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Clover the B - Transcript

[Speaker 1]

Welcome to Charity Therapy, the podcast where we explore the ups and downs of the nonprofit sector and answer your burning questions. I'm your host, Jess Birken, owner of Birken Law Office, and I'm excited you're here. Imagine hanging out with me and my super smart, funny nonprofit expert pals.

You get to ask them anything about your nitty gritty nonprofit life and get their wisdom for free. Whether you're a seasoned pro or just strapping on your nonprofit boots, we're here to share stories and remind you you're not alone on this journey. So get ready to join the conversation and bring me the tough questions.

I ain't scared. Ready to rock? Let's dive in.

Hello and welcome to this episode of Charity Therapy. Meghan and I are back again with more answers to your nonprofit questions.

[Speaker 2]

The questions never end and we've got the answers. So we're here. I'm excited.

[Speaker 1]

We're here. There's a duck in my bathtub. Everything is chaos.

[Speaker 2]

No context for the duck in the bathtub. Just it's just it is.

[Speaker 1]

Well, so this morning I went outside to let the ducks out of the barn, so to speak.

And turns out my little tiny bitchy duck Clover, who is the loud quacker, was getting Clover the bee has been was running around getting chased by another duck. And I noticed that Clover's white wing had a bloody spot on it. And I was like, Ruh-roh.

So I had to chase Clover all around the yard, fell on my ass in a mud pit, salvaged this muddy wounded duck and brought the duck inside. Like what are we doing here? Which really is kind of a metaphor for starting a nonprofit, because.

[Speaker 2]

You know, to bring it back around.

[Speaker 1]

What are we doing here is so frequently the vibe of the questions that we get.

[Speaker 2]

Or on the flip side, the questions we are asking them of like, what are you trying to do here?

[Speaker 1]

Yeah. What are we doing here? Yeah.

So there's a duck in my bathtub. She has taken a bath in a dish pan, and I will figure out what the wing situation is after we're done recording.

[Speaker 2]

Well, thoughts and prayers to Clover and thank you for being here today.

[Speaker 1]

Yeah, no problem. No problem. Another day on another day in the life of Jess Birken.

With the Menagerie of Pets. Pets and nonprofits. Yep.

[Speaker 2]

Well, on the nonprofit side of your of your life, do you like that segway? Let's get into it.

[Speaker 1]

Yeah, let's do it.

[Speaker 2]

So today we're going to talk about people who are, you know, newer nonprofits and a lot of the folks who are starting up a new nonprofit, the like big step that they're all super focused on is applying to get their tax exempt status with the IRS. It's like the big hurdle that everybody's focused on. Jess, as you know, we're working on these applications like day in and day out.

This is our bread and butter. So can you give us like a little rundown about like what those applications even are or look like for folks who haven't put one in before?

[Speaker 1]

Yeah. So the thing you got to know is that income tax exemption for nonprofits is not automatic. If you start a nonprofit corporation in your state and you say we're a 501c3, that doesn't make you a 501c3.

You have to actually write to the IRS, fill out a bunch of forms and paperwork and say pretty please, could you maybe look at our stuff, think we're a charity and let us not pay income tax. So that is sort of the fundamental piece that you have to go ask from the IRS. And the way that you do that are forms and they're called the 1023 or the 1024, depending on what kind of charity you're starting.

And then like in the 1023 world, which is like your garden variety nonprofit public charity, there's like the long form or the short form. So the long form is, it's long, it is named appropriately. It takes a lot of work.

It's like you got to have a whole business plan and a bunch of documents and financial information and all this stuff. And it's seen as the most professional version of the application because it's very transparent. It says a lot about what you do.

The 1023EZ is the short form and it's much more like quick and dirty. You don't have to disclose a lot of information. It's sort of in the professional world, it's sort of seen as a little bit fly by night.

Feeding Our Future, great example of a charity that used the 1023EZ for their tax application. Didn't want to share too much about what was going on there. So that's the quick one.

And there's like, you can only use that one if you meet certain criteria. And one of those criteria is like, you're not sending money overseas. You're not a church.

You're not a school. You're not making very much money. There's like a worksheet that you got to do.

