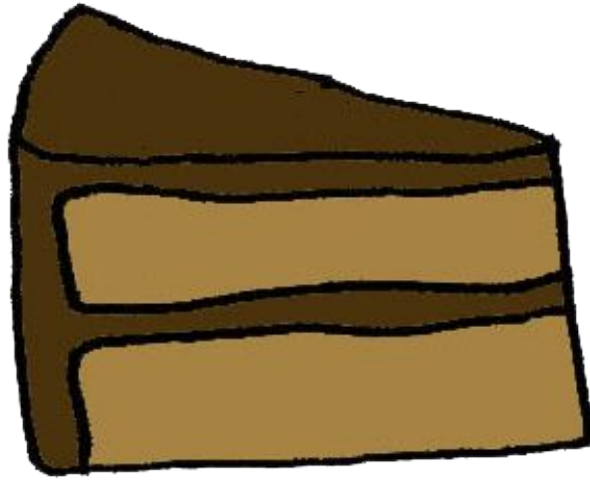
501(c)(12) - energy coops, etc.

Subchapter T - cooperatives

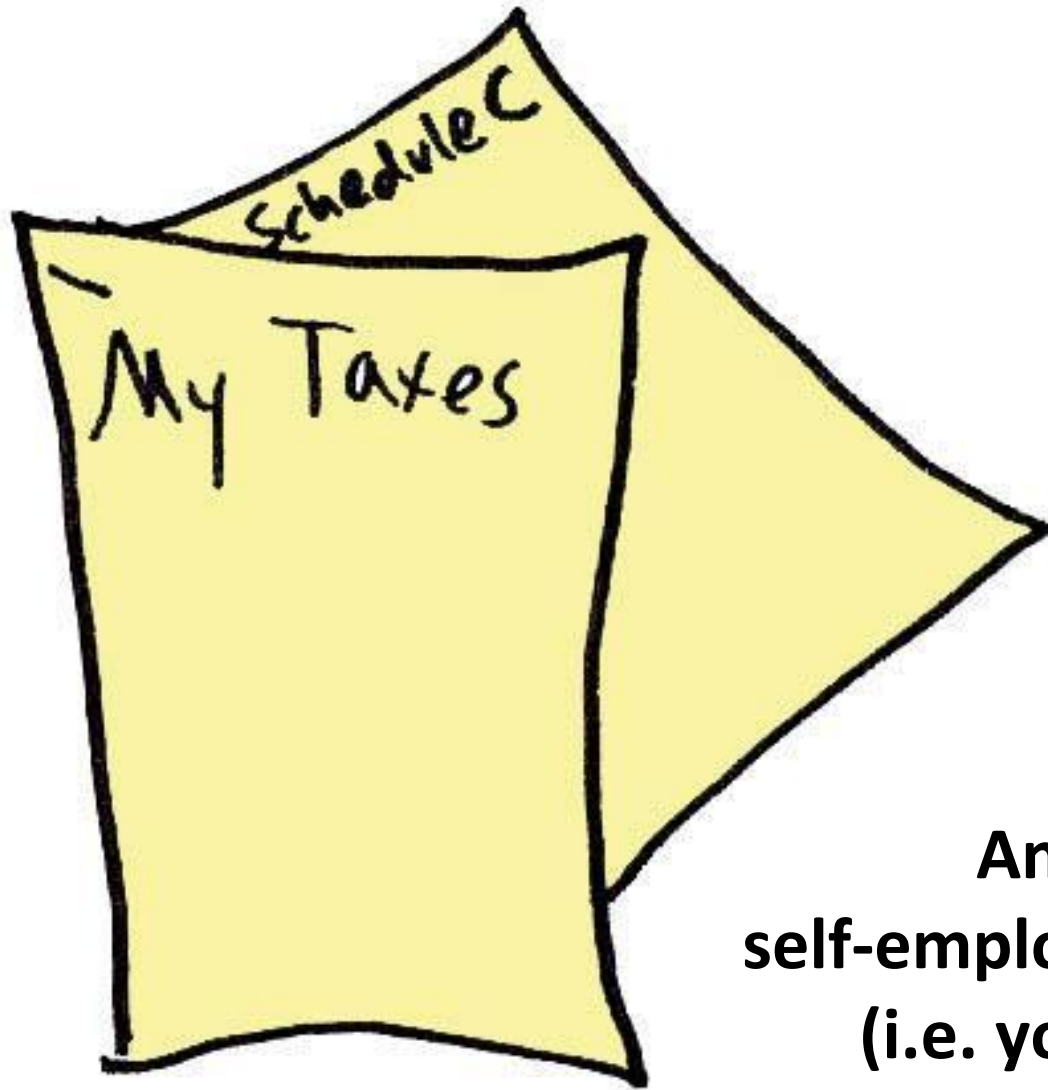
Subchapter C - i.e. C corps

Subchapter S - i.e. S corps

Subchapter K - most LLCs and partnerships



Sole proprietors:



**And it's all
self-employment income.
(i.e. you pay FICA)**

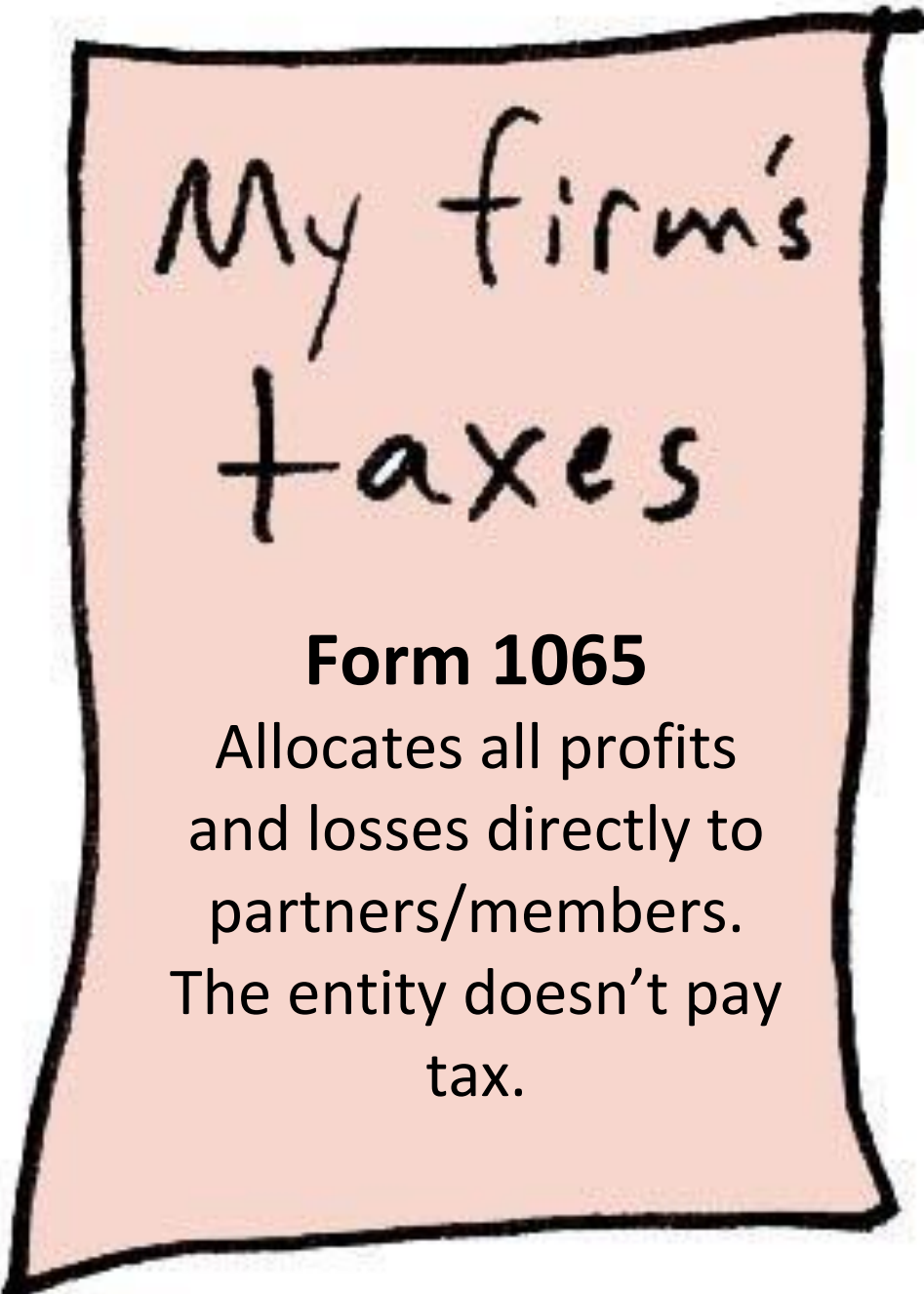
All other entities: file a separate tax return.



Partnerships and LLCs default to “partnership taxation” or Subchapter K taxation, unless they elect to be taxed as corporations.

Note:

**It’s all self-employment income.
(i.e. you pay FICA)**

A hand-drawn sign with a black border and a light pink background. The text is written in a casual, hand-drawn style. The top line says "My firm's" and the second line says "taxes". Below that, in a smaller font, it says "Form 1065". At the bottom, it explains that the form allocates profits and losses to partners/members and that the entity itself doesn't pay tax.

My firm's
taxes

Form 1065

Allocates all profits
and losses directly to
partners/members.
The entity doesn't pay
tax.

Corporate Taxation:

Money you pay yourself as a profit dividend.

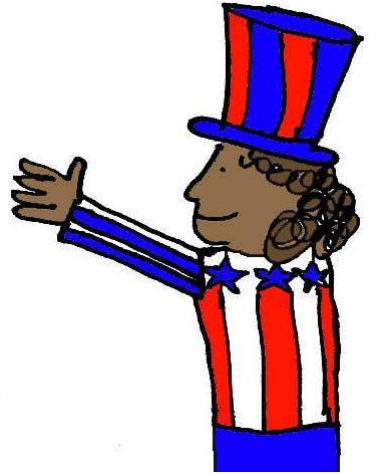
Income tax

medicare

social security

Money you pay yourself as "salary."

Income tax

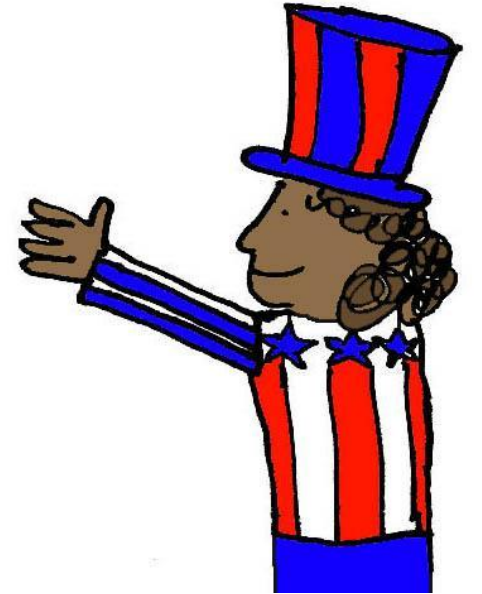




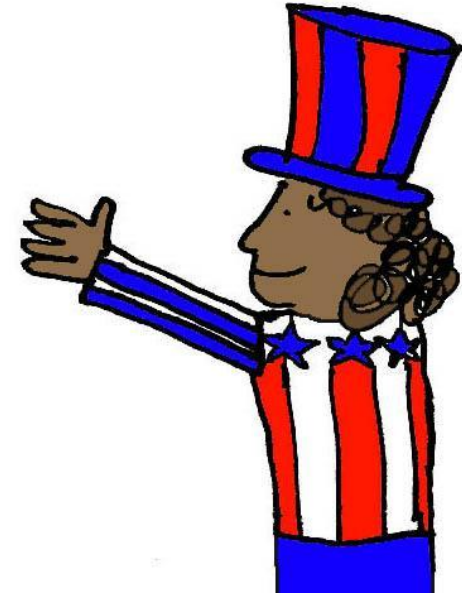
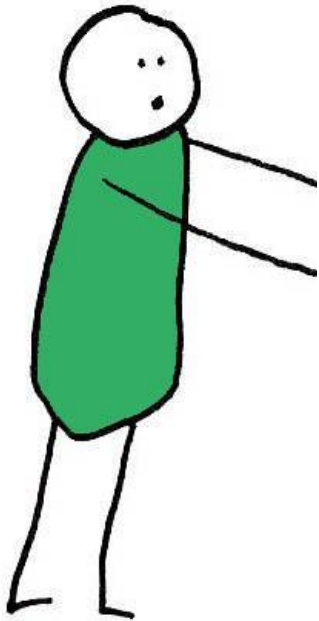
C corp
Inc.

C corp (Subchapter C of Internal Revenue Code)

Pays taxes on profits
(at corporate tax rate.)



Then you pay taxes on it again
when/if dividends are paid to you.



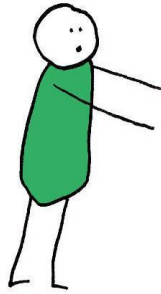
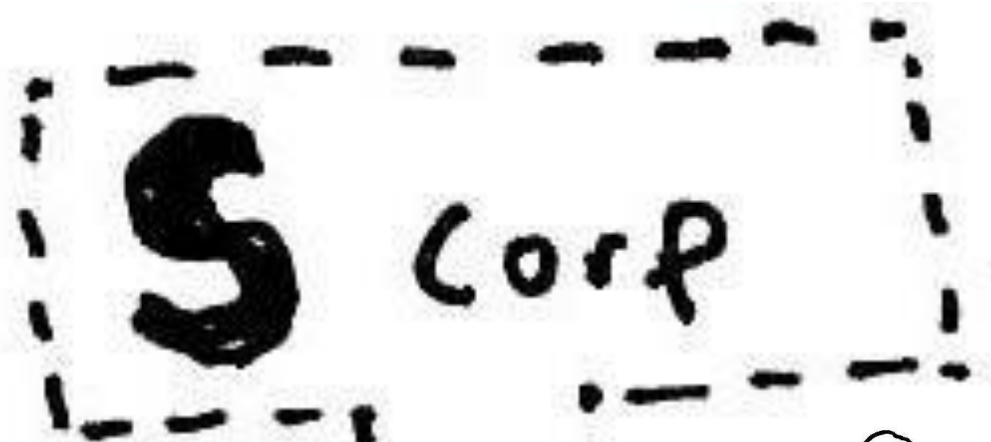
In essence: Double taxation



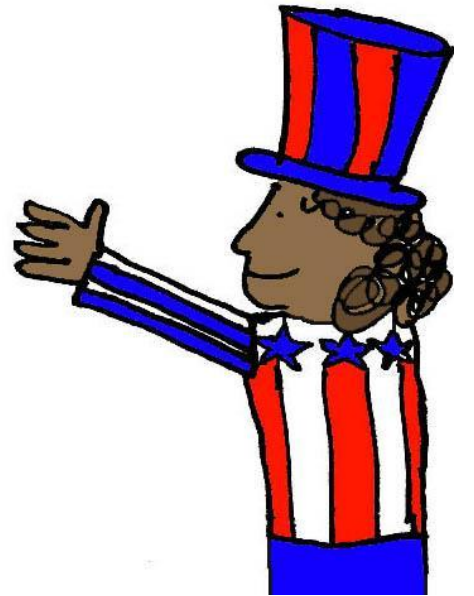
Corp tax benefits:

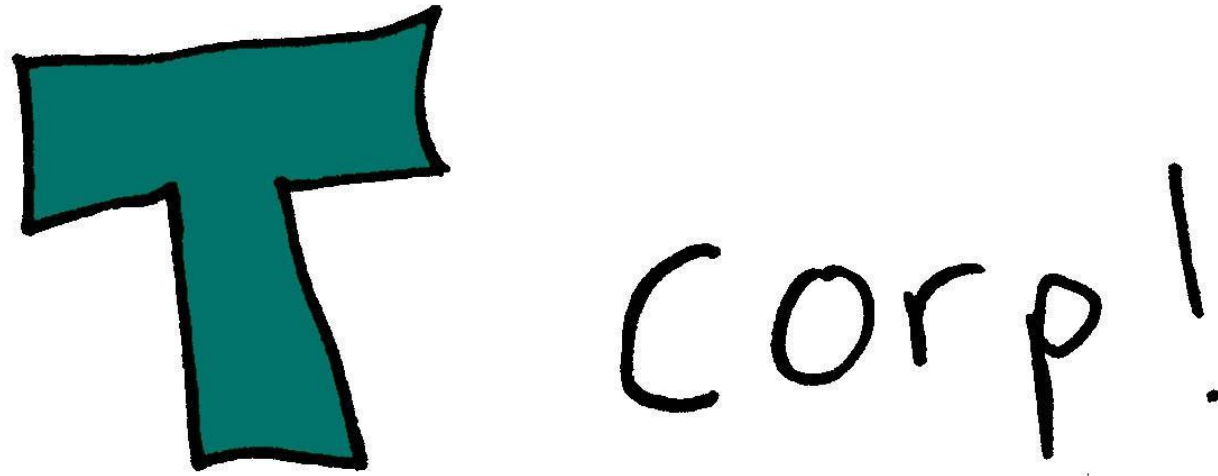
- More flexible for tax planning purposes.
- Lower tax rate for profits kept in smaller corporations.

