yellow

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact: [redacted]
Telephone Number: [redacted]
Refer Reply to: [redacted]
Date: [redacted]

EIN: [redacted]
Key District: [redacted]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code. We have concluded that you do not qualify for recognition of exemption as an organization described in that Code section. Our reasons for this conclusion and the facts upon which it is based are explained below.

You initially organized as a for profit corporation under the laws of the State of [redacted] on [redacted] You operated as a for profit corporation for the tax years ending [redacted] through [redacted]. Your activities as a for-profit corporation consisted of holding a partnership interest in three partnerships: [redacted], [redacted], and [redacted]. The [redacted] operates an outpatient hemodialysis facility, [redacted] provides various medical services to patients, and [redacted] constructs medical buildings. You now believe that the business reasons for operating as a for-profit corporation are no longer valid, so you amended your Articles of Incorporation and reorganized as a non-profit corporation on [redacted]. There was no sale or transfer of assets when you made this conversion.

You are organized for charitable and educational purposes, and specifically, operating for the benefit of, performing the functions of, or carrying out the purpose of [redacted] ("[redacted]"), which is a tax exempt parent corporation of a multi-entity healthcare system exempt under section 501(c)(3) of the Code. Your Articles of Incorporation state your activities that will further the purposes of [redacted], include:

- developing, participating in, carrying on, supporting or taking such other actions in connection with the activities or programs designed and carried on to promote care of the sick,

[redacted]

disabled or elderly, or to promote the general health of the community; and

· provide and/or participate in the delivery of healthcare and healthcare related products and services of every kind of nature.

Organizational Structure

You are part of a multi-entity health care system. Your Articles of Incorporation provide that your sole member is [redacted], an [redacted] Corporation ([redacted]). [redacted] does not directly provide healthcare services. [redacted] is a wholly owned for-profit subsidiary of [redacted] ([redacted]), a section 501(c)(3) entity. You have no employees. [redacted] also provides healthcare services, none of which are related to hemodialysis or end stage renal disease.

Services sole member is [redacted], a section 501(c)(3) parent entity of a multi-institutional system. [redacted] has overall control and responsibility for managing the system and insuring that it continues to meet the healthcare needs of the community. [redacted] does not directly provide healthcare services. All such services are provided by [redacted]'s affiliate and subsidiary corporations. [redacted]'s organizational model emphasizes the placement of diverse lines of healthcare services in separate corporations for more effective management. In the event other healthcare services are provided to the community in the future, the services will be provided through joint venture agreements. To provide such services, [redacted] would either utilize you, form another subsidiary, or utilize one of its other subsidiary corporations to operate a new joint venture.

Your officers are comprised of three members of the executive staff of [redacted]. All of your officers are also officers of [redacted]. One of your directors serves as your official representative at all partnership meetings.

[redacted] responsibility with respect to your operations include:

· elect and remove your board of trustees;

· require submissions by you on a periodic basis of financial or operating reports to Ventures as deemed appropriate;

[redacted]

- require submissions for approval before becoming effective of expenditures, plans, budgets, or activities as Ventures deems appropriate;

- approve all amendments to your Articles of Incorporation and Code of Regulations;

- ensure that you are acting in a manner consistent with, for the benefit of and to carry out the purposes and mission of WRHC and Services; and

- develop your policies and guidelines for mutual and consistent guidance and operation.

Your current activities include holding partnership interests in three partnerships: the [redacted], and the [redacted]. These activities will be described below. At the time these partnerships were formed, it was decided you would hold these partnership interests in order to minimize liability exposure to assets of the health care system of [redacted] as well as to allow for the management of the partnership interests on a stand-alone basis for operational, financial and risk management purposes. None of [redacted]s officers or directors are employed by the partnerships or by the for-profit partners. During the establishment of each partnership, all parties acted in an arm's length manner and independently of each other, with appropriate legal representations as necessary in order to ensure that each partners' interests were adequately represented and protected.

You have adopted a conflicts of interest policy. The conflicts of interest policy is a system wide policy that all subsidiaries of [redacted] are required to adopt and follow.

[redacted]

This partnership was formed to provide and operate an outpatient hemodialysis facility. The [redacted] serves Medicare/Medicaid recipients as well as private pay individuals. Ninety percent of the [redacted]'s business is attributable to Medicare/Medicaid recipients. The [redacted] is located [redacted] and [redacted] miles from [redacted]s two main hospital campuses. You do not directly employ or contract for staff at the [redacted] since your only activity is to hold the three general partnership interests.