And then if you want to slide under those criteria, you can do the EZ. Does that help? Was that too much technical jargon?

[Speaker 2]

No, I think that made sense. The only thing I will add is just that while the long form is appropriately named at being long, the EZ is not necessarily easy. Oh, yeah, that's a given.

We talked to lots of people who get it screwed up. So we're talking about bad naming. The 1023EZ, it's maybe easier, but it's not.

[Speaker 1]

It just means short. Because frankly, lawyers, out of the goodness of their heart, who are just trying to help out a friend who's doing whatever, F this up constantly. It is like everything from the IRS.

It's not written for human consumption. It's very confusing. You have to check all the right buttons.

And it's very easy to make a mistake. Yep.

[Speaker 2]

Okay. Anyways. Great.

That's our little rundown. If you are starting a nonprofit, you need to apply for tax exemption with either the long form or the short form. Okay.

So with that little backdrop of information, I've got a listener question for you, Jess. Are you ready?

[Speaker 1]

Okay, I'm ready. Let's do it.

[Speaker 2]

All right. I started my nonprofit two years ago, and I filed for tax exemption myself with the 1023EZ application. I've done tons of work and built up my programs, and everything is going really well.

So well, in fact, that my friend, who's a grant writer, donated her time to apply for a grant for us, and we got it. We're being given a \$750,000 grant. I was so excited until I remembered the 1023EZ.

I swore to the IRS that I wasn't going to bring in more than \$50,000 in the first few years. Do I have to turn down this money, or is there a way to make this right with the IRS? I really don't want to do anything illegal, but it also feels terrible to turn down these funds for my mission.

[Speaker 1]

Okay. All right. I'm going to start.

I'm going to try and start with the good. The good is, first of all, amazing that somebody outside of your core constituents believes in your mission enough to give you shy of a million dollars. That's like crazy.

That's awesome. Also, good on you that you don't want to do anything illegal. You're trying to be ethical.

You're trying to do things right. I love that. Awesome.

The problem I'm picking up in here is I started my nonprofit. I have done a lot of work. I did this all myself.

It feels a little bit like this person is an island, and that is making me very scared for them because trying to spend \$750,000 responsibly is going to require more help. Just even before we get to the actual question, I'm like, please be sure that you are hiring a bookkeeper who understands nonprofits. Please get a CPA, an accountant to do your taxes who specializes in nonprofits.

Also, where is this money coming from? Is it foundation money? Great, because foundations are like, whatever we want to do, we do, and whatever they tell you your report needs to be is what it needs to be.

If this money is from the government, you're walking into a whole enchilada of stuff that you're not prepared for because government money comes with government strings and a lot of government requirements. When you get that award letter, you need to really read it and plan and understand what you are agreeing to do because most grant money comes with a lot of rules around how you're going to operate so that you take that three quarters of a million dollars and you don't spend it like Feeding Our Future did. Okay, soapbox about taking that much grant money this early on being a by yourself aside, the actual question is, I filed a 1023EZ, the short form, and one of the criteria for being able to file that form is you certify that you do not believe that you are going to bring in more than \$50,000 in gross revenue in the first year, the second year, or the third year.

That's why they're willing to let you not tell them all the details because they're like, you are a little aunt that is spending two pennies, and we don't care. In the grand scheme of things, we aren't resourced enough to care about your mission and you're probably going to go out of business anyway, so just give us the bare minimum.

[Speaker 2]

Jess is cynical this morning, she's got an attacked duck.

[Speaker 1]

The IRS, realistically, if you were to look at the number of new nonprofits that are formed nationwide every year, they just can't. If you're on text, Twitter, or you're anywhere in a profession that deals with the IRS, we all know the IRS is underfunded, they don't have the resources. I'm not being cynical, I'm just being real that they're just like, you're rubbing two pennies together, it's fine, whatever.

[Speaker 2]

More cynical on the fact that you're probably going to go out of business, that's where my...

[Speaker 1]

Yeah, but nonprofits are like new restaurants, nine out of ten fails in the first year. That's why we are here, to help people actually do things right and build a strong foundation because it is such a high risk that it's just not going to work.

