

# Nonprofits in Bankruptcy Must Plan Carefully

07.11.17 | Linda J. Rosenthal, JD



“Although it’s a step rarely discussed in the philanthropic community,” we explained in [“Yes, Nonprofits Sometimes Do File Bankruptcy.”](#) “filing for federal bankruptcy relief is not uncommon and is a way to resolve the status of a nonprofit in serious financial difficulties.” Sometimes – for individuals, for businesses, for charities – “this drastic remedy is necessary.”

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*Non-profits can benefit from the bankruptcy process, either by restructuring debts and continuing to operate, or by providing a method to transfer valuable assets to another entity which can continue to make use of them.”*

## ***Good Bankruptcy Planning is Critical***

In our [earlier post](#), we highlighted an example in which this sometimes necessary – but rather painful – step in an organization’s lifecycle was carried out with the greatest possible care and sensitivity to all of the stakeholders.

The Tumbleweed Center for Youth Development had [been in operation](#) for some 45 years in the Phoenix, Arizona area. It had provided “hundreds of homeless people ages 12-25 each year with resource centers, emergency and transitional housing, life counseling and other programs,” as well as “services for youth refugees and unaccompanied minors from outside the U.S.”

In December 2016, the nonprofit had reached the point of insurmountable debt after years of severe cash-flow difficulties and turnover of key personnel. Interim leaders taking the helm found that the organization was “grossly overspending”; there was no alternative to bankruptcy.

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*What made the difference in terms – primarily – of the needy client population about to be deprived of critical services was that a handful of private foundations donated hundreds of thousands of dollars as the bankruptcy was declared to allow for an orderly transition even while programs continued to function.*

Under court supervision, all of Tumbleweed’s programs were transferred to other local nonprofits over a period of months “as Tumbleweed liquidates assets to pay off its debts.” A nonprofit’s bankruptcy – unlike those involving for-profit businesses – affects charitable-beneficiary stakeholders who are often at risk in the best of circumstances. Here, there was good planning as well as invaluable help from the charitable community; Tumbleweed was “able to close up without the pain and chaos that often surrounds an abrupt shutdown.”

### *Poor Bankruptcy Planning Creates Undue Harm*

Sadly, not all nonprofit bankruptcies end so harmoniously (relatively speaking.)

A case in point is the Independent Adoption Center (Atlanta, GA). Its bankruptcy “isn’t going smoothly.” In January 2017, when “(a)lmost 2,000 families were planning to adopt – from around the nation – this nonprofit “abruptly closed its doors.”

“Out of the blue,” the organization sent out a letter to stakeholders, “announcing their bankruptcy and the immediate closing of the agency.” Hopeful couples waiting to adopt were stunned by the news.

“Since then, families have been trying to find answers and help.” But there is a technical complication that is leaving these parents-to-be with no legal option to file claims against the Independent Adoption Center. Because “...another nonprofit has taken over their adoption cases,” they are exempted from the IAC bankruptcy proceeding. They haven’t heard from the new agency, and “no one seems to know anything about the new nonprofit, including its name and contact information.”

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*The families still on the waiting list for babies not only lost thousands of dollars they entrusted the organization with, but also important personal documents like, birth certificates and marriage licenses. One family in Raleigh, North Carolina, is having trouble buying a new house because mortgage companies are asking for their original tax returns, not copies, which IAC stuck in an undisclosed location.”*

Although there is not enough money in the bankrupt agency's account to repay monies owed, the "trustee hired by the organization that abruptly closed its doors is now planning to sue the agency's board of directors for failure to properly handle the bankruptcy case." It has been a "chaotic bankruptcy"; the trustee alleges that the organization was "losing money every month with no apparent improvement and shut down without giving government regulators notice about confidential records."

### *Conclusion*

While the closing of a nonprofit through bankruptcy is always a sad outcome, the effect can be more devastating than necessary without proper planning, careful governance, and – often – some outside assistance.