The Nonprofit Sector: Navigating its Waters from a Surgery Vantage

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Abstract

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The nonprofit sector is a vibrant, dynamic, and expanding portion of the United States' economy. Its growth over the past two decades has opened up many avenues for entrepreneurs wishing to create corporations that are community- and need-driven, particularly in the health services industry. The fertility of this sector has not been maximized by physicians in particular due to the tortuous path of nonprofit incorporation and accreditation. This article focuses on reviewing the structure of nonprofits and streamlining the establishment process.

A nonprofit organization (NPO) is an institution dedicated to a particular cause, explicitly defined through a mission statement, which must legally funnel all profits gained through its activities back into the funding of the corporation itself. An NPO cannot be organized to financially benefit its members, officers, or directors.¹ The accreditation for existence is granted at the state level, whereas tax exception status—501(c)(3) charitable tax exemption—is allocated at the federal level.²

In the United States, there are now more than 1.5 million registered NPOs according to the National Center for Charitable Statistics. This sector of the economy contributed US \$878 billion to the U.S. economy in 2012, an equivalent of 5.4% of the nation's gross domestic product. This equates to the 16th largest international economy in terms of GDP according to data from the World Bank.³ Of the total NPOs in the United States, 13% are focused on health services. In the surgical realm, the three most common specialties represented are general surgery, obstetrics and gynecology, and plastic surgery.⁴ Well-known examples include Surgeons of Hope Foundation, Mercy Ships, and Smile Train.

This article is aimed at providing a concise review of what an NPO is, how to establish a U.S.-based NPO, and alternatives to NPOs, which can still provide care to the community, all in the scope of health services, particularly surgery. After reviewing this article, a physician should have a deeper

understanding of the nuances of formulating, organizing, and constructing a U.S.-based NPO.

What Is a Nonprofit Organization?

An NPO, in simplest terms, is like any other corporation, except that all profits that are generated through its actions and activities must be recycled into the company's revenue stream. This differs from a for-profit organization, where the profits may be divided among the employees, management, and/or shareholders. To that point, NPOs do not have shareholders or owners. The board of directors is the "owner" equivalent in an NPO.

Furthermore, NPOs are classified as charitable organizations and thus may apply for tax-exempt designation, most commonly 501(c)(3), which is granted at the federal level as set forth by the Internal Revenue Code.² They may also qualify for additional state-level exemptions, which vary depending on the jurisdiction they fall under. Qualification for national-level tax exemption does not guarantee state-level exemption and vice-versa.

One common misconception of NPOs is that individuals who work for them do not get paid. Instead, state-level laws allow NPOs to pay their employees "reasonable salaries" for their work.⁵ This means that surgeons creating their own NPOs must allocate in their budgets salaries for administrators and

ancillary staff in addition to relying on volunteers. A 2015 Nonprofit Employment Practices survey showed that NPOs employed more than 10.7 million individuals, which accounted for more than 10% of the U.S. workforce.⁶

In comparison to for-profit corporations, which reflect their strategies based on budgets, NPOs rely heavily on their mission statements. These are overlying mantras that must be a clear description of where the organization is headed in the future, that distinctly set it apart from other entities, and make a compelling case for the needs it fills.⁷ These mission statements are what allow an NPO to have focused projects and are also what drive funding support. Additional information concerning mission statements follows next.

How to Establish a Nonprofit Organization?

Establishing an NPO is no small feat. It involves detailed needs analysis, navigation of state- and national-level tax codes, and scrupulous ongoing reporting to maintain compliance. This section will break down this seemingly arduous process into four refined steps.

Step 1: Research

The initial step to establishing any NPO is to understand what the marketplace is lacking and what it can accommodate. For example, although valiant in intent, trying to start an NPO aimed at cleft palate pathology based out of Virginia may not survive given its next-door neighbor will be Operation Smile.

Prior to beginning the heavy lifting of planning and incorporating an NPO, a needs analysis is mandatory. This analysis looks at what the market landscape is, where the deficits exist, and what types of opportunities are available. It also allows one to understand what kind of funding will be sufficient for the organization's needs.⁸ This research is the checkpoint to all steps moving forward. Often, this step reveals an already established, thriving NPO that has the lion's share of the market. This can alter your planning; you may choose to join this existing corporation instead of establishing a new one.

Step 2: Design

As previously described, an NPO's mission statement is its heart and soul. Like all good patient handoffs, a mission statement must be concise, accurate, and impactful. The mission statement is, in essence, the face of the NPO. It is what the public associates your corporation with and it is what determines funding from donors (how your corporation stays true to its missions speaks of core value alignment).