[Speaker 2]

And especially in a situation like this, where you go from your two pennies to three quarters of a million dollars, it's like, that's where you suddenly are in the sink or swim territory, and you might sink. You gotta be prepared for that.

[Speaker 1]

Yep. So that's the reality. This person applied and they certified under penalty of whatever, that they were not going to make more than \$50,000.

So they're totally on point to be concerned about this.

[Speaker 2]

And I will just break in and say, proud of them for actually reading it. Most people who file this have no idea what they agreed to or what they certified or any of it. And they're just like, great.

I have my status. I never have to think about the IRS again.

[Speaker 1]

Yeah. They're like mash the keypad Homer Simpson at the plant until you get the thing out the other end. Totally.

[Speaker 2]

So anyways, I will just give them kudos for even two years down the line, remembering what they certified.

[Speaker 1]

100%. Yeah. That's what I'm saying.

Like, I love this person for caring.

[Speaker 2]

Yes.

[Speaker 1]

Okay. So what is the reality here? The reality is the IRS just wanted you to certify that you weren't like knowingly going into this where you knew you were going to get three quarters of a million dollars.

You had that grant opportunity lined up and they were just like, go get your C3 status. We'll give you all this money. That's all you certified to.

You just certified to the fact that you did not reasonably believe that your budget would exceed that number. What happens in reality after you get going, they're not going to punish you for being outrageously successful at fundraising. That's not going to happen.

The IRS doesn't like stand up and go, you've committed to a vow of poverty for the rest of your existence. Oh my God. Actually, what if psychologically people, I'm just thinking about the poverty mindset of nonprofits and how many nonprofits are started as a, with a 1023 EZ and like somewhere in their brain, do they have it sort of lodged in there that they have to stay poor?

Okay. Anyway.

[Speaker 2]

We are small potatoes. We made the decision to be small potatoes and therefore we can never be a big fat baked potato.

[Speaker 1]

Damn you IRS for making people be baby red potatoes in their brains.

[Speaker 2]

I mean, I love a red potato, but it takes all kinds.

[Speaker 1]

That was like a sociological...

[Speaker 2]

Like saw it in your face that you had the light bulb moment. I wish the listeners could have seen that moment of just like, wow, wait a minute.

[Speaker 1]

The power of suggestion is so deep. So anyway, they're not going to be angry with you for being good at fundraising. They're not going to come out and say like, no, you can't do that.

And when you file your 990 and it says more than 50, they don't have the ability to close the loop. And even if they did, they're not going to be mad about it. They want you to be successful just like anybody else does.

Well, I mean, it is the IRS, so actually I'm not sure they want anyone to do anything other than comply with their rules, but they're not going to be mad about it is the point. What you do need to know though, is you've probably been filing a 990 N as your tax return at the end of the year. And for anybody who doesn't already know this, you do actually have to file a tax return even though you don't pay taxes, otherwise you get revoked.

So you may actually need immediately to go get a bookkeeper and get an accountant lined up because I'm just going to go out on a limb here and say, you're probably using a Google sheet or an Excel sheet or a frigging notebook with sticky tabs in it or something to keep track of your money because it sounds like you're one person and I'm guessing you're not doing things in QuickBooks with gap counting and blah, blah, blah. And even if you are doing it in QuickBooks, you're doing it on your own and it's all wrong unless you went to school for accounting.

So immediately what you need to do is go hire some help for accounting because you're going to end up sending in a 990 full form. And what do we know about the word full form? It means long, it's going to be long and lots of detail.

You're not going to be able to do that by yourself and you should not do it by yourself. You should go get help because you're also going to need to report on last year's financials in your tax return because it's like, tell us about this year and then compare it to last year. So you actually need your books to be clean and tidy for not just the current year when you take the grant money, but also last year.

And this is where people like go and fall down a hole and like die because they haven't been doing it right. So you're fine. Don't worry about it.

You are going to have to file a more complicated tax return, and your next immediate step is to go make sure that your books and records are in order and that you have a plan for how to account for all of your money, all of your grant money, and a plan to be compliant with your grant requirements.

