



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Number: **201128028**  
Release Date: 7/15/2011

Date: April 19, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.03-00; 501.03-08; 501.03-15

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Date: March 9, 2011

UIL Code:

501.03-00  
501.03-08  
501.03-15

Legend:

Parent Hospital =  
Medical Center 1 =  
Medical Center 2 =  
Foreign Government =  
Country A =  
Country B =  
Country C =

Dear :

We have considered your application for recognition of exemption from Federal income tax under section 501(a) of the Internal Revenue Code ("Code"). Based on the information provided, we have concluded that you do not qualify for exemption as an organization described in section 501(c)(3). The basis for our conclusion is set forth below.

Facts

You were incorporated on November 25, 2005 under state law as a nonprofit membership corporation. Your sole member is Parent Hospital. Parent Hospital is a nonprofit corporation that is described in section 501(c)(3) of the Code and classified as other than a private foundation under sections 509(a)(1) and 170(b)(1)(A)(iii). Parent Hospital owns and operates a tertiary care hospital and related medical office buildings, research, outpatient and other facilities. Parent Hospital is also the parent of a large integrated healthcare delivery system, controlling, directly or indirectly, a number of other exempt and non-exempt entities that own and operate various healthcare facilities, including three full service acute care hospitals, a research institute, and a physician organization.

Your Articles of Incorporation state that you:

*... [W]ill conduct health care related activities, by means of providing services relating to management and operation of health care facilities providing inpatient,*

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

*outpatient and/or other health care services, all undertaken with the goal of improving health and the delivery of health care services in communities served.*

In your Form 1023 Application, you state:

*The Corporation will conduct health care related activities by means of providing services relating to management and operation of health care facilities providing inpatient, outpatient and/or other health care services, all undertaken with the goal of improving health and the delivery of health care services in the communities served. In support of such activities, the Corporation will enter into affiliation agreements to provide consulting services, materials and limited licenses to health care facilities (the "Affiliate") throughout the world. The purpose of such affiliations is to improve the quality of health care services by sharing the efficiency and effectiveness measures currently utilized by [Parent Hospital]. In accomplishment of such goals, the Corporation will provide opportunities for the Affiliate to observe departments at [Parent Hospital], provide in-depth analysis of the Affiliate's systems, resources, and processes and will monitor activities of the Affiliate to improve the performance of the facility. The Corporation will provide educational opportunities, internships and fellowships for the employees and staff of the Affiliate.*

You also state in your Application:

*The Corporation will assist hospitals in over 70 countries throughout the world, including \*\*\*\*\*. The Corporation's operations in foreign countries will allow the Corporation to fulfill its commitment to improving health and the delivery of health care services throughout the world.*

In subsequent correspondence, you state that you do not expect your charges for affiliation and consulting services to be substantially below your costs. You state, further, that you anticipate "that some of [your] affiliation arrangements and consulting arrangements will be entered into with for-profit organizations and the Corporation will not limit its services to organization that are the equivalent of governmental and charitable organizations."

You represent in your correspondence that you have received and expect to receive in the future, "contributions of capital" from Parent Hospital. You have also represented that you will solicit public funding and charitable donations and that you expect about 20 percent of your activities will be funded through "public and charitable funds." Your Form 1023 indicates that \$\*\*\*\*\* of your \$\*\*\*\*\* in revenue in 2006 was "intercompany revenue," while the remaining \$\*\*\*\*\* was consulting fee revenue. By contrast, your 2006 Form 990 indicates that all \$\*\*\*\*\* represented fees from "health care consulting." Similarly, your 2007 and 2008 Forms 990 show that health care consulting fees represented about 98 percent of your revenue during those years.

You maintain two websites on the Internet. On one of your websites, under the heading "Consulting Services," you state:

*Our consulting services provide expedient, step-by-step processes to create a foundation for efficient, quality-driven healthcare. We can offer specific services to address highly specific needs or we can provide comprehensive, across-the-board institutional assessments. [We offer] consulting services over a range of vital areas:*

- *Organization and Leadership*
- *Patient Care and Quality Measures*
- *Nursing Staff*
- *Support Services*
- *Finance and Accounting*
- *Medical Staff Organization*
- *Information Technology*

On this same website, under the heading "Affiliations," you state:

*[We work] with select hospitals around the world to help them achieve levels of excellence--clinical, technical, administrative, financial, and operational--unrivaled by any competing institution in their respective regions. These consulting services are offered to affiliated hospitals at significantly reduced rates. To join this elite network, candidate hospitals must, in addition to complying with the mandated standards, demonstrate their commitment to the highest quality and performance. This engagement generally consists of the following steps:*

- *An initial assessment of facility, systems, operations, and quality indicators*
- *Developing custom plans for clinical, financial, and/or operational improvements*
- *Implementing these improvements utilizing appropriate consulting services*
- *Implementing a quality measurement system to ensure long-term compliance with standards*
- *Optional branding as [our] affiliate . . . .*

On your other website, under the heading "About Us," you state:

**Advisory Services.** *Providing expert consultation and recommendations for international clients through [Parent Hospital]'s network of highly experienced administrators, physicians and health care professionals.*

**Education and Training.** *Developing academic and practical programs that advance professionals and institutions through customized learning opportunities at [our] facilities or onsite at a client's location.*

**Hospital Management.** *Planning, developing and operating specialty and general hospitals — including leadership team recruitment, staff and resource management.*

**Affiliation.** *Building a global network of hospitals committed to a higher level of clinical, operational and quality standards. Through this unique model, affiliates have real-time access to [Parent Hospital]'s vast intellectual property, validated expertise and brand.*

You describe each of these activities on this same website. Under the heading "Advisory Services," you state:

**Market Analysis and Business Development**

*Conducting feasibility studies*

*Developing strategic and business plans*

*Leadership Development*

*Recommending effective strategy and models for organizational governance and structure*

**Clinical Programs and Operations**

*Assessing clinical programs and identifying opportunities for growth*

*Determining the scope of services and planning for existing and new service lines*

*Consulting on the design of medical facilities and identifying appropriate diagnostic and therapeutic equipment*

**Quality and Patient Safety**

*Developing systems and processes for clinical quality management; benchmarking*

*Identifying areas for performance improvement and designing interventional procedures*

*Establishing policies and procedures for patient care, patient safety, infection control and patient education*

**Nursing Operations**

*Developing leadership structure and governance strategies*

*Implementing evidence-based practice and care delivery models*

*Setting standards for continuing education and quality assessment*

### **Financial and Business Operations**

*Selecting appropriate accounting systems and establishing effective budgeting processes; revenue cycle and supply chain management*

*Identifying key operational indicators and benchmarks, and implementing robust financial reporting and analysis*

### **Information Technology and Infrastructure**

*Selecting and implementing IT systems to efficiently and securely capture clinical, operational, quality and financial data in a reliable infrastructure*

### **International Accreditation and Recognition**

*Assessing organizations against international standards to determine readiness and compliance*

*Assisting clients to prepare for accreditation by internationally recognized certifying organizations*

On this same website, under the heading "Education and Training," you state

**Observerships:** *Organized individual learning experiences onsite at [our] facilities . . . . Personalized programs allow clients to interact and observe with colleagues and mentors in most areas of clinical and business operations.*

**Training Programs:** *Comprehensive rotations structured as practical experience. These programs provide clients the option of either receiving training onsite or at our . . . facilities in a dynamic and relevant setting.*

**Continuing Medical Education:** *Conferences, seminars and other targeted education offered by [Parent Hospital] can either be attended in [person] or, where available, broadcast via videoconferencing technology. Medical, nursing and administrative education content is also developed and conducted at international locations as requested.*

On this same website, under the heading "Hospital Management," you state:

**Leadership Selection:** *Choosing and directing executive leaders of the managed hospital*

**Training:** *Comprehensive, in-depth training programs conducted at [our] facilities . . . .*

**Operation:** *Using predetermined business and quality objectives to run the facility to international standards*

And on this same website, under the heading "Global Affiliations," you state:

**Knowledge Transfer:** *Unique privileges and up-to-date access to [Parent Hospital]'s administrative and clinical knowledge, operating standards, expertise, and measures*

**Benchmarking:** *Access to information including key operating statistics and performance measures; connected to a global initiative based on quality, patient safety and performance*

**Local and Regional Differentiation:** *Enabling affiliates to provide best-in-market medicine and demonstrate superior operating efficiency and clinical outcomes to competing institutions*

**Brand Differentiation:** *Access to [Parent Hospital]'s marketing expertise, and assistance with marketing and business development*

You have entered into several agreements with foreign governments and foreign healthcare organizations. You state that in the future, you intend to enter into similar agreements with many other foreign governments and foreign healthcare organizations. Three of these agreements, which are typical of the types of agreements you expect to enter into in the future, are described below.