S corp (Subchapter S of Internal Revenue Code)



All profits pass through to you.
The corporation doesn't pay tax.





Favorable tax status:

You can combine pass-through and entity-level taxation as needed.

Only for entities “operating on a cooperative basis,” which means:

- **Democratic:** One vote per member
- **Equitable:** Profits distributed on the basis of value or quantity of services (not on the basis of equity share)

Cooperatives!

(That is supposed to be an elephant)



What Kind of Cooperative?

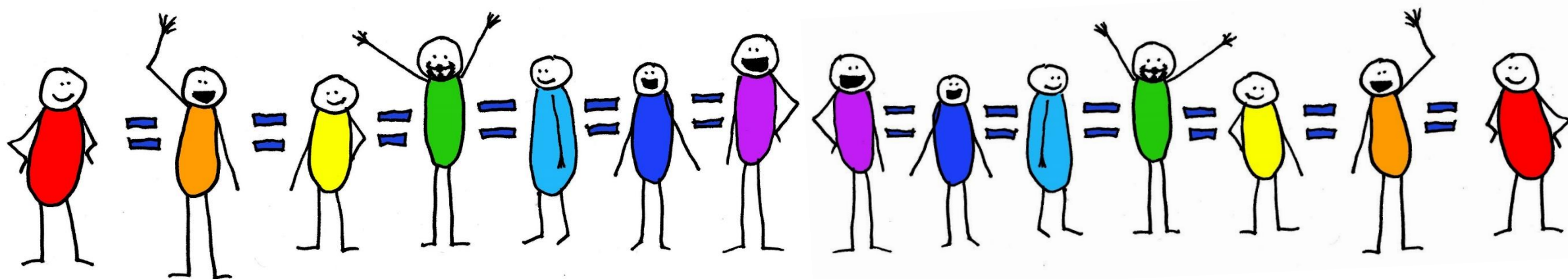
- **Worker cooperative:** Owned by the people who do the composting
- **Consumer cooperative:** Owned by the people who generate organic material, or by the people who buy the finished compost, or both.
- **Producer cooperative:** Your compost enterprise probably wouldn't structure this way, but you can join with other compost enterprises to market together, purchase supplies together, or sell compost together.



Nonprofits can be structured quite a bit like cooperatives.



Sustainable Economies Law Center



A non-hierarchical nonprofit organization.

Pay is equal and governance is distributed among all staff.

Learn more: www.theselc.org/worker_selfdirected_nonprofits

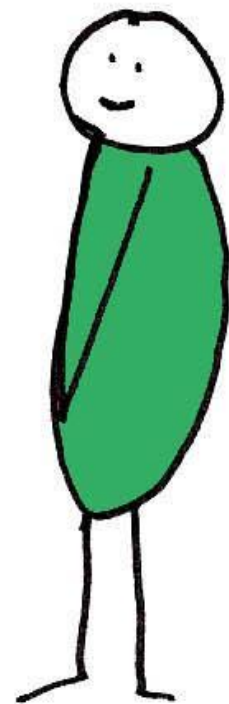
We look more like this, though:



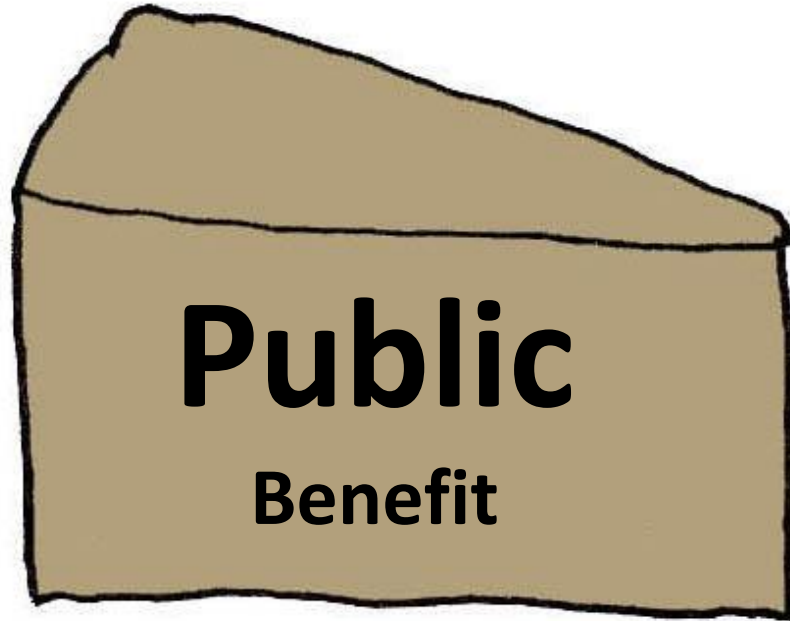


Can hire, fire,
decide your salary, etc.

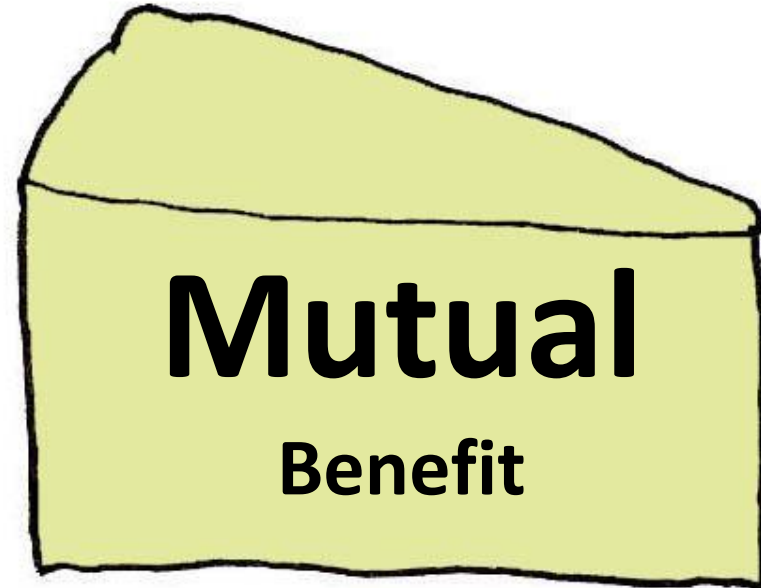
But can delegate
most other decisions to
staff, with oversight.



Choose a cake:



Most 501(c)(3)s and
501(c)(4)s nonprofits

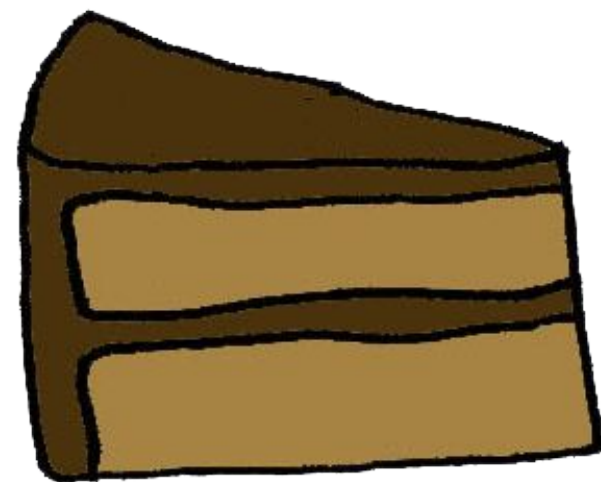


Cooperatives and mutual
benefit nonprofits

Big \$

Energy Water
Land

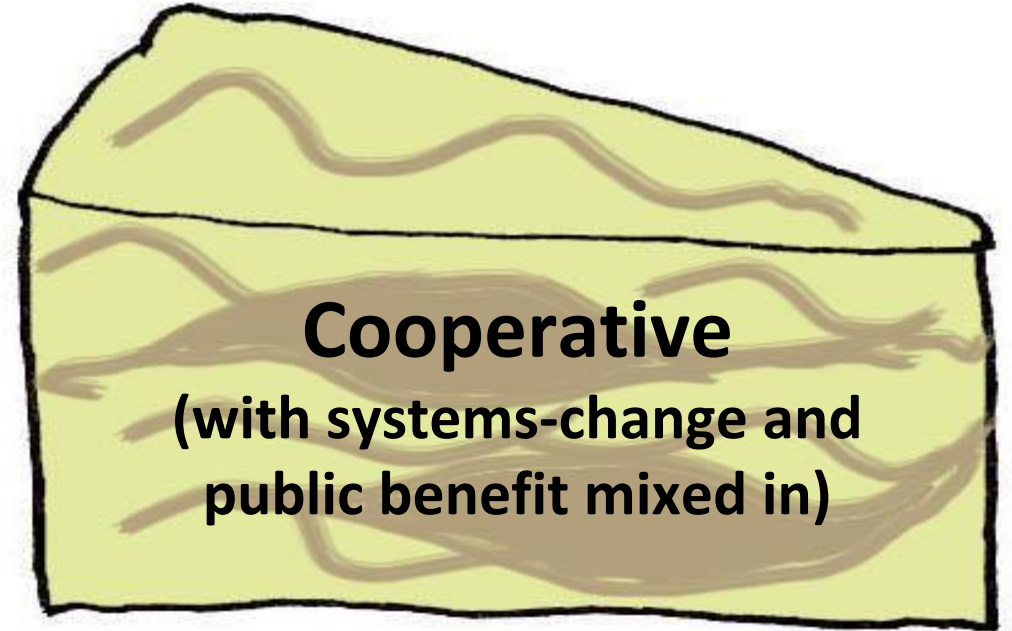
Everything



Our sweet spot:



Communities organizing nonprofits to benefit their own communities.



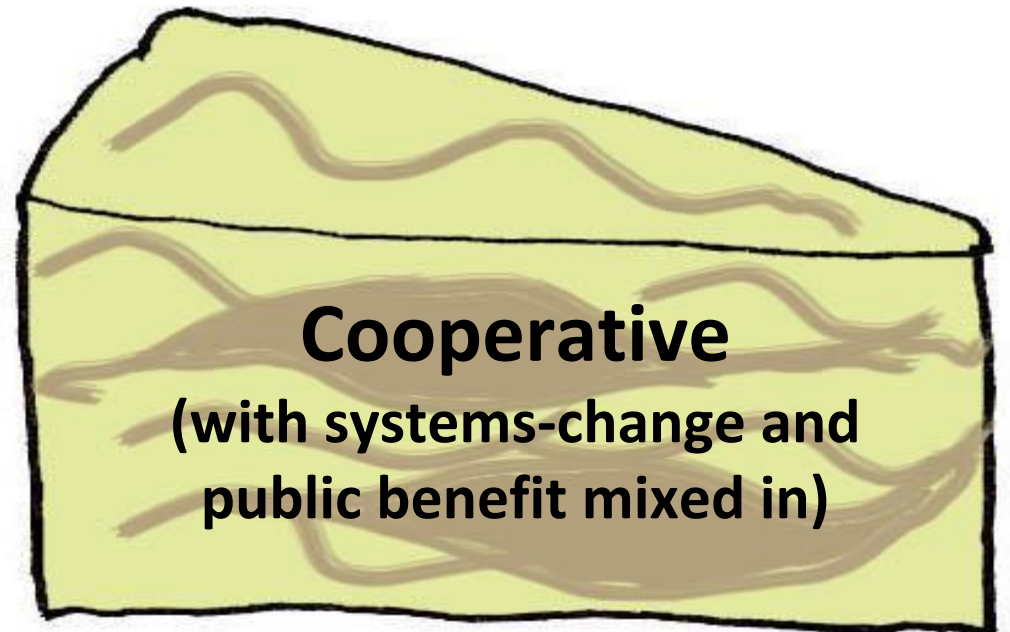
Movement-based, social change-oriented cooperatives, especially those designed for *permanent* community benefit.



Funding the sweet spot!

(With gift capital, risk-tolerant capital, etc.) We need:

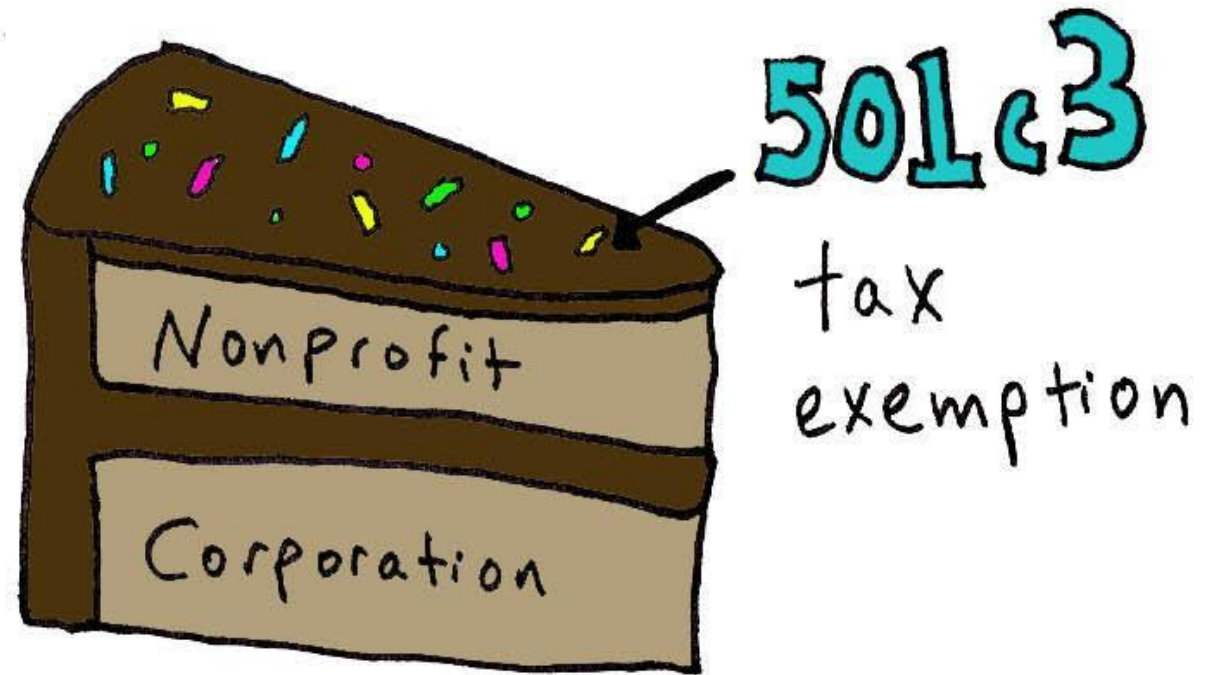
1. More things to be 501c3s
2. Existing 501c3s to do more things
3. 501c3s to support non-501c3s (**with PRIs, grants, partnerships**)



501(c)(3): It's not just about tax exemption and funding!

