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Refusal of Charter of a Non-Profit Corporation

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EVERY STATE HAS PROVISIONS relating to the formation of non-profit corporations.¹ The procedure for forming a non-profit

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- ¹ Ala.: Code, Recomp. 1958, Tit. 10, Secs. 203-263;
 Alaska: Stat., 1963, Secs. 10.20.010-270;
 Ariz.: Rev. Stat., Sec. 10-45;
 Ark.: Stat., 1963, Act 176; set forth in Ark. Stat. 1947, Secs. 64-1901 et seq.;
 Calif.: Corp. Code, amend. 1949, Ch. 997. The Code is divided into three titles: Title 1 is entitled "Corporations," and is divided into three divisions: Division 2, Non-profit Corporations is subdivided into 4 parts of which the first is the General Non-Profit Corporation Law;
 Colo.: Rev. Stat. Secs. 31-19-1-7; 31-20-1-7;
 Conn.: Gen. Stat. as amended 1963, Sec. 33-423-427;
 Del.: Tit. 8 of Code—Non-profit corporations are formed under the General Law;
 D. C.: Non-profit Corp. Act (Feb. 2, 1963), Secs. 1-73; 29-1001;
 Flor.: Stat., Ch. 617, Sec. 617.01 et seq.;
 Ga.: Act of 1938, Sec. 42, as amended by act of Feb. 23, 1949; Tit. 22-1 et seq.;
 Hawaii: Rev. L. 1955, Secs. 172-16 and 172-17;
 Idaho: Code of 1947, Sec. 30-1001;
 Ill.: Rev. Stat., Ch. 32, Secs. 163a-163a100;
 Ind.: Burns' Stat. Anno., Sec. 25-507-553;
 Iowa: Code, Ch. 504;
 Kan.: Gen. Stat. (1949) Sec. 17-2401-4505; 17-2901;
 Ky.: Rev. Stat. Sec. 273.160-290;
 La.: Rev. Stat., 12:101 to 12:155;
 Me.: Rev. Stat., Ch. 53: for the organization of both non-profit and profit corporations;
 Md.: Anno. Code, Art. 23, Sec. 256-314;
 Mass.: Gen. Laws, Ch. 180;
 Mich.: Comp. Laws of 1948, Secs. 450.117 to 450.132a;
 Minn.: Stat., Ch. 317;
 Miss.: Code of 1942, Sec. 5319 et seq.;
 Mo.: Rev. Stat., 1959, Ch. 355;
 Mont.: Rev. Codes, 1947, Sec. 15-1401 et seq.;
 Neb.: Rev. Stat., 1943, Secs. 21-1901 to 21-1991;
 Nev.: Rev. Stat., Sec. 81.010 et seq.;
 N. H.: Rev. Stat. Anno., 1955, Ch. 292;
 N. J.: Rev. Stat., 1937, Tit. 15, Ch. 1 contains general provisions relating to all corporations not for profit;
 New Mex.: Stat. Anno., 1953, Sec. 51-14-20 et seq.;
 N. Y.: Memb. Corp. Law, Sec. 10, sets forth requirements;
 N. Car.: Gen. Stat., Ch. 55A;
 N. Dak.: Cent. Code, Chs. 10-24 through 10-28;
 Ohio: Rev. Code, Secs. 1702.01-1702.98;
 Okla.: Stat., Tit. 18, Ch. 14, Secs. 541-591;
 Ore.: Rev. Stat., Secs. 61.005-61.950;
 Penna.: Stat. 15-2851;
 R. I.: Gen. Laws of 1956, Secs. 7-6-1 to 7-6-17;

(Continued on next page)

corporation is similar to that of organizing a corporation for profit.² The purpose of this note is to summarize the reasons for which a non-profit corporate charter may be refused by a state.

Name

The name of a proposed corporation must not be so similar to that of an existing corporation as to mislead the public into thinking that there is a connection between the two.³ A corporation may not assume a name that could be used by any person or persons,⁴ or one which could be used by most religious bodies or churches.⁵ The corporate name must be acceptable under a state's non-profit corporation law,⁶ and it has been held that a

(Continued from preceding page)

S. Car.: Code of Laws 1962, Sec. 12-745-765;

S. Dak.: Code of 1939, Sec. 11.1401 et seq. (South Dakota on July 1, 1965 adopted the Model Non-Profit Corporation Act);

Tenn.: Code, 1932, Sec. 43-1801 et seq.;

Tex.: Stat. 1925, as amended 1959 Ch. 162; Ch. 9.1396-1 et seq.;

Utah: Code Anno. 1953 as amended 1963, Sec. 16-6-18;

Vt.: Stat., Tit. 11, Sec. 41-50; a non-profit corporation is formed under the general corporation law;

Va.: Code, 1950, as amended 1956, Tit. 13.1;

Wash.: Rev. Code, Ch. 24.01;

W. Va.: Code, 1961, Ch. 31;

Wis.: Stat. 1961, Ch. 181;

Wyo.: Stat., 1957, Secs. 17-122.1-17-122.9;

² See, Oleck, *Non-Profit Corporations, Organizations & Associations* (2d ed., 1965).