#### Agreement with Medical Center 1

Effective August 25, 2005, you entered into a "Consulting Services Agreement" with Medical Center 1. Under this agreement, which would continue through March 30, 2006, you will provide various specified services to Medical Center 1, a hospital located in Country A, in connection with the opening of a cancer center. Your agreement with Medical Center 1 states: the "Objective" is:

*Comprehensive review, analysis and recommendations for the cancer center opening Nov/Dec 2006.*

The "Approach" is:

*[You] will first conduct a thorough needs assessment prior to visiting the Hospital in [Country A]. Next, two visits to the hospital to meet and collaborate with the key personnel and to develop relationships that solidify assessing the information required to complete all phases of this process.*

The "Resource Team" will consist of five of your employees specified by name. Your fee for the above services is \$\*\*\*\*\*, plus a "mentoring fee" of \$\*\*\*\*\*per year.

In 2007, you reported the receipt of \$\*\*\*\*\* in contract revenue from Medical Center 1.

#### Agreement with Medical Center 2



Effective January 1, 2007, you entered into a "Consulting Services Agreement" for a term of two years with the Medical Center 2, a hospital located in Country B. Section 1 of this Agreement states:

*. . . [You] shall provide to [Medical Center 2] management and administration consulting services (collectively, the "Consulting Services") in the areas of administrative leadership and organization, financial operations and systems, nursing quality and support services. While personnel of [you] may travel to [Country B] in order to undertake some on-site assessments, most of the Consulting Services will be provided by [your] personnel . . . . The focus of the Consulting services will be designed in order to allow [Medical Center 2] to achieve specific improvements in operations, staffing and evidence-based medical practices through the assessments undertaken by the personnel of [you] during the course of providing the Consulting Services, as well as during the visits by [Medical Center 2] personnel to [Parent Hospital]. The primary objective of the [Medical Center 2] Project will be:*

- a. Assist [Medical Center 2]'s management leadership to organize an efficient and effective governance structure that can better formulate and execute [Medical Center 2]'s strategic plan, as well as identify areas for improvement;*
- b. Advise [Medical Center 2] regarding the institution of systems and processes that provide oversight and direction for quality patient care (i.e., medical staff bylaws and continuing medical education for physicians);*
- c. Educating the financial leadership of [Medical Center 2] regarding how to effectively utilize accounting and budgeting systems in order to maintain viable hospital operations and determine future sources of increased revenues for [Medical Center 2];*
- d. Assisting [Medical Center 2]'s management to identify the clinical services needed in the local community and thereafter design plans for the growth and development of appropriate areas to serve the healthcare needs of the local community;*
- e. Advising [Medical Center 2] on the establishment of nursing, quality, and safety programs (including additional training) that are developed to facilitate the measurement of outcomes and continuous improvement of clinical care; and*
- f. Counseling [Medical Center 2] on what actions can be taken by [Medical Center 2] to improve the [Medical Center 2] facilities, support services and supply chain management (e.g., radiology, laboratory, food and nutrition; waste management, housekeeping, security, etc.)*

The Agreement does not state that Medical Center 2 will pay you any fees, although they will reimburse you for travel costs and for "any costs directly in the course of rendering the Consulting Services that are not paid directly by [Medical Center 2]." In 2007, you reported the receipt of \$\*\*\*\*\* in contract revenue from Medical Center 2.

### Agreement with Foreign Government

On May 3, 2006, you entered into "Health System Management and Development Agreement" with the Investment Development Office ("IDO" or "Owner") of Foreign Government in Country C for a term of ten years. The Preamble to this Agreement states that:

*. . . IDO is building a private fifty (50) bed acute care hospital (the "Hospital") in the [Country C] as well as the centers of excellence to be developed in accordance with this Agreement (the "Centers") and desires the assistance of [you] to provide management services to assist in the operation of the Hospital and/or the Centers and to consult in the development and management of additional private healthcare facilities to be owned by IDO in the hospital system.*

*. . . [You desire] to work with IDO in the management and development of its hospitals and healthcare facilities in [Country C].*

Article 2 of the Agreement is entitled "General Scope of the Agreement." Article 2.1 of states:

*IDO hereby engages Manager [i.e., you] and Manager hereby accept such engagement, to provide the hospital management services set forth in this Agreement (the "Management Services"). The Management Services include:*

- 2.1.1 Manager shall assist IDO in pre-opening requirements and managing the Hospital.*
- 2.1.2 Manager shall assist IDO in evaluating the feasibility of developing, and operating three or four ambulatory care centers (the "Centers") - - specializing in heart, ortho, neurology, and/or urology, including rehab and observation facilities.*
- 2.1.3 Manager shall assist IDO in reviewing opportunities to develop other healthcare facilities in [Country C] and elsewhere. The management of such facilities is not included in the Management Services, but IDO can request Manager to consider entering into a management contract for such facilities. . . .*

Article 3 is entitled "Joint Goals and Objectives." Article 3.1 of states:

*The Parties recognize that Manager is qualified and competent to provide the Management Services, to advise Owner as to the Hospital's and the Centers' needs and to suggest ways to enhance and improve services to the patients and the communities served by the Hospital and the Centers. . . .*

Article 3.2 states:

*It is the joint goal of Manager and Owner to:*

- 3.2.1 Establish goals and objectives for the operation of the Hospital and the Centers;*
- 3.2.2 Provide a consistent level of high quality services to patients of the Hospital and the Centers;*
- 3.2.3 Operate the Hospital and the Centers on a sound financial basis, through effective financial accounting reporting systems and internal controls;*
- 3.2.4 Establish and maintain an excellent public image for the Hospital and the Centers; and*
- 3.2.5 Operate the Hospital and the Centers at appropriate levels of staffing to promote quality care and financial viability.*

Article 4 of the Agreement, relating to Governance, establishes a Steering Committee. Article 4.1 states:

*A steering committee comprised of four (4) appropriately experienced designated healthcare executives [designated by you] and four (4) appropriately experienced IDO designated healthcare executives shall be established to oversee the development and operations of the Hospital and the Centers (the "Steering Committee"). . . . Manager shall present to the Steering Committee (i) annual operating and capital budgets, (ii) a three (3) year strategic plan, (iii) an annual work plan, (iv) an annual business plan and (v) the administrative and financial policies. The Steering Committee shall review such budgets, plans and proposals and make a final recommendation to IDO for approval. IDO shall have sole authority to approve all matters brought before the Steering Committee and Manager shall be entitled to rely on the approval of chairman of the Steering Committee to act on behalf of IDO. . . .*

Article 4.2 states:

*The Steering Committee shall be chaired by a nominee designated by IDO.*

Article 4.3 states:

*In the case of equal votes, the chairman of the Steering Committee shall have a casting vote.*

Article 5 states:

*Manager shall provide the Management Services consistent with the following standards:*

- 5.1 Standard of Health Care
- 5.2 Quality Controls
- 5.3 Planning
- 5.4 JCI [Joint Commission International] Standards
- 5.5 Confidentiality of Records
- 5.6 Patient Services
- 5.7 Physician Recruiting
- 5.8 Third Party Contacts
- 5.9 Training
- 5.10 Method Statement [strategic plan]
- 5.11 Feasibility Study

Article 8 is entitled "Intellectual Property." Article 8.1 states:

*[You] shall provide the Hospital and the Center with a revocable, non-transferable and non-exclusive license to access the applicable policies and procedures of The [Parent] Hospital System . . . .*

Article 9 is entitled "Marketing." Article 9.1 states:

*[You] shall provide access to its marketing expertise and assist the Hospital and the Centers in developing methods for the Hospital and the Centers to more effectively market the Hospital's and the Centers' services in [Country C] . . . .*

Article 10 is entitled "Branding." Article 10.1 states:

*During the term of this Agreement, the Hospital and the Centers shall have the ability to brand itself as a "Network Hospital of [You]", or a similar term as mutually agreed by [you] and IDO after the confirmation of applicable regulatory requirements.*

Article 10.2 states:

*The Hospital and the Centers shall have the ability to use [Your] name and logo (in the manner authorized by [you]) in its marketing activities and in its materials, as approved by [you] for each separate marketing activity; . . .*

The fee arrangement between you and IDO is stated in Article 11. The fees consist of two components: "Fee for Developing the Centers" and "Fee for Managing the Hospital and the Centers." The Fee for Developing the Centers consists of three parts:

- \$\*\*\*\*\* for the preparation of the feasibility study for the Centers
- \$\*\*\*\*\* for the development of the Centers

- \$\*\*\*\*\* for the continued development of the Centers.

