Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:

Date:

Employer Identification Number:
Key District:

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.

FACTS

You were incorporated on in the State of . Your Articles of Incorporation provides that your purposes shall include: (1) facilitating coordinated and collaborative health planning and service delivery through an integrated process involving health providers, educators, payors, and consumers; (2) providing a strong emphasis on community-oriented primary care research and on the evaluation of the community based programs arising out of the integrated planning process; (3) developing a data gathering, management and analysis consortium which will ensure that appropriate needs assessments and program and policy evaluations are undertaken and utilized; (4) performing or cause to be performed the administrative and management duties necessary to accomplish your enumerated purposes.

Essentially, you are an . You state that the ISN will coordinate activities to strengthen market share; maintain quality, cost effective care; maintain service to all patients regardless of ability to pay; enhance resource sharing and reduce costs to promote community health center activities.

Your primary financial support consists of federal and state grants and membership dues. Your primary membership requirement mandates that the ISN organizations must be located in the State of Georgia and provide health care. Your membership fees range

[redacted], Inc.

from $3,000 to $18,000 annually based upon the member's operating budgets.

LAW

Section 501(c)(3) of the Internal Revenue 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 1.510(c)(3)-1(b)(1) of the Income Tax Regulations provides that an organization is organized for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

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

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

In Better Business Bureau of Washington, DC v. United States, 326 U.S. 279, 283 (1945), the Court held 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."

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization will not be considered as operated exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

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

(Second), Trusts, sec. 368 and sec. 372; IV Scott on Trusts (3d ed. 1967), sec. 368 and sec. 372; and Rev. Rul. 69-545, 1969-2 C.B. 117.

Section 501(e) of the code provides that a cooperative hospital service organization is treated as if it were exempt under section 501(c)(3) if it performs certain specific service activities enumerated in the statute for two or more exempt hospitals and allocates or pays, within 8-1/2 months after the end of the year, all net earnings to its members on the basis of the services performed for them.

Section 1.501(e)-1 of the regulations provides that section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization.

Section 1.170A-9(c)(1) of the regulations defines a "hospital" as including an "out patient clinic" if its principal purpose or function is the providing of hospital or medical care. Furthermore, the term "medical care" shall include the treatment of any physical or mental disability or condition, whether on an inpatient or outpatient basis, provided that the cost of such treatment is deductible under section 213 by the person be treated.

In HCSC-Laundry v. U.S., 450 U.S. 1 (1981), the Supreme Court held that a cooperative laundry organization that served exempt organizations could not qualify as exempt under section 501(c)(3) because laundry services is not one of the activities enumerated in section 501(e).

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.

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 purchasing of supplies and performing 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.

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. The ruling states: "[a]n organization is not exempt merely because its operations are not conducted for the purposes of producing a profit . . . providing 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. Comm., 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.

RATIONALE

1. To qualify for exemption under section 501(c)(3) of the Code, an organization must be organized exclusively for an exempt purpose. While the promotion of health is considered a charitable purpose within the meaning of section 501(c)(3) of the Code, providing management, administrative and consulting services for a group of tax-exempt health care providers does not directly promote health. Instead, you are providing ordinary commercial services.

There are no broad community benefits that result from such activities. Providing these services is not a charitable activity but rather an ordinary commercial activity. *See* Rev.

Rul. 54-305, supra; Rev. Rul. 69-528, supra; Rev. Rul. 72-369, supra; and B.S.W. Group, Inc., supra. Therefore, you are neither organized nor operated exclusively for charitable purposes under section 1.501(c)(3)-1(b) nor 1.501(c)(3)-1(c)(1) of the regulations.

2. Under section 1.502-1(b) of the regulations, one organization may derive its exemption from a related organization exempt under section 501(c)(3) of the Code if it is an integral part of the exempt organization. To obtain exemption derivatively, two requirements must be satisfied: (1) the two organizations must be "related" and (2) the subordinate entity must perform "essential" services for the parent. The related organization must be structurally related, not just functionally related, to be considered related for purposes of the integral part theory. Section 1.502-1(b)(1) of the regulations includes the following example of an organization that is considered as providing essential services: a subsidiary which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax exempt educational organization, in carrying on its educational activities.

Under the regulations, a subsidiary organization that is engaged in activity that would be considered an unrelated trade or business if it were regularly carried on by the exempt parent does not provide an essential service for the parent. The regulations include an example of a subsidiary organization that is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization.

Similarly, if the subsidiary organization were owned by several unrelated exempt organizations and operated for the purpose of furnishing electric power to each of them, it would not be exempt because the business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For this purpose, organizations are related only if they consist of (1) a parent and one or more of its subsidiaries, or subsidiaries having a common parent. An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities. See section 1.501(2)-1(b) of the regulations.

You are comprised of several unrelated exempt organizations and operate for the purpose of providing various administrative, consulting and network management services to your members, all of which are exempt organizations. You are not "structurally" related to your members; hence, you do not satisfy the integral part theory test. Section 1.502-1(b). Moreover, if any one of your members regularly carried on these activities for the other

members, such activities would be an unrelated trade or business. Therefore, you do not qualify for exemption under section 501(c)(3) as an integral part of your members.

3. An organization that provides services for more than one exempt hospital, including outpatient clinics, may qualify for exemption under section 501(c)(3) if it meet the requirements of section 501(e) of the Code. However, the exemption applies only to organizations providing the services specifically enumerated in the statute and the regulations. Since section 501(e) is the exclusive means by which a hospital service organization may qualify for exemption under section 501(c)(3) (See section 1.501(e)-1 of the regulations and HCSC-Laundry, supra), a hospital service organization providing services other than those specifically enumerated in the statute does not qualify.

The various administrative, consulting and network management services you provide to your members, which are considered hospitals under section 1.170A-(9)(c)(1) of the regulations, are not services which are specifically enumerated in section 501(e) of the Code. Furthermore, you do not meet the requirements of section 501(e)(2) regarding allocation or payment of net earnings. Therefore, under section 501(e), you do not qualify as an organization that is treated as exempt under section 501(c)(3).

CONCLUSION

For the reasons stated above, 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, 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 copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

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

Internal Revenue Service
Attn: CP:E:EO:T:1; Room 6142
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you wish to FAX any information to us, our FAX number is (202) 622-5797. If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Technical Branch 1