Non-Profits Facing Bankruptcy: Going Broke Can Cost A Lot

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In the cat and mouse game that is debt collection, non-profit entities have a distinct advantage over for-profits; they can't be forced into bankruptcy. The Bankruptcy Code says involuntary cases can't be filed against entities that are not "moneyed, business or commercial."

That edge gives organizations in healthcare, education, and other non-profit sectors breathing room to wind down their operations according to their own timetable and not be rushed by creditors into a liquidation. That doesn't mean charitable entities can ignore the bills, turn off the lights, and go home, however. Regardless of whether a charity will have net assets remaining after creditors' claims are paid or settled, the procedure can be complex and lengthy.

First, the charity's board must approve dissolution–sounds self-evident, but sometimes there are board members with conflicting views. Even if a charity will have no remaining assets, it must go through the Attorney General's Public Charities Division, which will require that it submit overdue reports and provide financial information. If the charity *will* have assets remaining after creditors are paid, things get more complicated. If that's the case, the charity must start a legal proceeding for voluntary dissolution with the state's highest court (SJC) and the cooperation of the Attorney General, which must approve the charity's plan of liquidation.

A charity can't just give away its assets to avoid this procedure, although it can make grants if that is one of its charitable purposes. A public charity seeking to dissolve must notify the Attorney General of the proposed transaction and submit overdue filings and required financial information. Only after the Attorney General has approved the transaction, which must include a plan to transfer its remaining assets to another charity, does the case proceed to the SJC for approval. The assets

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of public charities are subject to oversight by the Attorney General because by law she represents the public interest in the proper use and solicitation of charitable funds.

Massachusetts public charities law gives the SJC the power to allow the Attorney General to dissolve charities with net assets below a particular threshold, but the SJC has yet to establish such a rule. So for now, all non-profit dissolutions must go through the existing process.

It may seem like a lot of trouble to a non-profit that just wants to throw in the towel, and a board member with business experience may ask: Can't we just stop filing annual reports and let the state shut us down? While this approach has a surface appeal, it comes with risks, the most serious of which is personal tax liability. Non-profits may be exempt from taxes, but they are required to turn over taxes withheld from employees' wages, and the IRS considers officers and trustees of nonprofits "responsible persons" liable for a 100% penalty if these are not paid.

So even if you're not in business to make a profit, it can cost a lot of money to go broke.