

Internal Revenue Service

Department of the Treasury

[REDACTED]

Contact Person: [REDACTED]

Telephone Number: [REDACTED]

In Reference to: [REDACTED]

Date: [REDACTED]

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Form: [REDACTED]

Tax Years: [REDACTED]

Dear Applicant:

This letter constitutes a final adverse ruling with respect to your claim of exemption from federal income taxation under section 501(c)(4) of the Internal Revenue Code.

We make our ruling for the following reasons:

FACTS

You were incorporated on [REDACTED] as a [REDACTED] nonprofit membership corporation. According to your amended articles of incorporation, your purpose is to defray and assume the costs of [REDACTED] by establishing a fund from periodic payments by subscribers or beneficiaries, from which fund these costs may be paid. Your amended articles do not include as one of your purposes the performance of social welfare or community benefit activities.

On [REDACTED], you filed, on Form 1024, an application for recognition of exemption under section 501(c)(4) of the Code. On [REDACTED], we sent you a letter in which we proposed denying recognition of your organization as exempt under section 501(c)(4). On [REDACTED] you filed a protest, and on [REDACTED], we held a conference with you on this matter at our offices. On [REDACTED], we sent you another letter revoking our letter dated [REDACTED] and again proposed denying recognition of your organization as exempt under section 501(c)(4). On [REDACTED], you filed a protest, and on [REDACTED], we held a conference with you on this matter at our offices. Following this conference, you submitted additional information.

I. Current Structure and Operations

According to your amended and restated bylaws, you have two classes of members: Participating Members and an Administrative Member. Participating Membership is available to all persons who are licensed to practice [redacted] or who are licensed [redacted] specializing [redacted]. As of [redacted], you had [redacted] Participating Members. All Participating Members have entered into provider contracts with your organization referred to as [redacted]. Your sole Administrative Member is [redacted], formerly known as [redacted] membership corporation.

Under your bylaws, the Administrative Member has the exclusive right to approve all matters (with one exception), including the right to appoint your directors, the right to approve a disposition of all or substantially all of your assets or a merger and the right to approve changes to your articles of incorporation or bylaws. Participating Members have no voting rights other than the exclusive right to vote on your dissolution.

Your bylaws do not include provisions relating to the performance of social welfare or community benefit activities.

Board of Directors. Your bylaws provide that you have [redacted] directors. The bylaws provide that [redacted] of the directors must be a Participating Member in your organization and [redacted] must be laypersons who are not Participating Members and who are selected from the general public. Currently, your board is comprised of one [redacted], who is also a Participating Member [redacted], and [redacted] senior officers of [redacted].

Enrollment. As of [redacted] your enrollment was:

Small employer groups (25 or fewer employees)	[redacted]	[redacted]
Other employer groups	[redacted]	[redacted]
Individuals	[redacted]	[redacted]
Medicare	[redacted]	[redacted]
Medicaid	[redacted]	[redacted]
HMOs	[redacted]	[redacted]
Total	[redacted]	[redacted]

The enrollees listed above under "Medicare" are Medicare beneficiaries who are enrolled in other HMOs. Pursuant to agreements with your HMO subscribers, you are contractually

[REDACTED]
required to provide [REDACTED] to persons who are Medicare beneficiaries enrolled in these HMO plans. The services you perform for these HMOs cover only the portion of [REDACTED] that relate to the health of the [REDACTED], but do not cover the [REDACTED] (i.e., [REDACTED]), since Medicare does not cover [REDACTED].

Participation Agreements. You have provider contracts with each of your Participating Members who agrees to accept fees equal to the lower of a discount from usual and customary fees or the established cap. For examination services, you pay providers generally [REDACTED] percent or less of the usual and customary fees and for [REDACTED] services, you pay providers [REDACTED] percent or less of the usual and customary fees. [REDACTED] percent of the time, you pay the discounted fee and [REDACTED] percent of the time you pay the cap.

You provide services only to persons enrolled in your plan and to persons enrolled in the plans of your affiliates. Your Participation Agreements do not require that your Participating Members perform any social welfare or community benefit activities, such as charitable or educational activities.

