STRENGTHMATTERS®

NeighborWorks AMERICA | HOUSING PARTNERSHIP NETWORK | SAHF

STRENGTH MATTERS Boot Camp on Financial Reporting for Rental Housing Nonprofit Enterprises

Module 2: Entity Formation and Deal Structure

Materials:

- Handout on the key elements of Non Profits, Limited Partnerships and Limited Liability Companies
- Organizational Chart - Restoration Housing LP

Nonprofit Corporation

- Generally seen as either the general partner in a partnership, managing member in an LLC, as the sole owner of an affordable housing property or parent organization
- Tax-exempt status granted by IRS and state counterpart
- Various types of tax exempt organizations (e.g. 501(c)3 charity)
- Characteristics 501(c) organizations
    - No ownership of a 501(c)3 organization
    - Controlled by a board of directors
    - Board Members may have a liability for their conduct as board members
    - Board members generally are not liable for debts of the organization
    - Certain states prohibit the Board from being compensated
    - When a 501(c)3 liquidates, it distributes its net assets to a similar charity
    - Subject to income tax on unrelated business income – describe situations that could lead to taxable income
    - Despite nonprofit name, organizations can and should make a profit
    - Files Form 990 and corresponding state form, due 15th day of 5th month, six month extension is available
    - Nonprofit may be taxable if tax-exempt status is not granted by federal or state (some NPOs file an 1120 for federal purposes and a nonprofit state return (with 990 attached) for state purposes because federal exemption was denied after the NPO registered with the state as a charity

Limited Partnership (LP)

- No board of directors
- Owned by at least two partners
    - At least one partner is a general partner – unlimited liability for partnership obligations
    - At least one partner is a limited partner – no liability for partnership obligations so a limited partner cannot lose more than capital invested
    - Generally you will also see a special limited partner
        - They will provide oversight on behalf of the investor
        - Provides a third partner so that in the event the GP is removed the partnership does not dissolve
- Partnership agreement dictates capital contributions, P&L sharing %s
- Capital accounts are maintained to identify each partner's share of equity based on contributions, share of income/loss, distributions
    - A limited partner's capital shouldn't go negative (except for tax purposes), unless there are provisions in the partnership agreement that allow for it
- Files Form 1065 and corresponding state form
- Form K-1 issued to each partner shows income/loss, credits, capital account

Limited Liability Company (LLC)

- No Board of Directors, Owned by at least one member (a sole member LLC) or multiple members

- Managing member in an LLC and a general partner in an LP are entitled to manage the business, however a managing member retains the limited personal liability. Normally LLC members are not personally liable for LLC debts or legal liabilities, putting only their financial contributions to the LLC at risk. LLC owners may still be personally liable for their own conduct that harms others, for breaches of their duties owed to the LLC or any personally-guaranteed LLC loans
- Commonly seen as either the property owner (normally multi-member) or a managing member which is equivalent to a general partner in a partnership (normally sole-member)
- When LLC’s are used for property owner entities they are typically set up a sole member LLC to hold pre - development activity. Upon syndication the LLC admits a new investor member and another sole member LLC to serve as the managing member
- Owned by at least one member
- If only one member it is “disregarded” for tax purposes and activity appears on the member’s tax return
- If more than one member, the LLC formed to own a property generally elects to file as a partnership.
- Sole member LLC's formed to hold the managing member’s interest can remain a pass-through entity but are required to elect to be treated as a taxable corporation if the property owner elects a 27.5 year accelerated depreciation method.
- Pass-through entities avoid double taxation and the costs involved with preparing and filing a standalone tax return
- All members have limited liability so they cannot lose more than their capital invested
- LLC capital accounts can go negative (ASC 272-10-45-4)
- Easier to maintain from a governance standpoint as there is no annual meeting or board of directors
- Files same IRS return as a general partnership (unless elected to be taxed as a corporation) but state form may be different if the state taxes gross receipts

Restoration Deal Structure