³ *In re Boy Explorers of America, Inc.*, 67 N. Y. S. 2d 108 (1946). *Benevolent & Protective Order of Elks v. Improved Benevolent & Protective Order of Elks of the World*, 205 N. Y. 459, 98 N. E. 756 (1912); *International Committee Young Women's Christian Association v. Young Women's Christian Association of Chicago*, 194 Ill. 194, 62 N. E. 551 (1901), *Parma Democratic Club v. Democratic Club of Parma, Inc.*, 29 Ohio Law Abs. 30 (1939); 1947 Ohio Atty. Gen. Op. 190.

⁴ *In re We Americans, Inc.*, 166 Misc. 167, 2 N. Y. S. 2d 235 (1938). Court held name belongs to all Americans and by forming a corporation under such a name, millions of Americans would be excluded.

⁵ *In re Church of God World Headquarters, Inc.*, 182 Misc. 851, 46 N. Y. S. 2d 545 (1944) (every church is a church of God). *In re General Council of Assemblies of God of New York, Inc.*, 96 N. Y. S. 2d 521 (1950) (name was too broad.)

⁶ *In re Proposed Incorporation of Long Beach Defense Guards, Inc.*, 100 Misc. 584, 166 N. Y. S. 459 (1917). The words "Guard" and "Defense" might mislead the public into believing it is connected with the National Guard. Also a corporation which has proposed military purposes would have to be organized with the Governor of New York, who has control over the military. *In re Mazzini Cultural Center, Inc.*, 185 Misc. 1031, 58 N. Y. S. 2d 529 (1945), purpose of the corporation was to promote Americanism and also to provide musical education to underprivileged children. Mazzini, after which the corporation was to be named, was an Italian patriot, had never been to America, had no connection with America and was not a musician.

corporate title must give some indication as to the true purpose of the corporation.

Purposes

In order to be acceptable, the corporate purposes must be lawful. Articles of incorporation were refused by the Secretary of State of Ohio for a corporation which aimed at operation of a nudist camp,⁷ which is forbidden by Ohio statute.⁸ Charters have also been refused to corporations intending to practice law⁹ or optometry,¹⁰ and to teach astrology.¹¹ Corporations cannot be established in West Virginia for promoting religion or collecting funds for the erection of religious houses.¹²

To organize a corporation, one court held that there must be some necessity,¹³ since the operation of the corporation is a privilege which may be withheld.¹⁴ It must also be shown in the purpose clause that the corporation has the facilities and ability to carry out the stated purposes.¹⁵ *In re Rox Athletic Ass'n of McKees Rocks*,¹⁶ the charter was refused acceptance, because the corporation obviously could exist only by "passing the hat," or by obtaining a liquor license which, in the court's words, would be "adding one more drinking resort to those posing as Chartered Clubs."

A corporation whose "political" purposes are so broadly stated that it might include overthrow of the government could

⁷ *State, ex rel. Church v. Brown, Secretary of State*, 59 Ohio Op. 45, 165 Ohio St. 31, 133 N. E. 2d 333 (1956), app. dism. 352 U. S. 884, memo decision No. 340.

⁸ Ohio Rev. Code, § 2905.31.

⁹ *Dworken v. Apartment House Owners Assn.*, 28 Ohio N. P. (N. S.) 115 (1930) affd. 38 Ohio App. 265, 34 O. L. R. 234, 176 N. E. 577; *L. Meisel & Co. v. National Jewelers' Board of Trade*, 90 Misc. 19, 152 N. Y. S. 913 (1915).

¹⁰ *State ex rel. Harris et al. v. Myers, Secretary of State*, 128 Ohio St. 366 (1934); 191 N. E. 99.

¹¹ 1942 Opinions Atty. Gen. Ohio, No. 5141. Astrology is placed in the same category as fortune telling and palmistry, both of which the Ohio legislature has made unlawful.

¹² *Powell v. Dawson, Secretary of State*, 45 W. Va. 780, 32 S. E. 214 (1899); *Lunsford v. Wren*, 64 W. Va. 458, 63 S. E. 308 (1908).

