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Can a Nonprofit Organization Invest in Stock?

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Written by **The Motley Fool** →



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Nonprofit organizations serve a vital role in society, with most such entities having a religious, charitable, scientific, or educational purpose that qualifies them for exemptions from income tax. Yet even an organization set up as a nonprofit can still invest its financial resources in most of the same investments as a for-profit business entity, with some limitations that ensure that the organization's charitable purpose is fulfilled.

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Most nonprofit organizations rely on consistent donations from outside donors for much or all of their financial support. For many nonprofits, the income they earn from donations in any given year is barely sufficient to cover their operating budget, leaving them unable to set aside financial reserves for future use.

Once nonprofits get larger, however, some are able to start thinking for the future. Taking money and putting it toward longer-term goals like capital spending or a permanent endowment requires prudent investment. In order to take initial seed money and grow it into a substantial nest egg for use toward those longer-term charitable purposes, nonprofits are allowed to invest in stocks, bonds, funds, and other typical investments. In addition, they're allowed to accept donations of stock and other securities from donors in-kind, allowing the donors to reap tax benefits for charitable contributions while the nonprofit can benefit from holding onto the stock and keeping any future returns.

For small holdings in large companies, there really aren't any restrictions on nonprofits holding stock of for-profit businesses. In that regard, nonprofits are identical to any other minor shareholder of a company.



When nonprofits do business

Where things get trickier, though, is when nonprofit organizations have wholly owned for-profit businesses. This is common in the healthcare industry, where nonprofit hospitals or other healthcare institutions can own for-profit enterprises like medical professional practices or real-estate holding companies.

In such cases, the key question for the nonprofit is whether the for-profit subsidiary will jeopardize its tax-exempt status. The IRS has drawn the line at the point at which the business activities of the for-profit subsidiary essentially become the key aspect of the nonprofit parent's operations.

Fortunately, it's generally fairly easy for nonprofits to stay on the right side of the line. As long as the for-profit business is kept in a separate corporate entity with distinct boards of directors and officers, then it will be hard for the IRS to challenge the separation of the two. Only when there's no functional distinction is it likely that the nonprofit will lose its tax-exempt status.

The idea that a nonprofit shouldn't hold stock makes a degree of sense, but such a prohibition would keep the nonprofit from making smart investments to further its charitable purpose. Smart nonprofit organizations invest in stock all the time as a means to earning more money to support their missions.

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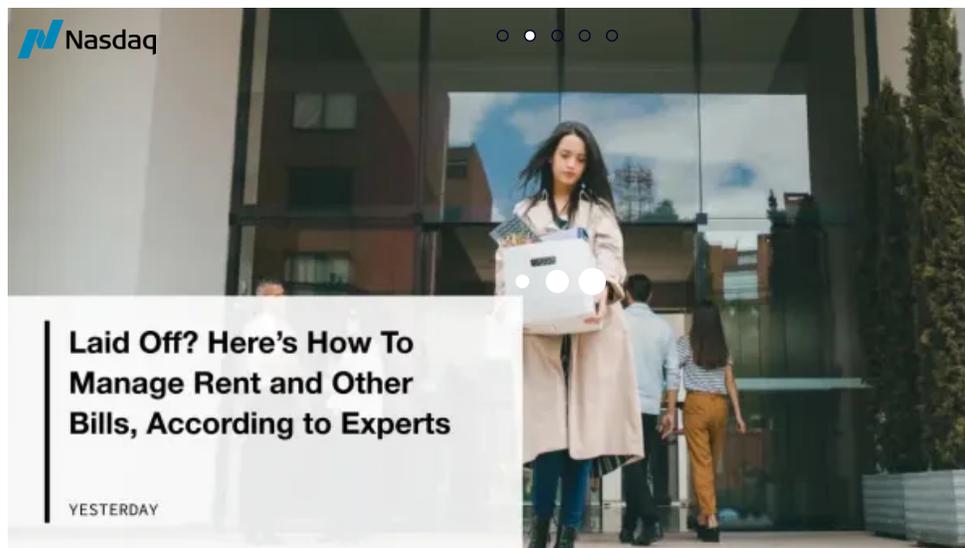
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