Other benefits of 501c3 include, and are definitely not limited to:

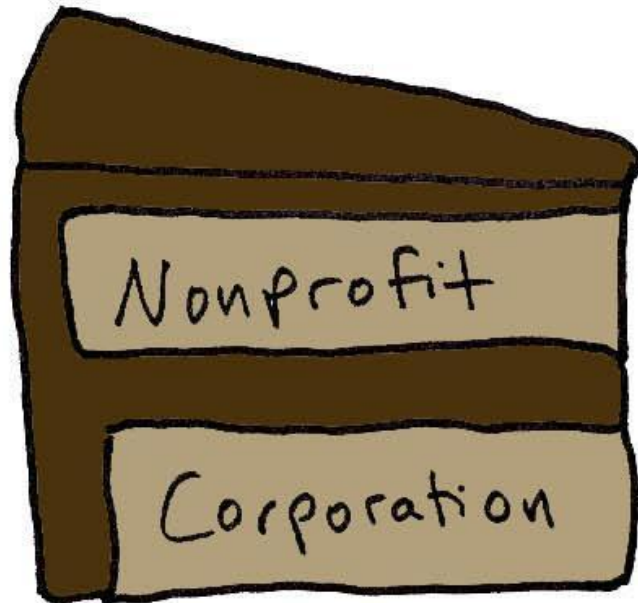
- Educational debt forgiveness for staff
- Ability to engage unpaid volunteers
- Exemptions in various regulatory contexts:
 - Zoning
 - Securities
 - Health & safety law
 - **Organics hauling**
 - **Many more we will likely advocate for!**
- Access to discount programs like Google Nonprofits, TechSoup





501c3

tax
exemption



501c4

tax
exemption

Charitable & Educational

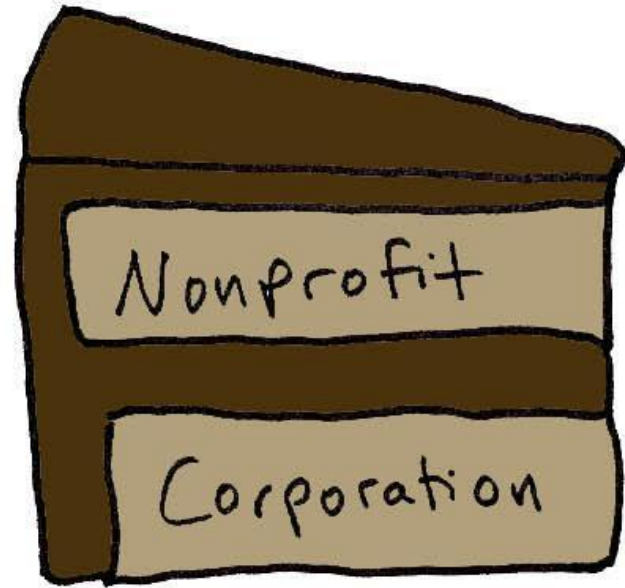
With sprinkles!
Tax-deductible
donations!



501c3

tax
exemption

Social Welfare



501c4
tax
exemption

No
tax
exemption

Pays tax like
a corporation

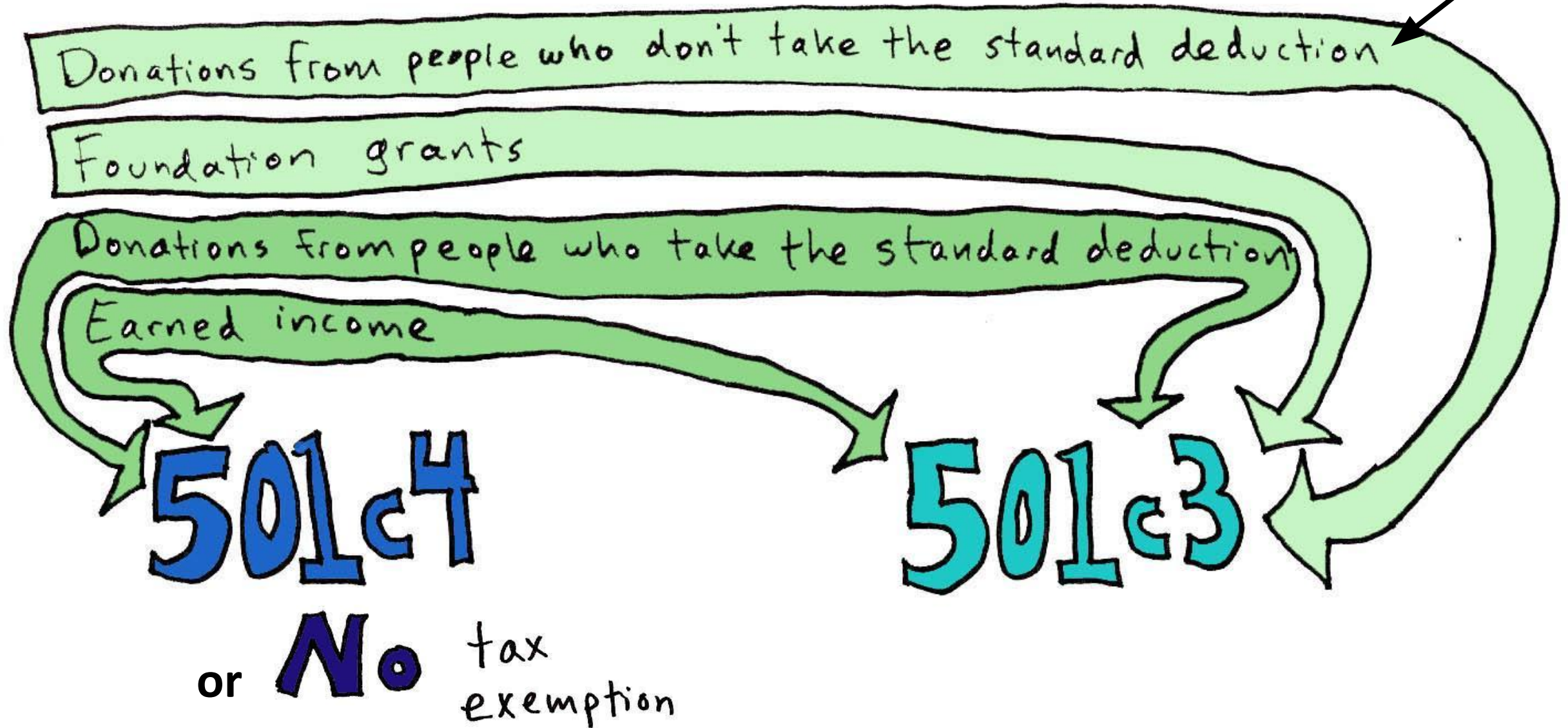
That's not such a
bad thing if you
think about...

"Public" purpose

Any lawful purpose


Income Sources:

Which is hardly anyone,
thanks to the Tax Bill



Primary Purpose:

Charitable
&
Educational



**The boundaries of
501(c)(3) law move
to accommodate our
understandings of
problems and their
solutions.**

We learn more about problems every day!



World » Planet has only until 2030 to stem catastrophic climate change, experts warn

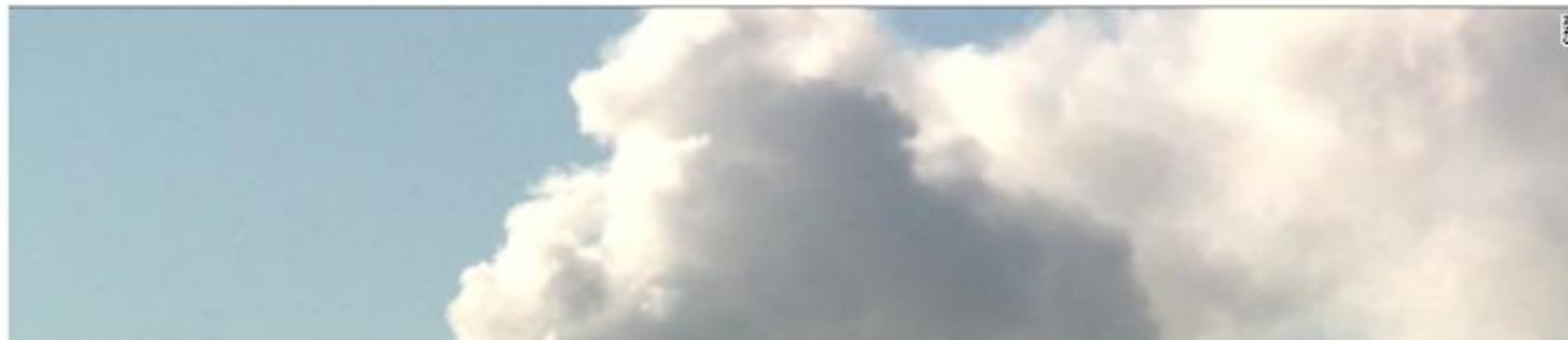
Live TV

U.S. Edition +

Planet has only until 2030 to stem catastrophic climate change, experts warn

By [Brandon Miller](#) and Jay Croft, CNN

🕒 Updated 6:54 PM ET, Mon October 8, 2018



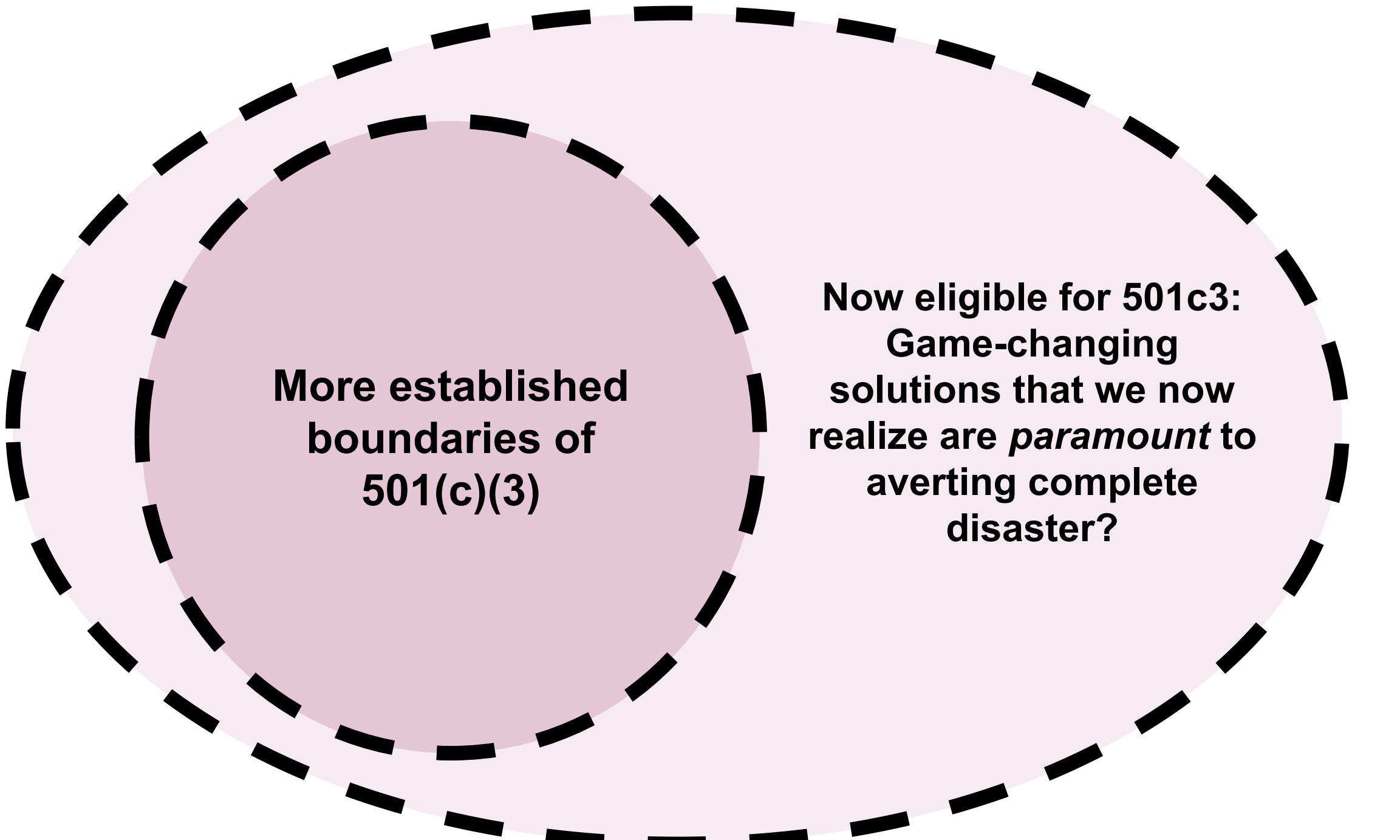
More from CNN



Lemon shreds Trump's double standard



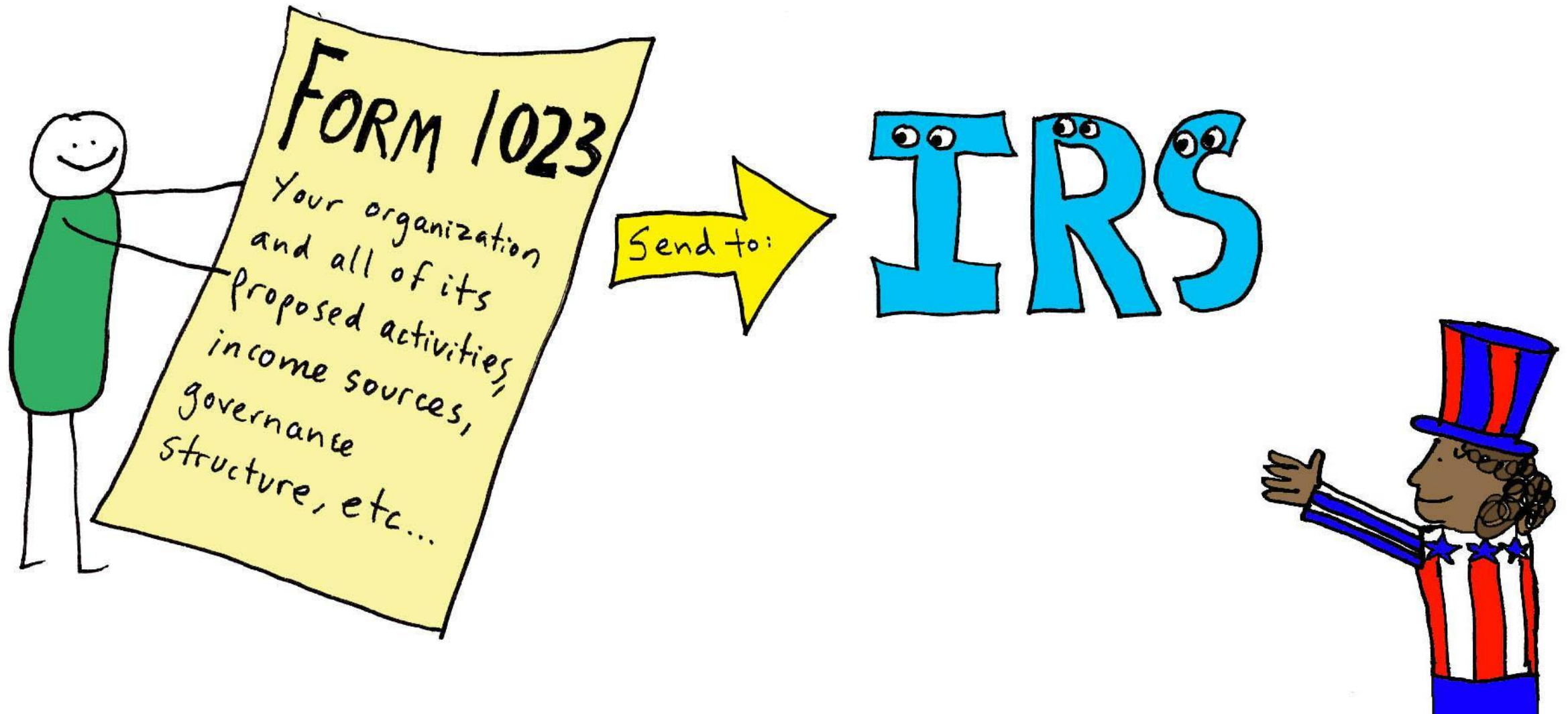
Nicole Kidman duets with Keith Urban in honor of

