



This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Accepting a Loan from an Insider: Conflict of Interest Issues Nonprofits Should Consider

At a certain point in an organization's lifespan, nonprofits may face financial constraints and seek emergency funding to help sustain their missions. In some cases, board members, officers, or nonprofit staff may wish to help support the nonprofit organization's activities by loaning money to the organization. While this may seem like a simple solution, nonprofits should proceed with caution. This article lays out state and federal legal obligations of a Georgia nonprofit organization that accepts a loan from a board member, officer, or employee.

Can board members and officers loan money to a nonprofit organization?

Yes. However, because loaning the money will constitute a transaction between the organization and a person with a fiduciary duty to the organization (i.e. the board member or officer), there is the appearance of a conflict of interest. This does not mean that the transaction cannot occur. However, the organization must follow the procedures in its conflict of interest policy to ensure that the loan is fair, reasonable, and in the organization's best interests.¹ This also applies if the loan is from a relative of the board member or officer (spouse, child, sibling, parent, etc.).

Because the loan involves an insider, the IRS may review it more closely than a typical transaction. If the IRS determines that the loan terms are not reasonable, it may treat the loan as an excess benefit transaction and impose financial penalties on both the lender and the nonprofit. However, if the nonprofit follows the approval process described below, including reviewing comparable loan rates and documenting its decision, the IRS will generally treat the loan as reasonable *unless* it has evidence to the contrary. Following the process outlined in this article can help protect both the organization and the insider from penalties.

Can staff members loan money to the nonprofit organization at which they work?

Yes, staff members may generally loan money to the nonprofit organizations that employ them. But an organization should tread very carefully in this situation. An employee should not be "pressured" to give a loan to the organization, and the employee should continue to receive payment for any work performed for the organization. Although people may volunteer at a nonprofit, employees who perform work in contemplation of pay cannot be "converted" to volunteers, and encouraging loans may be viewed by government agencies as a back-door way of circumventing this rule.

The organization should also review its personnel policies to make sure that accepting the loan is not prohibited by any policies. Practically speaking, the organization should consider whether accepting a loan from an employee may complicate future employment decisions with respect to that individual.

How can the organization determine that the loan is reasonable and in the best interests of the corporation?

Accepting the loan may be in the best interest of the organization if the loan proceeds are needed to fund programming or meet other financial needs and the terms of the loan are the same as or better than the organization would receive from an unrelated party. The organization will need to follow the

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process for addressing conflicts of interest as set forth in its conflict of interest policy. In general, the process for addressing conflicts is as follows:

1. Any insider who stands to gain financially from a transaction with a nonprofit organization must disclose the conflict ahead of time and non-interested board members must review the transaction. If there are doubts about whether there is a conflict, the best course of action is for the insider to disclose the financial transaction.
2. The board of directors (or an authorized committee of the board) should make sure that the interested party (i.e., the person who stands to gain financially from the transaction) recuses himself or herself *before* deliberation over the transaction takes place. The interested party cannot be present at, nor participate in, board or committee deliberations or vote on the matter giving rise to the conflict. The interested party cannot attempt to improperly influence the deliberation or voting on the matter.
3. Next, the board or authorized committee of the board should make a determination about whether the transaction is fair, reasonable, and in the best interests of the nonprofit organization. The organization's conflict of interest policy may include a process for researching the fair market value of a transaction. The transaction should be more advantageous (for example, in terms of interest rate or loan repayment schedule) than what could be obtained in a third-party, arm's length transaction. In any case, the board should ask questions like:
 - Did the organization seek out multiple loan quotes?
 - What terms do private lenders impose for similar transactions in the market?
 - What is the current interest rate environment? A 5% loan may seem generous in 2025 but not so much in 2020-2021.
 - Are interest rates expected to drop? Could the organization hold off on the transaction?
 - Is there another option that would be better for the nonprofit organization?
4. After the transaction is reviewed, the board or committee will vote to approve (or disapprove) the transaction.
5. Don't forget to document the organization's compliance with its conflict of interest policy! The documentation should be contemporaneous (meaning very soon after the transaction), and should record:
 - The fact that the interested person was recused;
 - The factors and datapoints the board considered in determining whether the transaction was fair, reasonable, and in the corporation's best interest; and
 - The board's ultimate determination.

For more information on conflict of interest policies under Georgia law, please see "Navigating Conflicts of Interest in Nonprofits," <https://pbpatl.org/competing-professional-or-personal-interests-when-somebodys-gain-is-your-organizations-loss/>.

Once approved by the board, how should my organization document the loan?

It is important that the parties sign a promissory note or loan agreement that establishes the following terms of the loan: (i) the amount of the loan; (ii) the interest rate; and (iii) when and how the loan will be repaid. This helps to ensure that all parties agree on the key terms, and creates a record of the loan. The organization should work with an attorney to draft or review the relevant documents.

After the loan transaction is approved, what are my organization's obligations?

Once the board has approved the transaction and the organization has received the money, the organization must continue to follow its conflict of interest rules throughout the life of the loan. The person who loaned the money will continue to have a conflict of interest regarding the loan. The organization will need to follow its conflict of interest policy to ensure that the conflicted individual is not present for any deliberations regarding the loan and does not vote on any issue relating to the loan.

The lender may also have conflicts with regard to other organizational decisions. For example, consider an organization that has taken a loan from a board member for general operating expenses. A year later, the board learns of a great new opportunity to expand its services under a government contract and wants to apply for it. However, the contract creates additional financial risk for the organization, and part of that risk is that the organization may not be able to pay some of its debts, including the loan from the board member. In this case, the board should consider whether the board member who loaned the money should be recused from conversations about whether to apply for the government contract.

What if my organization cannot repay the loan in a timely manner?

An organization should take out a loan only if it intends to repay it. However, loans sometimes need to be renegotiated. If an organization finds itself in a situation where it is questioning whether it can repay the loan on time, the board will likely need to discuss how to proceed. The person who provided the money should not be present at any deliberations or be involved in any discussions. Again, that individual must recuse him or herself, because he or she has a conflict of interest with respect to the loan.

If the lender decides to forgive the loan, can it take a tax deduction?

If an organization takes a loan from a board member, officer, or employee, and later cannot repay the loan, the lender may decide to forgive the loan. That person may be able to take a charitable tax deduction for the amount forgiven, but only if there is valid evidence of an enforceable loan (such as a written promissory note or loan agreement) and subject to his or her personal tax status.

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