The [redacted]'s ownership consist of a [redacted]% interest by [redacted] ([redacted]), [redacted]% interest by [redacted], [redacted], and a [redacted]% interest by you. You contributed $[redacted] to the

[redacted]

partnership. [redacted] has three physician shareholders and [redacted] has one physician shareholder. All physician shareholders have medical staff privileges at [redacted], a hospital affiliated with you. One of the physician shareholders of [redacted] has a contract to be the medical director of nephrology services at [redacted] since [redacted] maintains an inpatient hemodialysis service which requires clinical oversight. [redacted] and [redacted] have no other business relationships with [redacted].

[redacted] is the managing partner of the [redacted] pursuant to the terms of the partnership agreement and is responsible for the day to day operations. [redacted] as managing partner has all rights and powers required to operate the [redacted], which include:

1. The right to enter into all contracts, agreements and other undertakings binding the Partnership;

2. To engage engineers, consultants, accountants, attorneys, and all other agents, and to compensate them for services rendered as the Managing Partner deems reasonably necessary or desirable in furtherance of the purposes of the partnership;

3. To collect all sums due the partnership;

4. Open, maintain, and close bank accounts and draw checks and other orders for the payment of moneys;

5. To pay all debts of the partnership;

6. To take any an all other action which the Managing Partner deems to be reasonably necessary or desirable in furtherance of the purposes of the Partnership.

Major partnership decisions

The partnership agreement states that major partnership decisions need to be approved by all partners in writing. Such major decisions include:

1. Sale, lease or other transfer of partnership assets;

2. The borrowing of any sums of money in excess of $[redacted];

3. Initially establish or move the principal place of business of the Partnership;

4. Mortgage, pledge, or granting of a security interest in any partnership property;

[redacted]

5. Increase or decrease the number of licensed stations operated by the partnership;

6. The establishment and/or implementation of the annual or capital budget of the partnership;

7. The establishment of policies and procedures general to the operation of the partnership as a whole;

8. Borrowing any sums of money in excess of $[redacted] which are not in accordance with the partnership budget;

9. Making any capital expenditure or incurring obligations in excess of $[redacted] which are not in accordance with the budget of the partnership;

10. The fixing of compensation or other terms of employment of the managing partner or an affiliate of the managing partner relating to the management services or the rights and duties of the managing partner;

11. Entering into any contract with the managing partner or an affiliate of the managing partner relating to the management services or the rights and duties of the managing partner;

12. Establishment of policies and procedures general to the operation of the partnership as a whole;

13. Doing any act which would make it impossible to carry on the ordinary business of the partnership.

Thus, concerning these major partnership issues, you have veto power. If the partners do not unanimously agree on any of the major decisions, the proposed action could not be taken. If the partners are unable to agree on a needed action, legal remedies could be pursued.

[redacted] provides its own management employees. The following administrative and management services have been delegated to PVC:

1. Overall management, administration and technical development of the [redacted] and business;

2. Represent the partnership in the development, negotiation and implementation of operational agreements and contracts;

[redacted]

3. Development of an overall organizational plan, including the development and implementation of an accounting and reporting system and operating and capital budgets;

4. Provide periodic reports and information to the partnership regarding facility operations;

5. Represent the partnership in all matters pertaining to the day to day operations and management of the Kidney Center;

6. Insure the employment of appropriately qualified personnel;

7. Maintain and implement written personnel policies and procedures;

8. Develop management team; and

9. Interview, hire and terminate staff.

Under the partnership agreement, [redacted] will be paid $[redacted] for managing partner services and $[redacted] for administrative and management services. Commencing on [redacted] is compensated $[redacted] for nursing administrative services, payable in equal monthly installments.

Patients are referred to the [redacted] by local nephrologists, including those in the partnership, for hemodialysis treatment. Almost all patients that receive hemodialysis treatment are enrolled in a federal end stage renal dialysis program. Such treatment requires ongoing supervision by nephrologists. You entered into this relationship with [redacted] because of PVC's expertise in the area of end stage renal disease and ability to have a positive effect on the health of the community, since [redacted] would be involved not only in the ownership and management of the [redacted], but also in the direct provision of patient care. [redacted] believes that the provision of outpatient hemodialysis services can be provided to the community in a more cost-effective, higher quality and more accessible manner through a partnership/joint venture relationship with the nephrologists of [redacted].