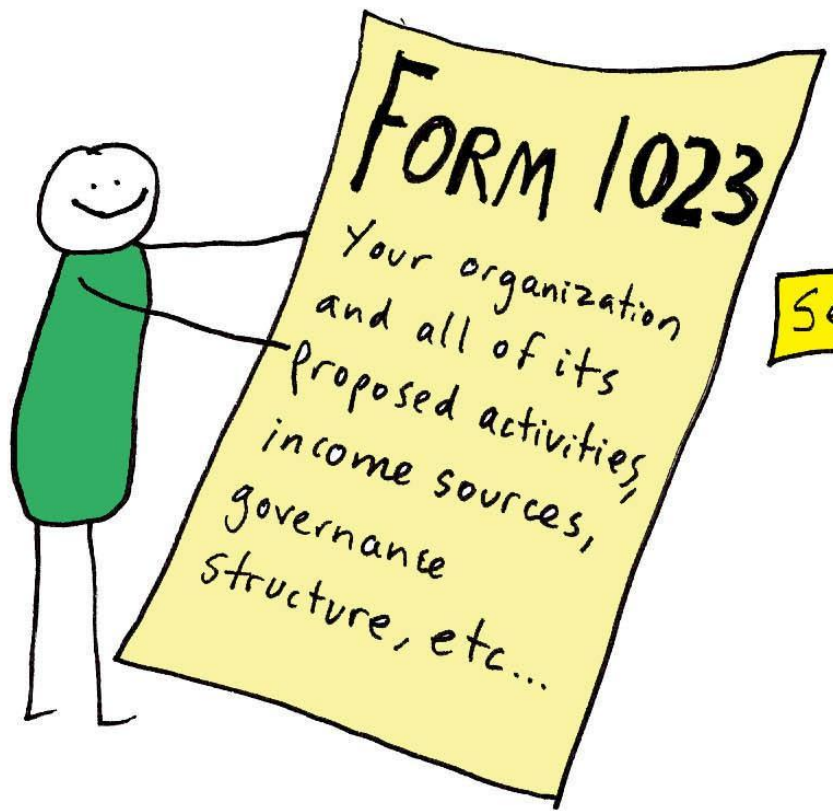


**More established
boundaries of
501(c)(3)**

**Now eligible for 501c3:
Game-changing
solutions that we now
realize are *paramount* to
averting complete
disaster?**

How do the boundaries move?

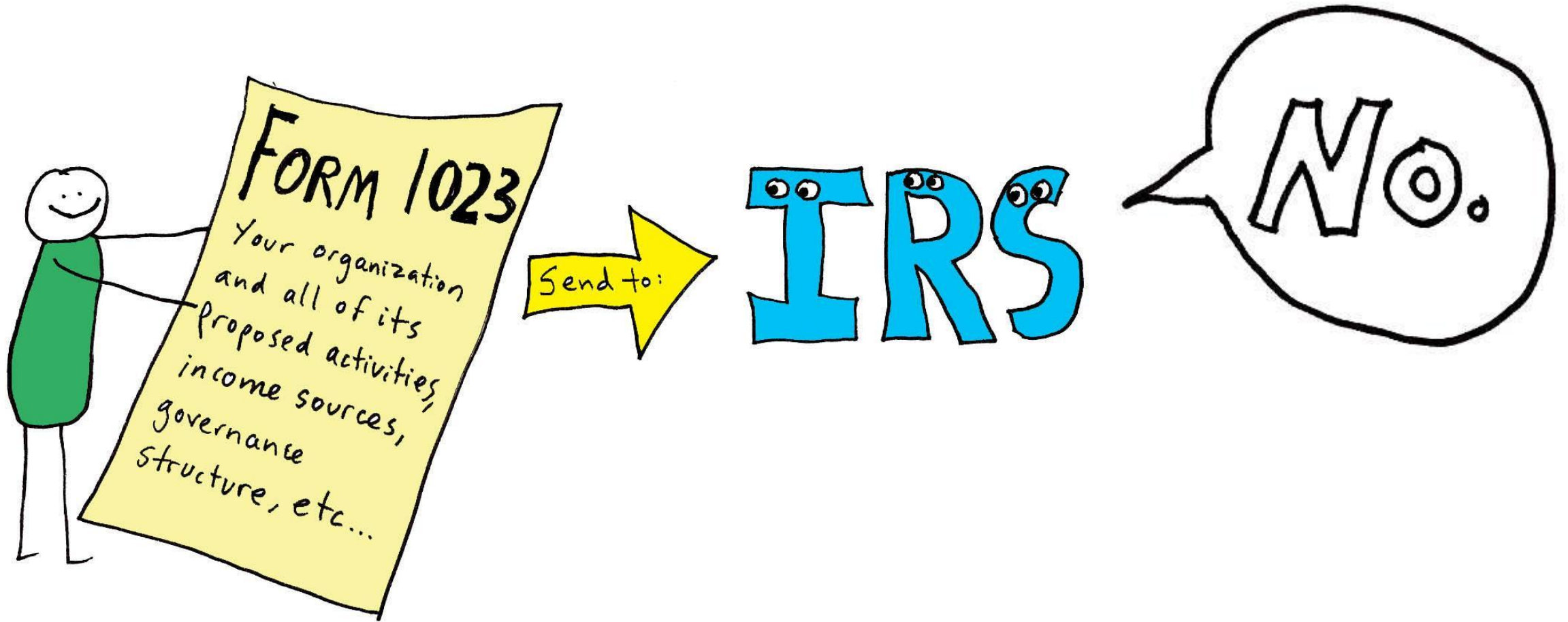




IRS



Yep, that's basically law getting made.



Rough History of the IRS' Reactions to Land Conservation

Things can change based both on what we know (about problems and solutions) and on what we value as a society:

Rev. Rul. 67-292,
1967-2 C.B. 184

Protecting
land for
educational
purposes is
cool.

Rev. Rul. 76-204, 1976-2 C.B. 152 and
Rev. Rul. 75-207, 1975-1 C.B. 361

Protecting
“ecologically
significant”
land is a
charitable
purpose.

Rev. Rul. 78-384,
1978-43 I.R.B. 8

Farms aren't
ecologically
significant.

See: William T. Hutton,
[Agricultural Preservation:
Protesting the Application
of Revenue Ruling 78-384](#)

Oh! Farms ARE
ecologically
significant.

1967

1975

1978

After that...

Congress and various states
recognized threats to farmland
and passed laws to protect it.

Rev. Rul. 67-292,
1967-2 C.B. 184

**Protecting
land for
educational
purposes is
cool.**

1967

Rev. Rul. 76-204, 1976-2 C.B. 152 and
Rev. Rul. 75-207, 1975-1 C.B. 361

**Protecting
“ecologically
significant”
land is a
charitable
purpose.**

1975

Rev. Rul. 78-384,
1978-43 I.R.B. 8

**Farms aren’t
ecologically
significant.**

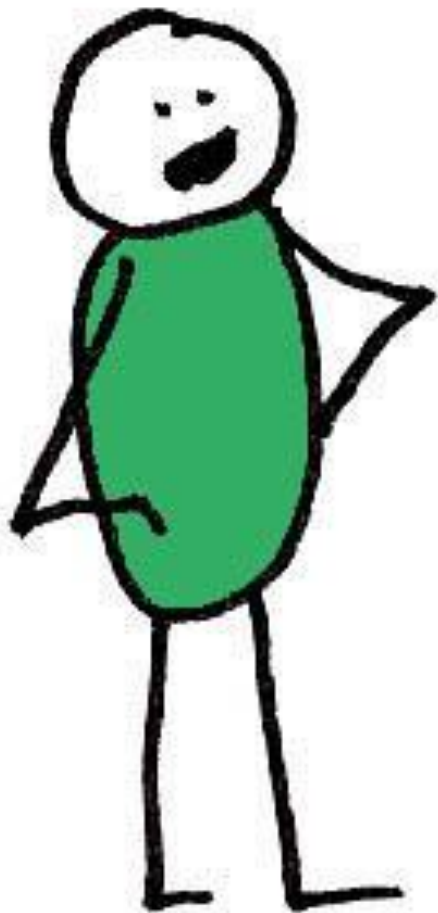
1978

After that...

Various ag land trusts have
gained 501c3 recognition
since the 1978 ruling.
See: William T. Hutton,
[Agricultural Preservation:
Protesting the Application
of Revenue Ruling 78-384](#)

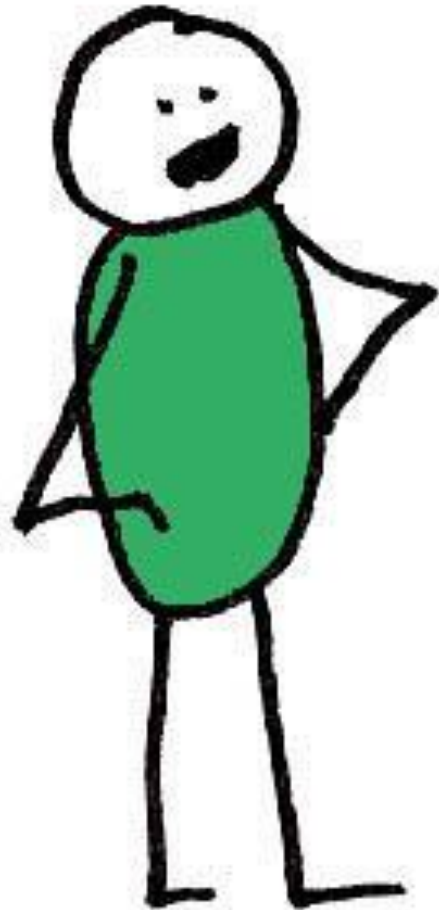
**Oh! Farms ARE
ecologically
significant.**

**All of our organizations (and staff) can learn to explore
the legal frontiers of 501(c)(3).**



I sound like such a
lawyer right now.

1. First, ask:



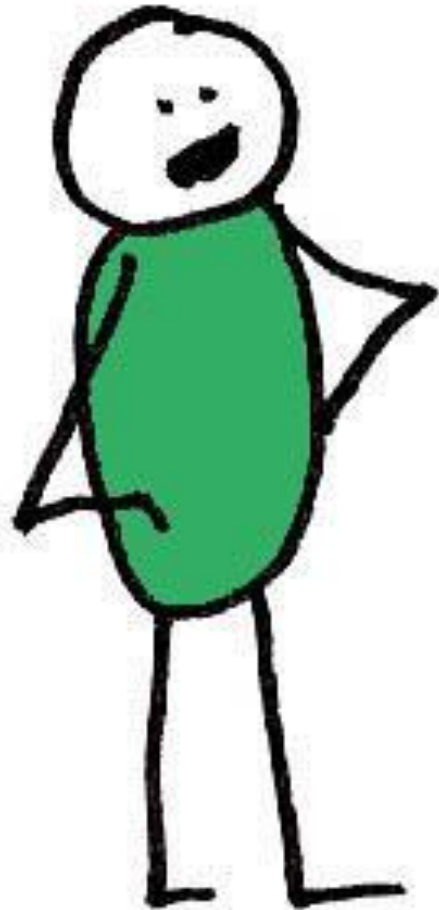
What are the threats we're addressing? What is the need that is not being met?

Data helps!

[Soil & Compost Fact Sheet](#)

2.

Then, ask all the time:

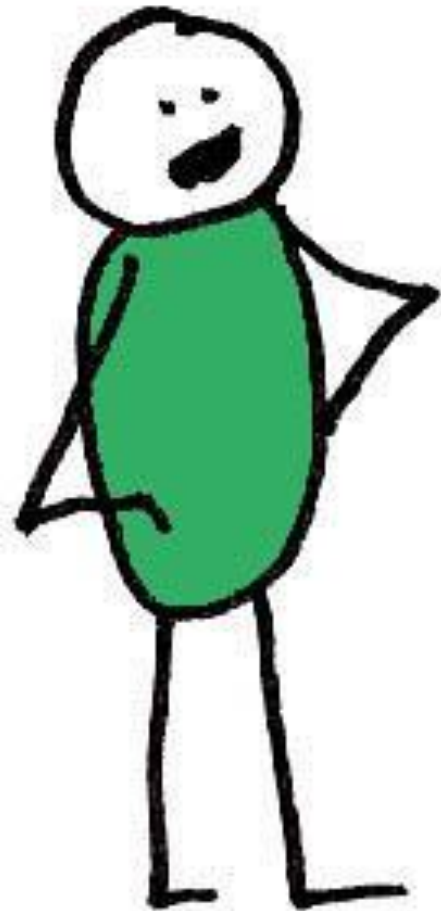


Does our activity have a **substantial causal relationship to** remedying the problems or meeting the needs?

Data helps!

[Soil & Compost Fact Sheet](#)

3. Then, ask all the time:



**Does it cross any
boundaries of 501(c)(3)?**

**Is it not larger in scope than is necessary
to achieve our charitable or educational
purposes?**

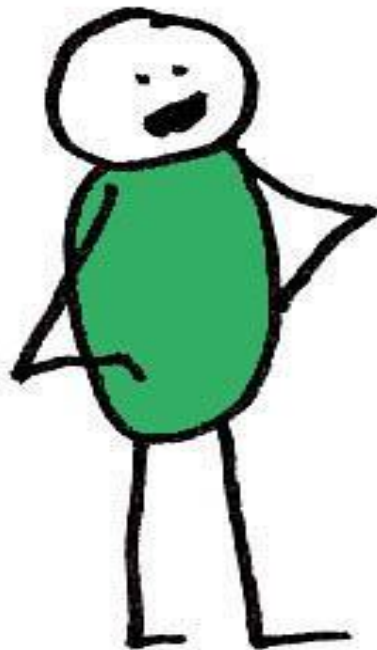
Educational & scientific purposes hold possibility:

Educational: Every human needs to learn how to manage organic material.

That will take practical and hands on experience!


Scientific: There's still so much to learn about effective composting and soil stewardship. That will take actual composting and experimentation.

But they could be limiting:



Is our compost enterprise **larger in scope than is necessary** to achieve our **educational** or **scientific** purposes?