¹³ *In re We Americans, Inc.*, *supra* n. 4. Court felt that it was not necessary to form a corporation to preserve American freedom and Democracy.

¹⁴ *Mayor, etc., of The City of New York v. Twenty-Third St. Ry. Co.*, 113 N. Y. 311, 21 N. E. 60 (1889).

¹⁵ *Application of Stillwell Political Club, Inc.*, 109 N. Y. S. 2d 331 (1951).

¹⁶ 318 Pa. 258, 178 A. 464 (1935).

not be chartered.¹⁷ Neither would a New York court accept a corporation whose object was to promote amendments to Federal and State Constitutions providing for the forfeiture of citizenship of those distributing or possessing matter advocating the overthrow of the United States Government by force.¹⁸ Further, the purposes of a corporation could not be approved if the corporation is "intended to be used as a cloak of respectability in which "Bunds" or other semi-military and un-American organizations might masquerade."¹⁹

The Supreme Court of New York refused to charter a non-profit corporation on the grounds that the corporate purposes might endanger individual thought and opinion.²⁰ The formation of an organization to be named "Cancer Research Association" was refused admittance on the grounds that it would be duplicating²¹ the functions of the "American Cancer Society," and thus would lead to confusion. A corporation whose purposes would interfere with religious freedom, which is guaranteed by the United States Constitution, is not acceptable.²² Where the purpose clause showed that the corporation was to organize people resentful of America's victory over Germany, with the intent of dividing the American people, a charter was refused.²³

¹⁷ *In re Lithuanian Workers' Literature Soc.*, 196 A. D. 262, 187 N. Y. S. 612 (1921). This corporation attempted to amend their charter to publish books and periodicals on Marxian principles. Court held that the right of free speech which is guaranteed by the United States Constitution does not include the right to overthrow an organized Government, which is a felony in New York.

¹⁸ *In re Patriotic Citizenship Ass'n, Inc.*, 53 N. Y. S. 2d 595 (1945).

¹⁹ *In re German and Austrian-Hungarian War Veterans Post No. 65 of Glendale, Queens, Inc.*, 13 N. Y. S. 2d 207 (1939).

²⁰ *In re Grand Jurors Ass'n, Bronx County, N. Y., Inc.*, 25 N. Y. S. 2d 154 (1941).

²¹ See also, *In re Marine Corps Vets Foundation, Inc.*, 79 N. Y. S. 2d 18 (1948): This corporation's purpose was to raise funds for ex-marines. Court held that it would only be duplicating functions that are being performed by other organizations and that there are already too many of these fund-raising corporations in existence. *Application of Kneseth Harabonim D'America, Inc.*, 131 N. Y. S. 2d 543 (Supreme Court, Special Term, New York County, Part II) (1954): This corporation would only be duplicating the functions of other rabbinical organizations long established. *In re Waldemar Cancer Research Ass'n, Inc.*, 205 Misc. 560, 130 N. Y. S. 2d 426 (1954): The corporate title is misleading in that the proposed corporation would not be conducting any research, but its only function would be to raise funds.

²² *In re American Jewish Evangelization Soc., Inc.*, 183 Misc. 634, 50 N. Y. S. 2d 236 (1944) purpose was to persuade people to change their present religious belief for another religion.

²³ *In re Voters Alliance For Americans of German Ancestry, Inc.*, 64 N. Y. S. 2d 298 (1946): Time (1945) was an important factor in denying the chartering of this corporation.

A corporation to be named "Allied Federation of Labor," which was to act as a labor union, was denied a charter under the Illinois Non-Profit Act of 1938,²⁴ because in 1937 the legislature had amended the Non-Profit Act and, in place of the phrase "any lawful purpose," specified the types of acceptable non-profit corporations. The court held that labor unions did not meet these specifications.

The case *Association For the Preservation of Freedom of Choice, Inc. v. Irwin Shapiro*,²⁵ is one of the most recent and probably the most controversial case on the subject.²⁶ Judge Shapiro refused to give his approval to the formation of this corporation which had for its avowed purpose the encouragement of people to choose and associate with only those persons one prefers. Refusal was based on the grounds that it is the judiciary's duty to determine whether a corporation's objects are lawful and not contrary to public policy. Reversing the judgment, the New York Court of Appeals held that the judiciary could only pass on the lawfulness of the objectives, but not whether those objectives are in accord with public policy. The Court gave its approval to the corporation because there appeared to be nothing unlawful in its objects or purposes. There was a dissent by Judge Burke, who said that to be "lawful," the purposes of the corporation must be in accordance with the policy of the state in which it wishes to be chartered. Since a New York law forbids practices of discrimination, Judge Burke agreed with Judge Shapiro in refusing the charter.²⁷