You state that you are committed to ensuring that the partnership provides healthcare services to the community in a cost-effective, high quality and accessible manner. These objectives are met by the your regular attendance at partnership meetings, the receipt of periodic updates from the managing partner and your involvement in all major decisions affecting the

[redacted]

partnership. [redacted] executive members attend the partnership meetings, as your representatives, to add their experience, expertise and system perspective to the discussion of any important issue or matter facing the partnership. In this manner, you and WRHC ensure that the partnership does not lose focus of its primary mission, which is to provide a needed healthcare service to the community.

You do not directly employ or contract for staff since your only activity is to hold partnership interests. The [redacted] hires and manages its own staff to operate the facility. Distributions from the [redacted] represent [redacted]% of the applicant's total income.

[redacted]

This partnership was formed primarily to train people in the field of continuous ambulatory peritoneal dialysis (CAPD), promoting CAPD to the public, providing medical management of patients, and coordinating and providing medical supplies (durable medical equipment, prosthetics, and orthotics) to patients.

You are a one-third partner, and [redacted], a for-profit entity, is a two-thirds partner in the partnership. Partnership interests are based on capital contributions and all income and losses are allocated in proportion to those interests. [redacted] has no other business relationship with [redacted] or any affiliated organizations of [redacted].

Pursuant to Article 12 of the partnership agreement, [redacted] has been designated the managing partner and has complete authority over and exclusive control and management of the business and affairs of the partnership. Article 12.3 of the partnership agreement specifies certain matters that need unanimous consent of all partners such as: the power to sell property; funds of the partnership to be loaned; to borrow funds on behalf of the partnership; and establish a budget on behalf of the partnership. You have a veto power to prevent the partnership from conducting any proposed action listed in section 12.3 that does not further your exempt purposes. If the partners are unable to agree on any action, legal remedies may be pursued through the courts under general [redacted] partnership law.

You entered into this partnership because you viewed the establishment of this program as a means to expand healthcare services to the community without the necessity of a significant capital outlay that would be necessary to acquire the necessary expertise to make this a viable operation. By participating in

[redacted]

this venture, you believe that are able to pool diverse areas of expertise resulting in a program that provides a significant benefit to the community consistent with section 501(c)(3) status.

You do not directly employ or contract for staff of the [redacted] since your only current activity is to hold the three general partnership interests. The [redacted] plans on hiring and managing its own staff, and [redacted] as managing partner provides general administrative oversight through its own management employee.

The patients serviced by this partnership either have no working kidneys or have a kidney disease which impairs normal kidney function. Rather than receiving dialysis services at a free standing hemodialysis center, these patients have chosen to receive their treatment at home. The partnership is a home dialysis supply company that provides the equipment and supplies necessary for patients to receive home dialysis. Once the patient, in conjunction with his or her physician, elects to be dialyzed at home, he or she must then select, pursuant to federal regulations, a Medicare approved supply company to provide those items necessary to perform home dialysis. There are no physician investors in the [redacted] partnership.

Almost all patients that receive hemodialysis treatment are enrolled in the federal end stage renal dialysis program. The fees for hemodialysis treatment are therefore set by the federal government. The [redacted] does not have the ability to set or control the price of the services and goods that it provides.

You regularly attend partnership meetings to ensure that the partnership provides healthcare services to the community in a cost-effective, high quality and accessible manner. [redacted] executives attend the partnership meetings and add their experience, expertise and system perspective to the discussion of any important issue or matter facing the partnership. [redacted] and you attempt to ensure that the partnership does not lose focus of its primary mission, which is to provide a needed healthcare service to the community.

[redacted]

This partnership was formed as a means to construct medical office buildings without the significant capital outlay that would be necessary if you undertook this venture by yourself.

You are one of five partners in this partnership. The remaining four partners are physicians. The physician investors

[redacted]

have no employment relationship with any entity related to [redacted], except for one of the physicians who is a medical director with [redacted].

PBG owns the building in which the [redacted] is housed and operated. The four physician investors and you are also the same partners that comprise the [redacted] partnership. One of the physician investors in the partnership has been designated as the managing partner. There is very little management activity in this partnership since it is was formed for owning the [redacted] building.

The partnership agreement provides that the managing partner is authorized to manage the partnership. However, you indicate that all major decisions are thoroughly reviewed and discussed by all partners and any actions are taken in what is believed to be the best interests of the partners, including your healthcare mission. If the partners cannot agree on any action, legal remedies may be pursued. Your rights are protected through your attendance at partnership meetings, receipt of periodic updates from the managing partner and right to be involved in all major decisions affecting the partnership.

