

LEGAL SERVICES OF EASTERN MISSOURI

COMMUNITY ECONOMIC DEVELOPMENT
MICROENTERPRISE PROGRAM

WHAT YOU SHOULD KNOW ABOUT INTERTWINING NON-PROFITS AND FOR-PROFITS

WHY CAN'T YOUR FOR-PROFIT COMPANY ALSO BE YOUR NON-PROFIT?

It is not recommended that your non-profit organization also be a for-profit organization because doing so runs the risk of losing the non-profit's tax-exempt status.

Unlike a for-profit venture, a non-profit organization that's been granted tax-exempt status by the IRS is bound by certain rules that must be followed if the organization wishes to keep its tax-exempt status. Therefore, while a non-profit organization may carry out an unrelated business which generates income, if such unrelated business activities become too successful—that is, if they generate too much income—the non-profit runs the risk of losing its tax-exempt status.

Another challenge of a non-profit organization also being a for-profit is that each organization has a different distribution requirement for its profit. A for-profit organization can distribute its profit to its shareholders in the form of dividends. A non-profit must reinvest all its profits into the non-profit.

CAN MY NONPROFIT SERVE FOR-PROFIT CLIENTS?

A non-profit cannot serve, cater to, or work on for-profit clients. A non-profit is formed for the purpose of providing a benefit or service to its primary audience. Its purpose is not to generate profits. Therefore, if you want your non-profit to cater to or work on for-profit clients, then your organization is no longer acting as a non-profit because its purpose now is to generate profits and not to provide a benefit or service to the community.

CAN A NON-PROFIT HAVE A SUBSIDIARY OR VICE-VERSA?

A non-profit can form a subsidiary for-profit company. The non-profit keeps its focus on its primary purpose, while the for-profit subsidiary carries out unrelated business activities.

In addition to helping the non-profit maintain its tax-exempt status, there are a number of business advantages to having a for-profit subsidiary, such as the ability to offer different compensation arrangements to employees. While the subsidiary may be a limited liability company (LLC), there are a number of complications associated with the pass-through tax nature of the LLC. The most common organization form for a non-profit's subsidiary is the C Corporation. Likewise, a for-profit can also form a subsidiary non-profit.

WHAT ARE THE RISKS OF INTERTWINING A FOR-PROFIT AND A NONPROFIT?

The non-profit and for-profit require separate boards and management staffs, given that significant crossover in leadership might signal a conflict of interest to the IRS. Any time there is a service transaction between a non-profit parent and a for-profit subsidiary, both boards have to approve it and be able to show that the for-profit paid actual market rates for the product or service (proving that the parent and subsidiary are conducting arm's length transactions and not receiving special favors).

Each organization is taxed as if it is independent of the other. Non-profits are still exempt from federal income tax, as well as taxes in states and localities in which their tax-exempt status is approved. For-profits are taxed according to their corporate structures.



Donation

WHAT ABOUT A SOCIAL ENTERPRISE?

A social enterprise is business that operates for more than just profit-making. A social enterprise business typically has two objectives: doing public good and making money. Social enterprises include non-profit and for-profit ventures and their returns blend social benefit and financial revenues. However, many states, such as Missouri, don't have any laws governing social enterprises. **Therefore, you cannot create a social enterprise in the state of Missouri.**

OUT OF STATE ALTERNATIVE

If you are still interested in setting up a social enterprise, you can have your business incorporated in a state that allows for the creation of social enterprises, like Michigan.

Outside of forming a social enterprise, it is possible for a non-profit to earn unrelated income without losing its non-profit status. However, it will have to pay taxes (called UBIT) on it. Also, if a non-profit makes too much income from unrelated activities, it may lose its tax-exempt status. For most organizations, an activity is unrelated and subject to income tax if it meets three requirements: it is a trade or business, it occurs regularly, and it is not related to the purpose of the organization.

FOR-PROFIT OPTIONS FOR DOING PUBLIC GOOD

If you are a for-profit organization and are interested in doing public good, you can get involved in your community and commit to public good. Here are some good ways to help:



DONATE TO
VARIOUS
CHARITIES
AND
NONPROFITS



PARTICIPATE IN
COMMUNITY
EVENTS



VOLUNTEER AND
BUILD
PARTNERSHIPS
WITH OTHERS IN
THE COMMUNITY

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