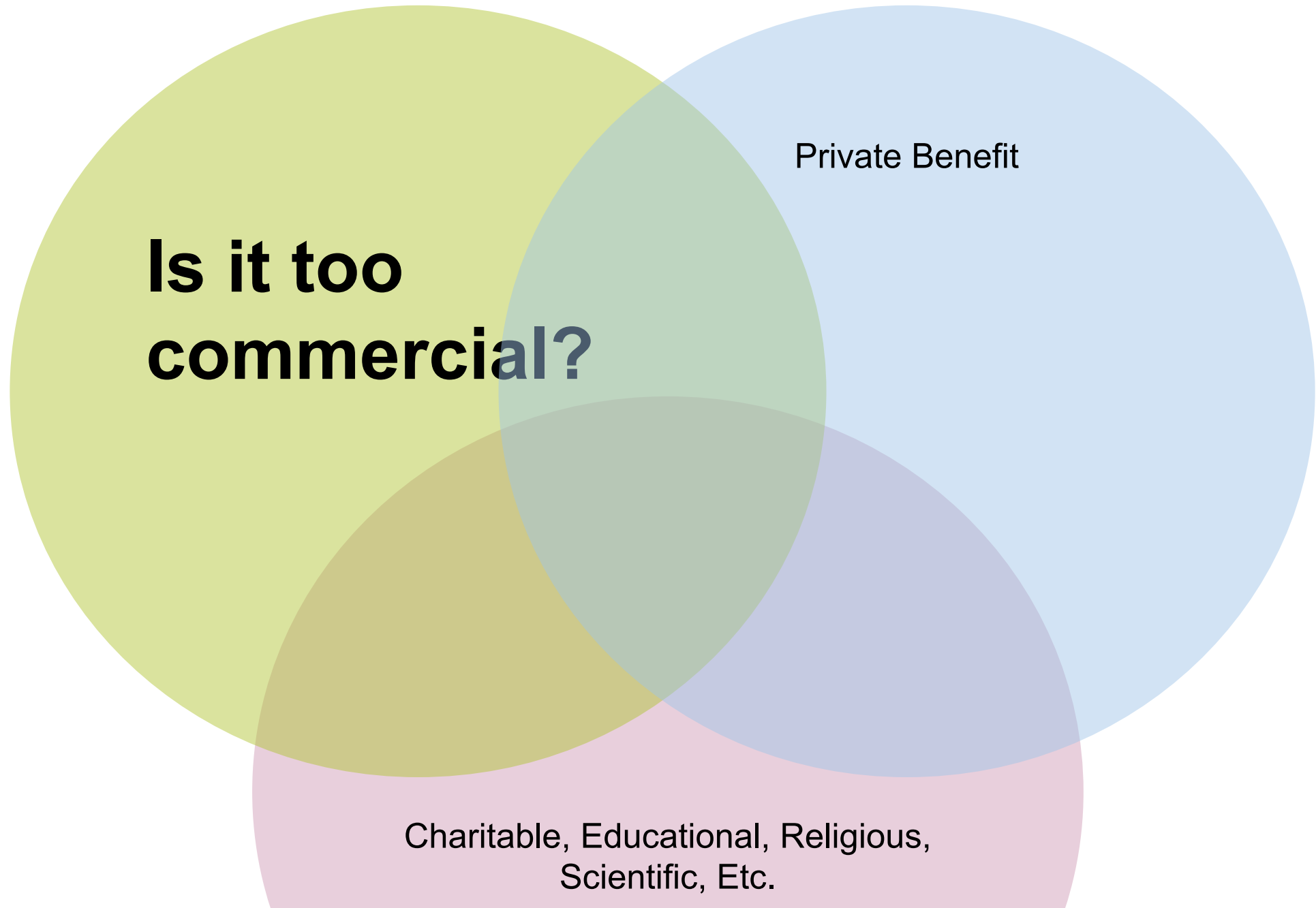
What are the boundaries we need to know about?



Charitable,
Educational,
Religious,
Scientific, Etc.

Charitable includes a lot of things:

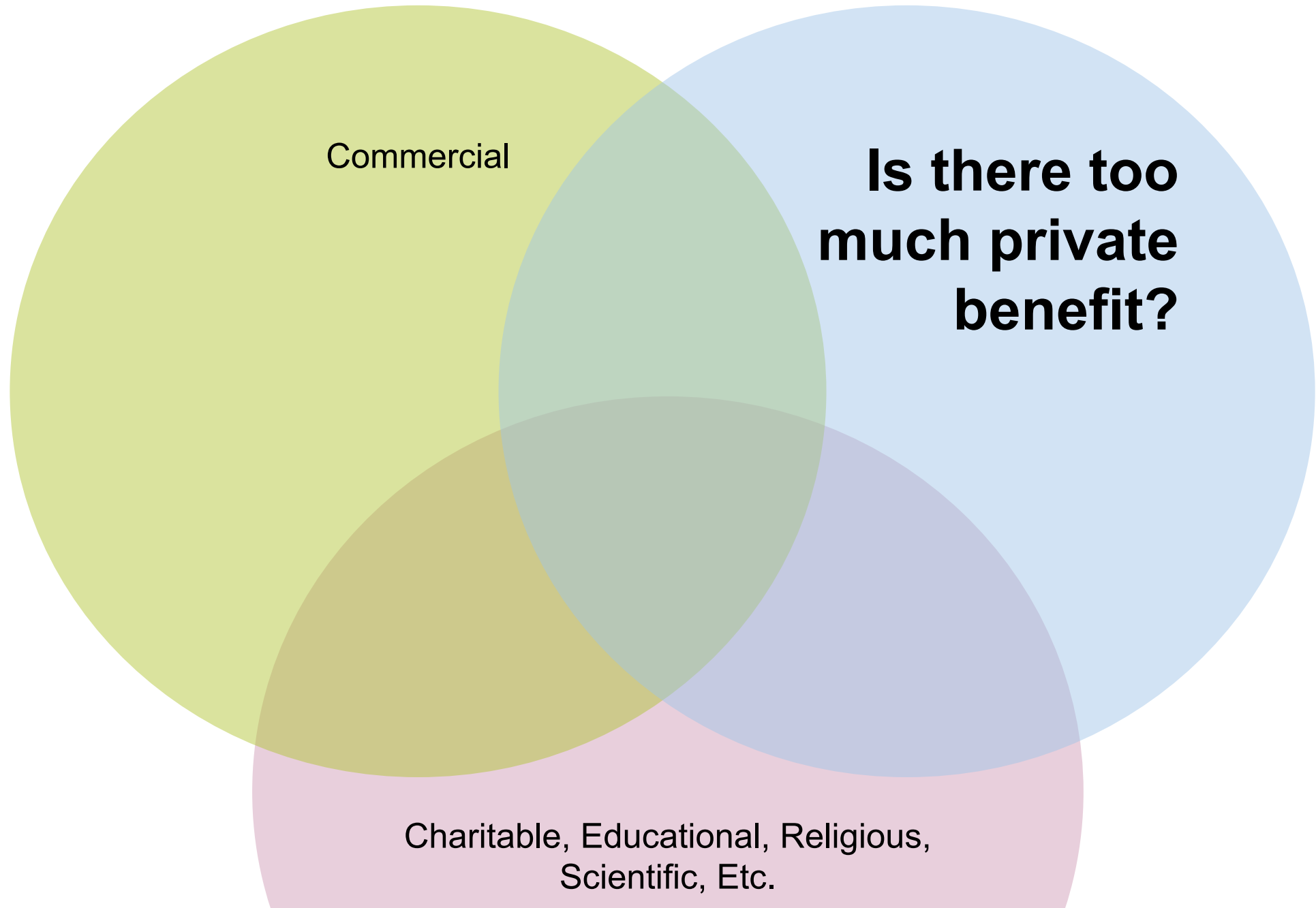
- Relief of the poor, distressed, & underprivileged
 - Lessening neighborhood tensions
 - Eliminating prejudice and discrimination
 - **Combating community deterioration**
- **Lessening the burdens of government**
 - Other stuff, too.



**Is it too
commercial?**

Private Benefit

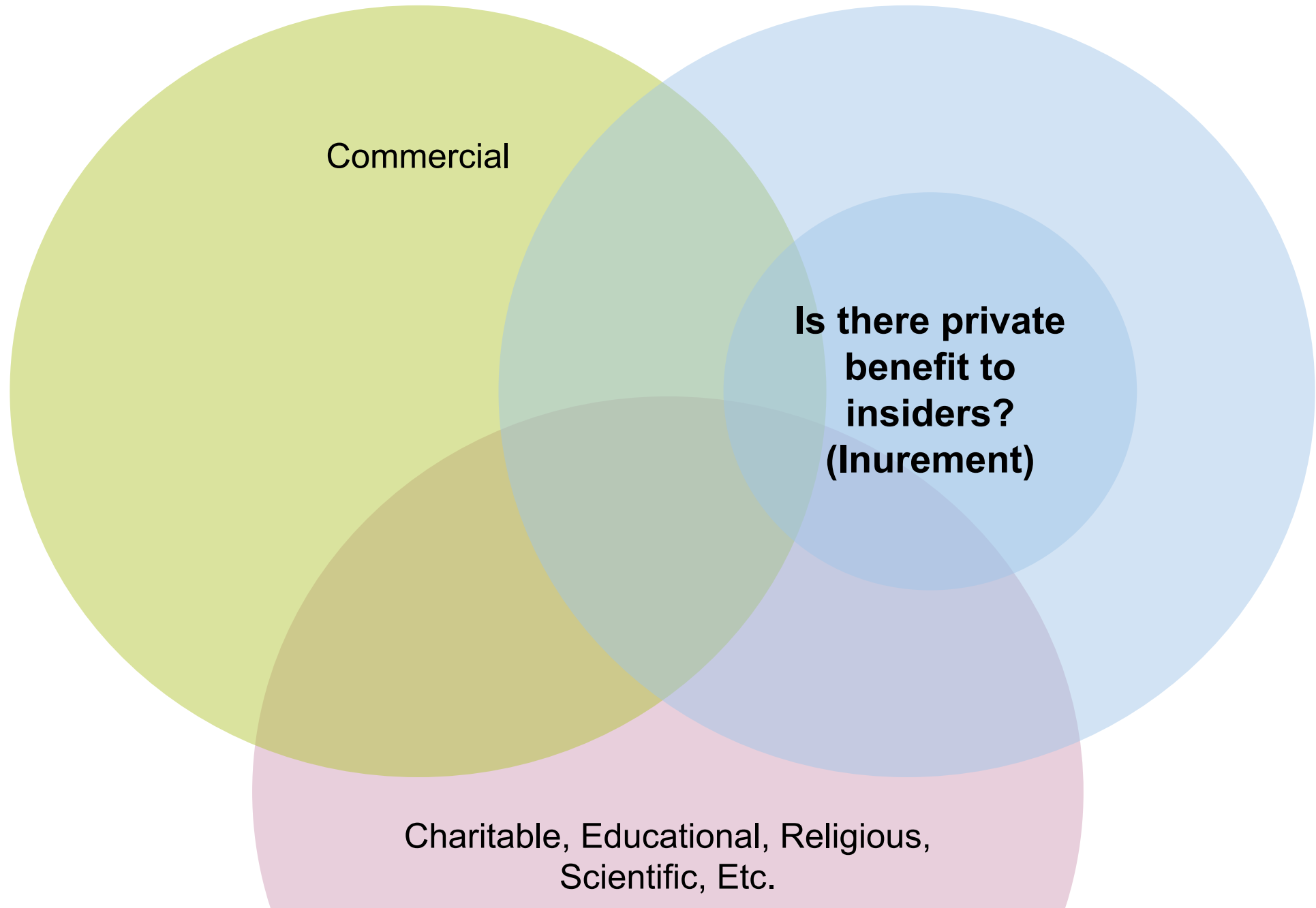
Charitable, Educational, Religious,
Scientific, Etc.

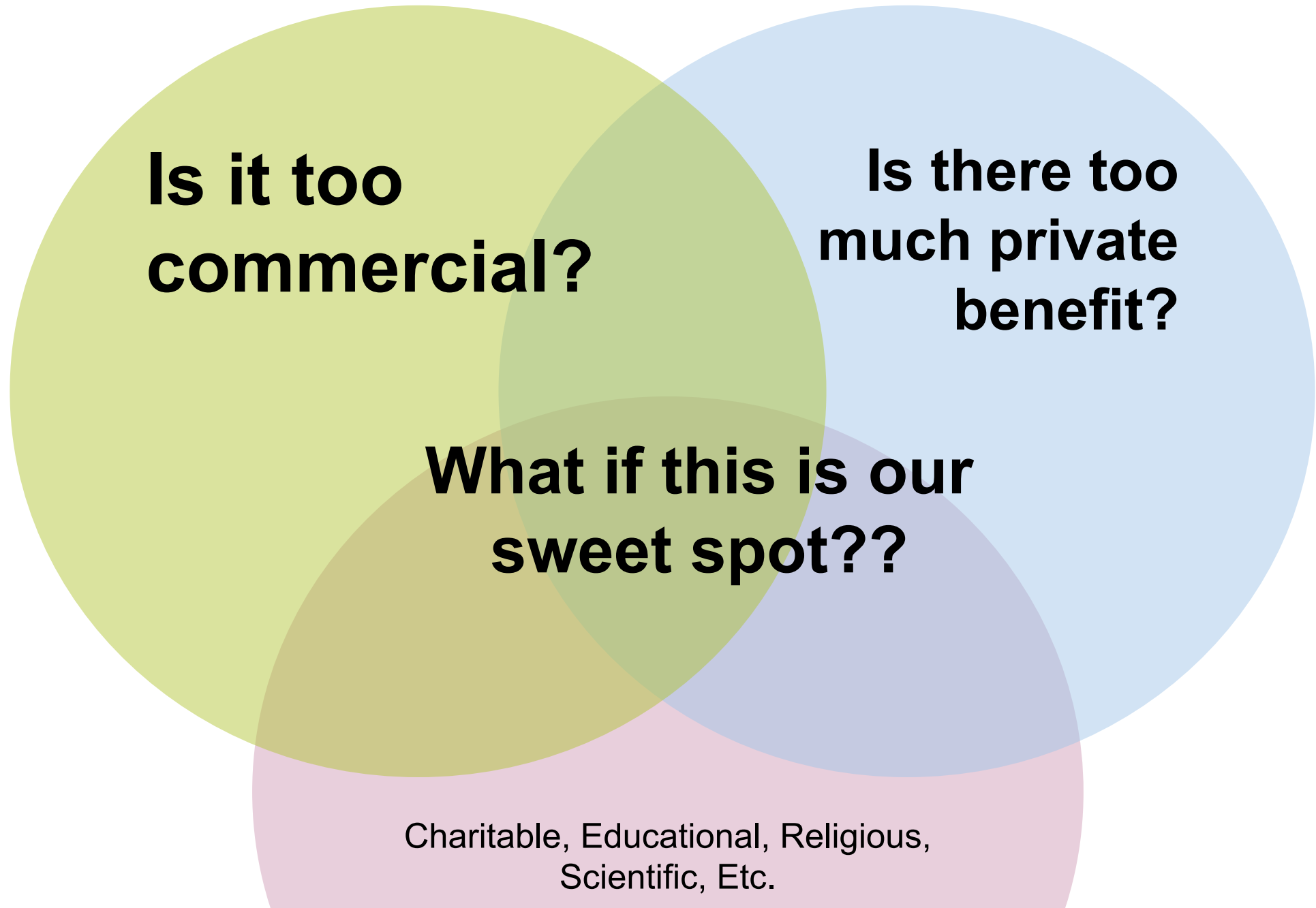


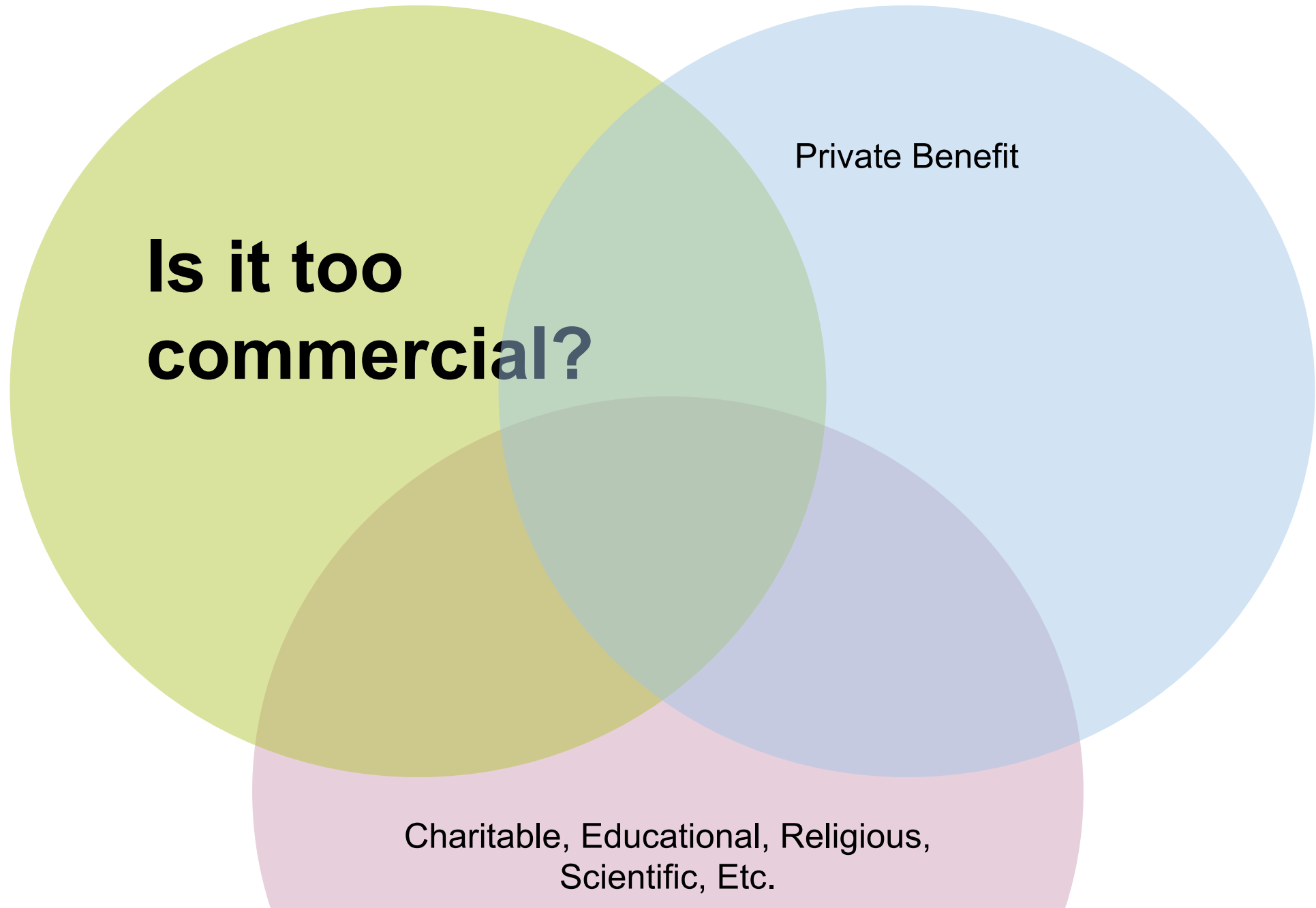
Commercial

**Is there too
much private
benefit?**

Charitable, Educational, Religious,
Scientific, Etc.



