MERGER OF NONPROFIT ORGANIZATIONS

Combining the staffs, boards and fund-raising resources of two or more nonprofit organizations might enable the resulting organization to more efficiently achieve the common mission of the combining organizations. There are several methods of combining. Often, overcoming inertia is the biggest hurdle. Sometimes, the combined entity will have less access to funds that if the organizations had remained separate.

There are two principal ways to combine nonprofit organizations: a technical merger or a board take-over.

Technical "Merger." A nonprofit corporation can merge with another corporation, including a for-profit corporation or another nonprofit corporation. In a technical "merger," a document is filed with the Secretary of State, and the effect of the filing is that one or more corporations disappears and one corporation survives.

The surviving corporation has all of the assets and all of the debts and liabilities of each disappearing corporation. The surviving corporation is subject to any trust obligations affecting the assets of each disappearing corporation. The merger document says what effect, if any, the merger has on the memberships in and directors of the disappearing corporation and the effect on the articles and bylaws of the surviving corporation.

A California nonprofit public benefit corporation may merge into another public benefit corporation or a religious corporation without the consent of the California Attorney General. With the Attorney General's prior consent, a nonprofit public benefit corporation may merge into any other corporation, association, partnership or limited liability company.

Generally, tax issues prevent a for-profit corporation from merging into or converting to a tax-exempt, nonprofit corporation. A for-profit corporation can convert to a nonprofit by amending its articles of incorporation, but the conversion is treated as a taxable liquidation for federal income tax purposes.

A merger of a nonprofit charitable organization into a for-profit is rarely possible. But a trade association can become a for-profit corporation.

Board Take-Over. An alternative is to have the board of the “target” or “taken over” organization resign and then to have the “acquiring” organization name the new directors of the target organization.

Typically, there would be an agreement or a memorandum of understanding about the mechanics. All but one of the directors of the target organization would agree to resign. The remaining director would agree to elect to the target board those directors designated by the acquiring organization. After the new directors are elected to the target board, the last “old” director would either resign or agree to resign when the new president asked for the resignation of the last “old” director.

In the board take-over, it is not necessary to get the permission of the Attorney General, because the target continues to exist.

Generally, the articles of incorporation and bylaws of the target corporation are amended to provide that all or a majority of the directors of the target are designated by the acquiring organization. If effect, the target becomes a “subsidiary” of the acquiring corporation, even though the target has no shares outstanding and might not have any membership interests.

A board take-over can precede a technical merger. When the officers of the acquiring organization become comfortable with the exposure of the target to liability, they might propose a technical merger to achieve additional efficiencies. On the other hand, they might decide that using more than one entity protects the overall assets from a catastrophic judgment against one of the entities.

Dissolution. Instead of merging, a target organization can transfer its assets to the acquiring organization and the target can then dissolve. For a target that is a California nonprofit public benefit corporation, this requires the prior consent of the California Attorney General. The benefit is that the acquiring corporation does not take on all debts and of the liabilities of the target. The disadvantage is that the assets must be transferred by bill of sale. Compare a merger, in which it is not necessary to transfer the assets and the acquiring organization inherits all of the debts and liabilities of the disappearing target.

Other Considerations. Will the surviving organization be able to receive more grant money than the merged organizations received, in the aggregate, before the merger? Less? This is something that should be discussed with grantmakers before pursuing the merger. Grantmakers that advocate economies of scale for their grantees do not always have funding policies that support this aspiration.

Before the merger, the officers should try to get buy-in from the board of directors, the staff, constituents and grantmakers. Not everyone is happy with every merger, but it is good to minimize the risk of disparaging comments about the transaction in the media and online.

Before any transaction, the officers should be sure that the transaction will not be an event of default or have other negative consequences under any lease, line of credit, deed of gift, gift acceptance letter or other arrangement.

The merger will raise questions in the minds of the constituencies of each organization involved. Consider issuing a joint press release and/or holding community meetings to minimize confusion and anxiety.

It is possible to unwind a board take-over. The take-over can occur over several months or years, with an ability in one or both sides to stop the take-over process and "unscramble the egg" if specified events occur (such as failing to achieve the hoped-for efficiencies).

Generally, each organization uses its own attorney.

After a merger or dissolution, the disappearing or dissolved organization must file its final state and federal tax returns.

I would be pleased to discuss with you a possible merger of your organization with another.

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