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Varying Degrees of F'd Up - 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, hello, and welcome to this episode of Charity Therapy. Meghan is here with me today. Hello, hello.

[Speaker 2]

Hello. How's it going, Jess?

[Speaker 1]

It's going good, except we are now in fully into fall and it's too hot outside and it's messing with my enjoyment of all things pumpkin, apple, cinnamon. It's like it's 80.

Yeah, what are we doing?

[Speaker 2]

Just your like pumpkin cake or whatever in the air conditioning on and then wear your sweater inside. Oh, the existential dread. A hundred percent real.

Thanks.

[Speaker 1]

Yep.

[Speaker 2]

Anyway, real problem.

[Speaker 1]

Enough about our warming climate. And let's talk about nonprofit.

[Speaker 2]

What are we doing?

[Speaker 1]

Always.

[Speaker 2]

Yeah. Okay. So I hear a lot from folks calling the firm who are reaching out because they want to convert their for profit to a nonprofit or vice versa.

And I hope that you heard the air quotes in that word convert. I did. I did.

I usually have to like break it to them. That is like not that easy of just like flipping it over kind of a thing. So just can you give us just a quick overview of what it means to switch between a nonprofit and a for profit?

Yeah.

[Speaker 1]

So it kind of depends which way we're going. So if you own a business, a for profit, a taxable entity, you own it. It's yours.

It belongs to you and you can like do what you want with it. So if you decide that you no longer want to own this and you don't want the money that's in the business, you could start a nonprofit and give away your rights and your intellectual property and your branding and your

money to the nonprofit and then you will no longer own it. And you can't just be like, hey, we're an LLC and now we're tax exempt.

Like you have to start a whole new entity. And going the other direction, if you're a nonprofit and you're like, F this, we should be a business. Well, you don't own it.

So it's quite a bit more complicated. And you usually have to tell the state's attorney general, figure that out. All right.

[Speaker 2]

Well, that teases up perfectly for our question. So let's just go straight into it. Listener writes in and says, I am a manager of a farmer's market.

We have previously been a nonprofit, but our IRS status was revoked and we decided it would be easier to just be a for profit going forward. Can we just continue as a small business now that we've lost our status? Okay.

[Speaker 1]

This is fascinating. I don't think they know what they're actually asking. Oh, no, they for sure don't.

Yeah. I love this question because there's a whole bunch of things happening here. All right.

So farmer's market is operating as a tax exempt nonprofit. There's some kind of charity. Maybe it's a C3.

We don't know. Then they get revoked. And that could be for a number of reasons.

We don't know. They don't say, but they've lost their income tax exemption. So can we continue just as a small business now that we've lost our status?

Technically, yes, I think. The thing is, they're still a nonprofit corporation.

[Speaker 2]

Yeah. I think that's where they're confused in their phrasing here, because like, can we continue as a small business? Yes.

You're a small nonprofit business without tax exemption.

[Speaker 1]

Just don't have any income tax exemption anymore. So now you're a nonprofit corporation with a board of volunteers, not owners, and you pay taxes, which I feel like that's not actually what they want. I think what they want is to have a company that is owned.

[Speaker 2]

In the previous sentence, they say, we decided it would be easier to be a for-profit. So I think to this question asker, if I'm sort of like interpreting their question, it's that they're like, oh, the fact that we had nonprofit status is what makes us a nonprofit. And now that it's gone, we can just be a for-profit now.

[Speaker 1]

Right. And that's where I'm like, no. So like, let's run both scenarios.

One is you lost your income tax exemption. You're no longer tax exempt. That means any revenue that comes into the organization right now, you have to pay income tax on.

And theoretically, there are nonprofit corporations that pay tax. For some reason, they have decided it behooves them to pay tax. So any revenue that comes in from the farmer's point that you lost your income tax exemption is taxable revenue.

That's taxable income after expenses and your accounting and whatever. So if you want to continue as a nonprofit corporation that pays tax, sure. Yes.

Why? You could do that. It feels complicated because that's sort of advanced baseball and there's not like a good reason for doing that.

Let's say that they really mean is they want to start over and be an S Corp or an LLC or some sort of corporation that has owners and shareholders and can issue dividends and things like that. They can still do that, but they can't just continue to operate as a small business because the literal entity that you're continuing under is a nonprofit corporation formed under the nonprofit corporation statutes. So if you want to flip the script and be a for-profit entity, you're going to have to start a taxable for-profit entity.

You're going to have to start an LLC, start an S Corp and form that corporation, decide who the owners are. And then you're going to have to go through whatever your state's process is to say, hi, Attorney General's Office, we don't want to be a nonprofit anymore and we're going to

just have a do-over as a for-profit. This is where you should call a lawyer because there's varying degrees of like how effed up this is going to get.

Now let's just assume this is the farmer's market's probably like living by the skin of its teeth financially. It doesn't seem like there's probably a lot of surplus at the end of the year. So there might not, I mean, maybe there is, I don't know.