[Speaker 2]

I have a question for you, Jess. I know I've heard clients talk about audits. At what point do they have to care about that?

They're obviously now out of like into 990 full form territory. Do you know about the audit side of this?

[Speaker 1]

So that's a great question and it's going to depend on the state that they're in. So it's also going to depend on what kind of money this is. It's also going to depend on the grant agreement.

It depends.

[Speaker 2]

It depends. The classic lawyer answer.

[Speaker 1]

If this person was in our home state in Minnesota, nonprofits in our state have an obligation to get a financial audit done when they get \$750,000 or more in revenue. But again, how is this grant getting dispersed? Is it, here's \$750,000?

Probably not. Probably it's going to be like, here's some money, reach a milestone. Here's money for year two.

So they might not reach the audit threshold for the state. They might not reach the threshold for any state. I have no idea because it depends on what state you're in.

And it also depends on what kind of money it is. And it depends on what your contract says. Because if the grant agreement says, hey, you're going to have to get audited financial statements every year when you take our money, well, I hope you have five grand saved up somewhere to pay for that.

Hope you budgeted for that when you did your grant proposal. And that gets into a whole other topic in a whole other episode, which is the cost of taking grant money.

[Speaker 2]

Yeah. Go back and listen to the episode with Allison Welch about some info about taking grants. Because there's a dark side to it, too.

It's not just like, yay, we have all the money we ever want.

[Speaker 1]

Grant money ain't free.

[Speaker 2]

Yes.

[Speaker 1]

Yeah. So, yeah. Good question.

But I mean, who knows?

[Speaker 2]

Who knows? All right, Jess. I've got a couple of takeaways from this question here.

First of all, most basic thing today is that income tax doesn't just happen. You have to apply for it. And there's a couple of ways to apply for it.

But it's not automatic. And another one I will say is that the IRS cares that you're following their rules, but they don't expect you to predict the future. So if you filed with a 1023EZ and you said, I reasonably didn't think I was going to make a bunch of money and you get a bunch of money, they're not going to be mad at you.

But that goes into the next one of you're not in trouble, but you are in the big leagues now. So you need to file your big 990 form. You need to know what your compliance is with this amount of money, both with the grant and with your state and with the IRS.

So you need to be ready to have this large of an increase in funds, because it will change the way that you have to run the nonprofit.

[Speaker 1]

Yeah. This is the kind of case, whatever, this is the kind of client that shows up and is like, help, I need your subscription, because they know they're about to have extreme growing pains because it is really a big step up operationally to go from we're teeny tiny and we do everything on a post-it note to, oh my God, we have this much responsibility. This is like totally, I mean, they should just reach out to us basically.

[Speaker 2]

Genuinely. Reach out to us. We'll get you a good CPA.

We'll get you, you know, like getting the people.

[Speaker 1]

You need a referral. Let us know. Okay.

[Speaker 2]

Yeah.

[Speaker 1]

Like this is like, these are our people where they're like, oh no, I'm about to level up.

[Speaker 2]

Yep. And I love the people who know that they're about to level up and they're like, I need help instead of getting halfway through this grant period and being like, we have to file a 990.

[Speaker 1]

And the funders mad at us and it's a mess and whatever. Totally. Totally.

[Speaker 2]

So despite the back and forth here, kudos on this person for knowing to take a pause and figure out how to do this right and MissionGuardian.com, hit us up.

[Speaker 1]

Shameless plug. Well folks, hey, if you enjoyed this episode, do me a huge favor, rate it with your podcast app. What are you listening on?

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So thank you very much in advance and it helps people find the show. If you have a question or a story to share, we would love to hear from you. Send me a note online at charitytherapy.show and thanks for listening.

About the Author



Hi, I'm Jess Birken.

I'm the owner of Birken Law Office, I help nonprofits solve problems so they can quit worrying and get back to what matters most – The Mission. I'm not like most attorneys, I actually have an outgoing personality, and – like you – I like to think outside the box. Most of my clients are passionate and have an entrepreneurial spirit. I'm like that too. My goal is to help you crush it. Getting bogged down in the minutia sucks the joy out of the important stuff. My clients want to do the work – not the paperwork.

Let's connect!

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