Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Contact Person: [redacted]

Telephone Number: [redacted]

[redacted]

In Reference to: OP:E:EO:T:1

Date: JUN 30 1998

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 under that Code section. Our reasons for this conclusion and the facts upon which it is based are explained below.

You were incorporated on [redacted]. Your stated purposes are to be organized and operated exclusively for charitable purposes, and specifically, to provide comprehensive home health care services to [redacted] patients regardless of their ability to pay, with a target population encompassing the sick, frail, disabled elderly and homebound residents of the County. Your Articles of Incorporation are silent as to shareholders or members.

You stated that you are controlled by [redacted] ("Health Corporation"), a section 501(c)(3) organization. You also indicated that although you have no members, Health Corporation is your shareholder. Health Corporation is organized to perform comprehensive home health care services which include home infusion therapy. You further reported that, currently, every member of your Board of Directors serves as a member of the Health Corporation's Board.

Your Bylaws provide that two directors shall be designated by Health Corporation and one director shall be designated by each affiliated participating health care agency, at the discretion of the Board. All other directors are elected from the community at large by a vote of the board at its annual meeting. The Bylaws further provide that you shall have no

[redacted]

members and that all decisions requiring a vote shall be approved by your Board of Directors, to number between eight and fifteen.

The Bylaws do not contain a definition of "affiliated participating health care agency." However, you indicated that you currently have three affiliated participating agencies, and each has a representative on your Board. The current affiliated participating agencies are IRC 501(c)(3) hospitals in the local area. You have no employees.

Your sole activity is participating in a general partnership formed [redacted], under the name of [redacted] - [redacted] ("GP"). The three other partners include two other nonprofit visiting nurse associations and [redacted] ("AIS"), a for profit corporation. You indicated that all income or loss distributed by the partnership to you will be distributed to Health Corporation, although nothing in your Articles or Bylaws so directs.

One of the nonprofit visiting nurse association partners, [redacted] ("VNS"), has been recognized as exempt from tax under section 501(c)(3) of the Code. The other nonprofit visiting nurse association partner applied for exempt status in conjunction with your application for recognition of exemption. It has not been recognized as exempt from tax under section 501(c)(3). AIS was founded by three pharmacists in [redacted] and is in the business of providing infusion and enteral therapy services, equipment, and supplies to skilled nursing facilities and home health care agencies and their respective patients.

You contributed $[redacted] in cash for a [redacted] percent general partnership interest, as did each of VNS and the other nonprofit, nonexempt visiting nurse association. In the aggregate, you and VNS have contributed $[redacted] for a [redacted] percent equity interest in the GP. AIS has contributed $[redacted] for the remaining [redacted] percent equity interest.

The Partnership Agreement provides that partners shall meet quarterly. Under the Partnership Agreement, you are collectively referred together with VNS and the other nonprofit, nonexempt visiting nurse association (the "VNAs"). The Partnership Agreement provides that the VNAs, collectively, have one vote [redacted] percent) and AIS has one vote (50 percent). The VNAs have a single representative who must act only on a two-thirds majority consent of the VNAs. A quorum is established only if all partners are represented.

The Partnership Agreement specifies that GP is organized under [redacted]. It will provide

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equipment, supplies, and pharmaceuticals related to infusion and enteral therapy to skilled nursing facilities and their patients, home health agencies and their patients and other home-based patients. Additionally, GP will supply and administer any and all oral medications to home-based patients under the direction of their physicians. Some of the patients discharged from your affiliated participating agencies become patients of GP.

You stated in your application that fees are based on patients' ability to pay and are set by insurance providers, Medicare and Medicaid, although the partnership agreement is silent as to fees to be charged. GP has no charity care policy, although you have indicated that your revenue sources include patients from Medicare and Medicaid, as well as managed care and other sources. You are not considered a qualified home health care agency as defined in section 1861(o) of the Social Security Act.

No partner is entitled to withdraw or reduce its capital contribution, to receive interest on its capital contribution, or to partition any partnership property. All items of income, gains, losses, expenses, deductions and credits will be allocated to the partners in accordance with their initial capital contributions. Distributable cash flow is defined in the partnership agreement as cash generated by operations, less current charges and expenses, principal payments on any partnership debt, and reserves for working capital, contingencies, capital improvements, replacements, and repair and warranty work. The agreement specifies distributions shall be quarterly. The agreement also provides a cross-indemnification clause between the partners for actions that may be brought against a partner for actions outside the partnership. In addition, the partners indemnify the partnership against any actions brought against the partnership for outside activities of a partner.