The Fee for Managing the Hospital and the Centers consists of:

- The greater of \$\*\*\*\*\* or 3.5 percent of Net Revenue of the Hospital, the Centers and any other IDO facility managed by Manager (collectively, the "Health System") from May 1, 2006 through April 30, 2007.
- The greater of \$\*\*\*\*\* or 3.5 percent of Net Revenue of the Health System from May 1, 2008 through April 30, 2009.<sup>1</sup>
- The greater of \$\*\*\*\*\* of 3.5 percent of Net Revenue of the Health System beginning May 1, 2009 and for each twelve-month period thereafter during the term of the Agreement.

Article 11.3 provides that IDO will pay you "an additional incentive" equal to 10 percent of "Adjusted Net Earnings" for the Health System for each fiscal year. Article 11.5 states that IDO will pay you for the name license referred to in Article 10: \$\*\*\*\*\* for the period beginning on the date of the Agreement through April 30, 2007; \$\*\*\*\*\* for May 1, 2007 through April 30, 2008; and \$\*\*\*\*\* per year for each twelve-month period from May 1, 2008 during the term of the Agreement.

Article 14 states that you will have the exclusive right to recommend a Chief Executive Officer; Chief Financial Officer, Medical Director and Chief Nursing Officer, subject to final recommendation of the Steering Committee and the approval of IDO. You will not have any employees on site on a full time basis at the Hospital or the Centers.

Article 20.5, entitled "No Partnership," states:

*Manager and Owner shall not by virtue of this Agreement be deemed partners or joint venturers or landlord and tenant in the operation of the Health System or any related facility. It is expressly understood that Manager is hereby retained by Owner as an independent contractor to manage Health System on behalf of Owner.*

For 2007, your contract revenues were:

International Observer Fees	\$	*****
Physician Training for Medical Center 1 Hospital	\$	*****
Quality Assessment	\$	*****
Nursing Assessment	\$	*****
Physician Training for Medical Center 1 Hospital	\$	*****
Physicist Training for Medical Center 1 Hospital	\$	*****

<sup>1</sup> Inexplicably, the Agreement does not address the period from May 1, 2007 through April 30, 2008.

Foreign Government Mgmt/Affiliation	\$	*****
Medical Center 1 Hospital Affiliation	\$	*****
Medical Center 2 Consultation	\$	*****
	\$	*****

## Law

Section 501(a) of the Code provides for the exemption from federal income tax for organizations described in Section 501(c) of the Code.

Organizations described in Section 501(c)(3) of the Code include corporations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the corporation's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations ("regulations") states that to be described in section 501(c)(3) of the Code an organization must be organized and operated exclusively for the purposes specified therein, which include charitable and educational purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations states that 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(d)(2) of the regulations states that an organization is not organized or operated exclusively for one or more exempt purposes specified in section 501(c)(3) unless it serves a public rather than a private interest. Thus, in order for an organization to qualify for exemption under section 501(c)(3), it is necessary for the organization to establish that it is 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 states, in part, that the term "charitable" in section 501(c)(3) of the Code includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; lessening of the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations states that the term "educational" in section 501(c)(3) of the Code includes the instruction or training of the individual for the purpose of improving or developing his or her capabilities or the instruction of the public on subjects useful to the individual and beneficial to the community

Section 1.501(c)(3)-1(e)(1) of the regulations states that an organization may meet the requirements of section 501(c)(3) even though it operates a trade or business as a substantial part of its activities, as long as the operation of the trade or business is in furtherance of its

exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities that are in furtherance of an exempt purpose.

In Rev. Rul. 68-504, 1968-2 CB 211, a nonprofit organization that was formed to conduct an educational program for bank employees in a particular urban area qualified for exemption under section 501(c)(3) of the Code.

Rev. Rul. 69-545, 1969-2 C.B. 117, holds that a non-profit hospital that benefits a broad cross section of its community by having an open medical staff and a board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare) may qualify as an organization described in section 501(c)(3) of the Code.