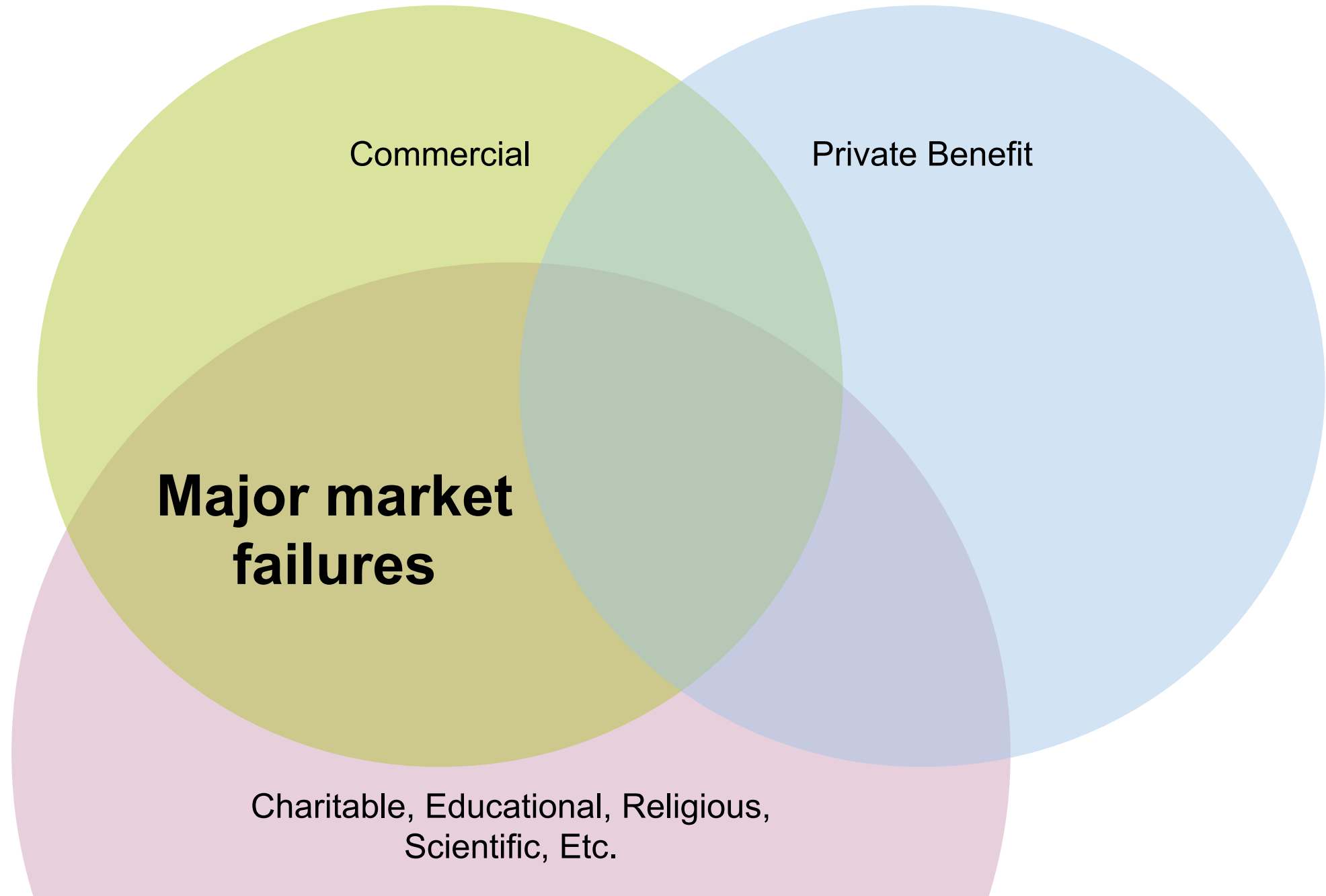




**Is it too
commercial?**

Private Benefit

Charitable, Educational, Religious,
Scientific, Etc.



Commercial

Private Benefit

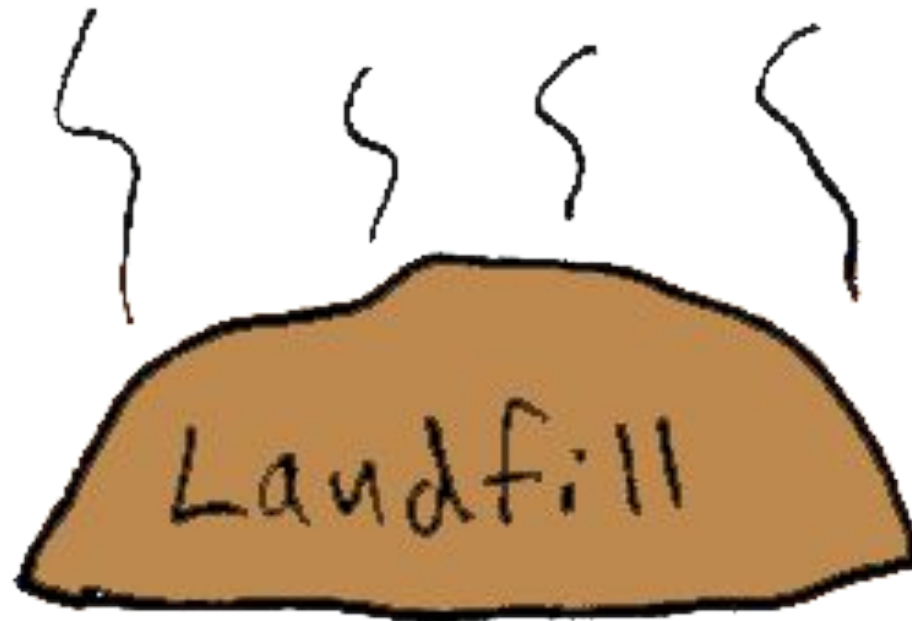
**Major market
failures**

Charitable, Educational, Religious,
Scientific, Etc.

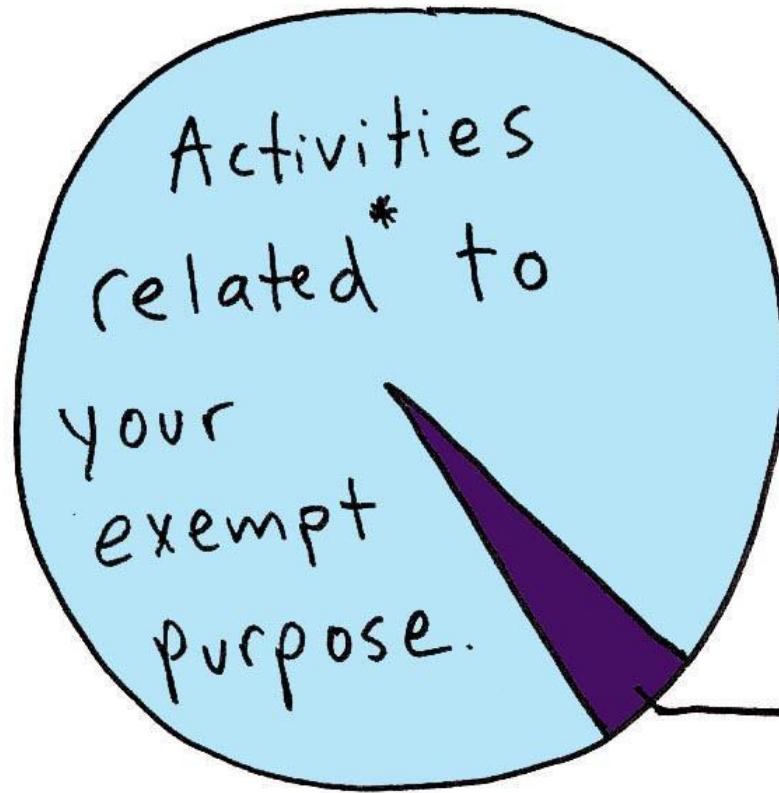
Example of market failure!

Legislators say: We have to get all the organics out of landfills.

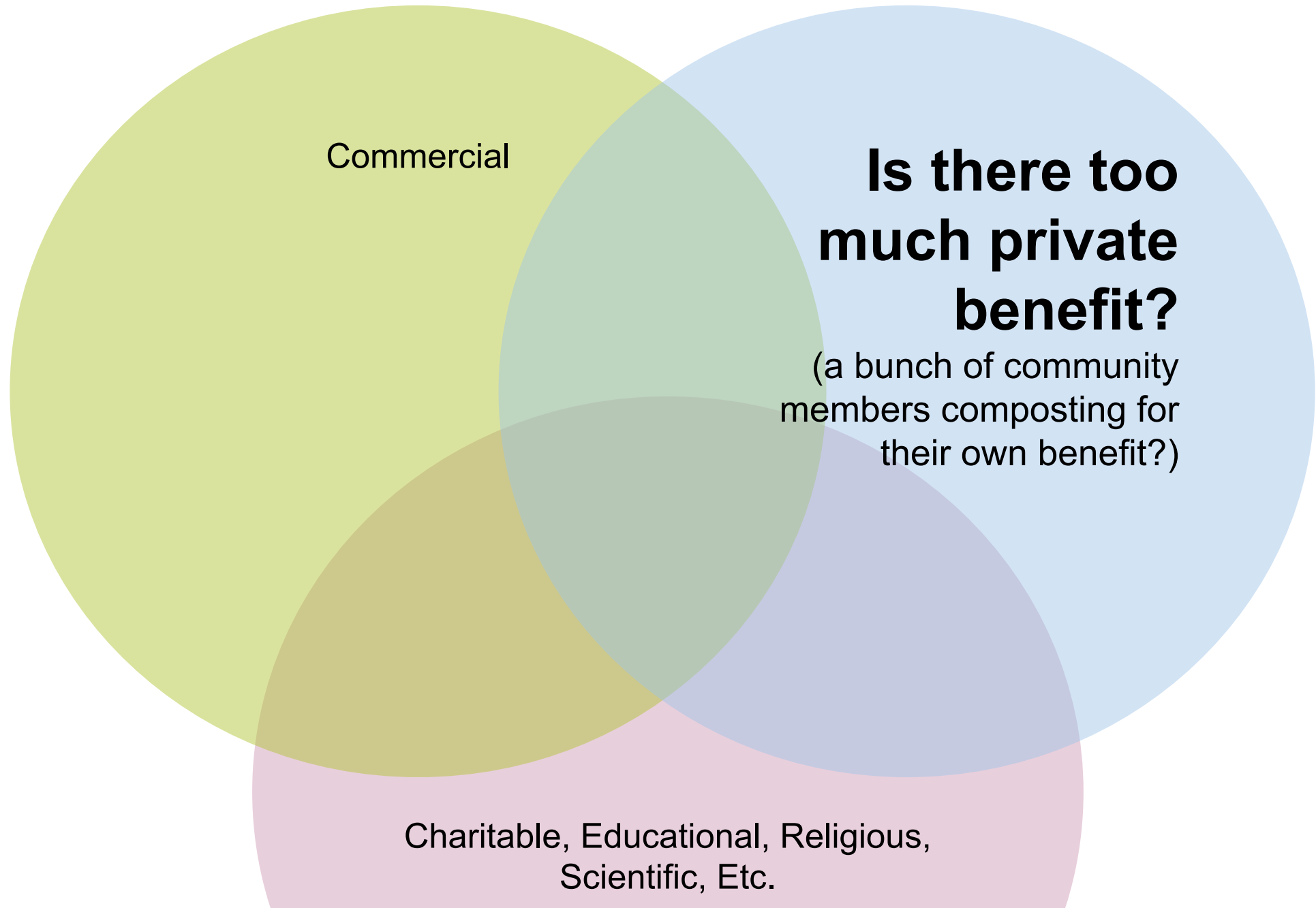
The commercial sector hasn't made it happen.



Your nonprofit's
activities:



Unrelated activities
are ok if they are
insubstantial in relation
to your exempt purpose
activities.

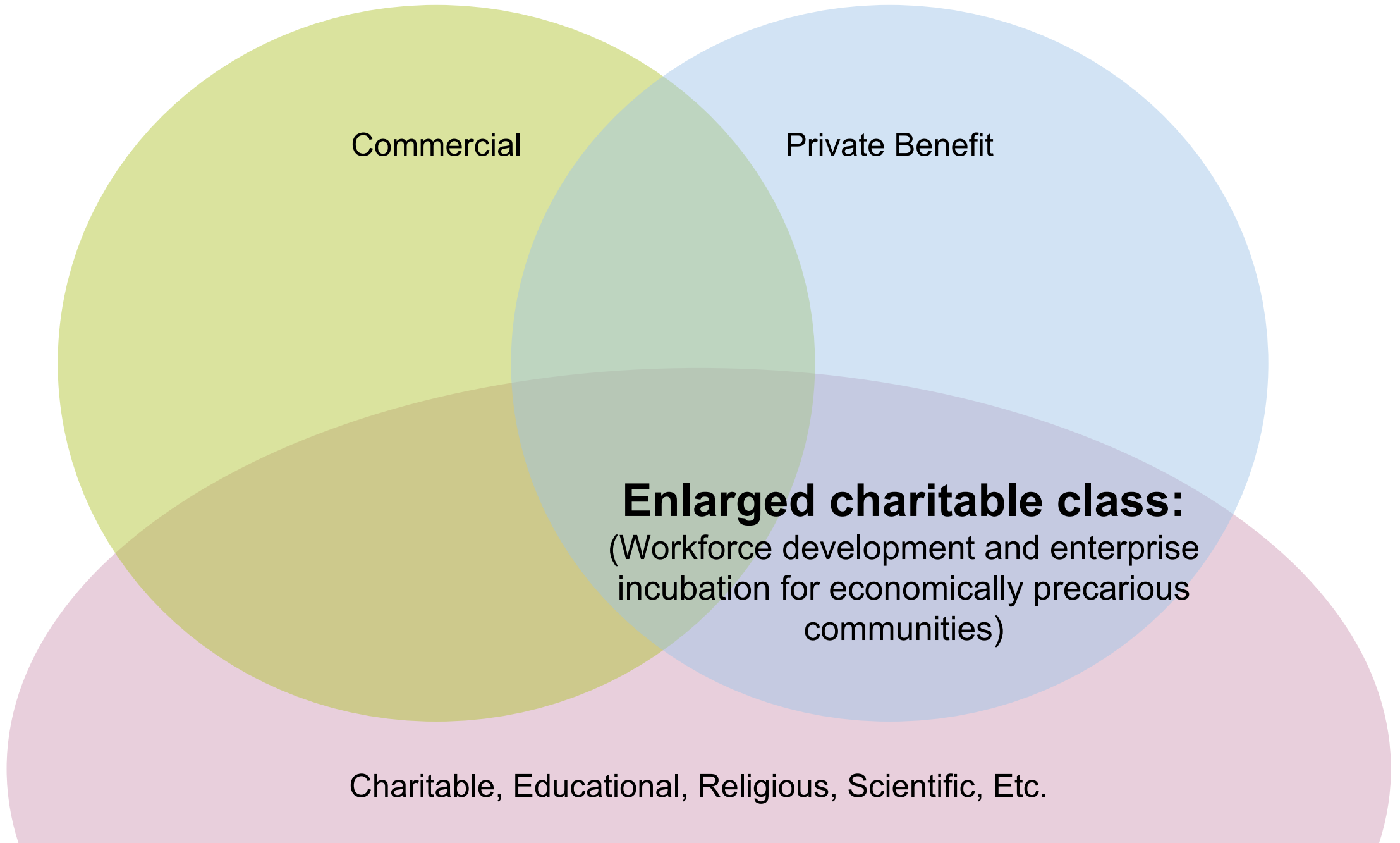


Commercial

**Is there too
much private
benefit?**

(a bunch of community
members composting for
their own benefit?)

