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## The Tough Love Episode - 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. We've got the giggles again.

[Speaker 2]

Always.

[Speaker1]

It's cold. It's cold and blustery in Minnesota.

[Speaker 2]

It is. We have reached fall and I'm so happy about it. Never give me 80 degrees again.

[Speaker 1]

I know, right? Well, except for by like March, we'll be begging for 50.

[Speaker 2]

For my short-term planning right now, never again.

[Speaker 1]

There you go. There you go. What are we doing today, Meghan?

[Speaker 2]

Well, Jess, I have a big question for you today. And like before we get into it, at the risk of spoiling like all of the future rants that we're going to have about this question, first, I have background information question for us all.

So can you tell us what is private benefit and why does it matter to like nonprofit people?

[Speaker 1]

Well, it matters because you're not supposed to have any. Here's the thing, okay? Private benefit is you individually or your business that you own benefiting usually financially from the nonprofit.

IRS doesn't like that. Go figure.

[Speaker 2]

So what does that look like? Like you set up a nonprofit just to pay yourself a big salary or something like that?

[Speaker 1]

Yeah. So this looks like we set up a nonprofit so that my dad can donate \$60,000 to charity, which will magically pay for my salary as the executive director.

Or we set up a nonprofit so that everyone we know and love can donate money to charity to fund the heart transplant for my niece. Sure. Who mysteriously is the only beneficiary of this nonprofit.

[Speaker 2]

When you're donating to charity, here are my air quotes, it's not actually for a public benefit. It's for your individual benefits. And the IRS is concerned with that because in theory, if they're not making you pay your taxes, your income tax, then it should be benefiting the public, right?

[Speaker 1]

Yeah. Yeah. The whole point of having a C3 status is that you're a public charity that serves the public and doesn't serve private interests.

Because if you serve private interests, you would be a regular taxable company.

[Speaker 2]

Right.

[Speaker 1]

And the easiest examples are obviously like the scammiest examples, but it's kind of a slippery slope. And there can be stuff where maybe it could have been okay if you'd done it the right way, but you didn't do it the right way. And now it's a problem.

It's a complicated topic, but that's kind of the nut of it is that you're not supposed to personally benefit.

[Speaker 2]

Makes sense. All right. So with that in mind, we do have a question from a listener.

I thought you might. Yeah. Here we go.

Let's jump right in. My wife and I have fostered for local pet rescues for years, and we'd like that to turn that into our jobs. We're moving out of the city and looking to buy acres of vacant land to build on and perhaps farm on.

Our dream is to open up a specialty rescue for large and extra large dog breeds. Our question is, can we kill two birds with one stone and established our home and grounds, which would be developed similar to a farm with all the space and amenities as a 501c3 and run our business while also living there? Anything helps.

Thanks so much.

[Speaker 1]

Well, the big red flag here is run our business while living there. That's the part that gives me real concerns because you don't own the nonprofit. It's not your nonprofit.

It's not your business. You don't get to benefit from it. So this is one of those things where, I mean, we see this a lot at the firm, right?

People want to get creative with the way they do stuff, or they have a crap load of rescue animals on their property. Then they start asking the question, could this be a nonprofit or could the nonprofit fund this or whatever? So it's not like people always set out to be a scammer in these sorts of situations.

[Speaker 2]

No. It feels like a win-win of like, we need more space for these dogs. We care about this mission.

You know, what would be a great way to have more space is to have a nonprofit that buys land for the dogs. Like you could have the best of intentions and say, this is for the dogs. And that creative win-win situation, feel okay in your head, but not feel okay to the IRS.

[Speaker 1]

Yeah. So, okay. There's a lot here and we have a very small amount of facts, but there are ways this could go.

One way this could go is they themselves are signing mortgage documents or they themselves have enough money to just flat out buy a house with some acreage. Then if they wanted to donate the use of some of their land to housing these rescue dogs, I guess they could do that if it was for \$0. And people don't want to do that.