The physician investors have medical staff privileges at all other area hospitals and privileges to refer and treat patients at the other three hemodialysis centers in the area. There are no contractual or investor restrictions that prevent the physician investors from admitting patients to any hospital or hemodialysis facility of their choice.

Section 501(c)(3) of the Code describes as exempt from federal income tax, as provided under section 501(a), organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that to be exempt under section 501(c)(3) of the Code an organization must be organized and operated exclusively for the purposes specified therein. The purposes specified in section 501(c)(3) include charitable purposes.

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 exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

[redacted]

Section 1.501(c)(3)-1(d)(1) of the regulations provides that an organization is not organized or operated exclusively for an exempt purpose unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of designated individuals.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in 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 (1959); 4A Scott and Fratcher, The Law of Trusts, sections 368, 372 (4th ed. 1989). It also includes advancement of education and lessening of the burdens of government.

Rev. Rul. 69-545, 1969-2 C.B. 117, sets forth standards under which a nonprofit hospital may qualify for recognition of exemption under section 501(c)(3) of the Code. This revenue ruling gave consideration to two separate hospitals, only one of which was determined to qualify for exempt status under section 501(c)(3). By weighing all the relevant facts and circumstances, the revenue ruling analyzed whether both the control and use of the hospitals were for the benefit of the public or for the benefit of private interests. The hospital that qualified for exemption was found to be organized and operated to further the charitable purpose of promoting health by satisfying a community benefit standard that included, among other factors, a board of directors that broadly represented the interests of the community. The hospital that did not qualify for recognition of exemption was found to be operating for the private benefit of those who controlled it rather than for the benefit of the public.

Rev. Rul. 69-463, 1969-2 C.B. 131, provides that the leasing by an exempt hospital of its adjacent office building, and the furnishing of certain office services to a hospital based medical group is not an unrelated trade or business under section 513 of the Code.

Rev. Rul. 98-15, 1998-12 I.R.B. 6, compares two situations where an exempt hospital forms a joint venture with a for-profit entity and then contributes its hospital and all of its other operating assets to the joint venture, which then operates the hospital.

In the first situation, the revenue ruling concludes that the exempt organization will continue to further charitable purposes when it participates in the joint venture. Favorable factors include the commitment of the joint venture to give

[redacted]

charitable purposes priority over maximizing profits; the community make-up and structure of the board; the voting control held by the exempt organization's representatives on the board; the specifically enumerated powers of the board; and, that the terms and conditions of the management contract are reasonable.

In the second situation, the revenue ruling concludes that the organization will fail the operational test when it participates in the joint venture, because activities of the joint venture will result in greater than incidental private benefit to the for-profit partner. Factors leading to this conclusion include: shared voting control with the for-profit partner; no binding obligation to serve the community; the joint venture's operation as a business enterprise will not necessarily give priority to the health needs of the community over maximizing profits; the chief executives of the joint venture have a prior relationship to the for-profit partner and the management company, a subsidiary of the for-profit partner; and, the management company is given broad discretion over activities and assets and may unilaterally renew the contract.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme 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."

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), a nonprofit hospital with an independent board of directors executed a contract with a medical partnership composed of seven physicians. The contract gave the physicians a virtual monopoly over the care of the hospital's patients and the stream of income they represented while also guaranteeing the physicians thousands of dollars in payments for various supervisory activities. The court held that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3d Cir. 1993) ("Geisinger II"), rev'g 62 T.C.M. 1656 (1991) ("Geisinger I"), the Circuit Court held that a health maintenance organization that provided no significant benefits to anyone other than its paying subscribers failed to demonstrate that it primarily benefitted the community and did not qualify for tax exempt status under section 501(c)(3) of the Code. The court determined that a charitable health care organization must meet a flexible community benefit test, based upon the totality of the circumstances, to show it is operated in furtherance of a charitable purpose.

[redacted]

In Broadway Theatre League of Lynchburg, Virginia, Inc. v. United States, 293 F.Supp. 346 (W.D.Va. 1968), the court held that an organization that promoted an interest in theatrical arts did not jeopardize its exempt status when it hired a booking organization to arrange for a series of theatrical performances, promote the series and sell season tickets to the series because the contract was for a reasonable term and the organization retained ultimate authority over the activities being managed.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F.2d 170 (9th Cir. 1981), the Tax Court found that for-profit est organizations were able to use est of Hawaii, a nonprofit entity, as an instrument to further their for-profit purposes even though the for-profits lacked structural control over the nonprofit, due to the significant indirect control exerted by the for-profits.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980), the Tax Court held that while selling prescription pharmaceuticals promotes health, pharmacies cannot qualify for recognition of exemption under section 501(c)(3) of the Code on that basis alone.

In Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980), aff'd 675 F.2d 244 (9th Cir. 1982), the Tax Court held that a charitable organization's participation as a general partner in a limited partnership did not jeopardize its exempt status. The organization co-produced a play as one of its charitable activities. Prior to the opening of the play, the organization encountered financial difficulties in raising its share of the costs. In order to meet its funding obligations, the organization formed a limited partnership in which it served as a general partner and two individuals and a for-profit corporation were the limited partners. Significant factors in the Tax Court's finding included that the limited partners played a passive role as investors only, that the organization remained in control of all aspects of the play, that none of the limited partners were directors or officers of the organization, and that the investors' interests in the particular play were not intrusive or indicative of serving private interests.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court concluded that an organization that trained campaign workers for the benefit of the Republican Party was not exempt under section 501(c)(3) of the Code due to the greater than incidental private benefit to the Party. The court noted that section 501(c)(3) organizations may benefit private

[redacted]

interests only incidentally. Conferring more than incidental benefits on private interests is a nonexempt purpose.

In United Cancer Council, Inc. v. Commissioner, 109 T.C. 326 (1997), appeal docketed, No. ____, (7th Cir. Apr. 30, 1998), the Tax Court determined that a for-profit professional fundraiser hired by UCC to conduct its direct mail fundraising campaign received excessive compensation. The Court concluded that the contractual arrangement caused the for-profit fundraiser to be an insider for purposes of the inurement provision of IRC 501(c)(3) because it allowed the fundraiser to exercise (a) substantial control over UCC's finances and (b) effectively exclusive control over UCC's fundraising activities. The Court held that there was inurement of UCC's net earnings to the fundraiser, thus disqualifying UCC from exempt status.

In Housing Pioneers v. Commissioner, 65 T.C.M. (CCH) 2191 (1993), aff'd, 49 F.3d 1395 (9th Cir. 1995), amended 58 F.3d 401 (9th Cir. 1995), the Tax Court concluded that the organization did not qualify as an organization described in section 501(c)(3) of the Code because its activities performed as co-general partner in limited partnerships substantially furthered nonexempt purposes and private interests were served by its activities. The organization entered into partnerships as a one percent co-general partner of existing limited partnerships for the purpose of splitting the tax benefits with the for-profit partners. Under the management agreement, the organization's authority as co-general partner was narrowly circumscribed. It had no management responsibilities and could describe only a vague charitable function of surveying tenant needs.

Section 502 of the Code states that an organization operated for the primary purpose of carrying on a trade or business for profit is not tax exempt on the ground that all of its profits are payable to one or more tax-exempt organizations.

Section 1.502-1(b) of the regulations provides that a subsidiary organization of a tax exempt organization may be exempt on the ground that the activities of the subsidiary are an integral part of the exempt activities of the parent organization. However, the subsidiary is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business if regularly carried on by the parent organization.

Section 512(c)(1) of the Code provides that if a trade or business regularly carried on by a partnership of which an organization is a member, is an unrelated trade or business with respect to such organization, this organization, in computing its

[redacted]

unrelated business taxable income, must include its share (whether or not distributed) of the gross income of the partnership from such unrelated trade or business and its share of the partnership deductions directly connected with such gross income. See also, section 1.512(c)-1 of the regulations.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the purpose or function constituting the basis for its exemption.

Section 1.513-1(a) of the regulations defines unrelated business taxable income to mean gross income derived by an organization from any unrelated trade or business regularly carried on by it, less directly connected deductions and subject to certain modifications. Therefore, gross income of an exempt organization subject to the tax imposed by section 511 of the Code is includible in the computation of unrelated business taxable income if: (1) it is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations states that the phrase "trade or business" includes activities carried on for the production of income which possess the characteristics of a trade or business within the meaning of section 162 of the Code. Section 1.513-1(c) of the regulations explains that regularly carried on has reference to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued.

Section 1.513-1(d)(1) of the regulations states that the presence of the substantially related requirement necessitates an examination of the relationship between the business activities which generate the particular income in question -- the activities, that is, of producing or distributing the goods or performing the services involved -- and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations states that a trade or business is related to exempt purposes only where the conduct of the business activity has a causal relationship to the achievement of an exempt purpose, and is substantially related for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business

[redacted]

from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Rev. Rul. 78-41, 1978-1 C.B. 148, concludes that a trust created by a hospital to accumulate and hold funds to pay malpractice claims against the hospital qualified for exemption under section 501(c)(3) of the Code as an integral part of the hospital. The hospital provided the funds for the trust, and the banker-trustee was required to make payments to claimants at the direction of the hospital. The organization conducted an activity that the hospital could perform itself.

