

Internal Revenue Service

Department of the Treasury <sup>Date: 6-22-95</sup>

Surname [REDACTED] [REDACTED] 2/12/95

Washington, DC 20224

[REDACTED]

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date: MAY 12 1995

Employer Identification Number: [REDACTED]  
Key District: Los Angeles

Dear Applicant:

We have considered your application for recognition of exemption as an organization described in section 501(c)(4) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

**FACTS**

You were formed on [REDACTED], pursuant to the [REDACTED] Corporation Law. On [REDACTED], you submitted your Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code. Your incorporator and sole corporate member is [REDACTED], an organization described in section 501(c)(3) of the Code. [REDACTED] serves as the sole member of [REDACTED] and [REDACTED]. In addition to your corporate member, you also have physician members.

A [REDACTED] member Board of Directors governs you. Two thirds of the Board members are elected by [REDACTED] and one third of the Board members are elected by the physician members.

As represented in your application, you will arrange for hospital and physician services for health maintenance organizations ("HMOs") and other health plans serving the community. [REDACTED] and [REDACTED] will enter into agreements, with you to act as providers of hospital services to health plans contracting with you. The physician members will enter into membership agreements with you. Under these membership agreements they will agree to act as providers to health plans contracting with you and to participate in various programs and services offered by you.

Article 8 of your Articles of Incorporation provides:

"The Corporation shall be organized for the following purposes:

- (a) to promote group identity and public image for the incorporator's hospitals and the physician members of the corporation;
- (b) to educate the public as to the skills and level of care available through the incorporator's hospitals and the physician members;
- (c) to create an association of hospitals and physicians to coordinate the delivery of comprehensive, affordable, quality integrated health care services to the communities served by the incorporator's hospitals and the physician members;
- (d) to create an entity which allows for the contracting of hospital and physician members services to health maintenance organizations and other health care plans;
- (e) to aid in the development of products and services that improve the delivery of health care services;
- (f) to provide a forum on methods of revenue enhancement, competitiveness, and other aspects of practice enhancement and management while encouraging free and fair competition among members and nonmembers of the corporation;
- (g) to operate as a social welfare organization within the meaning of Section 501(c)(4) of the Internal Revenue Code of 1986, as amended; and
- (h) to engage in all other activities not specifically enumerated herein which may be necessary, convenient or desirable to carry out the aforementioned purposes."

#### ANALYSIS

Section 501(c)(4) of the Internal Revenue Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable educational, or recreational purposes.

Section 1.501(c)(4)-1(a)(1) of the Income Tax Regulations provides that a civic league or organization may be exempt as an organization described in section 501(c)(4) of the Code if--

- (i) It is not organized or operated for profit; and
- (ii) It is operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(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. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A social welfare organization will qualify for exemption as a charitable organization if it falls within the definition of charitable set forth in paragraph (d)(2) of section 1.501(c)(3)-1 and is not an action organization as set forth in paragraph (c)(3) of section 1.501(c)(3)-1. Subsection (ii) provides that the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or it is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

In Rev. Rul. 86-98, 1986-2 C.B. 75, an individual practice organization ("IPA") sought exemption under section 501(c)(4) of the Code or, alternatively, under section 501(c)(6). Noting that the IPA functioned both as a bargaining representative and a billing and collection service on behalf of its members, that it did not provide access to any medical care for HMO patients beyond what was already available in the absence of the IPA, and that fees were not below what was customarily and reasonably charged by members in their private practices, the revenue ruling concluded that the IPA operated in manner similar to organizations carried on for profit, and that its primary beneficiaries were its member-physicians rather than the community as a whole. It operated, in effect as a mutual self-interest organization rather than an organization that promoted social welfare. Consequently, exemption was denied under section 501(c)(4) of the Code. It was also denied exemption under section 501(c)(6) because the billing and collection services provided an economic convenience to its members in relation to the operation of their private medical practices. The revenue ruling concluded that the IPA primarily performed particular services for its members rather than activities that

improved overall business conditions in the medical profession and in the public health field.

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 an activity that 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.

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 physicians in private practice, which is not a charitable activity because it serves the private interests of the physicians in conducting their private medical practices, as well as the private interests of other for profit-providers that participate in your network. You are a physician-hospital organization (PHO).

As a PHO, your implementation, coordination, and oversight of a managed health care delivery system, as well as other planning activities, only indirectly benefit the community as a whole. These planning activities are primarily beneficial to the private physicians because you are providing the physicians with specific long and short term planning information that can be used by them in their private business activities. Therefore, the private benefit to the physicians is not qualitatively or quantitatively incidental or insubstantial in comparison to the community benefit produced by your activities. The substantial private benefit to the physicians and other providers is fatal to your exempt status. Furthermore, you are carrying on a business with the general public in a manner similar to organizations operated for profit. Therefore, we have concluded that you do not qualify for exemption from Federal income tax under section 501(c)(4) of the Code. You are required to file Federal income tax returns.

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, signed by one of your principal officers, must be submitted in duplicate 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 principal officers, he or she must

[Redacted]

file a proper power of attorney and otherwise qualify under the Conference and Practice 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.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Los Angeles, California, which is your key district for exempt organization matters. Thereafter, any questions about your federal tax status or the filing of returns should be addressed to that office. If you want the matter reopened at a later time, you must pay a new user fee as provided in Rev. Proc. 95-8, 1995-1 I.R.B. 187.

Sincerely,

(signed)

[Redacted Signature]

Chief, Exempt Organizations  
Technical Branch 1

cc:

[Redacted CC list]

[Redacted line]

*cc: A/R*

*cc: State Authorities*

	Initiator	Reviewer	Reviewer	Reviewer
Code	[Redacted]	[Redacted]	[Redacted]	[Redacted]
Surname	[Redacted]	[Redacted]	[Redacted]	[Redacted]
Date	5-2-95	[Redacted]	[Redacted]	[Redacted]

*15/4/95*