

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Contact Person: [REDACTED]

I.D. No. [REDACTED]

Telephone Number: [REDACTED]

In Reference to: OP:E:EO:T:1:LMB

Date: MAR 18 1999

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)(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 [REDACTED] as a nonprofit membership corporation under the laws of the [REDACTED]. Your members consist of [REDACTED] unrelated organizations. [REDACTED] of these organizations are exempt under section 501(c)(3) of the Code<sup>1</sup> and [REDACTED] are state or county government agencies.<sup>2</sup> Your member organizations elect your board of directors.

On [REDACTED], your board of directors adopted a substantial conflicts of interest policy.

You operate as a consortium of these [REDACTED] charitable and governmental organizations. Your goal is to improve the health status of medically underserved residents of [REDACTED]. You further this objective by providing coordination, management and administrative services for and on behalf of your [REDACTED] member organizations. You coordinate the delivery of health care services by your members to poor and needy members of the community. Through this coordination, you expect that your

<sup>1</sup> The [REDACTED]

and [REDACTED]

<sup>2</sup> [REDACTED]

members can save money, avoid duplication of health care services, focus and track the delivery of health care services to families in your community and, over time, reduce the overall cost of health care in your community.

You do not employ or contract with health care providers to provide health care services directly to patients, or arrange for the provision of health care services to patients by employed or contracted health care providers. You have no agreements between your organization and your eight member organizations that describe your relationship with your members.

Your principal activities consist of the following:

1. Coordinating, implementing and monitoring the "Healthy Start" project pursuant to a contract awarded by the U.S. Public Health Service to one of your members, [REDACTED] ( [REDACTED] ). This program is directed toward low income individuals with the objective of reducing infant mortality in four targeted zip code areas in [REDACTED].

To be eligible for participation in this program, the U.S. Public Health Service requirements include that the applicant must be a public or nonprofit private organization that applies as or on behalf of an existing community-based consortium and must be in partnership with a current consortium, which may be a community-based organization. The U.S. Public Health Service does not require that the applicant itself must be tax-exempt under section 501(c)(3) of the Code.

2. Administering the "Healthy Futures" project, pursuant to grants awarded to [REDACTED] by the [REDACTED] for the purpose of reducing the incidence of child abuse and neglect in [REDACTED].
3. Providing integrated health care systems pursuant to a grant to [REDACTED] from the [REDACTED].

One of your activities includes the development of a networked, management information system that permits your members and other tax-exempt organizations and governmental agencies to make referrals and to coordinate the provision of social and clinical health services to those in need.

LAW

Stand Alone Basis for Exemption

Section 501(c)(3) of 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 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 recognized 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(b)(1) of the regulations provides that an organization is organized exclusively 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)(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.

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."

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.

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 qualified for exemption under section 501(c)(3) of the Code because it both promoted health and advanced education. Because its services are designed to relieve psychological tensions and thereby improve the mental health of the children and adolescents, it promoted health.

In Rev. Rul. 77-69, 1977-1 C.B. 143, an organization was formed as a Health Systems Agency (HSA) under the National Health Planning and Resources Development Act of 1974. As an HSA, the organization's primary responsibility was the provision of effective health planning for a specified geographic area and the promotion of the development within that area of health services, staffing and facilities that met identified needs, reduced inefficiencies and implemented the HSA's health plan. The revenue ruling concluded that by establishing and maintaining a system of health planning and resources development aimed at providing adequate health care, the HSA was promoting the health of the residents of the area in which it functioned. Therefore, the HSA qualified for exemption under section 501(c)(3) of the Code on the basis that it promoted health.

Rev. Rul. 81-298, 1981-1 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) of the Code because it promotes

health by helping to relieve the distress of hospital patients who benefit from the visitation and comfort provided by their relatives and friends.