Eventually they're like, well, it costs all this money and we need to build a special facility and we need this and we need that. And wouldn't it be great if the nonprofit actually started paying us rent for their use of our property? Now we start getting into the private benefit stuff.

So that's where I'm going to assume that this will end up, right? It's not that they're going to own their farm and just out of the goodness of their own heart, use it as a free place for rescue animals to live. The easiest way this comes up is you need to build a structure and you use nonprofit dollars to improve your property with a new pole barn or whatever.

Well, who owns that? It's not the nonprofits. It's connected to your land.

If you get the property appraised, that pole barn is part of your property. So this gets very muddy really, really fast and there's not a good way to do it. So one way they could do it, they buy a house and they buy a lot next door that could be parceled off separately.

And then eventually when the nonprofit has enough resources, the nonprofit could acquire that land maybe. If it's at fair market value or below fair market value, that gets into a whole other thing about like, is this an arm's length transaction? Do you have an independent appraiser determining the price?

Are you sort of like, you know, playing a little fast and loose with the valuation rules so that you can get all of your like back pay for all that time you donated the land? You know, like all of that stuff comes into play. The other thing that's important here is if you were to buy a property that also happens to have a house on it and somehow you were able to get financing in the name of the nonprofit, which if it's new, probably real unlikely.

Well, let's just play fantasy pretend where this new nonprofit that has no track record magically qualifies for a loan to buy all this land. And then you wanted to rent the house back from the nonprofit. Again, are you paying fair market value rent?

All of these things are like complicated and coming up because the IRS is, unfortunately, human beings love to find ways to abuse the tax code. And the IRS is hip to that. They've got PTSD from people doing tax frauds.

So the IRS's reaction to their PTSD is just keep making rules and regulations. So the hoops you have to jump through to make this happen and have it be legal and above board are very high. Then that doesn't even touch the optics of this.

I know a lady just in my personal life, because I adopt rescue animals sometimes, she's got the rescue at her farm. And holy hell, she emails me all the time just being like, people are angry and saying that I'm a scammer and I'm not. And I'm just like, what are you going to do?

You're doing this out of your backyard. It doesn't look good. It looks like you must be taking people's donations and improving your own property.

The optics are not great. You're not going to have a lot of fundraising success. And you and I both know, what do we know about animal missions?

[Speaker 2]

It gets messy real fast.

[Speaker 1]

It gets messy because those people are amped up. Lots of drama for the animals.

[Speaker 2]

Right. I feel like that is the biggest thing is this person is pitching it as like, oh, this just makes sense as a way to better serve these animals is we'll just have this nonprofit by this place. We can live there and take care of the animals.

It's all for the animals. Right. That's sort of where they seem to be coming from from this.

But the same story told from a different perspective is you started a nonprofit in order to buy a house for yourself and you are using donated funds to live potentially rent free.



[Speaker 1]

And sure, you have not to mention they want the money from the nonprofit to pay salaries for them, too. Don't forget that part of the question.

[Speaker 2]

Exactly. This is their jobs. Yeah, exactly.

So now this nonprofit is essentially bankrolling their entire lives. And when someone gives in a donation, is it going to pet food or is it going to like, you know, your personal Wi-Fi bill? Like, we don't know.

There's no clear distinction there when you are living in the property that the nonprofit has purchased in this fantasy land where that could work.

[Speaker 1]

It feels like a win-win when you're one of the winners, but it is a lose-lose because your fundraising is going to tank. You will have a bunch of drama. You will have people calling you out on Facebook and TikTok and Instagram.

You will have a lot of drama. The nonprofit will not qualify for financing, so you will end up being a personal guarantor, is my guess. It's just, or worse, you get some donor who's going to finance you buying your house.

Feels bad. Everything about this leads to a bad place.