Geisinger Health Plan v. Commissioner, 100 T.C. 394 (1993), ("Geisinger III"), aff'd, 30 F.3d 494 (3rd Cir. 1994) ("Geisinger IV"), held that a prepaid healthcare plan did not qualify for exemption under section 501(c)(3) of the Code based on the integral part doctrine of section 1.502-1(b) of the regulations.

Whether partnerships further section 501(c)(3) purposes

To be described in section 501(c)(3) of the Code, an organization must be organized and operated exclusively for exempt purposes. An organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities which accomplish those exempt purposes. An organization does not operate exclusively for exempt purposes if more than an insubstantial part of its activities does not further exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. Also, see, Better Business Bureau v. United States, supra.

For federal income tax purposes, the activities of a partnership are generally considered to be the activities of the partners. See, e.g., Butler v. Commissioner, 36 T.C. 1097 (1961), acq., 1962-2 C.B. 4. This is also consistent with the treatment of partnerships for purposes of the unrelated business income tax under section 512(c) of the Code.

An organization may participate in a partnership and meet the operational test if participation in the partnership furthers a charitable purpose and the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners. See Plumstead Theater Society, Inc. v. Commissioner, supra, and Housing Pioneers v. Commissioner, supra. When participating in a partnership is the only activity of a

[redacted]

nonprofit organization, the partnership agreement effectively controls the operations of the nonprofit organization. Therefore, if the partnership is primarily engaged in activities that further a charitable purpose, the nonprofit organization operates for charitable purposes. If more than an insubstantial amount of the partnership's activities do not further a charitable purpose, the nonprofit organization fails the operational test under section 1.501(c)(3)-1(c)(1) of the regulations.

The submitted information establishes that you seek exemption based upon your holding interests in three general partnerships. In each partnership, you hold a minority interest. The majority partners in each partnership are for-profit entities and physicians. We conclude that your participation in the three partnerships does not further a charitable purpose because the partnership arrangements allow for greater than incidental benefits to the for-profit partners.

An organization may enter into a management contract with a private partner giving that party authority to conduct activities on behalf of the organization and direct the use of the organization's assets provided that the contract is for a reasonable term and the organization retains ultimate authority over the activities being managed. See Broadway Theatre League of Lynchburg c. U.S., supra.

However, an exempt charity has the responsibility to use its income and assets primarily to further its charitable purposes. If a nonprofit organization allows a private party to control substantially all of the organization's activities or assets; e.g., if a private party has contracts, licenses, voting rights or other powers that enable it to control the flow of income or the disposition of assets owned by the charitable organization, it will violate the private benefit test of section 1.501(c)(3)-1(c)(1) of the regulations. In other words, a for-profit entity's ability to exert significant control over the operations of a nonprofit organization for the benefit of the for-profit entity will disqualify the nonprofit organization from exempt status, even if the for-profit's control is achieved indirectly through contractual arrangements and payments to the for-profit are reasonable. See, Harding Hospital, Inc. v. U.S., supra; est of Hawaii v. Commissioner, supra; and, United Cancer Council, Inc. v. Commissioner, supra.

Each of the three partnerships you hold an interest in needs to be evaluated to determine whether charitable purposes are being furthered or private interests control the partnership

[redacted]

assets and activities, enabling the profits of the partnership to be maximized.

[redacted]

An outpatient hemodialysis facility provides benefit to the community. The fact that the facility benefits your community needs to be balanced against whether private interests of the partners are being substantially served to determine whether the operation of this facility furthers your exempt purposes.

In determining whether private interests are being served, issues such as control and decision making over the partnership operations need to be analyzed. From the information submitted, you do not have any significant control over the charitable operations of the [redacted], due to your minority interest ([redacted]%) in the partnership.

You also lack control over the day to day operations of the [redacted], since the partnership agreed to appoint [redacted] as managing partner. The managing general partner has the right in part, without your approval:

- to hire personnel,
- develop and revise written policies and procedures,
- implement Medicare guidelines including compliance and reimbursement, and
- be responsible for overall management, administration and technical development of the [redacted] facility and business.