Administrative and Marketing Agreement. As of [REDACTED] you entered into an [REDACTED] ([REDACTED]) with [REDACTED]. Under this agreement, [REDACTED] you with all administrative and marketing services and expertise required to operate your organization. Sections [REDACTED] and [REDACTED] of the [REDACTED] specify the [REDACTED] terms. Section [REDACTED] provides that in return for these services, you pay [REDACTED] a fee of \$[REDACTED] per claim paid. The [REDACTED] does not provide that the services [REDACTED] performs for you include any services relating to social welfare or community benefit activities, such as charitable or educational activities.

Community Benefit Activities

On your Forms 990 for the years ended [REDACTED], you reported the following information regarding your surplus:

Balance at [REDACTED]	\$[REDACTED]
Surplus - [REDACTED]	[REDACTED]
Balance at [REDACTED]	\$[REDACTED]
Surplus - [REDACTED]	[REDACTED]
Surplus at [REDACTED]	\$[REDACTED]
Surplus - [REDACTED]	[REDACTED]
Surplus at [REDACTED]	\$[REDACTED]

[REDACTED]

For [REDACTED], you expect a surplus of approximately \$ [REDACTED] million and for [REDACTED] you expect a surplus of approximately \$ [REDACTED] million.

[REDACTED]

On [REDACTED], the Internal Revenue Service recognized [REDACTED] as exempt under section 501(c)(4). According to its restated articles of incorporation, [REDACTED] specific and primary purpose is to defray and assume the costs of professional [REDACTED] by establishing a fund from periodic payments by subscribers or beneficiaries, from which fund these costs may be paid.

Members. According to [REDACTED] restated bylaws, [REDACTED] members consist of [REDACTED] classes: Director Members, which includes Public Members, and Participating Members. Director Members are persons who are members of the board of directors. Public Members are persons who are neither [REDACTED] care professionals, employees of [REDACTED] or of any of its affiliates, nor any person having any significant financial interest in any organization providing health or [REDACTED] care services to [REDACTED], nor a spouse of the above. Participating Membership is available to all persons who are licensed to practice [REDACTED] in [REDACTED]. All Participating Members have entered into provider contracts with [REDACTED]. Currently, [REDACTED] has [REDACTED] Director Members and approximately [REDACTED] Participating Members.

Under [REDACTED] restated bylaws, Director Members have the exclusive right to approve all matters (except as stated below), including the right to vote for the election of directors, the disposition of all or substantially all of [REDACTED] assets or a merger of [REDACTED] and the right to vote on changes to the articles of incorporation or bylaws. Participating Members have the right to vote on a dissolution of [REDACTED] the conversion of the corporation to a stock, for-profit corporation; and the alteration of Article XII of the articles of incorporation, relating to the foregoing.

Board of Directors. Under Art. II, Sec. 1 of [REDACTED] restated bylaws, [REDACTED] board of directors consists of between [REDACTED] persons. At all times, a majority of the directors must be Participating Members and/or persons who are panel members of one or more of [REDACTED] subsidiaries; the remainder of the directors must be Public Members. At any meeting, a quorum consists of [REDACTED] of the Director Members. Currently, [REDACTED] board of directors consists of [REDACTED] persons. [REDACTED] directors ([REDACTED]%) are practicing [REDACTED]s who are Participating Members of [REDACTED] or of an organization [REDACTED] controls. [REDACTED] directors are independent business people who are Public Members.

[REDACTED]

[REDACTED] Standing Committee on Public Policy. Pursuant to the requirements of [REDACTED] [REDACTED] bylaws provides for the establishment of a Standing Committee on Public Policy, which is responsible for establishing public policy. Pursuant to the requirements of [REDACTED], the Standing Committee's recommendations and reports must be regularly and timely reported to the board of directors, which must act upon the committee's recommendation. [REDACTED] of Article VIII provides the Standing Committee shall consist of five members who are elected by your subscribers. ("Subscribers" refers to the employers with whom [REDACTED] contracts, not the individual enrollees.) Currently, the Standing Committee is comprised of [REDACTED] representatives of [REDACTED] subscribers and [REDACTED] Participating Members of [REDACTED]

Section 6 of Article VIII of [REDACTED] bylaws provides that the Standing Committee makes the final decision on all matters relating to rates or fees for professional services to Participating Members. Further, under [REDACTED] of Article [REDACTED] of your amended bylaws, [REDACTED] has the exclusive right to approve all matters with respect to your organization. Thus, [REDACTED] through its Standing Committee, has full and exclusive authority to determine the rates and fees that you pay to your Participating Providers.

