



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Date [REDACTED]

Date:

FEB 28 2001

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [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.

You were incorporated under the laws of the State of [REDACTED] on [REDACTED] for charitable purposes within the meaning of section 501(c)(3) of the Code. Your specific purposes are to:

- a. provide a full array of cost effective, high quality, coordinated behavioral services to those in need in [REDACTED] and [REDACTED];
- b. promote, by donation, loan, the provision of services or otherwise, the interests of your members;
- c. provide services, aid, assistance and support to one or more of your members in its or their:
 - (i) provision of mental health, drug and alcohol, rehabilitative, preventive, and/or related behavioral health services to individuals in need throughout the [REDACTED] area;
 - (ii) advancement and improvement of mental health, drug and alcohol, rehabilitative, preventive, and/or related behavioral health services;
 - (iii) provision of funds to further the erection, establishment, organization, equipment, operation, management, and maintenance of facilities providing mental health and/or related behavioral health services to individuals; research regarding mental health; the establishment of standards for such services; the development of improved methods of mental health and related behavioral health services delivery and methods to contain the costs thereof;
 - (iv) efforts to acquire and hold, either through purchase or lease, improved or unimproved real estate to be used for current needs and future expansion;
 - (v) efforts to receive contributions from whatever sources, whether unrestricted or designated purposes or subject to any conditions specified in the terms of

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- (vi) the gift or grant;
serve as a conduit for the pooling and disbursement of certain funds for investment purposes or any other lawful purpose;
 - d. contract with managed care plans, payors, and other purchasers of behavioral health services on behalf of your members in order to provide quality managed behavioral health services through your members in an efficient and competitive manner;
 - e. enable your members to actively and creatively offer and deliver comprehensive behavioral health services in managed care programs; and
 - f. to organize, develop, negotiate, and/or participate in capitation and other risk-sharing arrangements involving your members and other health care providers.

Article I of your Bylaws provides for definitions. "Members" is defined as [REDACTED] nonprofit corporations that join the Corporation as evidenced by contributions of representatives on the Board of Directors of the Corporation and capital for the Corporation.

Article III of your Bylaws provides for members. Section 3.1(a) provides for capital contributions. It states that the members shall contribute such initial capital to the Corporation as is determined by the Board. Such capital may include such items as cash and the book value of assets including, but not limited to, any leasehold improvements made to the Corporation's real property. It shall not be necessary for each member to provide an equivalent amount of initial capital to the Corporation. Section 3.1(b) provides, in part, that additional future capital contributions shall be made by each member in such amounts as the Board, by a supermajority vote (2/3), determines necessary. However, if the request calls for unequal contributions from members, the consent of those members from which a higher contribution is sought shall be required.

Section 3.2 of your Bylaws provides for revenue distribution and payments for services rendered. It states that except as may be authorized by the [REDACTED] nonprofit statute, the Corporation shall not pay dividends or distribute income or profits to members, Directors or officers. However, members shall be entitled to receive separate additional payments for services rendered to the Corporation or for services rendered to clients or patients of the Corporation provided such payments for services are pursuant to a contract approved by the Board.

Section 3.3 of your Bylaws provides that withdrawing members shall have no right to a return of capital contributed while a member of the Corporation. However, the Board may, in its discretion, return certain money or other capital contributed by the withdrawing member. The withdrawal or resignation of a member shall not relieve such member from its obligation to the Corporation for its accrued financial obligations.

Section 3.5 of your Bylaws provides, in part, that a member removed without cause shall be entitled to a return of the capital contributed by that member. A member removed with cause shall have no right to a return of money or other capital contributed while a member of the Corporation.

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Section 3.10 of your Bylaws provides that each member shall have one vote.

Article IV of your Bylaws provides for the Board of Directors. It states that your Board shall be composed of not more than the product of two (2) times the number of members. At all times each member shall be represented on the Board by having two (2) representatives serve as Directors. Each member shall select its two (2) members to serve on the Board. Each Director shall serve at the will of the member appointing him or her.

Article X of your Bylaws provides for a conflicts of interest policy. However, it does not meet the Service's requirements.

On Form 1023 you state that sources of financial support will be from membership fees from member corporations and reimbursement from members for the costs and expenses related to the services provided. You state that you have no assets other than cash.

Regarding membership, you state that membership is restricted to mental health agencies, behavioral care and treatment agencies, and organizations promoting services, aid, support, assistance and improvement of mental health and behavioral care services within Northwestern, Pennsylvania. You state that all member agencies are within the class of section 501(c)(3) of the Code. You state that dues range from \$[REDACTED] for the original members in the first and second years to \$[REDACTED] to \$[REDACTED] per organization in the third, fourth and fifth years depending on their respective budgets.

You state that direct services will be provided only to the member agencies. However, all patients and clients of the member agencies will benefit from the increased scope and more effective and timely delivery of mental health and behavioral care services which will result from the coordination provided by you.

Regarding benefits members will receive, you state that members will participate in planning for the managed care phenomenon and receive training for accreditation, so they may enhance their preparedness for managed care for mental health and behavioral treatment and services in the near future. You state that you will provide training and consulting services to your members which will prepare the agencies to participate effectively in managed care on a coordinated basis.