On October 5, 1964, the Secretary of State of Ohio accepted as a non-profit corporation the Articles of "National Knights of the Ku Klux Klan of Ohio."²⁸ In the wake of numerous complaints, the Secretary of State reversed himself and 18 days later revoked the corporation's charter explaining that the Ku Klux Klan was on the subversive list of the United States Attorney

²⁴ *People ex rel. Padula v. Hughes, Secretary of State*, 296 Ill. App. 587, 16 N. E. 2d 922 (1938).

²⁵ *Association for the Preservation of Freedom of Choice, Inc. v. J. Irwin Shapiro, as Acting Justice of the Supreme Court, Queens County*, 9 N. Y. 2d 376, 214 N. Y. S. 2d 388, 174 N. E. 2d 487 (1961).

²⁶ As to the subject, see Vance, *Freedom of Association and Freedom of Choice in New York State*, 46 Cornell L. Q. 290 (1961). (Cited in subj. case note at p. 489.)

²⁷ *Assn. etc. case, supra*, n. 25, 174 N.E. 2d at 490.

²⁸ *The Cleveland Plain Dealer*, Oct. 21, 1964, p. 11.

General and revocation was in the best interests of the people of Ohio.²⁹

Profit or Non-Profit?

It is frequently difficult to decide whether to accept or refuse a proposed non-profit corporation which in fact might be a profit-making organization. The following cases illustrate what the courts look for in determining whether a corporation is truly non-profit:

Judge Hough, in *Celina & Mercer County Telephone Co. v. Union Center Mutual Telephone Ass'n.*,³⁰ in refusing a telephone company a non-profit charter, distinguished profit from non-profit in the following manner:

How may it be determined whether a corporation or association is one for profit or not for profit? Does the filing of articles of incorporation in which the declaration is made that it is not for profit, and on which the charter is issued, govern or determine this question? Is the issuance or non-issuance of capital stock controlling, or is it whether a business is to be engaged in and operated with consideration of the character of what business, and the method of conducting it, that is the true test? We think the latter.

In *Read v. Tidewater Coal Exchange, Inc.*,³¹ profit was defined as follows:

Profit furthermore must be something of a tangible or pecuniary nature. Intangible benefits not capable of measurement in definite terms, though of value to the recipients, cannot be called profits. When we speak of a corporation for profit, I take it also that we mean profit coming to, or belonging to, the corporation qua such, as distinct from its members or stockholders."

Finally, the *Southerland, Attorney General, ex rel. Snider et al. v. Decimo Club, Inc.*,³² case made the distinction as follows:

If the facts and circumstances show the business to be such in character and volume as to indicate that the engaging in business and the making of profits therefrom for the benefit of its members is the principal or one of the principal objects of the corporation, rather than a thing which is sub-

²⁹ The Cleveland Plain Dealer, Oct. 23, 1964, p. 4.

³⁰ 102 Ohio St. 487, 133 N. E. 540 at 542, 21 A. L. R. 1145 (1921).

³¹ 13 Del. Ch. 195, 116 A. 898, 904 (1922).

³² 16 Del. Ch. 183, 142 A. 786, 790 (1928).

ordinate and merely incidental to the principal object of its existence, it is reasonable to conclude that the corporation cannot be called one which is organized 'not for profit.'

Where a corporation is set up for the operation of a hospital-nursing home and the purpose clause does not indicate a profit or non-profit motive, the Articles should be filed as a profit corporation.³³ A corporation formed for the purpose of buying the lands of a profit corporation and developing these lands for the benefit of its members in the community, is a corporation for profit and a statement in the Articles of Incorporation saying it is to be a non-profit organization is not conclusive.³⁴ A corporation was said not to be of a non-profit type where its purpose was to acquire lands and sell them to its members on easy monthly payments, thus encouraging financial responsibility among the working classes.³⁵ Nor could a corporation, whose purpose was to assist its members in obtaining a life insurance policy with payment of this policy to the member's family at his death, be organized as a non-profit corporation.³⁶

A group of automobile dealers attempted to form a non-profit corporation whose object was to exchange viewpoints and procedures, and to protect car sales. In refusing to accept this charter as a non-profit corporation, the Court could see no other purpose for which it could be formed but to increase the business and profits of its members.³⁷ A Savings Association attempting to be incorporated for the pecuniary profit of its stockholders was not granted a charter as a non-profit corporation.³⁸ An association whose function was to operate a funeral business was refused a charter because it was proven to be a profit-making operation for its founder.³⁹ The Secretary of State of Illinois

³³ 1942 Opinions Ohio Atty. Gen., No. 5425.