II. Proposed Changes

You have advised us that you and [REDACTED] are considering making various changes to your respective structures and operations.

Board of Directors

In your letters dated [REDACTED] and [REDACTED], you stated that you and [REDACTED] would each adopt a substantial conflicts of interest policy. You also stated that [REDACTED] would amend its bylaws to provide that a majority of its directors must be Public Members, rather than Participating Members. In your letter dated [REDACTED], you stated that [REDACTED] would amend its bylaws to provide that a quorum consists of a majority of directors, rather than 60 percent. You stated that [REDACTED] proposes that these changes would become effective by [REDACTED]

The three subscriber representatives are [REDACTED] and [REDACTED] are employed by the [REDACTED]. [REDACTED] is employed by a bank in [REDACTED]. The [REDACTED] Participating Members are [REDACTED], both of whom have provider contracts with [REDACTED]. [REDACTED] is also a member of the [REDACTED]

[REDACTED]

However, you have not proposed making any changes in the composition of the board of directors of your organization.

In addition, you stated that [REDACTED] would amend [REDACTED] of [REDACTED] of its bylaws relating to the Standing Committee on Public Policy to eliminate the requirement that the Standing Committee makes the final decision on all matters relating to rates or fees for professional services to Participating Members. Thus, [REDACTED] board of directors, rather than the Standing Committee, would have the authority to make this final decision.

Enrollment

In your letter dated [REDACTED], you described yours and [REDACTED] marketing program for new subscriber groups. You stated that [REDACTED], on behalf of your organization and all of [REDACTED] other affiliates, would continue to undertake a nationwide telemarketing effort to enroll new subscriber groups. [REDACTED] marketing group consists of [REDACTED] account executives, [REDACTED] sales administrators and four sales assistants. This sales unit principally focuses on employer groups of [REDACTED] or fewer employees. Included in these employer groups are employers having [REDACTED] or fewer employees ([REDACTED] percent). From [REDACTED] through [REDACTED] [REDACTED] submitted [REDACTED] proposals nationally to employers of all sizes, which included proposals to [REDACTED] Small Employers ([REDACTED] percent). For this same period, you submitted [REDACTED] proposals to employers of all sizes located in [REDACTED], which included proposals to [REDACTED] Small Employers ([REDACTED] percent).

Community Benefit Activities

In your letter dated [REDACTED], you represented that your board of directors would adopt a resolution to "commit a portion of excess revenues to provide [REDACTED] to the needy throughout [REDACTED]." Your board would also adopt a resolution to "commit to participate fully in the [REDACTED] educational program as developed by [REDACTED]"

In your [REDACTED] letter, you stated that the [REDACTED] [REDACTED] between you and [REDACTED] would be amended to include the costs of the [REDACTED]

You also stated in your [REDACTED] letter that you and [REDACTED] would amend their respective bylaws to include the requirement to perform social welfare and community benefit activities.

[REDACTED] You stated that [REDACTED] has recently adopted an extensive nationwide charity care program called

[REDACTED]

[REDACTED] " Under this program, [REDACTED] affiliates will provide [REDACTED] at no charge annually to [REDACTED] qualifying students on a national basis. [REDACTED] estimates the total annual cost of these services on a nationwide basis will be about \$ [REDACTED]. You stated that this program has been adopted by [REDACTED], but will be implemented by all of [REDACTED]. The free services will include [REDACTED] examinations, [REDACTED]

Qualifying students are children up to age 18 whose families earn up to [REDACTED] of the poverty level and do not participate in another [REDACTED] insurance program at work and who are not eligible for government aid, such as Medicaid.

You stated that [REDACTED] will implement the [REDACTED] program locally in collaboration with several nonprofit organizations. Current collaborations are with the [REDACTED] of [REDACTED] which has health clinics in [REDACTED] states serving [REDACTED] students; [REDACTED] which serves [REDACTED] students in [REDACTED] states; and The [REDACTED] in a pilot program ([REDACTED]), which expects to serve [REDACTED] in [REDACTED] states in [REDACTED]. Future collaborations are expected to be with the [REDACTED] (serving [REDACTED] students in [REDACTED] states), [REDACTED] (serving [REDACTED] students in [REDACTED] states), Corporation for [REDACTED] (serving [REDACTED] students in [REDACTED] states), and [REDACTED] (serving [REDACTED] students in [REDACTED] states).