[Speaker 2]

Yep. And not to mention, if you were to play this out to the fullest extent, say the nonprofit does buy this house and, you know, you're living there and everything's going great, and the nonprofit goes out of business, you can't make it float. You don't own your house then.

The nonprofit owns the house. And since you don't own the nonprofit, Jess, can you talk about what happens to assets when you have to dissolve a nonprofit?

[Speaker 1]

You have to give them to another nonprofit. Yeah. Or you have to sell it and give the money to another nonprofit because your home that you live in is a charitable asset.

It doesn't belong to you. And I, as a homeowner, don't know anybody that I'm related to in any way that wants their home to be taken away from them because the nonprofit went out of business.

[Speaker 2]

Exactly. Yeah. It's not like you get to say, oh, well, I'll sell the house and go buy a new house.

[Speaker 1]

Go buy a new one. No. It doesn't belong to you.

It belongs to the charity. And that is the thing that that's the major problem with this listener's question. Turn it into our jobs.

Turn it into our business. It doesn't belong to you. Fundamentally, a nonprofit, it doesn't have owners.

It doesn't have shareholders. It doesn't have anyone in control of it other than the community, which is represented by the board of directors. And the board shouldn't just be you two because you can't do any of this above board without at least three to five other people making decisions without you because you have massive conflicts.

[Speaker 2]

And when it comes up in a board meeting of like, you know, should we add that pole barn to the property? You know, if you are not the ones that get to make that decision, perhaps your board members are like, hey, actually, it seems like you need this pole barn, but like dogs don't. So why would we as fiduciaries of the nonprofit approve that kind of an expense?

You know, like that's how it should play out if you were to do things right.

[Speaker 1]

Or they decide the house is better used as a veterinary facility or for offices. And they're like, you know what, actually, you shouldn't live here anymore, which is why these people aren't going to want other people on their board. And that's why all of this is a terrible plan.

And if they were actually in my office, I would be telling them no.

[Speaker 2]

And this is where, again, kind of going back to where we started here. People want that win-win solution. It feels like a good idea when you were just like thinking about, hey, I have this hobby of fostering dogs, and you just don't realize all of the implications and the regulations that come into turning that into a nonprofit.

So it's like you may not have bad intention, but this is going to lead you down a road that you don't want to be on.

[Speaker 1]

Yep. Yeah, absolutely. What have we learned here, Meghan?

[Speaker 2]

Yeah, I got a couple things. First of all, private benefit is a bad thing in the nonprofit world. You don't want to create that.

Private benefit means that a nonprofit that is using donated funds and should be serving the public is serving an individual through the nonprofit. And another big takeaway, just because something feels like you have good intentions and it feels like a win-win doesn't mean that the IRS or your constituents and donors will think it's a good idea. So make sure to pass these kinds of ideas by a disinterested party, someone who doesn't know you and your specific situation.

Yeah, those are kind of the two big things. Jess, what else do you have?

[Speaker 1]

I think just reiterating the concept that nobody owns a nonprofit.

[Speaker 2]

Yes.

[Speaker 1]

It's not your nonprofit. Your nonprofit is the community's asset, and no matter how much blood, sweat, and tears you dump into it, it's not yours.

[Speaker 2]

Yep, absolutely.

[Speaker 1]

That can be hard to hear, but it's reality.

[Speaker 2]

Given the tough love.

[Speaker 1]

Well, folks, the tough love is what we're here for, man. Absolutely.

If you enjoyed this episode, if you need a little nonprofit tough love in your life, would you go give us a five-star review? Share this episode with a friend. Maybe you got somebody that you know that's trying to start a rescue in their backyard.

You know, you could save them a whole world of hurt on the interwebs from people hating on them for being a scammer by sharing this episode. It really helps us out if you send us questions. I love your stories and your questions.

Please send those in. You can send me a note online at [charitytherapy.show](https://charitytherapy.show), and thank you as always for listening.

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## 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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