Nonprofit vs. Not-for-Profit vs. For-Profit: What's the difference?

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These terms have different implications for your taxes, corporate governance, and business activities.

There are several key differences between these three business entities, such as differing profit structures and having employees versus volunteers.

While nonprofit and not-for-profit organizations may sound similar in name, they operate differently. They both come with different tax implications, governance, and functions, and each contrasts for-profit organizations.

Below, our guide will help you understand the critical differences between these business organization structures to help you choose the right one for your small business.

What is a nonprofit organization?

A nonprofit organization has a legally approved purpose or social cause beyond profit generation. The organization’s income is not dispersed to any shareholders but instead is invested back into the organization. These IRS tax-exempt organizations include many hospitals, universities, national charities, and foundations.

Notable examples include National Geographic, Alzheimer's Association, Big Brothers Big Sisters of America, American Red Cross, and PBS. The U.S. Chamber of Commerce is also an example of a nonprofit organization.

To qualify as a nonprofit, your business must serve the public good in some way. Nonprofits do not distribute profit to anything other than furthering the advancement of the organization. As such, you will be required to make your financial and operating information public so that donors can see how their contributions are being used.

The IRS grants nonprofits 501(c)(3) status, which means an individual or business that donates to a nonprofit is allowed to deduct their donation from their tax return. The nonprofit, likewise, pays no taxes on any money received through fundraising.

What is a not-for-profit organization?

Like nonprofits, a not-for-profit organization (NFPO) reinvests its financial gains back into the organization. However, an NFPO primarily exists to serve its members' goals rather than a social cause, and those goals can vary depending on the organization's purpose. Some well-known NFPOs include parent-teacher associations, homeowners associations, and college sororities and fraternities.

NFPOs are governed by IRS tax code Section 501(c), but depending on their purpose, they could fall under a different section, like Section 501(c)(7). NFPOs must apply for an IRS tax exemption, which grants exemption from specific local, state, and federal taxes, such as income and sales tax. However, donations made to NFPO are not tax-deductible for donors since these organizations don't operate for charitable purposes.

A key difference between a nonprofit and a not-for-profit is that nonprofits are run like a business, while not-for-profits are considered "recreational organizations" that do not operate with the business goal of earning revenue. Nonprofits also may have paid employees, whereas not-for-profits are run by volunteers.

What is a for-profit organization?

True to its name, a for-profit company is an organization that exists to earn a profit. These entities do not have legal obligations dictating where their profit goes. Instead, they can disperse the funds among the owners and employees, or spend it however they choose.

For-profit organizations are readily available, encompassing everything from airlines to restaurants to manufacturers and service providers. Even your favorite clothing brand or streaming platform is likely a for-profit organization.

Popular for-profit organizations span all industries, including Apple, the NFL, Hulu, Chewy, Google, Uber, and Sephora.

> Choosing the proper business structure depends on your goals, target audience, and desired tax advantages.

Can you change your legal entity?

Whether you decide to start a nonprofit, not-for-profit, or for-profit, the initial steps to creating your organization are the same. Start by filing for a business entity in the state in which you wish to run your operations. Your business entity might be a corporation, LLC, sole proprietorship, or partnership.

Once the entity has been formed, you will apply for an Employer Identification Number (EIN) with the IRS. It's during this step that you will select your tax-exempt status using Form 1024 if you wish to run as a nonprofit.

Some organizations start as one type of legal entity and later decide to convert to another. This is possible, but it can be a little complicated depending on the types of entities involved.

From nonprofit to for-profit

While uncommon, nonprofits requiring additional funding or more autonomy can dissolve their status and transition to for-profit by following the below steps:

- **Analyze your finances.** Review your tax returns with a trusted advisor to ensure that your income potential will be worth the additional yearly taxes your business will incur.
- **Give notification of intent.** Meet with your board of directors to vote on the status change, then disperse a notification of intent to employees and stakeholders.
- **Inform the IRS.** Explain your reasoning for dissolving your nonprofit by drafting a statement of nonprofit conversion for the IRS.
- **Change your status at the state level.** Request the necessary paperwork for a status change from your attorney general.
- **Notify key parties.** Communicate the change to employees, members, and relevant stakeholders.
- **Submit your final tax return.** File your final tax return within four months and 15 days of terminating your nonprofit status.

From for-profit to nonprofit

Converting from a for-profit to a nonprofit organization is possible by following these steps:

- **Confirm your 501(c)(3) eligibility.** Following the Internal Revenue Code Section 501(c)(3), determine whether your organization can obtain tax-exempt status.
- **Incorporate your business.** Your business must convert to an incorporation to obtain nonprofit status if it isn't already.
- **Submit Form 1023.** Apply for 501(c)(3) tax-exempt status using Form 1023; all paperwork should reflect valid information. Approved organizations will receive a determination letter from the IRS.
- **Register with the state.** To be exempt from state taxes, you may need to register your nonprofit at the local level. This is optional for all nonprofit organizations and will depend on your operating state.

Is it easier to manage a nonprofit or for-profit?

Managing a for-profit business can be easier than managing a nonprofit. For-profit organizations have fewer regulations and more control over how they use their funds. In contrast, nonprofits have fund restrictions and must comply with stringent reporting guidelines, which can vary based on the stakeholders involved, such as donors and regulatory agencies.

In addition to continually meeting IRS criteria and compliance requirements, nonprofit organizations must also manage paperwork and reporting for their programs, campaigns, and grant opportunities. They must adhere to the budget set by the nonprofit’s board of directors, meet its specific requirements, and address its concerns.

Which legal entity is best for your business?

Choosing the proper business structure depends on your goals, target audience, and desired tax advantages.

Both nonprofit and not-for-profit structures offer tax benefits, though nonprofits — focused on broad public service — must meet stricter qualifications. Both can fundraise, accept donations and membership dues, and earn from selling refurbished goods. However, not-for-profit contributions support more focused missions or specific communities, not the public.

A for-profit business is more appropriate if you want to make money and grow your wealth without restriction. With this structure, you can obtain funding from external sources, sell products or services for profit, and potentially become publicly traded.