You stated that [REDACTED] expects that the amount of free services provided by each affiliate will be proportionate to the population of the state or states serviced by the affiliate. Since [REDACTED] population is [REDACTED] of the U.S. population, you expect that your organization, which operates only in [REDACTED] will provide free [REDACTED] to [REDACTED] children annually at a cost of \$ [REDACTED] per year. This amount represents approximately [REDACTED] percent of your total projected revenues for [REDACTED] and [REDACTED]. [REDACTED] will track the number of children served and the value of the [REDACTED] services provided by each affiliate through [REDACTED] automated claims system.

You stated that [REDACTED] communicates the availability of its [REDACTED] through advertisements and press releases either on its own or with its collaborators.

[REDACTED]. You also stated that [REDACTED] has initiated a nationwide patient data collection, education, research and disease management program entitled [REDACTED] which will be implemented in [REDACTED] stages. [REDACTED] began in [REDACTED] and [REDACTED] will begin in [REDACTED]. This program will include a

[REDACTED]

diabetes outreach program, a patient wellness newsletter, other disease management programs for early detection and treatment of certain diseases that can be identified through a [REDACTED] [REDACTED] and a data collection program to demonstrate the health care quality of [REDACTED] [REDACTED] will coordinate the distribution of all related literature for patient education for all of its affiliates. [REDACTED] will also coordinate the diabetes outreach and other disease management programs for all affiliates. [REDACTED] is developing plans for communicating the [REDACTED] program to the general public, which is expected to begin in [REDACTED] as part of [REDACTED].

In your letter dated [REDACTED], you stated that you will amend the [REDACTED] with [REDACTED] to include social welfare and community benefit services in the services that [REDACTED] performs, and to modify the administrative charge to include the costs of the [REDACTED] educational programs that apply to your organization. However, you have submitted no information relating to the estimated amount of the additional per claim administrative charge or the total amount of such additional charges that you expect to incur 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, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines the words "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(4)-1(a)(1) of the regulations provides that 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.

Section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

In general, social welfare must benefit the general community as a whole and organizations exempt under section 501(c)(4) of the Code must be operated primarily to promote social welfare. Certain social welfare organizations serve only the community as a whole (pure public benefit) while others benefit a particular group of people but still primarily serve community interests. However, in instances where an organization limits its benefits to members, the organization is generally considered not to be operated for social welfare purposes.

There are a number of rulings that illustrate the distinction between organizations that serve the community and those that serve only their members or some other restricted class. See, e.g., Rev. Rul. 78-69, 1978-1 C.B. 156 (providing rush-hour bus service to members of the general public, where the bus service provided is subsidized by government and the regular bus service is not adequate or commercially available, constitutes a social welfare activity); and Rev. Rul. 78-429, 1978-2 C.B. 178 (an organization primarily promoted social welfare because it met a community need by operating an airport not otherwise available to the rural communities of the area). But see Rev. Rul. 75-199, 1975-1 C.B. 160, (an organization formed to provide sick and death benefits to members who are restricted to individuals of good moral character and health who belong to a particular ethnic group and reside in a stated geographical area provides only minor and incidental benefits to the community as a whole); and Rev. Rul. 55-311, 1955-1 C.B. 72 (providing bus service for a local association of employees, the membership of which is limited to employees of a particular corporation, is not a social welfare activity).

The distinction between "pure" public benefit and private benefit is illustrated by comparing Rev. Rul. 54-394, 1954-2 C.B. 131 (an organization does not primarily promote social welfare where it provides television reception on a cooperative basis) with Rev. Rul. 62-167, 1962-2 C.B. 142 (an organization retransmitting TV signals for the benefit of the entire community qualifies as a social welfare organization). See also Rev. Rul. 80-206, 1980-2 C.B. 185, (an organization formed to promote the legal rights of all tenants in a particular community qualifies as a social welfare organization) and Rev. Rul. 73-306, 1973-2 C.B. 179 (a similar organization, formed to protect the rights of

tenants in one particular rental complex, was not primarily promoting social welfare).

Another example of an organization benefiting only its members is Rev. Rul. 66-148, 1966-1 C.B. 143, in which the Service held that an organization formed to establish and maintain a system for water storage and distribution was exempt under section 501(c)(4) of the Code. Although it was a membership organization, its activities resulted in an increase in the level of underground water, which benefited the entire community, irrespective of membership.

