

Internal Revenue Service  
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Department of the Treasury

Washington, DC 20224

Date [REDACTED]

Surname [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date: [REDACTED]

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4). 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.

FACTS

You were incorporated on [REDACTED] in [REDACTED] the name [REDACTED]. You subsequently changed your name to [REDACTED]. Your purposes include engaging in all activities relating to the ownership of [REDACTED] and the development and operation of health care delivery systems and related activities for all subscribers to [REDACTED] health maintenance organization, including medical assistance recipients.

[REDACTED] is a [REDACTED] nonprofit corporation and licensed health maintenance organization that is hereafter referred to as the "HMO." On [REDACTED] the Internal Revenue Service recognized the HMO as an organization described in section 501(c)(4) of the Code.

Prior to your formation, the HMO's members were [REDACTED] nonprofit teaching and other hospitals in [REDACTED] all of which are exempt under section 501(c)(3) of the Code. As a result of a planned corporate restructuring, you were formed, so that the [REDACTED] hospitals are now your members and you are the sole member of the HMO.

Your Bylaws provide that as a condition of admission to membership, a member must become a party to one or more risk contracts with your organization under which the member provides health care services to subscribers of your health maintenance

organization or that of your affiliate. In addition, the member must pay you an entrance fee.

According to your Bylaws, the number of persons on your Board of Directors is the sum of the number of your members plus such number of additional Directors so that at least one-third of the Board is comprised of persons who are not officers or employees of your organization, or of a parent or subsidiary organization.

Your specific activities are:

1. Performing the policymaking and strategic planning activities for the entities within the corporate structure;
2. Positioning the HMO to serve as the core of a broader managed care strategy for the member hospitals in developing and providing managed care services to individuals, including medical assistance recipients, particularly in view of the current trends towards the utilization of managed care in providing health services to publicly funded health insurance programs;
3. Providing oversight management for the day-to-day operations of the HMO;
4. Separating the health maintenance organization related activities from the broader policymaking and strategic planning activities to provide the HMO with the ability to utilize the expertise and talents of health-related board members of the HMO board and diverse community representatives and business executives on the board of the HMO; and
5. Allowing the HMO to develop and engage in other health maintenance organization related activities, such as the provision of managed care management services to third party entities, without exposing the HMO to any of the capital or operational risks of such other business activities.

With respect to the HMO, you will be providing various operational, administrative, regulatory compliance, planning and policymaking functions. Currently, you do not have any contracts with the HMO to provide these services. You are in the process of developing the formal cost sharing agreement. The fees you will charge to the HMO will be based on cost and will not

[REDACTED]

necessarily equal fair market value since the basis for the charges will be actual incurred costs.

With respect to the services you will perform for third party health care organizations, you do not currently have any contracts or agreements. However, you intend to contract for and provide certain discrete administrative, operational and consulting services to health care entities and organizations developing integrated health care delivery systems in [REDACTED]

LAW

Section 501(c)(4) of the Code provides for the exemption from federal income taxation of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. Section 1.501(c)(4)-1(a)(1) of the Income Tax Regulations presents this requirement in a two-part test. An organization is described in section 501(c)(4) of the Code if (1) it is not organized or operated for profit, and (2) it is operated exclusively for the promotion of social welfare. Section 1.501(c)(4)-1(a)(2)(i) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

Rev. Rul. 54-305, 1954-2 C.B. 127, describes an organization whose primary purpose is the 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 stated that such activities in themselves cannot be termed charitable, but are ordinary business activities.

Rev. Rul. 69-528, 1969-2 C.B. 127, describes an organization formed to provide investment services on a fee basis only to organizations exempt under section 501(c)(3) of the Code. The organization invested funds received from participating tax-exempt organizations. The service organization was free from the control of the participating organizations and had absolute and uncontrolled discretion over investment policies. The ruling held that the service organization did not qualify under section 501(c)(3) of the Code and stated that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

[REDACTED]

Rev. Rul. 72-369, 1972-3 C.B. 245, describes an organization formed to provide management and consulting services at cost to unrelated exempt organizations. This ruling stated:

An organization is not exempt merely because its operations are not conducted for the purposes of producing a profit. . . . [P]roviding managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

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.

In Christian Stewardship Assistance, Inc., 70 T.C. 1037 (1978), a nonprofit corporation that assisted charitable organizations in their fund raising activities by providing financial planning advice on charitable giving and tax planning to wealthy individuals was held not to qualify under section 501(c)(3) of the Code because its tax planning services were a substantial nonexempt activity that provided a private benefit to its contributing clients.

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

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

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), involved an organization that operated restaurants and health food stores with the intention of furthering the religious work of the Seventh-Day Adventist Church as a health ministry. However, the Seventh Circuit held that these activities were primarily carried on for the purpose of conducting a commercial business enterprise.

#### RATIONALE

While the promotion of health is considered a charitable purpose within the meaning of section 501(c)(3) of the Code, not all activities that promote health are considered charitable such that an organization engaging in such activities is entitled to exemption under section 501(c)(3). See Federation Pharmacy Services, Inc., supra. Similarly, not all activities that promote health achieve the tax-exempt purpose under section 501(c)(4) of promoting the common good and general welfare of the people of the community and bringing about civic betterments and social improvements. See section 1.504(c)(4)-1(a)(2)(i) of the regulations. Although one result of your providing the various services described above to a tax-exempt HMO is improving access to, and delivery of, health care services to persons who are generally considered to be medically underserved, that result is incidental to your principal purpose of providing purely commercial services to the HMO and to third party health care organizations. Providing these services for a fee to a tax-exempt HMO is a commercial activity that does not directly promote health, even if the fee is less than fair market value. See e.g., Rev. Rul. 72-369, supra. There is no broad community benefit that results from such activity. Providing these services does not directly promote the common good and general welfare of the community or bring about civic betterments and social improvements but rather represents an ordinary commercial activity. The same is true with respect to the various services you intend to provide to third party health care organizations. See e.g., Rev. Rul. 54-305, supra; Rev. Rul. 69-528, supra; B.S.W. Group, Inc., supra; Christian Stewardship Assistance, Inc., supra; and Living Faith, Inc., supra.

#### CONCLUSION

For the reasons stated above, you do not qualify for exemption as an organization described in section 501(c)(4) of the Code and you must file federal income tax returns.

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

[REDACTED]

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

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office.

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

Internal Revenue Service  
[REDACTED]  
[REDACTED]  
[REDACTED]

For your convenience, our FAX number is [REDACTED]

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

[REDACTED]  
[REDACTED]  
Chief, Exempt Organizations  
Technical Branch 1