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Operations

Taking a For-Profit Business to Nonprofit

by Greg Shulas
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As the U.S. health care sector has grown into a $3.5 trillion economic juggernaut, the steady rise of for-profit health care providers has been credited with escalating the pace of the expansion.

In the home health care industry alone, for-profit firms such as Amedisys and Kindred Healthcare are not just market share leaders, they have been early adopters of new technology, including mobile applications for clinicians and telehealth initiatives.

Indeed, the success of for-profit providers is the main reason why the Nashville, Tennessee, region is a health care power center, as it claimed seven Fortune 1000 health care companies that had close to $100 billion-plus in annual revenue in 2017.

But while the for-profit model is credited with fueling growth and innovation, it may not always be the best tax structure for patient-focused health care organizations.

A case in point is Bayada Home Health Care, a New Jersey-based provider that will formally change in January 2019 from a for-profit entity to a nonprofit one, capping off a two-year-plus transition process. While the switch will place new restrictions on how Bayada can run its business affairs, it also will spur deeper alignment between the organization's operational goals and its community mission.

Further, the change also can help organizations maintain an independent status—no small feat in a market being rapidly reshaped by consolidation.

In many cases, organizations that make the leap from a for-profit status to tax-exempt status experience a new empowerment in their social mission as well as a boost in local credibility.

"Having a tax-exempt mission helps the organization make a connection to the community," said Frank Giardini, the national nonprofit health care tax leader at Grant Thornton, an independent audit, tax and advisory firm. "It resonates a lot more to individuals than a company making a buck to benefit private shareholders."

Transitioning to Nonprofit

As with any major change to a business tax structure, transitioning to a nonprofit status is no easy task and requires deep due diligence, experts say.

To start with, such a change will require the for-profit organization to pay a so-called “toll tax” on proceeds generated from for-profit business activity that won’t be allowed in the new nonprofit structure, Giardini said.

It’s incumbent for the provider to conduct an independent assessment of all the for-profit organization’s assets and how they will be impacted by any transition, Giardini said. This review must also verify whether the institution has the resources to pay all toll tax costs, he added.

“There is a certain cost of doing this transition with the toll tax you have to pay....You want to make sure that if you…do this, that the new structure meets the short-term and long-term goals of the organization,” Giardini said.

But while the toll tax review is a crucial part of the review, it is only one part of the due diligence process.

Home health care providers must closely examine the state tax laws that organizations must register under if they become a nonprofit entity. This review should closely examine the corporation statutory language that will help define the tax-exempt mission of the new entity.

And once the company’s board signs off on such state-level requirements, the organization then must seek out IRS approval.

“The IRS will then have to approve it as a public charity. If you meet the charity status, you cannot use the charity part of the organization to benefit a party like a shareholder,” Giardini said. “You cannot pay someone excessively. You will also be subject to the watch of the IRS and Attorney General to make sure you are furthering the community [mission] versus private concerns.”

Other crucial matters for the new tax-exempt organization to deal with include forming a board of independent directors. This new governing body should have on its roster individuals with solid nonprofit and fundraising experience, and who can understand how to maximize the financial opportunities afforded to nonprofit institutions. Some of these opportunities include the capability to issue special private activity bonds that represent a form of tax-exempt financing, Giardini said.

Why Nonprofits Give Up Their Status

But while the for-profit to nonprofit transition may have its advantages, the concept may be relatively new in the home health care space. Matthew Bavolack, principal and national health care practice leader at accounting firm Marcum, says the main trend he sees is providers moving to for-profit and doing so through mergers, acquisitions and/or bankruptcies.

“If the nonprofit’s endowment shrinks, it has to run as a for-profit entity even though it is a nonprofit,” Bavolack said, adding that poor business performance is a primary reason for why nonprofits must give up their tax-exempt classification.

Overall, the regulatory requirements of running a nonprofit can be more arduous in cases when compared to running a privately held, for-profit company, as tax-exempt health care organizations must be audited annually.

However, both nonprofit and for-profits have the same level of access when it comes to patient care funding from the federal government, including the Centers for Medicare & Medicaid Services. The only true difference favors competing for grant financing.

Ultimately, the push to become a nonprofit entity can be fueled by a strong personal conviction from the health care organization's ownership or management team, making issues such as effective marketing less important priorities.

Mission Minded Organizations

After Bayada announced its decision to go nonprofit, founder and chairman Mark Baiada said the change would not only allow his son David to lead the company—therefore, helping keep the organization in the family for now—it would support Bayada's future growth as a mission-based organization.

"Transforming Bayada into a nonprofit reflects our company's deep commitment to helping people live safely at home and protecting employees' livelihoods, while also setting the stage for sustainable future growth," said Mark Baiada, according to an August 2017 NJBiz article covering the transition. "I am incredibly excited to watch David lead Bayada into an undeniably bright future, guided as always by the framework of The Bayada Way."

On Tuesday, November 20, 2018, Bayada brought together employees, ranging from home health aides and clinicians to client services managers and business staff, for a Gratitude Luncheon in Philadelphia, where Mark Baiada announced that he would distribute some $20 million to employees, ranging from those who just started to those who have been with Bayada for many years. The gesture is a final element of Baiada's Lasting Legacy succession plan, according to the company.