

# Nonprofit Strategies



SAN LUIS OBISPO COUNTY COMMUNITY FOUNDATION

## How nonprofits can use income

By Barry VanderKelen

Diversifying sources of revenue has been a long-held goal of all nonprofits. Having multiple sources of financial support helps protect the organization if income from any one source decreases.

Many nonprofits that rely too heavily on state or local government funding are feeling the pinch right now because of funding cutbacks.

Some entrepreneurial organizations are developing activities that create new streams of income or enhanced fees for service in order to offset decreases from other sources.

The income from these endeavors is used to support the charitable mission of the organization.

For instance, Girl Scouts sell cookies in order to help fund their leadership development programs. These kinds of activities are commonly referred to as social enterprises.

A new kind of social enterprise is growing in popularity, which places earned income at the core of the organization. An example of this is Paul Newman's Own food products.

The proceeds of the manufacture and sale of goods fund numerous nonprofit activities. Without the food company,

the charitable good works would not be possible.

There are a number of opportunities and risks for nonprofits that wish to develop social enterprises.

On the one hand, the earned income is a new source of revenue that may allow the organization to do more good works.

On the other hand, if the social enterprise is not substantially related to the charitable purpose of the sponsoring organization, the Unrelated Business Income Tax might be assessed. Furthermore, if the venture is so successful that the income derived is greater than total income from all other sources, the sponsor's nonprofit status may be jeopardized.

One risk that cannot be overlooked is claims of unfair competition from similar for-profit organizations.

One strategy is to put the social enterprise in a for-profit subsidiary with the net revenue flowing up to the sponsoring organization in the form of dividends.

The subsidiary insulates the nonprofit from liabilities arising from the subsidiary's activities; the risk to the sponsor's nonprofit status is somewhat minimized; the dividends received are likely not to be subject to UBIT; and issues related to leadership, staffing and marketing are separated from the nonprofit's activities.

Five states — Vermont, Michigan, North Dakota, Wyoming and Utah — have passed legislation that encourages the creation of social enterprises without forcing nonprofits to enter into complicated subsidiary and limited partnership arrangements.

The legislation in these states allows for the creation of Low-profit Limited Liability Companies (L3Cs). An L3C is a hybrid company that sells a good or service in order to carry out a charitable mission.

The social benefit is the primary mission of the organization, not profit. In exchange for limiting profits paid out to partners, the company invests earnings into its charitable mission.

L3Cs can be incorporated in the states that allow for their creation, and then they can file as foreign corporate entities in the state in which they operate.

Anyone interested in exploring earned income strategies, including L3Cs, is encouraged to contact an accountant or attorney for specific guidance.

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### Resource Use

- Support nonprofit leadership
  - Board development/training
- Strategic planning

### Nonprofit Business Column of The Tribune

The San Luis Obispo Tribune publishes a column every other week in the Business section dedicated to the business practices of nonprofit orgs. Barry VanderKelen, Executive Director of the San Luis Obispo County Community Foundation writes the bi-

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