A well laid out business plan with a minimum of 3 years of projections is the support beam to the mission statement. When applying for grants or pitching to donors, this detailed business plan will allow the donors to determine the feasibility of your corporation. The business plan will also determine the structure of the NPO. All NPOs have a board of directors to serve as the voice of the organization. The decision to structure based on membership voting rights or to allocate all decision-making to the board of directors

must be determined. Either structure will allow for the election of directors, amendment of bylaws, and decision on mergers and/or dissolution of the corporation.¹

Step 3: Incorporation, State Laws, and Federal Laws

Once needs have been determined and a potential solution has been formulated, it is time for the legal portion of NPO creation. This process involves incorporating at the state level, securing tax-exempt status from the federal government, and filing for tax-exempt recognition at the state and local levels.⁹

Each state has unique criteria for NPO incorporation. In addition to filing an Article of Incorporation (also known as a Certificate of Incorporation), certain states may require a Certificate of Disclosure, a proof of corporate name, and additional forms of validity. A list of state-level associations and their contact information can be found on the National Council of Nonprofits web site.¹⁰

Once the NPO has been incorporated at the state level as a trust/corporation/association, it may apply for tax exemption status at the federal level. Internal Revenue Service (IRS) Form SS-4 and Form 1023 must be completed, which allocate a Federal Employer Identification Number and Regular Tax Exemption, respectively. Additionally, if the particular NPO plans on expenditures to influence legislation, Form 5768 must be completed (this may not be within the scope of many NPO startups and we suggest prudence). As of 2018, the IRS has created a new form, 1024-A, Application for Recognition of Exemption Under Section 501(c)(4), which also grants exemption. In-depth explanation of this new form and exemption process can be found in the IRS Publication 557.¹¹ This federal process can take anywhere from 6 to 12 months and cost US\$275 to 600 depending on the forms used.

Further local and state exemptions may be granted independent of federal designation. We recommend conferring with local tax authorities to determine eligibility and application process.

Step 4: Maintaining Compliance

After you have incorporated your NPO, gained tax exemption, and have the actual work underway, it is critical to maintain compliance with local, state, and federal regulations. Given that an NPO is a charitable organization, it falls under the jurisdiction of each individual state and its respective charitable organization laws. These are overseen by a central office, which often is a branch of the Attorney General. Additional information concerning these offices can be found at the National Association of State Charity Officials web site.¹²

Similar to detailed documentation in the electronic medical record, an NPO must keep scrupulous records of the board of directors' meeting minutes and financial records documenting revenue sources and expenditures in a double-entry bookkeeping system.¹ These records are not only used for annual reporting but can also be used for auditing an NPO's actions. Yearly reporting to the IRS using Form 990 is mandatory financial records. It should be noted that these records are public domain and can be accessed.

As previously mentioned, due to the charitable designation granted to NPOs, there are certain restrictions that apply to its actions.¹ First, NPOs cannot contribute money to political campaigns. The IRS can revoke the tax exemption status and execute an excise tax against the corporation. Next, the amount of lobbying that can be engaged in is limited. As mentioned previously, IRS Form 5768 must be used for such actions. Lastly, given the intrinsic lack of profit sharing in an NPO, if it is to be dissolved and its assets liquidated, they must be donated to another tax-exempt entity.

Is a Nonprofit Organization the Only Path to Your Goals?

Creating and running an NPO can be a very rewarding endeavor. However, this comes at a cost of tedious planning, arduous paperwork, and no personal financial profits. Data from the U.S. Census Bureau show that only 43% of NPO startups survive at 5 years.¹³ The limitations on the type of revenue that can be generated can be daunting to the novice, community outreach oriented entrepreneur. One alternative, as previously mentioned, is simply to join an already existing NPO in the particular sector of interest. This can be done by volunteering and/or by soliciting to become a member of the board of directors. One can also create a for-profit organization, which focuses on community outreach, allocating shares of its profits, which is subject to a lot less regulatory red tape than NPOs.

A clever solution was found by Jane Chen with the creation of Embrace Innovations.¹⁴ Chen's original corporation, Embrace, is an NPO focused on providing low-cost infant warmers to disadvantaged communities. Chen and team quickly realized the difficulties in raising capital to fulfill their vision and thus created Embrace Innovations, a for-profit firm that could raise money from venture capitalists. Embrace Innovations licensed the warmer technology by paying royalties for every product sold. With this dual-arm structure, Chen is able to provide adequate funding to fulfill the vision of Embrace.

Conclusion

Carefully consideration must be taken prior to pursuing the goal of starting a successful and viable NPO. Given the relatively small number of surgical entrepreneurs currently in the nonprofit space, there is ample opportunity yet available for those armed with the appropriate information.

With this article, the authors hope to make this task clearer and more manageable.

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None.

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