Therefore, when the services furnished by an organization are beneficial to the community and available to all members of the community on an equal basis irrespective of membership, a social welfare objective will generally be found to exist. However, where an organization limits its services and benefits to its members, the organization is not ordinarily operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4).

While a social welfare organization necessarily benefits private individuals in the process of benefiting the community as a whole, even when the benefits are confined to a particular group of individuals, the organization may be exempt if the general community derives a substantial benefit. Conversely, an organization that benefits a large number of people will not necessarily be organized for social welfare purposes within the meaning of section 501(c)(4) because numbers are not necessarily determinative of social welfare objectives. Social welfare is the wellbeing of persons as a community and classification depends upon the character -- as public or private -- of the benefits bestowed, of the beneficiary, and of the benefactor. See Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962).

Therefore, the issue is whether the organization's activities result in so much private benefit as to preclude it from qualifying as a social welfare organization. The test in resolving this question with respect to exemption under section 501(c)(4) is "primarily," which, as used in the regulations, means that some amount of private benefit may be permissible so long as the organization's activities remain primarily social welfare. This necessarily requires weighing the extent to which an organization's activities are social welfare activities versus those that result in a private benefit. An example of the balancing between public and private benefits is Rev. Rul. 72-102, 1972-1 C.B. 149. In this revenue ruling, a homeowner's association formed by a developer to administer and enforce

[REDACTED]

covenants for preserving the architecture and appearance of a housing development and to own and maintain common green areas, streets and sidewalks for the use of development residents was held to be exempt under section 501(c)(4) of the Code even though there existed some amount of private benefit to the developer and individual residents because these benefits were incidental to the benefit provided to the community as a whole.

A similar analysis has been applied in the case of organizations exempt under section 501(c)(3) of the Code. Although an organization's operations may be deemed to be beneficial to the public, if it also serves private interests other than incidentally, it is not entitled to exemption under section 501(c)(3). The word "incidental" has both qualitative and quantitative connotations. To be qualitatively incidental, any private benefit must be a necessary concomitant of the activity which benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting certain private individuals. To be quantitatively incidental, any private benefit must be insubstantial measured in the context of the overall public benefit conferred by the activity.

Accordingly, exemption under section 501(c)(4) of the Code depends on an organization's ability to serve in some manner the general welfare of the community rather than providing benefits primarily to its members or to other interested parties.

In Rev. Rul. 86-98, 1986-2 C.B. 75, an individual practice association (IPA) sought recognition of exemption under section 501(c)(4) of the Code. The IPA's purpose was to arrange for the delivery of health service through written agreements negotiated with health maintenance organizations (HMOs). Its membership was limited to licensed physicians who were members of a specified county medical society. The IPA's primary activities were to serve as a bargaining agent for its members in dealing with HMOs and to perform the administrative claims services required by the agreements with the HMOs.

The IPA in this revenue ruling was akin to a billing and collection service and a collective bargaining representative negotiating on behalf of its member physicians with HMOs. The IPA did not provide access to medical care which would not have been available but for the establishment of the IPA, nor did it provide such care at fees below what was customarily and reasonably charged by the member physicians in their private practices. As a result, the Internal Revenue Service concluded that the IPA operated in a manner similar to organizations carried on for profit, the primary beneficiaries of which are its

member physicians, rather than the community as a whole. Therefore, the Service held that it was not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

Rev. Rul. 70-535, 1970-2 C.B. 117, describes an organization formed to provide management, development and consulting services for low and moderate income housing projects for a fee. The revenue ruling held that the organization did not qualify under section 501(c)(4) of the Code. The revenue ruling stated:

Since the organization's primary activity is carrying on a business by managing low and moderate income housing projects in a manner similar to organizations operated for profit, the organization is not operated primarily for the promotion of social welfare. The fact that these services are being performed for tax exempt corporations does not change the business nature of the activity.

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.

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 revenue ruling states:

Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code.

In Rev. Rul. 77-3, 1977-1 C.B. 140, a nonprofit organization that provides rental housing and related services at cost to a city for its use as free temporary housing for families whose homes have been destroyed by fire is not an exempt charitable organization. This revenue ruling states:

[I]t is the city rather than the organization that is providing free temporary housing to the distressed families. The organization is merely leasing housing property and providing certain maintenance and other services in connection therewith to the city at cost in a manner similar to organizations operated for profit, and is not itself engaged in charitable activities.