³⁴ State ex rel. Russell v. Sweeney, Secretary of State, 153 Ohio St. 66, 91 N. E. 2d 13 (1950); note the dissent by Judge Taft.

³⁵ State ex rel. Attorney General v. Home Co-Op Union, 63 Ohio St. 547, 59 N. E. 220 (1900). Court held this was profit making and therefore must have capital stock and operate as a profit corporation.

³⁶ People ex rel. Blossom v. Nelson, Secretary of State, 46 N. Y. 477 (1871). Court held that even though the corporate purposes contemplate "temporal interests of others," this is only incidental to the main purposes, that of profit making.

³⁷ Application of Pittsburgh Chevrolet Dealers' Ass'n, Inc., 296 Pa. 431, 146 A. 26 (1929).

³⁸ Sheren v. Mendenhall, 23 Minn. 92 (1876).

³⁹ In re Henry County Mutual Burial Ass'n, 229 Mo. App. 300, 77 S. W. 2d 124 (1934).

was held justified in refusing to accept a corporation as non-profit where it could be shown, from its Certificate of Incorporation, that it was being formed for the profit of the incorporators.⁴⁰

The organizers of a corporation created for the purpose of furnishing medical aid to its members at a cost less than that charged by the state, could not obtain a non-profit charter because of the resulting profit to the members.⁴¹ In *People ex rel. Davenport v. Rice*,⁴² the Secretary of State's refusal to grant a non-profit charter to a corporation whose purposes were "to establish and create a helpful opportunity for thrift among cash purchasers upon their individual and family expenditures, by providing for commissions from tradesmen on cash sales, which are to benefit, through the company, the purchasers," was upheld by the Supreme Court, which held that the purpose was in reality profit-making.

A corporation engaged in educational teachings, which guaranteed the members who contributed funds a substantial increase in their investment, could not be classified as a non-profit type corporation.⁴³ A corporation whose remaining funds after expenses were to be used as the Board of Directors saw fit could not be granted a non-profit charter, because such funds were under the exclusive control of the Directors, and it could be shown that the corporation was intended to be organized for the profit of its originators.⁴⁴

Conclusion

The states are not in agreement as to what precisely constitutes an acceptable non-profit corporation. In some states the question seems to be governed by the feelings of the judiciary. In others, the Secretaries of State seem to be exceeding the authority given to them in ruling on whether a corporation can be chartered as non-profit.

⁴⁰ *People ex rel. Bonney v. Rose*, 188 Ill. 268, 59 N. E. 432 (1900).

⁴¹ *State ex rel. Troy, Pros. Atty. v. Lumbermen's Clinic*, 186 Wash. 384, 58 P. 2d 812 (1936). This is contrary to *Read v. Tidewater Coal Exchange*, *supra*, n. 31, but in accord with *Southerland v. Decimo*, *supra*, n. 32.

⁴² 68 Hun (N. Y.) 24, 22 N. Y. S. 631 (1893). This is in accord with the *Celina Mercer County Telephone Company case*, *supra*, n. 30.

⁴³ *People ex rel. Hughes, Secretary of State v. Universal Service Ass'n.*, 365 Ill. 542, 7 N. E. 2d 310 (1937). This corporation was already formed under the Illinois non-profit law and was ousted by the Secretary of State.

⁴⁴ *In re St. Louis Institute of Christian Science*, 27 Mo. App. 633 (1887).

One solution might lie in liberalizing the requirements for granting a non-profit charter and then requiring frequent filings of detailed reports concerning the corporate activities to ascertain whether the corporation was truly operating as a non-profit organization. If it were found to be a profit-making venture, then the state could initiate proceedings to oust the corporation. This, of course, would place a great burden on a state.

Another solution would be to encourage the states to adopt the Model Non-Profit Corporation Act, prepared by the Committee on Corporate Laws and the Committee on Non-Profit Corporations of the American Bar Association. An alternative suggestion is the Uniform Act proposed by Dean Oleck in his work on non-profit organizations.⁴⁵ Fourteen states have already adopted at least parts of the Model Act. Such adoptions would standardize state laws on the subject and define exactly what requirements must be met for a non-profit corporation to obtain a charter.

⁴⁵ Oleck, *Non-Profit Corps., Orgns. & Assns.* c. 40 (2d ed., 1965).