yellow

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

EXEMPT AND
ENT ENTITIES
/ISION

Date:

SEP 30 2002

Contact Person:

Identification Number:

Contact Number:

[redacted]

NO PROTEST RECEIVED
Release to Manager, EO Determinations - Cincinnati
DATE:
SURNAME

Employer Identification Number:

Dear Applicant:

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

Information presented discloses that you were incorporated on [redacted] under the non-profit, non-stock corporation laws of the State of [redacted] Article 3 of your Articles of Incorporation states that your purposes shall be to engage in any lawful activities authorized by [redacted] of the [redacted] Statutes. An attachment to your Articles of Incorporation further states, among other things, that notwithstanding any other provision of your Articles, you shall not carry on any other activities not permitted to be carried on by an organization that is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code.

A brochure you have provided indicates that you are a [redacted] health care coalition whose members are several for-profit companies. You state that you want to assure that high quality health care is available locally for employees and families of member companies. You represent over [redacted] employees and over [redacted] "covered lives" in the [redacted] areas. Your current network includes [redacted], numerous local physicians and additional specialty providers. You state that you contract with an outside consultant to negotiate "preferred pricing" arrangements and to provide advice on matters affecting your organization.

Other reasons you give for your formation are:

Member companies individually lack time and perhaps expertise to manage health care expenditures.

Improve the quality, and availability of services rendered.

[redacted]

Negotiate contracts with healthcare providers.

Identify and decrease system inefficiencies.

Improve the overall perception of healthcare delivered in the geographic marketplace.

Protect employees from unexpected out-of-pocket costs.

You indicate that your sources of financial support are payments of initiation fees by member companies and a monthly fee based on employee participation. An employer becomes a member of your network by paying the following initiation fees:

# of Employees	Initiation Fee
50-500	$[redacted]
501-1000	$[redacted]
1,000-2000+	$[redacted]

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

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (the regulations) provides that in order for an organization to be exempt as one described in section 501(c)(3) of the Code, it must be both organized and operated exclusively for one or more exempt purposes. Under section 1.501(c)(3)-1(d)(1)(i)(b) of the regulations, an exempt purpose includes a charitable purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been regarded 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.

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

In Rev. Rul. 69-545, 1969-2 C.B. 117, the Service established the community benefit standard as the test by which the Service determines whether a hospital is organized and operated for the charitable purpose of promoting health.

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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."

Geisinger Health Plan v. Commissioner, 985 F. 2d. 1210 (3rd Cir. 1993 rev'g 62 TCM 1656 (1991) ("Geisinger II"), held that a prepaid health care organization that arranges for the provision of health care services only to its members benefits it members, not the community as a whole and therefore does not promote health in a charitable sense. Under the community benefit standard, the organization must benefit the community as a whole in addition to its members. In concluding that the organization did not qualify for exemption under section 501(c)(3) on the basis of promoting health, the court of appeals states that an organization must meet a flexible community benefit test based on a variety of indicia.

Rev. Rul. 75-197, 1975-1 C.B. 156, held that a nonprofit organization that operates a free computerized donor authorization retrieval system to facilitate transplantation of body organs upon a donor's death qualifies for exemption under section 501(c)(3) of the Code because by facilitating the donation of organs which will be used to save lives, it is serving the health needs of the community and therefore is promoting health within the meaning of the general law of charity.

Rev. Rul. 77-68, 1977-1 C.B. 142, held that a nonprofit organization formed to provide individual psychological and educational evaluations, as well as tutoring and therapy, for children and adolescents with learning disabilities qualifies for exemption under section 501(c)(3) of the Code because it both promotes health and advances education. Because its services are designed to relieve psychological tensions and thereby improve the mental health of the children and adolescents, it promotes health.

Rev. Rul. 81-298, 1989-1 C.B. 328, held that a nonprofit organization that provides housing, transportation and counseling to hospital patients' relatives and friends who travel to the locality to assist and comfort the patients qualifies for exemption under section 501(c)(3) because it promotes health by helping relieve the distress of hospital patients who benefit from the visitation and comfort provided by their relatives and friends.