AIS will serve as the managing partner of GP. For its services as managing partner, AIS will be reimbursed for reasonable out-of-pocket expenses and will be compensated for personnel services. Subject to the actions requiring unanimous consent by the partners, the managing partner is responsible for the day-to-day partnership operations. The partnership agreement requires unanimous consent for the following actions:

1. amendment of the partnership agreement;
2. disposition of any of the partnership's assets other than in the ordinary course of business;
3. admittance of a new partner;

[redacted]

4. permitting a partner to encumber its interest in the partnership or its right to receive profits and/or cash distributions therefrom;
5. the partnership entering any new line of business;
6. acceptance by the partnership of discounted payment of any kind from a customer or class of customers other than discounts required by third-party payors;
7. borrowing in excess of $[redacted], either individually or in the aggregate, for the account of the partnership;
8. taking any action which would make it impossible to carry on the ordinary business of the partnership;
9. encumbering any assets of the partnership other than with purchase money security interest;
10. leasing or purchasing any real property on behalf of the partnership (other than the lease for offices of the partnership);
11. causing the partnership to enter into any transaction with a partner or an affiliate of a partner;
12. approval of the annual budget;
13. changing the name of the partnership;
14. making any loan to any person or entity;
15. spending in excess of [redacted] percent over the amount budgeted in the applicable budget for any expense category (excluding any budget items that are variable based upon the volume of actual business);
16. confessing judgment against the partnership;
17. making any changes in the distribution policy;
18. merging or consolidating with any other entity;
19. causing the partnership to file for bankruptcy; and
20. selecting an independent certified public accounting firm to review or audit the partnership's financial statements and related books of account and financial records.

Besides its responsibilities as managing partner, AIS also manages the daily operations of the business pursuant to a management services agreement between itself and GP. The agreement is automatically renewed for up to four additional one year periods. AIS is paid a management fee based on an hourly basis for authorized work performed at the rates listed in the management agreement. AIS will provide pharmacy management, contracting, marketing, nursing backup and administrative services in conformity with standards defined by the Partnership Management Committee. AIS is responsible for hiring the staff, including the Pharmacy Manager and the General Manager.

At the end of the second year, and at the conclusion of each one year period thereafter, the Management Committee will evaluate the performance of services of AIS to determine if the agreement should be renewed. The Management Committee meets on a

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monthly basis to monitor the services provided by AIS as the manager and reimbursements for these services. The Management Committee is composed of two members from AIS, two members representing the VNAs, and the General Manager of the GP pharmacy. You stated that the current committee chairman is an executive director of VNS, although that is not a requirement under the partnership agreement nor the management agreement.

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.

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).

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

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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. 72-209, 1972-1 C.B. 148, provides that a nonprofit organization formed to provide low cost home health care for people of a community may qualify for exemption under section 501(c)(3) of the Code as a charitable organization. The revenue ruling concludes that by providing home nursing and therapeutic care in the manner described, the organization serves many of the same health care needs of the community that hospitals traditionally serve, and therefore, is promoting health within the meaning of the general law of charity.

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 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.

[redacted]

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."

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 (3rd 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.

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

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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 Republication 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 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

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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 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

[redacted]

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 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. 68-375, 1968-2 C.B. 245, concludes that the sale of pharmaceutical supplies by an exempt hospital to private patients of physicians with offices in a hospital-owned medical building results in unrelated business taxable income to the hospital.

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 health plan did not qualify for

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exemption under section 501(c)(3) of the Code based on the integral part doctrine of section 1.502-1(b) of the regulations.

We have concluded that you are not operated exclusively for exempt purposes as described in section 501(c)(3) of the Code.

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 do not further exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations. Also, _see_, _Better Business Bureau v. United States_, _supra_.

An organization may participate in a partnership without jeopardizing its exempt status 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 members or partners. _See_ _Plumstead Theatre Society, Inc. v. Commissioner_, _supra_, and _Housing Pioneers v. Commissioner_, _supra_. The activities of a partnership are generally considered to be the activities of its 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. When participating in a partnership is the only activity of a 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 exempt organization operates for charitable purposes. If more than an insubstantial amount of the partnership's activities do not further a charitable purpose, the exempt 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 on your sole activity of participating in a general partnership with other exempt entities and a for-profit corporation. We conclude that your participation in the general partnership does not further a charitable purpose, and allows for greater than incidental benefits to the for-profit partner.

An organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. An organization must establish that it does not operate for the benefit of private interests such as designated

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individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Section 1.501(c)(3)-1(d)(1) of the regulations.

An organization may enter into a management contract with a private party 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 v. 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.