In Professional Standards Review Organization of Queens County, Inc. v. Commissioner, 74 T.C. 240 (1980) ("Queens County PSRO"), acq., 1980-2 C.B. 2, the Tax Court held that an organization that reviewed the propriety of hospital treatment provided to Medicare and Medicaid recipients was exempt under section 501(c)(3) of the Code because it lessened the burdens of government and promoted the health of persons eligible for Medicare and Medicaid.

In Rev. Rul. 81-276, 1981-2 C.B. 128, the Service held that a PSRO qualifies for exemption under section 501(c)(3) of the Code because it lessens the burdens of government and promotes the health of the beneficiaries of the Medicare and Medicaid programs.

Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980), held that while selling prescription pharmaceuticals promotes health, pharmacies cannot qualify for recognition of exemption under section 501(c)(3) on that basis alone.

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.

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 for exemption under section 501(c)(4) of the Code.

Rev. Rul. 54-305, 1954-2 C.B. 127, involves 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, deals with an organization formed to provide management and consulting services at cost to unrelated exempt organizations. This revenue ruling held that providing managerial 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 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 a charitable organization exempt under 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.

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 for exemption 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.

In Rev. Rul. 76-455, 1976-2 C.B. 150, a nonprofit organization formed to encourage and assist in establishing nonprofit regional health data systems, to conduct studies and propose improvements with regard to quality, utilization and effectiveness of health care and health care agencies, and to educate those involved in furnishing, administering, and financing health care was operated exclusively for scientific and educational purposes and qualified for exemption under section 501(c)(3) of the Code.

#### Integral Part Basis for Exemption

Section 502 of the Code states that an organization operated for the primary purpose of carrying on a trade or business for profit is not tax exempt on the ground that all of its profits are payable to one or more tax-exempt organizations.

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.

In Rev. Rul. 78-41, 1978-1 C.B. 148, a trust created by a hospital to accumulate and hold funds to pay malpractice claims against the hospital was determined to be an integral part organization because the hospital exercised significant financial control over the trust. This was because the trustee was required to make payments to claimants at the direction of the hospital, the hospital provided the funds for the trust and the hospital directed where the funds from the trust were to be paid.

#### Cooperative Hospital Service Organizations

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 (e.g., "clinical" services). These services must be performed for two or more exempt hospitals and the organization must allocate or pay, 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. To qualify under

section 501(e), the services must be such that if they were performed by an exempt hospital, they would constitute activities in exercising or performing the purpose or function constituting the basis for the hospital's exemption. Therefore, implicit in section 501(e) is the requirement that hospital service organization must also satisfy the community benefit standard of Rev. Rul. 69-545, supra.

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.

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).

#### RATIONALE

##### Stand Alone Basis for Exemption

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 regulations also provide 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.

The promotion of health has long been recognized as a charitable purpose. Whether a hospital promotes health in a charitable manner is determined under the community benefit standard of Rev. Rul. 69-545, supra. This standard focuses on a number of factors to determine whether the hospital benefits the community as a whole rather than private interests. The application of the community benefit standard to exempt hospitals and other exempt health care organizations was sustained in Eastern Kentucky Welfare Rights Org. v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), vacated on other grounds, 426 U.S. 26 (1975); and in Sound Health Association v. Commissioner, 71 T.C. 158 (1978), acq., 1981-2 C.B. 2.

The Service and the courts have recognized that the promotion of health includes activities other than the direct



provision of patient care. See Rev. Rul. 81-298, supra; Rev. Rul. 81-276, supra; Rev. Rul. 77-69, supra; Rev. Rul. 77-68, supra; Rev. Rul. 75-197, supra; and Queens County PSRO, 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.

A nonprofit organization that provides ordinary business services for one or more exempt health care organizations does not promote health in a charitable sense. See Rev. Rul. 70-535, supra; Rev. Rul. 54-305, supra; Rev. Rul. 69-528, supra; Rev. Rul. 72-369, supra; Rev. Rul. 77-3, supra; B.S.W. Group, Inc. v. Commissioner, supra; and Christian Stewardship Assistance, Inc. v. Commissioner, Inc., supra.