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. v. Commissioner, 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 enabling the corporation to provide commercially available services to wealthy individuals free of charge.

Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980), held that while a pharmacy that sells discounted prescription pharmaceuticals promotes health, it does not qualify for exemption under section 501(c)(3) of the Code on that basis alone because it operates for a substantial commercial purpose rather than for an exclusively charitable purpose.

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. Therefore, the organization did not qualify for recognition of exemption under section 501(c)(3) of the Code.

RATIONALE

One of the requirements of section 1.501(c)(4)-1(a)(1) of the regulations is that a section 501(c)(4) organization must be "operated exclusively for the promotion of social welfare" [emphasis added]. Under section 1.501(c)(4)-1(a)(2), 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" [emphasis added]. Such an organization must be "operated primarily for the purpose of bringing about civic betterments and social improvements" [emphasis added].

Unlike section 501(c)(3) of the Code, which includes both an organizational test and operational test, section 501(c)(4) has only an operational test. Thus, establishing whether an organization qualifies for exemption under section 501(c)(4) of the Code requires analysis of the organization's actual operations based on an examination of all of the relevant facts and circumstances.

One relevant fact is whether the organization has a community board of directors. This fact is relevant because an organization that has a community board is more likely to operate in a manner that primarily benefits the community as a whole rather than in a manner that primarily benefits its members or other restricted groups. Conversely, an organization that has a board that is controlled by private interests is less likely to operate in a manner that primarily benefits the community as a whole.

Another relevant fact is the character of an organization's enrollment. If an organization's enrollees are comprised primarily of persons who are considered medically underserved, this would tend to indicate that the organization operates in a manner that primarily benefits the community as a whole. Persons are considered to be "medically underserved" if they are unable to obtain, or cannot afford to pay for, the health care services that the organization provides. Conversely, if an organization's enrollees are comprised primarily of persons who are not considered medically underserved, this would tend to indicate that the organization operates primarily in a manner that provides health care services to the public on a commercial basis rather than in a manner that primarily benefits the community as a whole.

A third relevant fact is whether an organization is engaged to a substantial degree in social welfare and community benefit activities. If the organization's social welfare and community benefit activities represent a substantial part of its overall activities, this would be a positive fact. Conversely, if the organization's social welfare and community benefit activities represent only an incidental part of its overall activities, this would be a negative fact.

Each of these three elements is discussed further below.

1. Governance

Significant community benefit, as opposed to benefits that are limited to an organization's members or other restricted groups, is more likely to occur when the organization's board of directors is controlled by persons who broadly represent the community.

Presently, your board is comprised of [redacted] persons, [redacted] of whom is a contracted [redacted] and [redacted] of whom are principal officers of [redacted]. Thus, your board is not controlled by persons who broadly represent your community.

You have stated that [redacted] would adopt a substantial conflicts of interest policy; that it would amend its bylaws to provide that a majority of its directors must be independent members of the community; and that it would amend its quorum requirement to consist of a majority of directors. You have also stated that [redacted] would amend Section [redacted] of Article [redacted] of its bylaws relating to the Standing Committee on Public Policy to eliminate the requirement that the Standing Committee makes the final decision on all matters relating to rates or fees for professional services to Participating Members. Thus, [redacted] board of

[REDACTED]

directors, rather than the Standing Committee, would have the authority to make this final decision. Based on these proposed changes, it is likely that [REDACTED] would be controlled by members of the community and therefore, would be considered as having a "community board."

However, other than the adoption of a substantial conflicts of interest policy, you have not proposed making any changes to the structure of your board of directors. Thus, even if [REDACTED] has a community board, it does not automatically follow that you also have a community board.

In appropriate circumstances, where the board of directors of a controlling exempt organization is a community board, the Internal Revenue Service has treated the board of a nonprofit subordinate organization as also having a community board. The rationale for this treatment is that the board of the controlling organization and the board of the subordinate organization have common community interests. Thus, the Service has limited this treatment to circumstances where the component organizations of a integrated [REDACTED] delivery system are primarily located in the same geographic area, where the members of the boards of directors of the exempt organizations in the system substantially overlap and where the directors of both organizations generally live or work in the same geographic area.