Since all day to day decisions, including the right to hire employees, are made by the managing partner of the [redacted], the control exercised by the managing partner over the partnership makes it unlikely that a charitable program would take precedence over the business concerns of the managing partner. This control by the managing partners will influence the staff and executives of the [redacted] to be more responsive to the profit agenda of the managing partner. Thus, through the control exercised by the managing partner of the [redacted], private interests are benefitted more than incidentally. See American Campaign Academy v. Commissioner, supra.

Even though you retain a veto power over ultimate decisions, it does not mean that you can force the managing partner to take certain actions to advance a charitable purpose, nor does it grant you any ability to definitively affect policy or direction; e.g., allowance for charity care, willingness to contract with Medicare and Medicaid programs, and willingness to provide

[redacted] to be more responsive to the profit agenda of the managing partners. Thus, through the control exercised by the managing partner of the [redacted], private interests are benefitted more than incidentally. See American Campaign Academy v. Commissioner, supra.

Even though you retain a veto power over ultimate decisions, it does not mean that you can force the managing partner to take certain actions to advance a charitable purpose, nor does it grant you any ability to definitively affect policy or direction; e.g., allowance for charity care, willingness to contract with Medicare and Medicaid programs, and willingness to provide services that meet a community need but that would not necessarily maximize profits or produce enough profits to make them commercially viable. Furthermore, you do not have the majority interest in voting or equal voting rights in this partnership.

[redacted]

The initial inquiry in determining whether this partnership will further exempt purposes is whether the activity of constructing office medical buildings is a charitable activity.

The leasing of medical space to a hospital medical group that is owned by an exempt hospital is an activity that further the hospital's exempt purposes. See Rev. Rul. 69-463, 1969-2 C.B.131, infra.

You are not similar to the organization described in Rev. Rul. 69-463 because you have only a minority interest in a partnership that primarily benefits private interests. Due to your lack of majority control, the for profit partners can outvote you in how to operate the partnership. The for-profit managing partner is responsible for all ministerial functions such as accounting records, tax returns and payment of operating expenses. Additionally, the managing partner of [redacted] shall have authority to enter into agreements for the partnership regarding partnership investments. There is no provision in this partnership agreement which provides that you will have a significant involvement in this partnership.

Thus, the [redacted] partnership is not providing a substantial benefit to the community but is providing a substantial benefit to the physician investors.

[redacted]

Partnerships do not further exempt purposes

The situation in each of the three partnerships is comparable to the indirect control exhibited in est of Hawaii v. Commissioner, supra. In the court case, the indirect control exerted by the for-profit entities was found to generate impermissible private benefit. Here, the direct and indirect control maintained from the managing partners position, where the nonprofit entities have only a veto power over major decisions, and from the managing partners position as the manager of the business operations with control over personnel and other daily business decisions, results in impermissible private benefit to all of the managing partners.

The present situations are distinguishable from the joint venture described in Plumstead Theatre Society v. Commissioner because in Plumstead, the joint venture was limited in scope and the charity maintained full management control over the activities of the partnership. In your case, the for-profit interests have more than simple managerial control, as in Broadway Theatre League of Lynchburg v. U.S.. The for-profit interests have day-to-day authority. Instead, you are like the organization in Housing Pioneers v. Commissioner, which did not control the activity of the partnerships. This conclusion is based on actual control as evidenced by the partnership agreements.

Accordingly, you are operated for the private benefit of others and this is a substantial non-exempt activity. Therefore, you do not qualify for recognition of exemption under section 501(c)(3) of the Code.

Whether community benefit is served

You also are not entitled to exemption because your activities do not promote health in a charitable manner. As the Tax Court stated, "[w]hile the diagnosis and cure of disease are indeed purposes that may furnish the foundation for characterizing the activity as 'charitable,' something more is required." Sonora Community Hospital v. Commissioner, 46. T.C. 519, 525-526 (1966), aff'd 397 F.2d 814 (9th Cir. 1968). See also Sound Health Association v. Commissioner, 71 T.C. 158 (1978), acq. 1981-2 C.B.2; Geisinger II, supra. Even though the partnerships you hold interests in provide some community health care benefits, the absence of your control over the partnership operations is evidence that the partnerships are not furthering exempt purposes but serving private interests.