You are in a minority ownership position. You own only a [redacted] percent interest, and together, the two tax exempt partners own only [redacted] percent, while AIS owns [redacted] percent. The Partnership Agreement provides that the partnership will be governed by an equal number of directors, one chosen by the nonprofit partners together (although one is nonexempt) and one chosen by AIS, the for-profit partner. The representative for the nonprofit partners must act on a two-thirds majority vote. You do not have equal voting power to AIS, because your decisions may be countermanded by a two-thirds vote of the other two nonprofit partners, only VNS of which is recognized as exempt from federal income tax, prior to the partnership vote. Thus, you are unable to exert any decisive influence or actual control although you have a significant stake in the partnership's earnings.

The partnership and management arrangement of the joint venture are structured and operated to give private interests control over the partnership activities and assets and to

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maximize profits, not to serve charitable purposes. You are grouped together in the voting structure with a nonexempt entity, which may or may not serve charitable purposes. Even though the Partnership Agreement deems you to have equal representation to AIS in the decisions regarding the Partnership, in reality you do not. You and VNS are bound together in voting power with a nonexempt entity. A nonexempt entity has a one-third vote in deciding how your representative will represent your exempt interests in GP.

Yet, even if all three of the VNAs voting together were tax exempt, technically giving exempt interests equal representation on the governing board, AIS still in reality would have greater power and authority over the decision making. AIS has managing control over the day-to-day operations of the partnership business as well as the partnership itself.

As the managing general partner of GP, AIS decides all major decisions not requiring the unanimous consent of all partners. As the day to day manager, AIS is responsible for hiring the staff and executives, including the [redacted] and [redacted]. The [redacted] is the tie breaker on the Management Committee. The control by AIS over the [redacted] makes it unlikely that he or she could impartially review AIS, to ensure a charitable program. This control will influence the staff and executives to be more responsive to AIS's agenda, such as in fee schedules and patients served. Thus, through the control exercised by AIS, it is benefitted more than incidentally. <u>See American Campaign Academy v. Commissioner, supra</u>.

The veto power retained by your representative over ultimate decisions and his or her participation on the Management Committee does not mean that the representative can force GP to take certain actions to advance a charitable purpose, nor does it grant the nonprofit partners any ability to definitively affect policy or direction; <u>e.g</u>, allowance for charity care, provision of research and training, willingness to contract with Medicare and Medicaid programs, and willingness to provide services that meet a community need but would not necessarily maximize profits or produce enough profits to make them commercially viable.

In this regard, under the Partnership Agreement and laws of the state, GP was formed to carry on as a business for profit. In general, partners share in the profits and losses of the partnership. [redacted]. A partnership is intended generally to maximize profits for the partners. An exempt entity participating in a partnership with a for-profit corporation has to take into account the for-profit partner's pecuniary interests. When the exempt entity is in

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control of the partnership, it can take steps to satisfy this need while assuring the accomplishment of its exempt purpose. However, AIS has a fiduciary duty to maximize profits and no responsibility to further exempt purposes.

[redacted] provides that partnerships operate for the purposes stated in their partnership agreements. [redacted]. GP appears to be a typical partnership designed to operate the home health services as a business for profit. The Partnership Agreement does not include any charitable purposes nor require GP to operate for charitable purposes. Thus, AIS, as manager of GP, ~~has~~ no express duty to the partners to serve charitable purposes and instead, appears to have a duty to operate the partnership as a profit-making business. Moreover, if arbitrators are needed to resolve a deadlock between the directors, it appears that they would rule in favor of a decision likely to yield larger profits to GP, based on its formation as a for profit business, as well as the definition of a general partnership under [redacted] as an entity engaged in business for profit. Conversely, there is no assurance that arbitrators would consider the accomplishment of exempt purposes to take precedence over the accomplishment of business purposes.

In your case, the primary beneficiary from the partnership activity is AIS. AIS has actual control over partnership issues due to its position as managing general partner in addition to its management of the day-to-day business. The primary source of information for the representatives will be the chief executives, who are employees of AIS. Moreover, AIS will have broad discretion over all of GP's activities and assets that are not required to be under the representatives' supervision. AIS, as the managing partner, has the authority to decide all the major decisions not requiring unanimous consent, including fees to be charged for services, among other major decisions.

Also, although a Management Committee will oversee AIS's performance as the manager of the business and will decide whether to renew AIS's management term, the majority of the Management Committee is composed of representatives for AIS and an employee of AIS. Therefore, it is doubtful that the Management Committee will find fault with AIS's performance as the manager or remove it as the manager, particularly in regard to ensuring charitable services. The partnership arrangement allows AIS to increase its client base, improve its marketability, realize a stream of referrals from the enterprises operated by the nonprofit partners, save on expenses through consolidation and economies of scale, and exercise increased bargaining leverage with vendors. Under the balancing test of

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American Campaign Academy v. Commissioner, supra, AIS will be benefitted more than incidentally by the actions of GP.