On Form 1023 you state that you are organized to be a coalition for planning, coordinating and promoting mental health services and behavioral treatment, care and counseling. You state that you are organized to assist represented charities in securing a cooperative environment to provide care and receive payment for mental health services within current guidelines required under Pennsylvania law and the counties of the Northwest Region of the State.

There are twenty-two (22) [REDACTED] private non-profit behavioral health corporations which make up your organization. All of these members serve the public county-based community mental health, mental retardation, and substance abuse treatment programs, either directly or through the member's provider affiliate.

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You state that the State of [REDACTED] has elected to purchase behavioral health services separately from general medical and surgical services for the Medicaid initiative known as "HealthChoices". You state that you are a provider-owned integrated delivery system which proposes to share financial risk and reward and to manage and provide those behavioral health services to the publicly funded client base in [REDACTED] and [REDACTED] under contract with one or more contracting entities, including county governments, their (managed care organization or health maintenance organization) partners and potentially other commercial carriers.

You state that postponement of the State of [REDACTED]'s Behavioral Health Medicaid initiative (HealthChoices) in [REDACTED] until [REDACTED] makes it a virtual certainty that you will not become an operating entity until [REDACTED] or later. Accordingly, you have reconvened your strategic planning process to react to this new reality and have redirected your efforts toward further preparing your member agencies for the managed care phenomenon. This will mainly take the form of providing training and consultation for your members directed toward their achieving appropriate accreditation by national accrediting bodies, such as the National Committee on Quality Assurance (NCQA) and the Joint Commission on Accreditation of Healthcare Organizations (JCAHO).

Section 501(c)(3) of the Code provides for the exemption from federal income tax, as provided under section 501(a), of organizations organized and operated exclusively for, among others, charitable or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides, in part, that the term "charitable" is used in its generally accepted legal sense.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that, in general, 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 empower the organization to engage, other 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(b)(1)(iv) of the regulations provides that in no case shall an organization be considered to be 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).

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose if, upon dissolution, such assets would by reason of a provision in the organization's articles or by

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operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose.

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 Revenue Ruling 54-305, 1954-2 C.B. 127, a corporation organized and operated for the primary purpose of operating and maintaining a purchasing agency for the benefit of unrelated tax-exempt charitable organizations was held not to be exempt under section 501(c)(3) of the Code (the predecessor to section 501(c)(3)) because it was engaged in ordinary business activities.

Revenue Ruling 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. This revenue ruling held that the service organization did not qualify under section 501(c)(3) and stated that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

Revenue Ruling 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 ruling held that the organization did not qualify under section 501(c)(4) of the Code (and by extension is not exempt under section 501(c)(3)). This 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."

Revenue Ruling 72-369, 1972-3 C.B. 245, describes an organization formed to provide management and consulting services for non-profit organizations exempt under section 501(c)(3) of the Code to improve the administration of their charitable programs. The organization enters into agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The services consist of writing job descriptions and training manuals, recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation. These activities are designed for the individual needs of each client organization. Receipts of the organizations are from services rendered. Disbursements are for operating costs.

The revenue ruling concludes that providing managerial and consulting services on a regular

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basis for a fee is 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. The revenue ruling holds that the organization's activities are not charitable and therefore the organization does not qualify for exemption under section 501(c)(3).

Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), held, in part, that the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption regardless of the number or importance of statutorily exempt purposes.

B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), held that an organization which provided consulting services for a fee to nonprofit organizations did not qualify for exemption under section 501(c)(3) of the Code. The court noted that B.S.W.'s activities constituted the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit.

Your Articles of Incorporation do not limit your activities to those activities within section 501(c)(3) of the Code. The promotion of your members' interests through the provision of management and consulting services is not an exempt purpose within the meaning of section 501(c)(3) of the Code. Consequently, your Articles of Incorporation do not meet the "purpose" requirement under section 1.501(c)(3)-1(b)(1)(i) of the regulations. Therefore, you fail to meet the organizational test under section 1.501(c)(3)-1(a)(1) of the regulations.

You are a management services organization. You operate in a manner similar to the organizations described in revenue rulings 72-369, 70-535, 69-528, and 54-305, *supra*, in that you are providing managerial and consulting services on a regular basis for a fee, and like the organizations in the revenue rulings, you are engaging in a trade or business regularly carried on for profit. You will contract with members, who are unrelated behavioral health care providers, to provide planning, coordination and promotion of mental health services and behavioral treatment, care and counseling. You will provide your members with consulting, financial and administrative management services.

You operate in a manner similar to the organizations described in the revenue rulings and court cases cited above in that you are engaging in the provision of services in a regular commercial manner. The organizations in the revenue rulings and court cases cited above also confined their services to organizations which were exempt from federal income tax.

The provision of administrative, managerial, financial, clerical, and clinical needs on a regular basis for a fee, whether to exempt or nonexempt organizations, is a trade or business ordinarily carried on for profit. The provision of services in a regular commercial manner does not further an exempt purpose within the meaning of section 501(c)(3) of the Code. Therefore, you are not operated exclusively for exempt purposes.

Based on the above, we conclude that you are neither organized nor operated exclusively for exempt purposes. Consequently, 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.

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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 to this office, 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 a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. 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
[REDACTED], T:EO:RA:T:1
1111 Constitution Ave, N.W.
Washington, D.C. 20224

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

Sincerely,

Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1