

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Release copies to District

Date [REDACTED]

Contact Person:

Surname [REDACTED]

Telephone Number: [REDACTED]

In Reference to: [REDACTED]

Date: [REDACTED]

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

This is an initial adverse ruling on your application for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code ("Code"). The reasons for this ruling are explained below.

FACTS

You were formed on [REDACTED] as a mutual benefit corporation under the [REDACTED] Nonprofit Corporation Act of [REDACTED]. Article II of your Articles of Incorporation states that you are "organized to negotiate and contract with managed care companies, employers, insurance companies and other health organizations for the provision of health services through independent contractor health care providers."

Your Articles of Incorporation do not include any limitation of your activities to those that further exclusively charitable, religious, educational, and/or scientific purposes. Furthermore, your Articles of Incorporation do not include a clause providing for the distribution of your assets in the eventuality of your dissolution.

Your membership will be comprised of physicians and other health care providers. These members will elect your Board of Directors which will also be comprised of physicians.

LAW AND ANALYSIS

Section 501(a) of the Internal Revenue Code exempts from taxation organizations described in subsection (c)(3), which includes corporations organized and operated exclusively for

charitable, religious, scientific, and educational purposes. Furthermore, the aforementioned subsection requires that no part of the organization's net earnings inure to the benefit of any private shareholder or individual, that no substantial part of its activities is to influence legislation, and that it does not participate in any political campaign on behalf of or in opposition to any candidate for public office.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that to be exempt as an organization described in section 501(c)(3) of the Code an organization must be both organized and operated exclusively for purposes specified in said section of the Code. If an organization fails to meet either test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i)(a) of the regulations provides that an organization's articles of organization must limit its purposes to one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities that are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iv) of the regulations provides that in no case shall an organization be considered organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created are broader than the purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization organized for exclusively exempt purposes dedicates its assets to an exempt purpose. To meet this requirement its articles of organization must provide that in the event of dissolution its assets are to be distributed for exempt purposes.

Section 1.501(a)-1(c) of the regulations provides that private shareholders or individuals are defined as persons having a personal and private interest in the activities of an organization.

Section 1.501(c)(3)-1(c)(1) of 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). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of section 501(c)(3) of the Code, it is necessary for you to establish that you are not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" as used in section 501(c)(3) of the Code includes its generally accepted legal sense. The promotion of health is a recognized charitable purpose. Rev. Rul. 56-185, 1956-1 C.B. 202, as modified by Rev. Rul. 69-545, 1969-2 C.B. 117; Rev. Rul. 80-114, 1980-1 C.B. 115; and Rev. Rul. 83-157, 1983-2 C.B. 94.

Rev. Rul. 69-545, 1969-2 C.B. 117, establishes the "community benefit standard," which focuses on a number of factors indicating the operation of a hospital benefits the community rather than serving private interests. The revenue ruling requires all relevant facts and circumstances to be weighed in each case. The facts in Situation 1 of the revenue ruling indicate that the hospital is controlled by a board composed of independent civic leaders, it has an open medical staff, and an active, open, and accessible emergency room. Therefore, the hospital operates to serve public rather than private interests. In Situation 2 of the revenue ruling, five doctors who owned a for-profit hospital sold at fair market value their interest in the hospital to a nonprofit hospital which they controlled. The new nonprofit hospital is not exempt because of excessive private benefit to the five doctors. The facts indicate that in five years of operation only four other doctors have been granted staff privileges, applications from qualified physicians in the community have been rejected, admissions are restricted to patients of doctors holding staff privileges, the emergency room does not demonstrate a commitment to charity care and the physicians maintain office space at less than fair market value. This revenue ruling establishes a "facts and circumstances test" to measure private versus public benefit.

The private benefit prohibition of section 1.501(c)(3)-1(d)(1)(ii) of the regulations applies to all kinds of persons and groups, not just to those "insiders" subject to the more strict inurement proscription of section 501(c)(3) of the Code. Prohibited private benefit may include an "advantage; profit;

fruit; privilege; gain or interest." Retired Teachers Legal Defense Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization may provide benefits to private individuals provided those benefits are incidental quantitatively and qualitatively. To be qualitatively incidental, 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 benefitting certain private individuals. To be quantitatively incidental, the private benefit must be insubstantial, measured in the context of the overall public benefit conferred by the activity. To illustrate the quantitatively incidental concept, compare Rev. Rul. 68-14, 1968-1 C.B., with Rev. Rul. 75-286, 1975-2 C.B. 210. In Rev. Rul. 68-14, an organization that helped beautify a city was exempt when it planted trees in public areas, cooperated with municipal authorities in tree plantings and programs to keep the city clean, and educated the public in advantages of tree planting. In Rev. Rul. 75-286, an organization with similar activities did not qualify under section 501(c)(3) where its members consisted of residents and business operators of a city block and its activities were limited to that block. The facts in Rev. Rul. 75-286 indicate that the organization was organized and operated for the benefit of private interests by enhancing the value of members' property.

RATIONALE

Your articles of Incorporation and Bylaws indicate that you are not organized for exclusively exempt purposes under section 501(c)(3) of the Code, having failed to include language that will limit your activities to those specified in section 501(c)(3). Furthermore, you failed to dedicate your assets to an exempt purpose as required by section 1.501(c)(3)-1(b)(4) of the regulations.

The facts submitted indicate you are not engaging in the practice of medicine or operating a hospital. You are merely negotiating managed care and physician care contracts for your physician-members and other member-health care providers. This is not a charitable activity because it serves the private interests of your members in conducting their private medical practices.

The physicians and other members under the facts submitted are "private individuals" and are subject to the private benefit proscription. They receive prohibited private benefit which includes an advantage, profit, fruit, privilege, gain and interest through this transaction with the Foundation. See Retired Teachers Legal Defense Fund v. Commissioner, supra. The substantial private

benefit to the physicians and other members is fatal to your exempt status.

Lastly, since the members of your Board of Directors are members of your organization, the physicians on your Board are "insiders" subject to the inurement proscription. Therefore, your activities result in prohibited inurement to the physicians on your Board of Directors.

Based on all the facts and circumstances, the Service must conclude that you do not perform a charitable activity, you more than insubstantially benefit the private interests of your physician-members, and you confer prohibited inurement on the physician-members of your Board of Directors. Therefore, you are not organized and operated exclusively for exempt purposes. See Better Business Bureau v. United States, 326 United States 278 (1945).

For all the reasons stated above, we have concluded that you do not qualify for exemption from Federal income tax under section 501(c)(3) of the Code and you are required to file Federal income tax returns. Contributions to you are not deductible under section 170 of the Code.

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

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States 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

[Redacted]

Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

Sincerely,

[Redacted]

[Redacted]

Chief, Exempt Organizations

[Redacted]

[Redacted]

	:	Initiator	:	Reviewer	:	Reviewer	:	Reviewer
Code	:	[Redacted]	:	[Redacted]	:	[Redacted]	:	[Redacted]
Surname	:	[Redacted]	:	[Redacted]	:	[Redacted]	:	[Redacted]
Date	:	[Redacted]	:	[Redacted]	:	[Redacted]	:	[Redacted]