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## Can You Convert a Failing Business Into a Nonprofit? – Transcript

**\*\*Jess Birkin\*\*** 00:00:02 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 Birkin, 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 from hot and steamy Minnesota. It's me, Jess Birkin, here with Megan.

**\*\*Meghan\*\*** 00:00:50 Yeah, she's cosplaying as a news anchor today. I like it. News anchor? Feels like.

**\*\*Jess Birkin\*\*** 00:00:56 No, I feel like. I feel like there should have been air horn. That's. That was. Yeah.

**\*\*Meghan\*\*** 00:01:02 Yeah. Yeah, exactly. There you go.

**\*\*Meghan\*\*** 00:01:04 Are you, like, an announcer watching? Right? Yeah. We're at, like, a monster truck rally, I don't know.

**\*\*Jess Birkin\*\*** 00:01:10 Going. Yeah. I'm going into my first robotics FRC game.

**\*\*Meghan\*\*** 00:01:14 Announcer mode. For the listeners who do not know, just is mega nerd and announces at, you know, robotics tournaments for the teens. Yeah.

**\*\*Jess Birkin\*\*** 00:01:26 High school robotics.

**\*\*Meghan\*\*** 00:01:27 Woo hoo! Go, Nightcrawler!

**\*\*Jess Birkin\*\*** 00:01:32 Yes, indeed. Indeed. All right, so, what are we doing today, Megan?

**\*\*Meghan\*\*** 00:01:39 Today we have a question from the listener today. Shocker. As we normally do. And before we get into it, there are a lot of kinds of people who we help that want to start a non-profit for like a ton of different reasons, right? But one of those groups, like one subset of all these people that like to start a nonprofit, are our entrepreneurs or business owners in the for profit world who are seeing an opportunity in the nonprofit world. So before we get into it, Jess, could you tell us if there was like one thing you could tell all business owners about getting into the nonprofit world? What would that be?

**\*\*Jess Birkin\*\*** 00:02:18 Okay, I think that it would be.

**\*\*Jess Birkin\*\*** 00:02:21 You don't know what you're talking about. Just the thing that I noticed with folks who come from the business world is they feel competent, but they're not. And so they they there are a lot of unknown unknowns for them. And they what is it? Unconsciously incompetent there unconsciously.

**\*\*Meghan\*\*** 00:02:47 And I like that phrase.

**\*\*Jess Birkin\*\*** 00:02:48 About the nonprofit space. I didn't invent either of those.

**\*\*Meghan\*\*** 00:02:51 Things, but that.

**\*\*Jess Birkin\*\*** 00:02:52 One I did learn about.

**\*\*Meghan\*\*** 00:02:54 Unconsciously incompetent.

**\*\*Jess Birkin\*\*** 00:02:55 Well, well, there's conscious incompetence where you're like, I don't know what I'm doing. And then there's unconscious incompetence where you're like, I totally know what I'm doing, actually does not know what they're doing. And I think the struggle bus here is that I know how to run my business. I know how to run business. I do business things all the time. I can totally do this. And it's like an astronaut saying, I'm going to become a scuba diver. I totally know how to go into areas that you can't breathe in. I wear spacesuit and I can exist in a vacuum and I can do all those things.

**\*\*Jess Birkin\*\*** 00:03:37 Clearly, I'm going to be the best scuba diver in the world and they don't know anything about it. And it's a totally different environment. There are just so many rules and regulations that you would never even think would apply. But because we're a nonprofit, there's a special role for that. And so they bring sort of their bias towards action. As an entrepreneur with a lot of I actually have no idea what I'm doing and it can just be sort of a difficult combo. Clients I have to like put the reins on and be like, slow down.

**\*\*Meghan\*\*** 00:04:11 And just as a little, you know, foreshadowing for this question, it can go the other way, too, of instead of just having a million ideas that maybe aren't allowed in the nonprofit world, I think there's also a kind of business owner who's like, well, because it's a nonprofit, it'll just work, you know, like it's easier because it's a nonprofit. It's like, I don't need it to actually function the way that my business does because it's a nonprofit and it's a shortcut.

**\*\*Meghan\*\*** 00:04:39 So yeah, foreshadowing for.

**\*\*Jess Birkin\*\*** 00:04:41 You or worse, they're like, I'm gonna use this creatively to get a tax advantage for myself, which those people don't become our clients.

**\*\*Meghan\*\*** 00:04:52 All right. Well, let's jump straight into it here. So our listener says Nurses. I'm an instructor at a small figure skating school. We've been around for about 30 years, and there's been some changes in ownership as time goes on. A couple of years ago, the current owner bought the school, mostly because she didn't want it to go out of business, but she doesn't want to be involved in running it at all. We're not really making ends meet. Some of the instructors and I want to convert this into a for profit so that we don't have to have an owner and we don't have to make this make a profit. How do we go about doing that?