Charitable, Educational, Religious,
Scientific, Etc.



Commercial

Private Benefit

Enlarged charitable class:
(Workforce development and enterprise
incubation for economically precarious
communities)

Charitable, Educational, Religious, Scientific, Etc.

“Charitable class” is context specific:

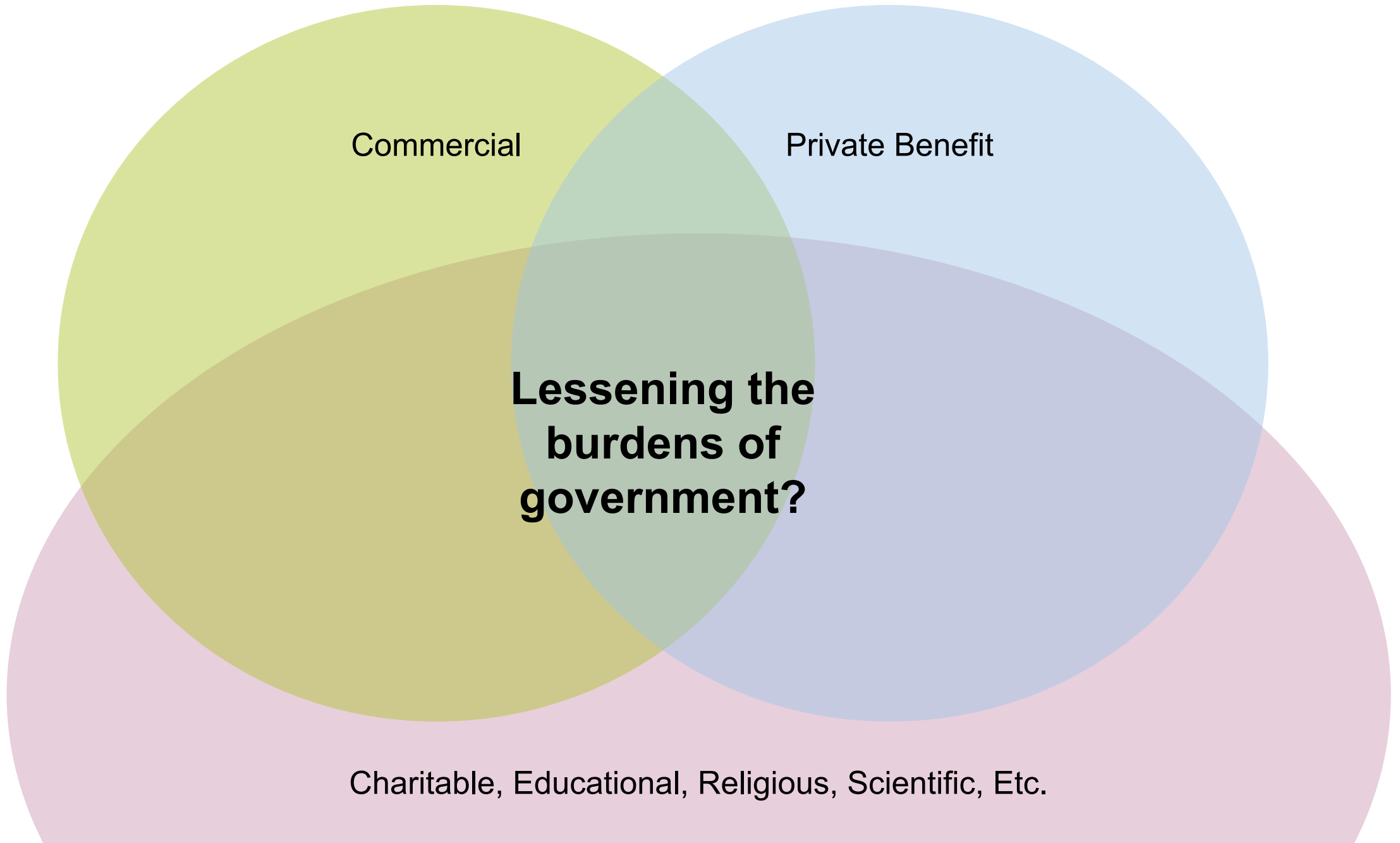
Older ruling:

“An organization formed to build housing for rent to **moderate income families** at cost was held to be **not charitable** within section 501(c)(3) since its program was **not designed to provide relief to the poor.**”

But what if it provides relief to the ***distressed***,
like moderate income people who are now:

- **Threatened** with displacement
- **Rent-burdened** (more than 30% of income goes to rent)
- **Precarious**: Moderate-income, but \$0 in assets
- Live in climate-**impacted** area



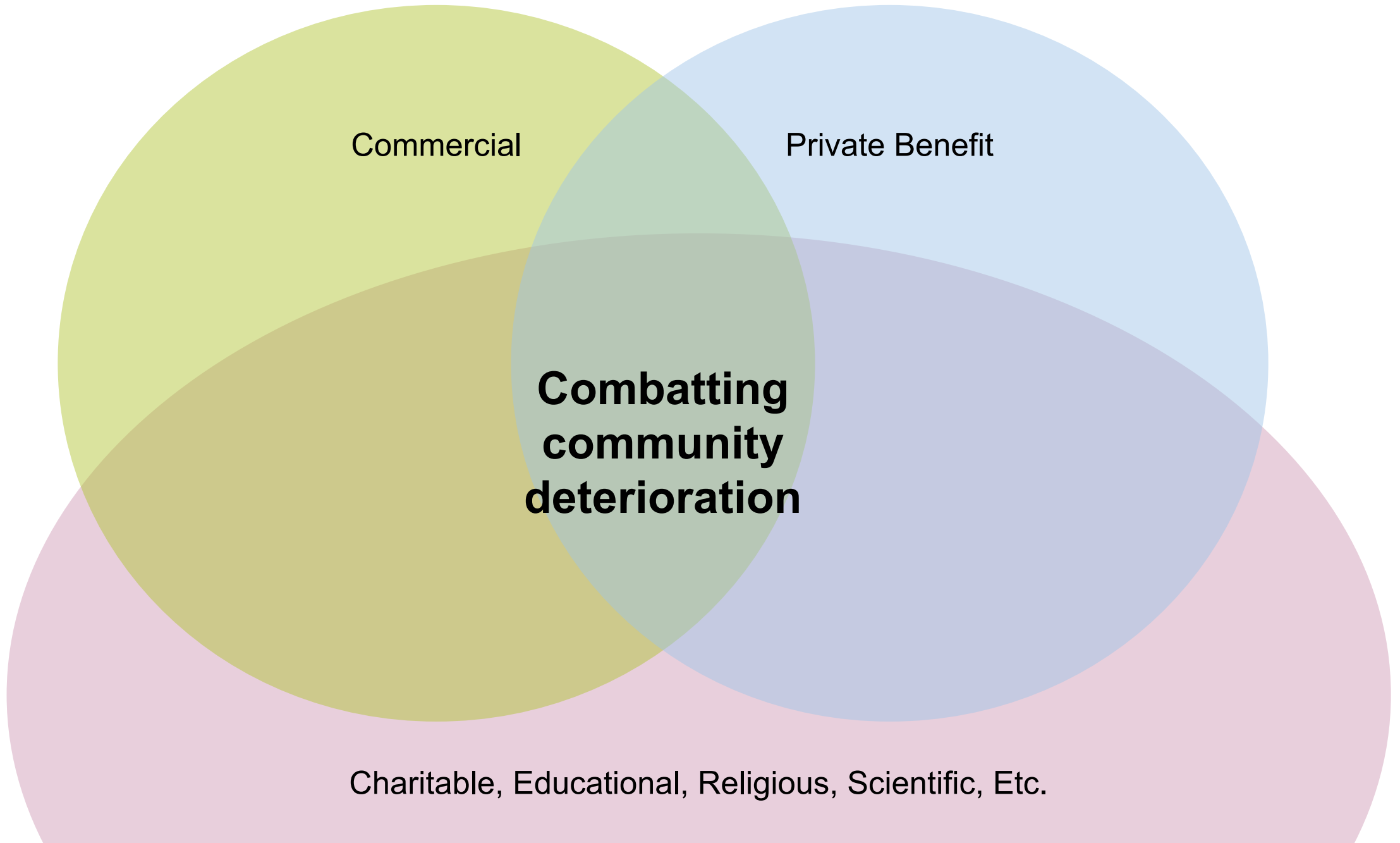


Commercial

Private Benefit

**Lessening the
burdens of
government?**

Charitable, Educational, Religious, Scientific, Etc.



Commercial

Private Benefit

**Combatting
community
deterioration**

Charitable, Educational, Religious, Scientific, Etc.

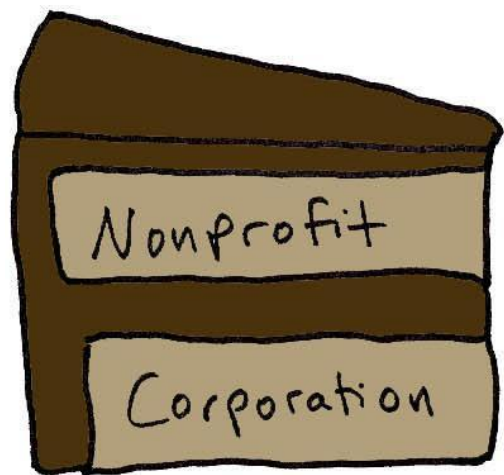


501c3

tax
exemption

With sprinkles!
Tax-deductible
donations!

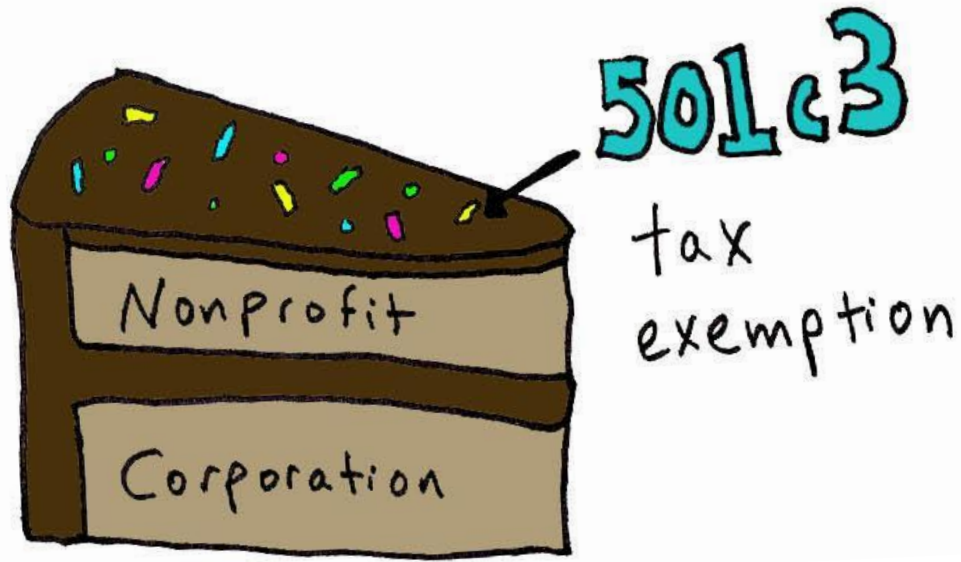
Charitable
&
Educational



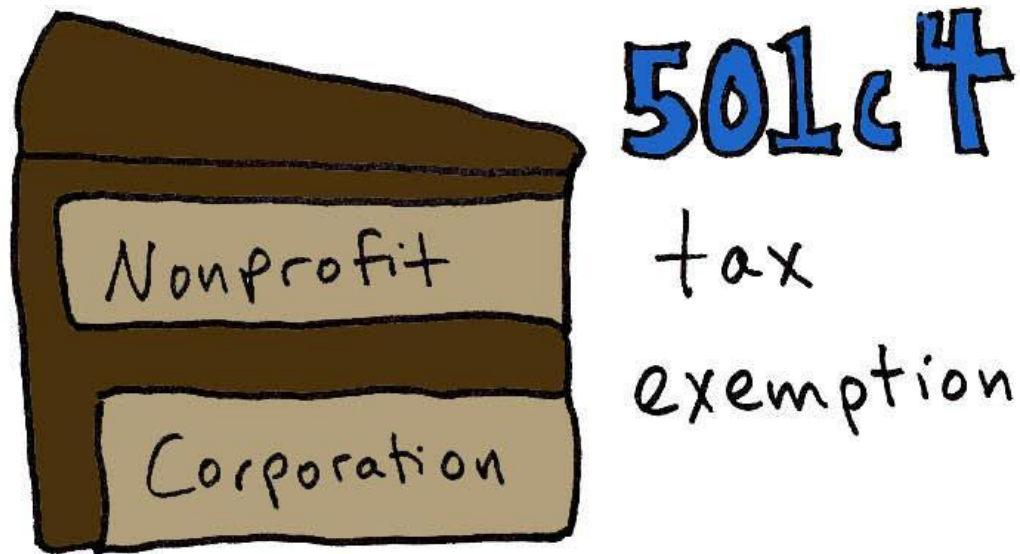
501c4

tax
exemption

Social
Welfare



Making the community
better, because if we
don't, **things will be bad.**

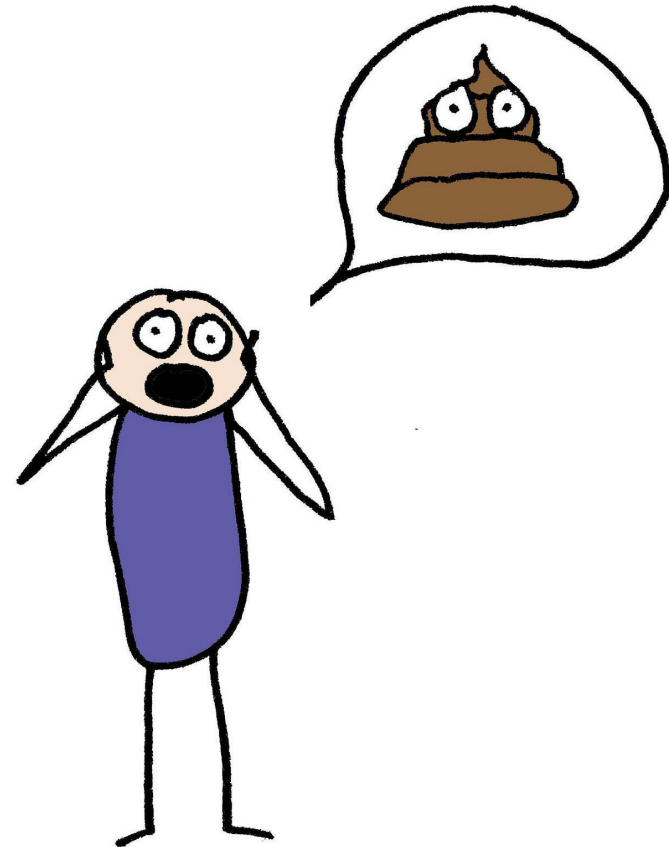


Making the community
better, just 'cuz.