By providing coordination, management and administrative services for and on behalf of your eight unrelated section 501(c)(3) member organizations, so that they can more effectively and efficiently deliver health care services to poor and needy individuals the community, you are engaged in ordinary business activities for these organizations that do not directly promote health in a charitable manner.

Although providing services to unrelated tax-exempt health care organizations promotes health, it does not promote health in a charitable manner. See Living Faith, Inc.; Federation Pharmacy Services, Inc. The services you perform for these organizations are commercial services that facilitate their performance of their activities in furtherance of their tax-exempt purposes.

Therefore, since you provide no more than incidental benefits to the community as a whole, you do not satisfy the community benefit standard of Rev. Rul. 69-545, supra.

While the development of a networked, management information system that permits your members and other tax-exempt organizations and governmental agencies to make referrals and to coordinate the provision of social and clinical health services to those in need may be considered a charitable activity (see Rev. Rul. 76-455, supra), this is not your predominant activity.

Because you have not established that a substantial portion of your activities consists of the promotion of health in a charitable manner, you do not operate 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.

### Integral Part Basis for Exemption

Section 1.502-1(b) of the regulations establishes the integral part doctrine for exemption. Under this principle, an organization may derive exemption from a controlling exempt organization if the subordinate organization is not engaged in an activity that would be an unrelated trade or business if the activity were performed by the controlling organization. See also Squire v. Students Book Corp., 191 F.2d 1018 (9th Cir. 1951).

Thus, for the integral part doctrine to apply, two requirements must be satisfied: (1) the exempt organization must exercise sufficient control and close supervision, based on all the facts and circumstances, to establish the equivalent of a parent and subsidiary relationship, and (2) the subordinate entity must perform "essential services" for the exempt parent.

Under the first requirement, in the absence of a direct parent-subsidiary relationship, the exempt organization from which the subordinate organization seeks to derive its exemption must exercise sufficient control and close supervision, based on all the facts and circumstances, to establish the equivalent of a parent and subsidiary relationship under section 1.502-1(b) of the regulations. See Rev. Rul. 78-41, supra; Rev. Rul. 75-282, 1975-2 C.B. 201 (organization controlled by a conference of churches to provide member churches with mortgage loans). The facts and circumstances must demonstrate that the "parent" organization exercises significant control over the subordinate's management and financial decisions. Where more than one exempt organization controls the subordinate, in order to establish the requisite equivalent of a parent and subsidiary relationship, the exempt organizations must be related to each other through common ownership.

You are not controlled by a single exempt organization or by multiple related exempt organizations. Instead, you are controlled by eight exempt organizations that are unrelated to each other through common ownership. Therefore, you do not qualify for exemption under the integral part doctrine in section 1.502-1(b) of the regulations. Thus, it is not necessary for us to consider whether you perform "essential services" for these unrelated organizations.

Cooperative Hospital Service Organizations

An organization that provides services for hospitals that are exempt under section 501(c)(3) of the Code may qualify for exemption under section 501(c)(3) if it meets the requirements of section 501(e). However, the exemption applies only to organizations that provide one or more of 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 for exemption.<sup>1</sup>

The activities you provide for your members are not the services specifically enumerated in section 501(e) of the Code or in section 1.501(e)-1 of the regulations. In addition, 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.

Donors may not deduct contributions to your organization under section 170 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 the appropriate service center indicated in the instructions for those returns.

<sup>1</sup> In effect, HCSC overruled the contrary decision in United Hospital Services, Inc. v. U.S., 384 F.Supp. 776 (S.D. Ind. 1974), which your attorney cited on page [redacted] of his letter dated [redacted].

[REDACTED]

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate a suit in 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 before the 91st day after the date that we mailed this ruling to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. The filing of a declaratory judgment suit under section 7428 does not stay the processing of income tax returns and assessment of any taxes.

In accordance with section 6104(c) of the Code, we will notify the appropriate State officials of this action.

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 representative.

Sincerely,

*Marvin Friedlander*

Marvin Friedlander  
Chief, Exempt Organizations  
Technical Branch 1