**\*\*Jess Birkin\*\*** 00:05:26 Oh, boy. Okay. So first of all, the first thing I know here is this the current owner of the school is really passionate about figure skating because you would never acquire a business that was failing if you didn't feel passionately about what they were doing.

**\*\*Jess Birkin\*\*** 00:05:48 So there's some good happening in here. But then the hard part is, I don't want to participate in running this business that I own. That's a pretty hard road for an entrepreneur. You're going to buy a struggling business and then you're not

going to work on it. Well, we don't know. Did the new owner hire somebody to come in and turn it around? Like just feels like, no, because they're not making ends meet and they're not turning it around.

**\*\*Meghan\*\*** 00:06:18 So and considering there's a group of instructors that are sort of scheming about how to keep this thing going. Makes me think that the owner bought it and was like, just keep doing your thing and don't talk to me about it. Like, I want you.

**\*\*Jess Birkin\*\*** 00:06:33 To keep.

**\*\*Meghan\*\*** 00:06:34 Running it, and I don't want to care about any of.

**\*\*Jess Birkin\*\*** 00:06:38 It.

**\*\*Meghan\*\*** 00:06:39 And so clearly.

**\*\*Jess Birkin\*\*** 00:06:40 Sort of absentee landlord.

**\*\*Meghan\*\*** 00:06:41 And she's clearly not in it for the profit, which this is the problem with the nonprofit world because people are like, oh, nonprofit, we don't need it to make a profit.

**\*\*Meghan\*\*** 00:06:50 Therefore, you know, we should just make it a nonprofit because the owner doesn't care about profit.

**\*\*Jess Birkin\*\*** 00:06:55 Yeah. Okay. So let's deal with the the hard facts here. The let's just pretend that the instructors could actually make this choice for the business owner, which they cannot. But let's just pretend that they can. First of all, you can't change a for profit into a non profit. So you'd actually have to start a new entity and sort of donate all of the stuff from the school to the non profit. And that's a whole rigamarole. So if we're already not making money to like pay to start a whole new thing re set up everything, make all those switching costs, that's already a little bit of a big hurdle for an organization that doesn't have a cash positive lifestyle. Then the idea that like we want to convert this so we don't have to have an owner, that's a very nebulous sentence. I, I that feels very loaded to me. Like the instructors don't want a boss or they don't like this boss, or it just feels very like there's an emotional undertone there.

**\*\*Jess Birkin\*\*** 00:08:06 Because even if non-profits don't have owners, they would have to have a board, and that means that they would have five bosses and they'd be wrangling a group instead of one person. So I don't know that that's actually the improvement, quote unquote, that you think it's going to be, because it's not like you're just going to get to do whatever you want and there's nobody in charge.

**\*\*Meghan\*\*** 00:08:33 Especially because, you know, go listen to our conflicts of Interest episode, but unlikely that the group of instructors who are paid by the organization would just be the board and you could just operate it all yourselves.

**\*\*Jess Birkin\*\*** 00:08:45 Right? So that's a whole other layer of complexity. If the instructors feel like they want to be the board. Well, first of all, you have to convince this owner to donate the company that they purchased with their own money. You have to get them to donate it to this new entity, which maybe they want to do. Maybe there's some sort of tax reason they would do that or whatever. And then you would be the board and you would also work for the organization, which is a massive conflict of interest.

**\*\*Jess Birkin\*\*** 00:09:17 And you would have to report that to the IRS, potentially. We don't know how much money is flowing through this organization, but like you'd be insiders being compensated. The entire board would be also holding roles where they're compensated. It's just it's very messy. It's I'm not saying you couldn't find a way to do that, but the optics of it for fundraising are meh. And then that kind of starts to go down the other road, which is why do people think that if you make something a nonprofit, the finances will magically clear up?

**\*\*Meghan\*\*** 00:09:51 Because nonprofits, profit. We don't have to have a profit, Jess.

**\*\*Jess Birkin\*\*** 00:09:55 You don't have to have a profit. But it's not viable. It's already not a viable business. So how would it be viable? Because just because we are have non profit tax status. Non profit is a tax status not a business model. Yep. Nothing changes. Nothing changes. You would have a fee for service revenue model. And your fee for service revenue model will also not be working.

**\*\*Meghan\*\*** 00:10:27 If that's the only change you're going to make, it doesn't mean anything for your bottom line at all.

**\*\*Jess Birkin\*\*** 00:10:32 Unless the amount of income tax this business is generating is just like absolutely massive, and not paying that tax would solve all of your problems. You're going to have the same cash flow crisis that you have right now, except for you have done all this work and gone to all this expense to start this whole other organization, only to transfer this business model that actually isn't working.

**\*\*Meghan\*\*** 00:10:58 And not to say that now you have a bunch of compliance and other things you need to keep up with, that costs money that eats into your savings from the income tax exemption.