This is not the case with [REDACTED] and with your organization. [REDACTED] operates in [REDACTED] and you operate in [REDACTED]. These states differ substantially in demographics, [REDACTED] needs of the population and availability of providers. Thus, the [REDACTED] "community" differs significantly from the [REDACTED] "community." Further, [REDACTED] of your [REDACTED] directors ([REDACTED]) are not also members of the [REDACTED] board. In addition, the [REDACTED] board is comprised of persons who are geographically dispersed throughout the country, primarily located in [REDACTED]. In fact, only one member of the [REDACTED] board is located in [REDACTED].² Therefore, even if [REDACTED] has a community board, under the present circumstances, it is inappropriate to treat your organization as also having a community board.

² Of the [REDACTED] current members of the [REDACTED] Board, [REDACTED] are located in [REDACTED] and [REDACTED], and only [REDACTED] located in [REDACTED]. The other [REDACTED] Directors are located in the States of [REDACTED].

[REDACTED]

Therefore, you do not have a community board of directors, either directly or indirectly.

2. Enrollment

Exemption under section 501(c)(4) of the Code depends on an organization serving the general welfare of the community rather than providing benefits solely to its members or to parties in control of the organization. The revenue rulings discussed above illustrate the distinction between organizations that primarily serve the community versus those that primarily serve their members or some other restricted class. See, e.g., Rev. Rul. 75-199, supra. By offering enrollment to persons who are generally considered to be medically underserved, a prepaid health care plan benefits the community as a whole. Groups that are generally considered to be medically underserved include individuals, employees of Small Employers, and Medicare and Medicaid beneficiaries.

As of [REDACTED], you enrolled virtually no individuals or Medicaid beneficiaries because you represent that it is not economically feasible for individuals to enroll in your plan and the State of [REDACTED] has assumed the burden of providing [REDACTED] to Medicaid beneficiaries. While these facts explain the reasons for not enrolling these medically underserved groups, they do not help to establish that your enrollment benefits the community as a whole.

Enrollees who are employees of Small Employers represent only [REDACTED] percent of your total enrollment. On the other hand, enrollees who are other than employees of Small Employers represent [REDACTED] percent of your total enrollment. Further, although [REDACTED] marketing department is attempting to enroll Small Employer groups in your organization, you have stated that this department principally focuses on employer groups of [REDACTED] or [REDACTED] employees. Thus, while you are attempting to increase your enrollment of [REDACTED], your current enrollment of [REDACTED] is minimal.

Although you arrange [REDACTED] for Medicare beneficiaries, you do so because of the requirements of your contracts with your [REDACTED], not because of your efforts to enroll this medically underserved group. Thus, you are a subcontractor to your [REDACTED] providing commercial services to their enrollees. Your [REDACTED], rather than you, enroll the Medicare beneficiaries. Thus, it is your HMO subscribers rather than you who benefit this medically underserved group by offering enrollment in an HMO with vision care services. Therefore, because you do not directly enroll

[REDACTED]

Medicare beneficiaries, but serve as a vendor of services to your HMO subscribers, your benefits to the community are incidental and remote. You are similar to the organization in Rev. Rul. 70-535, supra. In this revenue ruling, the organization provided management, development and consulting services for low and moderate income housing projects for a fee was found to be performing these services in a manner similar to organizations operated for profit and therefore was not operated primarily for the promotion of social welfare.

Therefore, your current enrollment is comprised predominantly of persons who are not considered medically underserved. As a result, your current activities do not primarily benefit the community as a whole but instead primarily benefit your large employer subscribers and your HMO subscribers.

3. Community Benefit Activities

Your community benefit activities consist of participation in two programs: [REDACTED]

Under the [REDACTED] program, in [REDACTED], you expect to provide [REDACTED] services to approximately [REDACTED] children per year at an annual cost of approximately \$[REDACTED]. However, [REDACTED] children represents only [REDACTED] percent of your total enrollment at [REDACTED] and \$[REDACTED] represents only [REDACTED] percent of your total annual revenues. Thus, your activities in connection with this program are insignificant.

You stated that you and [REDACTED] will amend the [REDACTED] to include social welfare and community benefit services and that the administrative charge will be amended to include the costs of the [REDACTED] educational programs that apply to [REDACTED]. However, you have submitted no information relating to the total amount of such additional charges that you expect to incur in [REDACTED]. Thus, it is unknown how much you expect to incur in connection with this program. Without this information, it cannot be determined whether your activities in connection with the [REDACTED] program will represent a substantial or only a minor portion of your overall activities.