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

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

[redacted]

Rev. Rul. 54-305, 1954-2 C.B. 127, involves an organization whose primary purpose is operation and maintenance of a purchasing agency for the benefit of its otherwise unrelated members who are exempt as charitable organizations. The ruling held that the organization did not qualify under section 101(6) of the Code (the predecessor to section 501(c)(3)) because its activities consisted primarily of the purchase of supplies and the performance of other related services. The ruling further stated that such activities in themselves cannot be termed charitable, but are ordinary business activities.

Rev. Rul. 72-369, 1972-3 C.B. 245, deals with an organization formed to provide management and consulting services at cost to unrelated exempt organizations. This revenue ruling held that providing management and consulting services on a regular basis for a fee is a trade or business that is ordinarily carried on for profit. The fact that the services in this case were provided at cost and solely for exempt organizations was not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the organization entered into consultant-retainer relationships with five or six limited resource groups involved in the fields of health, housing, vocational skills and cooperative management. The organization's financing did not resemble that of the typical section 501(c)(3) organization. It had neither solicited, nor received, any voluntary contributions from the public. The court concluded that because its sole activity consisted of offering consulting services for a fee, set at or close to cost to nonprofit, limited resource organizations, it did not qualify for exemption under section 501(c)(3) of the Code.

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

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 posses the characteristics of a trade or business within the meaning of section 162 of the Code. Section 1.513-1(c) of the regulations

[redacted]

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.

Section 1.513-1(d)(4) of the regulations states that gross income derived from charges for the promotion of exempt functions does not constitute gross income from the conduct of unrelated trade or business.

Your activities consist of arranging contracts for the delivery of health care services locally for employees and families of member companies. Essentially, you are a facilitator of these contract services and perform no other activities. Under the regulations, an organization that is organized and operated exclusively for charitable purposes may qualify for exemption under section 501(c)(3) of the Code. The promotion of health has long been recognized as a charitable purpose. Therefore, the question to be decided is whether your activities promote health in a charitable manner.

The Service and courts have recognized that the promotion of health includes activities other than the direct provision of patient care. See Rev. Rul. Rul. 81-298, supra; and Rev. Rul. 75-97, supra. However, an organization that merely promotes health, without more, is not entitled to recognition of exemption under section 501(c)(3) of the Code. See Living Faith, Inc. v. Commissioner, supra, and Federation Pharmacy Services, Inc. v. Commissioner, supra. You arrange contracts for the delivery of health care services for employees and families of member companies in your network. This may promote health. However your activities are indistinguishable from those of a commercial enterprise performing these same types of services. Therefore, although your activities may promote health, you do not promote health in a charitable manner.

In Geisinger II, supra, the court of appeals held that an HMO did not qualify for exemption under section 501(c)(3) of the Code because arranging for the provision of health care services exclusively for an organization's members primarily benefit the members, not the community as a whole. Under the community benefit standard, the organization must benefit the community as a whole in addition to its members. In concluding that the organization did not qualify for

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exemption under section 501(c)(3) on the basis of promoting health, the court of appeals stated that an organization must meet a "flexible community benefit test based on a variety of indicia."

By providing administrative and management services to your members, your activities primarily benefit your members, not the community as a whole. Therefore, you do not satisfy the "flexible community benefit test based on a variety of indicia" established in Geisinger II, supra. Because you have not established that you promote health in a charitable manner, and you do not satisfy the community benefit standard, you are not operated exclusively for a charitable purpose. See section 1.501(c)(3)-1(c)(1) of the regulations and Better Business Bureau of Washington, D.C., v. United States, supra. Therefore, you do not qualify for exemption under section 501(c)(3) of the Code as a charitable organization on the basis that you promote health.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

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

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

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

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

[redacted]

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

Internal Revenue Service
TE/GE T:EO:RA:T: 1
[redacted]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

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

Sincerely,

Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1

[redacted]