**\*\*Jess Birkin\*\*** 00:11:08 And you wouldn't have one boss, you'd have five bosses, and you would be regulated like a fortune 500 company and have to deal with all of those regulations at your expense. So what I would say to this group is what they should be doing is figuring out what would it take to make this figure skating school actually function? Because I, I mean, we don't know, but I highly doubt magically just not paying income tax is the linchpin to making this business model work.

**\*\*Jess Birkin\*\*** 00:11:41 Also, everybody is just like, oh, but we're a nonprofit, so then we'll get donations. How how where who's going to do that? Where are those going to come from? What's your fundraising strategy? Why would anybody want to just make a donation to a figure skating.

**\*\*Meghan\*\*** 00:11:57 School when there's a million other.

**\*\*Jess Birkin\*\*** 00:11:59 Things? I have questions about whether this even works for an IRS application because it's a quid pro quo. Unless you're going to give free lessons to people, in which case, again, how do you pay for that when you already can't pay for what you're doing? I would say try to make this business actually work. I would spend money on a business consultant before I would go down the road of like, we should make this a nonprofit.

**\*\*Meghan\*\*** 00:12:29 Because either you need to be making more money from the students at your school like they need to be paying more, or you need to change your model. The expenses, like something major, needs to change about the way that you function, not just, you know, the status that you have with the IRS.

**\*\*Meghan\*\*** 00:12:48 It's not a magic fix by any stretch of the imagination, and we'll give you a very large headache in exchange.



**\*\*Jess Birkin\*\*** 00:12:57 Yeah. Now, there could be something they haven't told us. There could be. Well, you know what? Right now we get charged \$10,000 a month for ice time. And if we were a nonprofit, the municipally owned ice rink would let us have our ice time for 20% of the cost. And that would. Right, right side up this whole thing. Okay, maybe, like, there could be a scenario where it does make sense. But unless that is your scenario where there is like somebody is standing there promising you if you were a C3, we could fix this today. If that's not the case, then I would just try and make the business work.

**\*\*Meghan\*\*** 00:13:42 And we hear this all the time from people being like, well, there will be more fundraising opportunities if we do this. And it's just sort of like unless you know what those are. No, there's not, you know, like, you don't know that if there are real relationships you have with donors who want to give, that's a great indication, or people who are already giving and want to contribute to the business and would contribute more if they got a tax deduction or whatever, you know.

**\*\*Jess Birkin\*\*** 00:14:12 Yeah. In which case, I would say start your fundraising campaign now and get pledge letters from those major donors who want to give \$10,000 to support the school and do that first. You can start a nonprofit anytime, anytime. Every day is a great day to start a nonprofit.

**\*\*Meghan\*\*** 00:14:34 Unless you're doing it because you think it's going to be easier than a for profit.

**\*\*Jess Birkin\*\*** 00:14:39 Yeah. When I meet with clients in this kind of situation, often the takeaway that comes out of it is I want you to go Find the grants that you think are out there and start forming those relationships and start applying for things and get a pending grant award that says, when you have your C3 status, we will give you this grant. And then it's a great day to start a nonprofit. It's always a great day to start a nonprofit. But until that time, I hate to say it, but it's a pipe dream. It's a fantasy, and it's not grounded in reality.

**\*\*Meghan\*\*** 00:15:18 Yep. And you can do the work to get it grounded in reality, like if that is a real possibility.

**\*\*Meghan\*\*** 00:15:24 But it does take work and a lot of work in order to make it a real thing and not just an idea.

**\*\*Jess Birkin\*\*** 00:15:31 Yep. Absolutely. So what's up? What are our takeaways here? Megan, now that I've rained on this person's parade completely so sorry.

**\*\*Meghan\*\*** 00:15:40 First, it's that knowledge about the for profit world does not translate to the non profit world in a 1 to 1 way that people think it does. Whether you are trying to be a really wily entrepreneur in the nonprofit world or you're not making it work in the for profit world, and you think that a nonprofit is going to be your your savior. It you don't think you don't know what you think you know about the nonprofit world when you're coming from a for profit background. Also another big one. There's no such thing as converting from a for profit to a non profit or vice versa. Like that does not exist. They are separate entities. So if you're considering making a shift from one kind of entity to another, it's not a simple like flip of the switch.

**\*\*Meghan\*\*** 00:16:24 This is going to take time and effort. And then lastly, getting nonprofit status is not a magic bullet. There is no perfect fix of now we're just going to get a bunch of fundraising or people are going to support the organization because it's a nonprofit, as just said earlier and likes to say nonprofit is a tax status, not a business model. So the nonprofit is not the fix for all of your problems that you might want it to be.

**\*\*Jess Birkin\*\*** 00:16:52 Yes, well, this was a good what my friend Steve Boland of Next in nonprofits would call nonprofit birth control. So if you know somebody who's thinking that starting a nonprofit is the solution to all their problems. Share this episode with them. Seriously, like save people the agony. Give us a rating review if you love the show. I would love to hear a story from you. We will keep it anonymous. Question, story,

incident, whatever. Please send it in online at Charity therapy. And thanks for listening. Stay by Meghan.

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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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