Internal Revenue Service

Department of the Treasury

Washington, DC 20224

[redacted]

Person to Contact: [redacted]

Telephone Number: [redacted]

Refer Reply to: CP:E:EO:T[redacted]

Date: [redacted]

Employer Identification Number: [redacted]
Key District: [redacted]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) of the Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated on [redacted]. You incorporated under the name [redacted]. Effective [redacted], a [redacted] stock corporation, merged with you. As the surviving entity, you changed your name to [redacted]. Your Articles of Incorporation do not indicate your purpose. They do not limit your purposes and powers to those described in section 501(c)(3) and do not contain a provision for the distribution of your assets upon dissolution which satisfies the requirements of section 1.501(c)(3)-1(b)(4) of the regulations.

Your bylaws state that you have two classes of members, Primary Care Members and Specialty Members. Members of both classes shall be [redacted]. Each member shall have one vote. Each class of members shall be entitled to separately vote for and elect one-half of the total number of members of your Board of Directors. You are supported by member assessments and a loan from a local bank.

In your application for exemption, you indicate that you were established by physicians to serve as [redacted] owner of the [redacted], a local physician hospital organization which facilitates managed care. You represent that you own [redacted]% [redacted]. Through you, your members are able to participate in [redacted] and to influence the medical and business management of [redacted].

[redacted]

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such a manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(e)(1) of the regulations states that an organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) of the Code.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court stated that "the presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

[redacted]

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts, sections 368, 372; IV Scott on Trusts (3d Ed. 1967), section 368, 372; and Rev. Rul. 69-545, 1969-2 C.B. 117.

An organization that merely promotes health, without more, is not entitled to recognition of exemption under section 501(c)(3) of the Code. For example, while selling prescription pharmaceuticals promotes health, pharmacies cannot qualify for recognition of exemption under section 501(c)(3) on that basis alone. In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980), the Tax Court stated:

> Virtually everything we buy has an effect, directly or indirectly, on our health. We do not believe that the law requires that any organization whose purpose is to benefit health, however, remotely, is automatically entitled, without more, to the desired exemption. 72 T.C. at 692.

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), involved an organization that operated restaurants and health food stores with the intention of furthering the religious work of the Seventh-Day Adventist Church as a health ministry. However, the Seventh Circuit held that these activities were primarily carried on for the purpose of conducting a commercial business enterprise. Therefore, the organization did not qualify for recognition of exemption under section 501(c)(3) of the Code.

Revenue Ruling 86-98, 1986-2 C.B 74, describes an individual practice association (an "IPA") formed to provide health services through written agreements negotiated with health maintenance organizations ("HMOs").

The [redacted] primary activities are to serve as a bargaining agent for its physician members in dealing with HMOs, and to perform the administrative claims services required by the agreements negotiated with the HMOs.

The main functions of the [redacted] are to provide an available pool of physicians who will abide by its fee schedule when rendering medical services to the subscribers of an HMO, and to provide the [redacted] members with access to a large group of

[redacted]

patients, the HMO subscribers, who generally may not be referred to nonmember-physicians. The [redacted] negotiates contracts on behalf of its members with various HMOs, administers the claims received from its members, and pays them according to its reimbursement agreement.

Revenue Ruling 86-98 states that these facts indicate that the [redacted] is akin to a billing and collection service and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs. In addition, the [redacted] does not provide to HMO patients access to medical care which would not have been available but for the establishment of the [redacted]. Thus, the revenue ruling holds that the [redacted] operates in a manner similar to organizations carried on for profit, and its primary beneficiaries are its physician members rather than the community as a whole. Therefore, the [redacted] does not qualify for exemption from federal income tax as a social welfare organization under section 501(c)(4) of the Code.

Your Articles of Incorporation do not limit your purposes and powers to those described in section 501(c)(3) and do not contain a provision for the distribution of your assets upon dissolution which satisfies the requirements of section 1.501(c)(3)-1(b)(4) of the regulations. Therefore, you do not meet the organizational test described at section 1.501(c)(3)-1(b)(1) of the regulations.

The facts submitted indicate that you are not engaging in the practice of medicine or operating a hospital. You were formed primarily for the purpose of conducting a commercial business enterprise which allows your physician members to participate in [redacted] and to influence the medical and business management of [redacted]. Your members' participation in [redacted] does not increase the amount of medical care that is available in the community. It merely allows your members to participate in certain managed care contracts. Thus, the primary beneficiaries of your activities are your physician members rather than the community.

Under the facts submitted, your physician members are "private individuals" and are subject to the private benefit proscription. Your physician members receive prohibited private benefit which may include an advantage, profit, fruit, privilege, gain or interest. See Retired Teachers Legal Defense Fund v. Commissioner, supra. The substantial private benefit to your physician members is fatal to your exempt status. See Better Business Bureau of Washington, D.C., Inc. v. United States, supra.

[redacted]

Physician members who serve on your governing board are "insiders" subject to the inurement proscription. Therefore, the same activities that constitute private benefit to your physician members result in prohibited inurement to those physician members who serve on your governing board.

Based on all the facts and circumstances, we conclude that you do not perform a charitable activity, you more than insubstantially benefit the private interests of your physician members and physician members serving on your governing board receive prohibited inurement.

You are neither organized nor operated exclusively for charitable purposes under sections 1.501(c)(3)-1(b) and 1.501(c)(3)-1(c)(1) of the regulations. You do not qualify for recognition of exemption from federal income tax under section 501(c)(3) of the Code and must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

[redacted]

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[redacted]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

For your convenience, our FAX number is [redacted]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[redacted]

[redacted]
Chief, Exempt Organizations
Technical Branch 1