The situation here 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 AIS's position as the managing partner, where the nonprofit entities have only a veto power over major decisions, and from AIS's position as the manager of the business operations with control over personnel and other daily business decisions, result in impermissible private benefit to AIS.

The present situation is 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 as well as long term planning authority over the provision of pharmaceutical supplies and the home health care services. 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 and the management agreement.

Accordingly, you are operating 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.

You also are not entitled to exemption because your activities do not promote health in a charitable manner. The promotion of health includes patient care through home health services. See Rev. Rul. 72-209, supra. However, not every activity that promotes health supports tax exemption under section 501(c)(3) of the Code. For example, selling prescription pharmaceuticals certainly promotes health, but pharmacies cannot qualify for recognition of exemption under section 501(c)(3) on that basis alone. See, Federation Pharmacy Services v. Commissioner, supra.

The same is true of hospitals and other health care organizations. 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.

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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.

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 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 governing board cannot primarily represent the interests of the community. There is an inherent conflict between the interests of your representatives to further charitable goals and those of AIS' representatives, who have a fiduciary duty to serve the pecuniary interests of AIS. 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 GP. Although the exempt partners participate in the Management Committee, its oversight capabilities are limited by the tie-breaker presence of the [redacted] on the Committee, who will be under the influence of its employer, AIS.

The lack of an exempt purpose in GP's operation is apparent from the facts disclosed in your application. GP is not a qualified home health agency, as the organization was in Rev. Rul. 72-209, supra. It does not have a charity care policy. Its activities primarily include dispensing equipment and supplies to patients. Fees charged will be sufficient to ensure a profit, as decided by AIS as the managing partner and day-to-day manager of the business. GP is not providing low cost home health care as described in Rev. Rul. 72-209. Thus, because GP fails to further an exempt purpose and your participation in GP is your only activity, you are not operated exclusively for charitable purposes as required for exemption under section 501(c)(3) of the Code.

In addition, you do not qualify for exemption as an integral part of Health Corporation. 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

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sufficient control and close supervision, based on all the facts and circumstances, to establish the equivalent of a parent and subsidiary relationship, and (2) the subordinate entity must perform essential services for the exempt parent.

You are a nonmembership corporation. Although the members of your Board of Directors and the members of the Health Corporation's Board of Directors are currently identical, neither your Articles of Incorporation nor your Bylaws provide that Health Corporation is your parent or your member. Its only relationship to you under the governing documents is to choose two of your Board members. Because your Bylaws provide that your Board shall number between eight and fifteen, the directors chosen by Health Corporation will constitute only between 13 and 25 percent of the Board. Because Health Corporation does not control your organization, you do not satisfy the control portion of the integral part doctrine.

You also 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, it is necessary to determine if the distributive share of ordinary income from the partnership would constitute unrelated business taxable income if Health Corporation, rather than you, were the partner in the partnership. In order to make this determination, it is necessary to determine whether the partnership's trade or business is substantially related to the Health Corporation's exempt purpose under section 501(c)(3) of the Code.

The facts show that if Health Corporation were a partner in GP, it would have invested in an entity that does not promote community health (the exempt purpose of Health Corporation). The facts also establish that GP generates impermissible private benefit to for-profit corporations.

In addition, the sale of pharmaceuticals by the partnership, like comparable sales by a hospital to private patients of its

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medical staff in Rev. Rul. 68-375, supra, has no causal relationship to the exempt purpose of Health Corporation, nor could it be considered as being primarily for the convenience of the patients of Health Corporation.

Therefore, the partnership's activities would not have a substantial causal relationship, as described in section 1.513-1(d)(2) of the regulations, to the achievement of the Health Corporation's exempt purpose. Thus, Health Corporation's distributive share of ordinary income from the partnership would constitute unrelated business taxable income.

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 hospitals in the system. Geisinger III is similar to the present situation because the activities of the partnership, which are controlled by a non-exempt organization, do not further the exempt purpose of the Health Corporation.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption from federal income tax as described under 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]

Internal Revenue Service
CP:E:EO:T:1:[redacted] Room 6514
1111 Constitution Avenue, N.W.
Washington, D.C. 20224.

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 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,

(signed) Marvin Friedlander

Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1

cc: [redacted]

cc: [redacted]

cc: [redacted] JK
[redacted]