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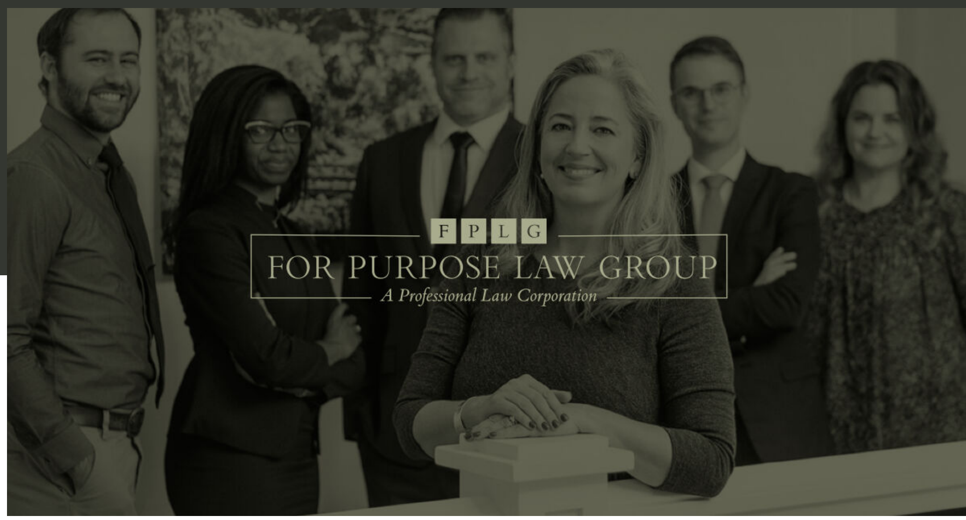
NONPROFIT

Yes, Nonprofits Sometimes Do File Bankruptcy

03.29.17 | Linda J. Rosenthal, JD



Although it's a step rarely discussed in the philanthropic community, filing for federal bankruptcy relief is not uncommon and is a way to resolve the status of a nonprofit in serious financial difficulties. As with individuals and for-profit businesses, sometimes this drastic remedy is necessary.

Bankruptcy As an Option for Troubled Nonprofits

Bankruptcy can become an option for a variety of reasons – some avoidable and others the result of outside, unexpected forces like a serious economic recession or sudden dry-up in government funding.

Nonprofits have an aversion to using bankruptcy as a tool. While nonprofit organizations constitute 30 percent of all corporations, they represent only 1 percent of corporate bankruptcy cases. I suspect the gap is indicative of their morality rather than their durability. Nonprofits are so anxious about reputation that they prefer risking liquidation to admitting financial distress.

"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." There are, however, restrictions that apply in case of a nonprofit entity "transferring its property.
Section 541(f) of the Bankruptcy Code provides that a "non-profit entity can transfer property only to the same extent it could if no bankruptcy had been filed."
These issues can include, for instance, "analysis of legal or donor restrictions on the transfer of property owned by a nonprofit." In certain industries, like healthcare, there are additional statutory obstacles, or there may be non-transferable licenses, or contracts with government or insurance companies.

Nonprofit Bankruptcy: Example

The Tumbleweed Center for Youth Development had been in operation for some 45 years. It had been serving "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."

By December 2016, though, the directors made the decision to file for bankruptcy. The group "was having severe cash flow difficulties and what became insurmountable debt." Earlier in the year, there had several key resignations: the CEO and not one, but two, CFOs. "New interim leadership determined that the organization was 'grossly overspending.'"

What made the difference in terms – primarily – of the needy client population that 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 the court proceedings, all of the programs will be transferred to other nonprofits over several months as Tumbleweed liquidates assets to pay off its debts.

With this assistance from the charitable community as well as good planning, this important service-provider was "able to close up without the pain and chaos that often surrounds an abrupt shutdown."

Conclusion

Sometimes, a bankruptcy decision does not mean that closure is the end result. There are options, under certain circumstances, that include reorganization and eventual continuation of operations.