If there's no real money sitting around at the end of the year, then there's nothing for you to really transfer. And probably what the Attorney General's Office is going to say is like, hey, great. Sounds good.

Because you're a charity and you have charitable assets that belong to the community, whatever cash you have on hand, they might require you to give it to another charity. And then you can start over as a business. And yeah, you can keep the name, that's fine.

But like money sitting in the bank that belongs to the community and you need to show us that it's going to the community, not to your new company. So that's one possible outcome. So if there's not a lot of money sitting around, it might just be like, yeah, whatever, that's fine.

But you're going to have to get permission from your state to transfer the intellectual property, any physical property, any money that the non-profit owns. And if you own, like, let's say this farmer's market owns a piece of real estate or has like a lease, now it's getting more complicated. And you definitely should be calling a lawyer because you can't just take stuff that belongs to the community and give it to yourself over here in a for-profit that you own.

[Speaker 2]

Does that make sense? It does. It does.

And I feel like that's an important distinction because based on talking to other people who are in this sort of situation, what I am assuming this person is going through is they're like, hey, we lost the benefit of being a non-profit by our status, and it hasn't been that great for us anyway. So why don't we just make our lives simpler by being a for-profit? And in their mind, I am sure this is a way of saying, let's continue the exact same work we're doing.

We're doing the exact same kind of thing for the community, but in a way that feels easier to us. And it feels like a very intuitive thing to be like, we're just going to do the same thing, but easier. And it's important to note that it's not necessarily easier in order to make that transition if you have all of these other extenuating factors.

Because even though for you it feels the same, you're doing the same work, whether it's under a for-profit or a non-profit, the state cares, like you said, about charitable assets and has different rules about that compared to for-profit revenue.

[Speaker 1]

There is a third option that just pops into my head as like, you could just put the non-profit out of business. That's also an option. Dissolves a non-profit, go through whatever your state's statutory process is for properly dissolving the non-profit.

That'll release the name for use by another business in the future, which could be a business that you start or change the name or whatever. But that's also an option. But you can't just be like, oh, we forgot about this non-profit.

Like you have to dissolve it through the right channels, through the right process. And depending on what state you're in, that looks different. Like if you're in Florida, it's a no big deal.

If you're in California or New York, it's a real pain in the hiney.

[Speaker 2]

Yeah. Well, and I think that is one of the big things that is underneath this question is that it's easy to assume that being a non-profit only really matters at the IRS level, right? Like you get your income tax status and that your income tax exemption.

And that's like what makes a non-profit. But state non-profit statute exists too. And that's why you can't just be like, nevermind, we're not a non-profit anymore when our tax exempt status from the IRS goes away because you are formed at the state level.

So it's like there are two sets of regulations that you have to care about the federal IRS ones and the state ones. And just because the federal IRS ones don't apply because you're not exempt anymore, doesn't mean the state ones don't.

[Speaker 1]

Yeah. And I mean, frankly, maybe go to an accountant that does non-profit accounting and get an estimation of what the tax bill would be for this non-profit if it paid tax. If y'all are netting like a hundred dollars at the end of every year, maybe you do continue and just file a tax form.

I don't know. This is one of those things where it's all depends on all the circumstances and you need to get professional advice, but it's not just simple like the tax status is not what makes you a non-profit. That's the thing I want this listener to understand.

[Speaker 2]

So I have a couple of takeaways then. And that is sort of the first one is that non-profit does not equal 501c whatever. Tax status is one thing, but being a non-profit means more than that and comes with more rules that you have to follow beyond just your tax exempt status and those regulations.

So that's the first one. The second one is that it's not a simple process to convert some sort of operations from a non-profit structure to a for-profit. You can't just like switch back and forth flitly nilly.

Like if you need to pick a different lane for how you're going to do this farmer's market or any other activity, it usually involves, you know, starting up new entities, closing entities, like talking to your attorney general's office, especially if you're going from non-profit to for-profit. So if, you know, there is a reason to change midstream, just know that it's not going to be easy and you need to get some professional help from lawyers and accountants in order to figure out the best way to manage all of the changes that need to come. And that's really it, I think.

Those are the two big things.

[Speaker 1]

Jess, am I missing anything? I would just add that if you're trying to convert your business into a non-profit, you need to get advice because you are literally giving away what you own and you need to make sure that that is the decision that you really want to make.

[Speaker 2]

Yeah, I guess that's the big crux of it here is that the big, big difference is about whether or not there are owners and no matter which direction you're going, the ownership question gets complicated. So make sure you really understand what you're getting yourself into before you start filing paperwork. Absolutely.

[Speaker 1]

Meghan, thanks as always for being here. I appreciate you. Thanks so much, Jess.

Listeners, you're still listening right now. I know you are because we have the data. Libsyn shows us you're still here at the end.

[Speaker 2]

I love that.

[Speaker 1]

You're amazing. I just want to say thank you for listening. Thank you for rating and reviewing and sharing it.

I really appreciate that you all stay here right to the end. So love you. Have a pumpkin spice something.

Enjoy the fall. We'll see you next time.

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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