You stated that you will amend your bylaws and the [REDACTED] to provide for community benefit activities, and that you will adopt resolutions involving charity care and the Health [REDACTED]. Nevertheless, your current community benefit activities, consisting only of the [REDACTED] and [REDACTED], represent only an insignificant portion of your total current activities. Merely engaging in some community benefit activities is inadequate to satisfy the

[REDACTED]

primary activity standard of the regulations, because non-exempt organizations also commonly perform some social welfare or community benefit activities in addition to their for-profit activities.

Further, you continue to realize significant operating surpluses. Through [REDACTED], your accumulated surpluses were approximately \$ [REDACTED] and you continue to expect to realize significant operating surpluses: \$ [REDACTED] in [REDACTED] and \$ [REDACTED] in [REDACTED]. You have not demonstrated that you have used, or that you intend to use, these surpluses for community benefit or social welfare activities.

Therefore, your social welfare and community benefit activities represent only an incidental part of your overall activities.

Another requirement of section 1.501(c)(4)-1(a)(1) of the regulations is that a section 501(c)(4) organization must not be organized or operated for profit. Further, section 1.501(c)(4)-1(a)(2)(ii) provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit. In Rev. Rul. 70-535, *supra*, an organization that provided various services for low and moderate income housing projects for a fee was not exempt under section 501(c)(4) of the Code because its primary activity was carrying on a business in a manner similar to organizations operated for profit.

Your primary activity is to arrange for the provision of [REDACTED]. This is the type of business activity commonly conducted to produce a profit.

Your board of directors is appointed by [REDACTED] and is comprised of [REDACTED] senior officers of [REDACTED] and an [REDACTED] engaged in the private practice of [REDACTED]. Presently, [REDACTED] is controlled by [REDACTED]. Thus, your organization is indirectly controlled by [REDACTED]. The only other group with a significant role in your organization consists of Participating Members, who are practicing [REDACTED] with whom you contract to provide services to your enrollees. An organization controlled by persons with a common business motive is characteristic of a for-profit enterprise.

In addition, you have continuously realized substantial surpluses. At [REDACTED], your accumulated surplus was

[REDACTED]

approximately \$ [REDACTED] and you expect to continue to realize large surpluses in [REDACTED]. The continuous realization of substantial surpluses and the accumulation of these surpluses is also characteristic of a for profit rather than a non-profit organization.

Therefore, based on these facts, it is concluded that your primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit and, therefore, you are not operated primarily for the promotion of social welfare.

Additionally, where a nonprofit organization's activities are more commercial rather than a social welfare, the organization does not qualify for exemption under section 501(c)(4) of the Code. Rev. Rul. 70-535, supra. Similarly, an organization engaged in activities that promote health does not qualify for exemption under section 501(c)(3) where the organization's activities are primarily commercial rather than charitable. See, e.g., Living Faith, Inc. v. Commissioner, supra; Federation Pharmacy Services, Inc. v. Commissioner, supra; Christian Stewardship Assistance v. Commissioner, supra; B.S.W. Group, Inc. v. Commissioner, supra; Rev. Rul. 77-3, supra; Rev. Rul. 72-369, supra. Based on all the facts and circumstances, you are primarily engaged in commercial activities rather than social welfare activities.

In conclusion, you do not satisfy the requirement of section 1.501(c)(4)-1(a) of the regulations that you must be "primarily engaged in promoting in some way the common good and general welfare of the people of the community" and "operated primarily for the purpose of bringing about civic betterments and social improvements."

CONCLUSION

For the reasons stated above, you do not qualify for exemption as an organization described in section 501(c)(4) of the Code.

The Code and the regulations issued thereunder require that you file federal income tax returns. Based upon the financial information that you furnished, you should file returns on the form and for the tax years indicated above within 30 days from the date of this letter with your key District Director for exempt organization matters, shown above, unless you request and your key District Director grants an extension of time to file the returns. You should file returns for later tax years with

[REDACTED]

the appropriate service center indicated in the instructions for those returns.

If you have any questions concerning the reasons for this ruling, please contact the person whose name and telephone number appear in the heading of this letter. You should address questions concerning the filing of returns to your key District Director.

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 representatives.

Sincerely,

[REDACTED]