Our intern's assignment:

Gather data on how things are bad **and especially about how things are getting worse**. She produced these, which we encourage anyone to use:

- [Soil & Compost Fact Sheet](#)
- [Jobs & Income Fact Sheet](#)
- [Food Systems Fact Sheet](#)
- [Housing Fact Sheet](#)

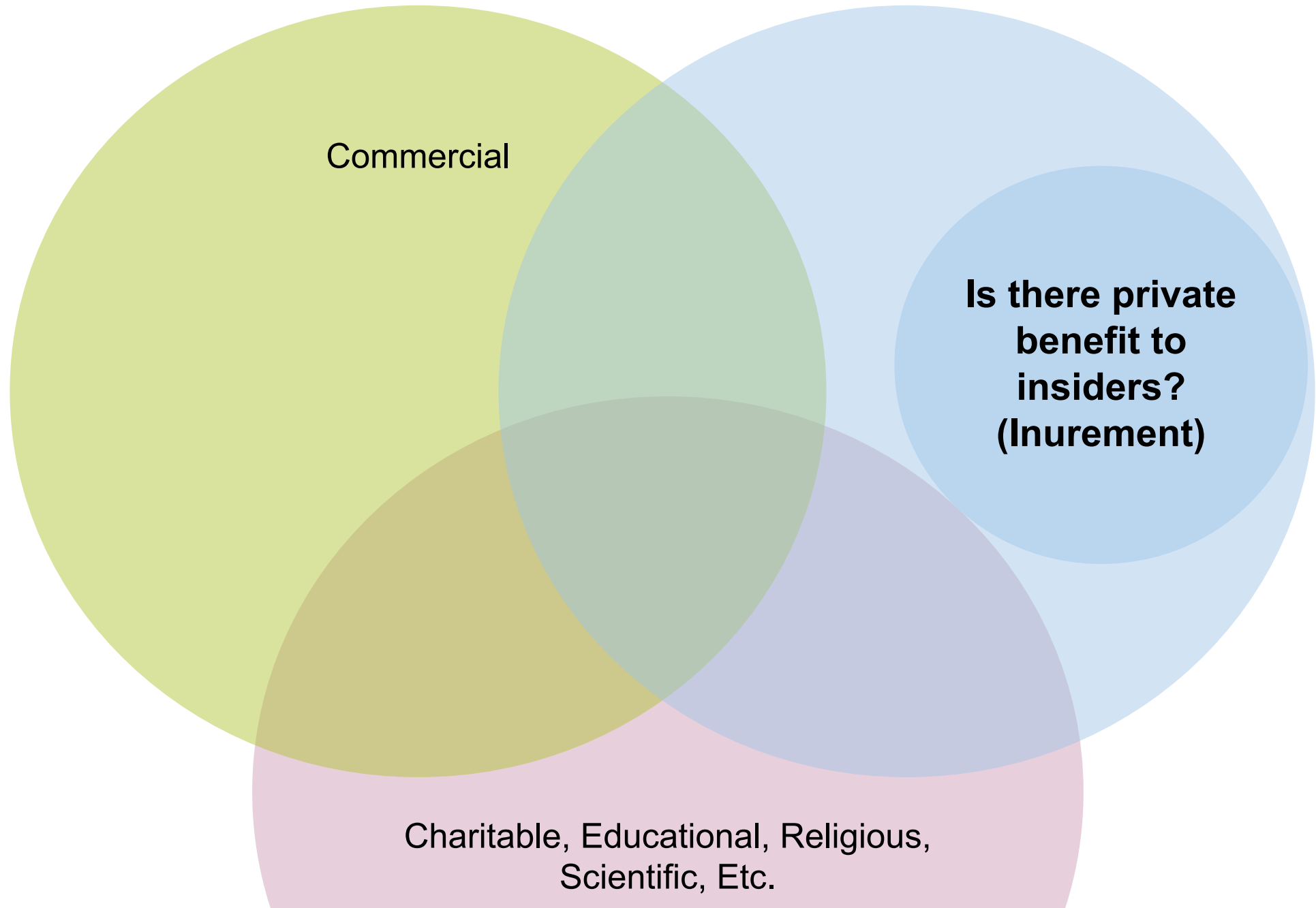


The IRS staff aren't soil scientists, so we can help educate them on we are all doomed if we don't use compost to reduce or prevent:

- Soil toxicity
- Soil depletion
- Drought
- Malnutrition
- Starvation
- Disease
- Waterway pollution
- Methane and CO2 release
- The end of the civilization and the planet

We can point to:

- 1) Data
- 2) Public policies



Commercial

**Is there private
benefit to
insiders?
(Inurement)**

Charitable, Educational, Religious,
Scientific, Etc.

Self-help is empowering *and necessary*, right?

Hmm, but self-help has always been an awkward fit for 501(c)(3):

“A membership organization formed to enable its low income members to purchase decent housing is not exempt under 501(c)(3) because it serves the private interests of its members. Such an organization **would be charitable if the low income families to which it provided decent housing had no relationship to the organization** or those who controlled it, as in Rev. Rul. 70- 585, 1970-2 C.B. 115.”

To sum it up:

- You can help other people.
- Other people can help you.
- But you can't join with others to help yourselves.
- Ugggh.



We WANT the community to bake the cake!



Good News



**We NEED the community to
bake the cake in order to
combat community
deterioration!**

**-- what Nobel Prize-winning economist
Elinor Ostrom said (more or less)**

We need self-help because smart Nobel Prize-winning university economists said so!



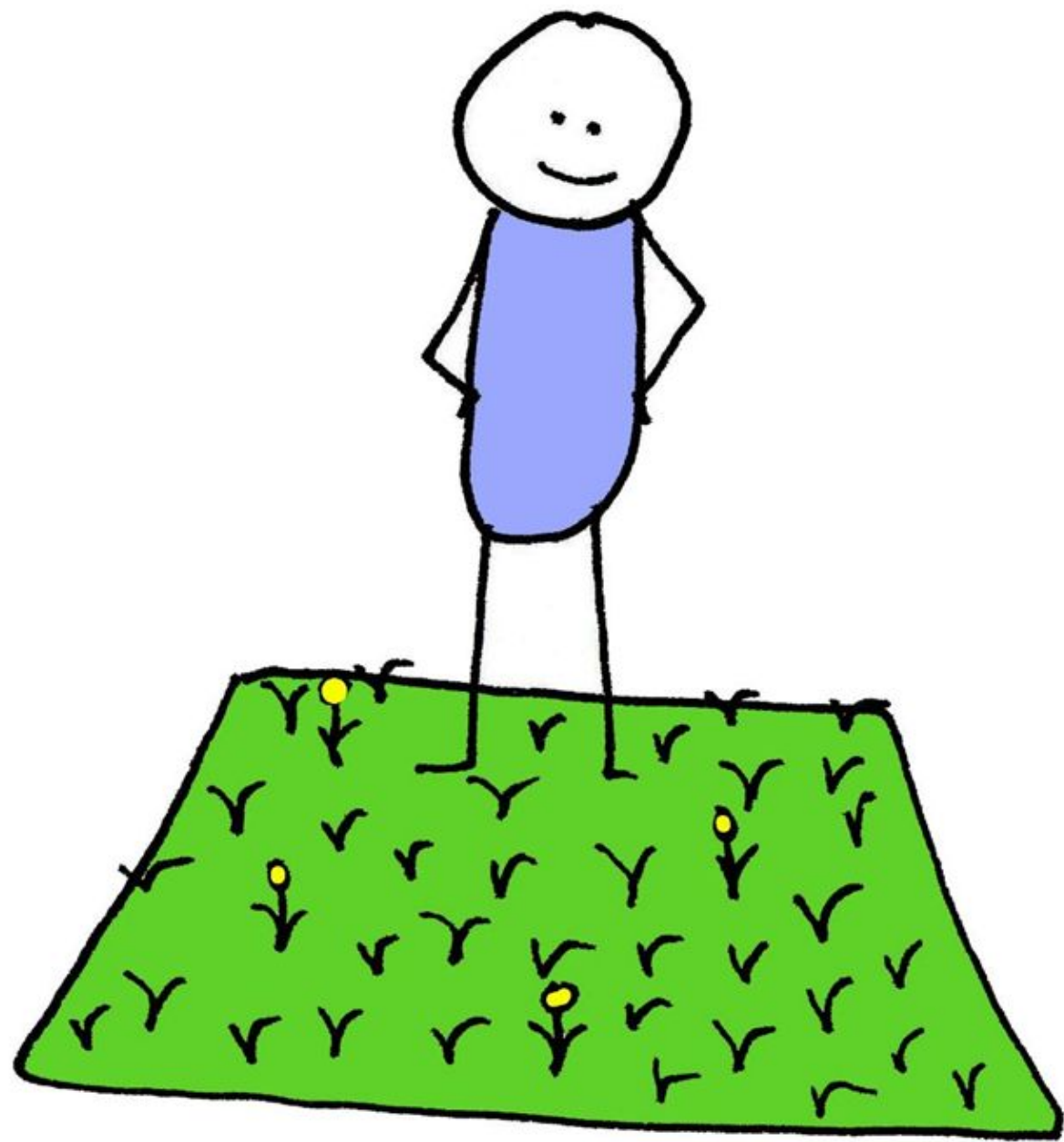
1. Clearly defined boundaries
2. Rules regarding the appropriation and provision of common resources that are adapted to local conditions;
3. Participatory decision-making
4. Monitoring by people who are accountable to resource appropriators
5. Graduated sanctions for exploitation of resources
6. Accessible conflict resolution methods
7. Recognition by the authorities of group autonomy and self-governance
8. For larger groups: Multiple layers of nested enterprises (to keep group sizes small)

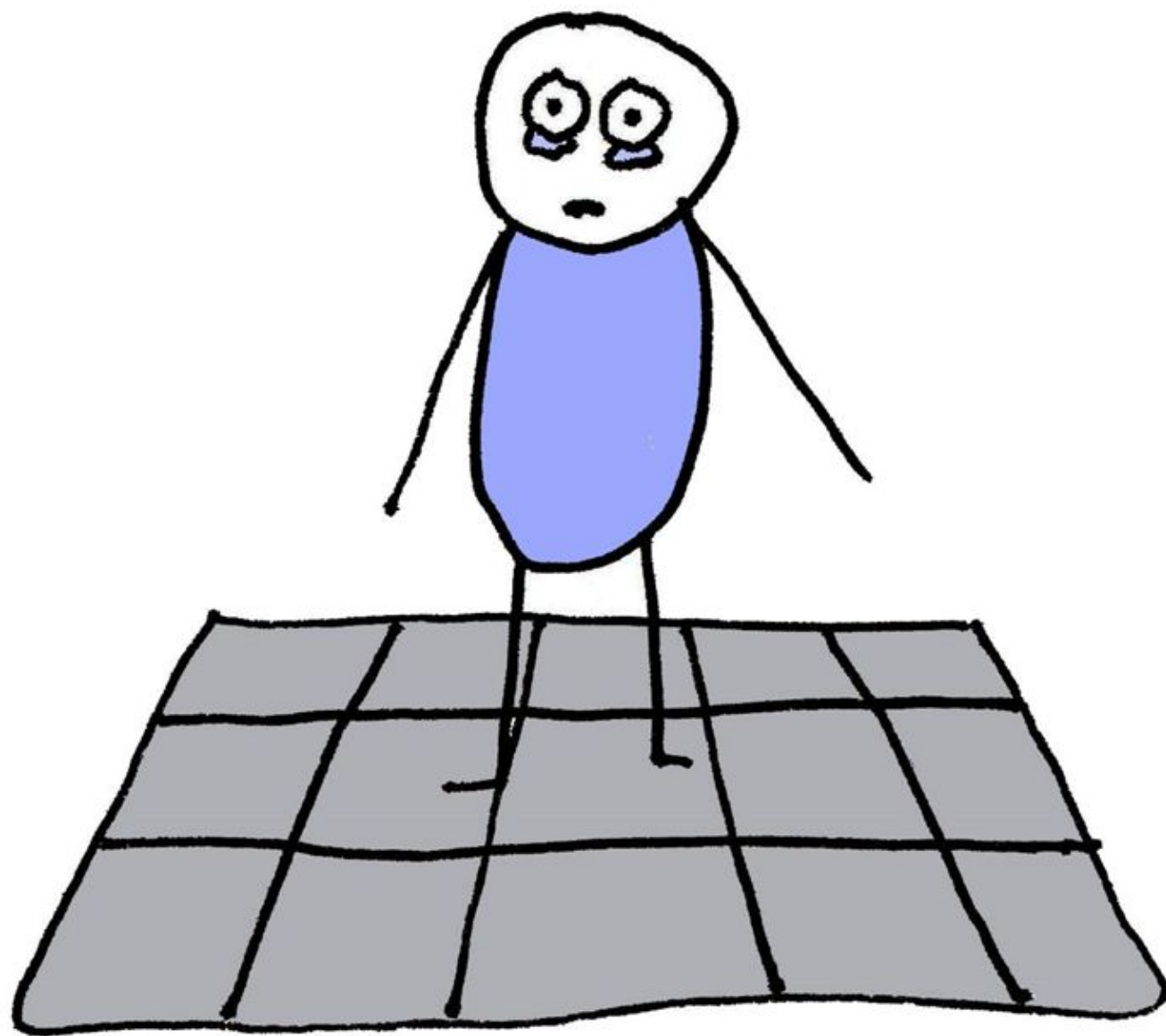
What Wendell Berry feels for soil:

Affection!

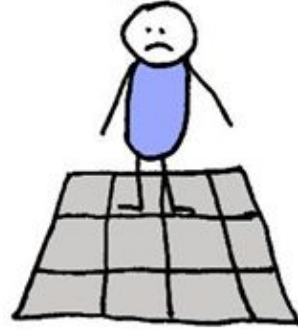
Read his lecture “[It All Turns On Affection](#)”

What is the legal lesson in that?

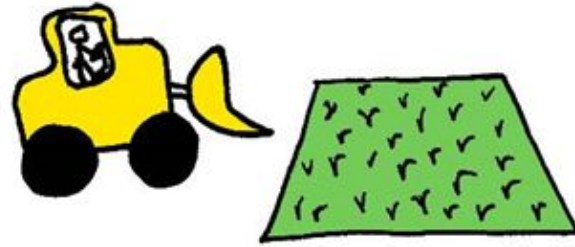




Affection minus (Power) = Disappointment



Power minus (Affection) = Destruction



Affection + Power = Stewardship



Moral to that story? The people who are composting should have the power.



Can we make the case to policymakers that worker cooperatives will be more responsible composters?
YES!

So is there an ideal cake for composting?
Maybe: Nonprofit (501c3) with participatory management by the people doing the composting.



We can ask policymakers to give certain kinds of compost enterprises:

- **Exemptions** from some regulations and hauling restrictions
- Public **funding** and **preferential contracting**

...on the basis of their:

- Small size
- Composting methods and practices
- Entity structure oriented toward public benefit (nonprofits and cooperatives)



There's not much else in the way of objective criteria....or is there?

Thoughts?
Questions?



CompostLaw.org