[redacted]

Health care organizations must meet a community benefit standard to qualify for exemption. Rev. Rul 69-545, supra; Geisinger II, supra. All the facts must be examined to determine whether a health care organization primarily benefits the community. What distinguishes charitable health care providers from their investor-owned counterparts is the willingness of charities to subjugate concern for the bottom line to concern for mission. In the case at hand, the structure of the partnerships cannot primarily represent the interests of the community. There is an inherent conflict between your interests to further charitable goals and those of the for profit partners' representatives, who have a fiduciary duty to serve the pecuniary interests of the for-profit interests. Because you are virtually a shell, with no employees or activities of your own, you have limited resources to exercise any role in the operation of any of the partnerships. Although you participate in some management decisions in the partnerships, your oversight capabilities are very limited.

The lack of an exempt purpose in any of the partnerships' operations is apparent from the facts disclosed in your application. The [redacted] and [redacted] are not qualified home health agencies, as the organization was in Rev. Rul. 72-209, supra. The [redacted] and [redacted] do not have a charity care policy. The [redacted] activities primarily include dispensing equipment and supplies to patients. The [redacted] and [redacted] are not providing low cost home health care as described in Rev. Rul. 72-209. [redacted] is not operating similarly to the organization described in Rev. Rul 69-463, supra. Thus, because all partnerships fail to further an exempt purpose and your participation in the three partnerships is your only activity, you are not promoting the health of the community in a charitable manner as required for exemption under section 501(c)(3) of the Code.

Whether integral part test is satisfied

In addition, you do not qualify for exemption as an integral part of WRHC. Section 1.502-1(b) of the regulations, in discussing the integral part test for exemption, provides that an organization may derive exemption from a controlling exempt organization if the subordinate organization is not engaged in an activity that would be an unrelated trade or business if the activity were performed by the controlling organization.

Thus, for the integral part test to apply, two requirements must be satisfied: (1) the exempt organization must exercise sufficient control and close supervision, based on all the facts and circumstances, to establish the equivalent of a parent and

[redacted]

subsidiary relationship, and (2) the subordinate entity must perform essential services for the exempt parent.

You are a membership corporation. Although the members of your Board of Directors and the members of [redacted]'s Board of Directors are currently identical, your Articles of Incorporation provide that a for-profit organization, [redacted], is your sole member and appoints your directors. Your Bylaws similarly provide that [redacted] will appoint your directors. Because your Bylaws provide that your Board shall be appointed by [redacted], you will not be controlled by an exempt organization. Therefore, you do not have the necessary organizational structure to satisfy the control portion of the integral part doctrine.

Even if you satisfied the control test, you do not satisfy the essential service component of the integral part test. Under section 1.502-1(b) of the regulations, a subordinate organization provides essential services for its controlling organization if the subordinate's activities would not be an unrelated trade or business if they were performed by the controlling organization. Thus, an organization that is operated for the sole purpose of furnishing electric power to its exempt parent would qualify for exemption as an integral part of its parent. However, if the subsidiary furnished electric power to consumers other than its exempt parent and the parent's exempt subsidiaries, it would not be exempt. Whether the activities of a subordinate organization would be an unrelated trade or business if the parent performed the activities is based on all the facts and circumstances.

Thus, in the present case, you are providing services to a non-exempt parent ([redacted]), and if [redacted] were the partner in any of the three partnerships, it would be receiving taxable income, since it is not exempt. If [redacted] were tax exempt, it would not satisfy the essential service component of the integral part test, since the partnerships do not further exempt purposes, and thus would be generating unrelated business income.

Therefore, since you are being controlled by a for-profit corporation, the income would be taxable and thus the integral part test would not be satisfied.

In Geisinger III, supra, the Tax Court held that a prepaid health plan created by an exempt hospital system was not an integral part of the system because a substantial portion of the enrollees of the plan, approximately 20 percent, were not patients of the exempt hospitals in the hospital system. The Tax Court reasoned that providing services to such a significant number of nonsystem patients precluded a finding that the plan's activities were devoted to furthering the exempt purposes of the

[redacted]

hospitals in the system. Geisinger III is similar to the present situation because the activities of the partnerships, which are controlled by non-exempt entities, do not further the exempt purpose of [redacted].

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Code.

You are, therefore, required to 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 principal 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 a 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 principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice requirements.

You should send your protest to our office at the following address: [redacted]

To help expedite our handling of this matter, you may fax your response at the following telephone number: ([redacted]. Please also send the original of your response by mail.

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status or the filing of returns should be addressed to that office. Also, the appropriate state officials will be notified of this action in accordance with section 6104(c) of the Code.

If you do not protest this proposed 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

[redacted]

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.

We have sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

[redacted]

Chief, Exempt Organizations

[redacted]