Rev. Rul. 71-529, 1971 C.B. 234, describes a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds. Because the organization is performing an essential function for tax-exempt organizations for a charge "substantially below cost," it qualifies for exemption under section 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, describes an organization formed to provide managerial and consulting services for nonprofit organizations to improve the administration of their programs. Its primary activities were to enter into agreements with unrelated exempt organizations to provide managerial and consulting services on a cost basis. The ruling held that the organization was not exempt because its primary activity of providing managerial and consulting services for a fee was a trade or business ordinarily carried on for profit. The fact that services were provided at cost solely to exempt organizations was not sufficient to characterize the activity as charitable within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 85-110, 1985-2 C.B. 166, describes a hospital exempt under section 501(c)(3) that performed diagnostic laboratory testing on referred specimens from private patients of hospital staff physicians. The ruling held, in effect, that this activity had no substantial casual relationship to the achievement of the hospital's exempt purpose of promoting community health.

In Rev. Rul. 98-15, 1998-1 C.B. 718, the IRS noted that "not every activity that promotes health supports tax exemption under section 501(c)(3). For example, selling prescription pharmaceuticals certainly promotes health, but pharmacies cannot qualify for recognition of exemption under [section] 501(c)(3) on that basis alone."

In Better Business Bureau of Washington D.C., Inc. v. U.S., 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that a trade association had an "underlying commercial motive" that distinguished

its educational program from that carried out by a university, and therefore, the association did not qualify for exemption.

American Institute for Economic Research v. U.S., 302 F.2d 934 (Ct. Cl. 1962), cert. denied, 372 U.S. 976 (1963), described an organization that had a stated aim of teaching and disseminating economic knowledge, published two semi-monthly periodicals available for subscription, and provided investment advice services for a fee. The court held that this organization did not qualify for exemption under section 501(c)(3) of the Code, because its commercial purpose of selling investment advice was primary and not incidental to its educational purpose.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of an organization formed to provide consulting services for a fee to nonprofit and tax exempt organizations in the areas of health and health delivery systems, housing, vocational skills, and cooperative management. In concluding that the organization did not qualify for exemption, the court noted that such consulting services were "not inherently charitable, educational, or scientific." Id. at 359. It also noted that "the critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for petitioner." Id. at 357. Among the factors the court listed in support of its conclusion that the organization was furthering a substantial non-exempt commercial purpose were competition with commercial firms, the lack of financing in the form of "voluntary contributions from the public," the presence of net profits, the failure to offer any free or below-cost services, and the "failure to limit its clientele to organizations which are themselves section 501(c)(3) exempt organizations." Id. at 358-60.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8<sup>th</sup> Cir. 1980), the court held that, while selling prescription pharmaceuticals to elderly persons at a discount promotes health, the pharmacy did not qualify for recognition of exemption under section 501(c)(3) of the Code on that basis alone. Because the pharmacy operated for a substantial commercial purpose, it did not qualify for exemption under section 501(c)(3).

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), an organization was formed for charitable and educational purposes. The organization's primary activity was to operate a school. The school trained individuals for careers as political campaign professionals. Prior to the formation of the organization, the National Republican Congressional Committee (NRCC) sponsored programs designed to train candidates and to train and subsequently place campaign professionals in Republican campaigns. The organization stated that it was an outgrowth of the programs operated by the NRCC. While applicants were not required to formally declare their political affiliation to attend the organization's school, such affiliation could be deduced from the campaign experiences and political references contained in the applications. No graduate was known to affiliate with any domestic political party other than the Republican Party.

The court held that an organization's activities did not exclusively serve exempt purposes because it did not operate on a nonpartisan basis and it served private interests more than incidentally. The court concluded that the organization conducted its activities to benefit the



private interests of Republican entities and candidates. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest. While the school had a legitimate educational program, the court held that the school conducted its educational activities with the objective of benefiting the private interests of the Republican Party.

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7<sup>th</sup> Cir. 1991), involved an organization established by the Seventh Day Adventist Church to carry out its "health ministry" through operation of two vegetarian restaurants and health food stores. The court sustained the IRS's denial of tax exemption under section 501(c)(3) of the Code because the organization was operated for a substantial non-exempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3<sup>rd</sup> Cir. 1993), the court held that a pre-paid health care organization that arranged for the provision of health care services only for its members, benefited its members, not the community as a whole and therefore did not further charitable purposes within the meaning of section 501(c)(3).

IHC Health Plans, Inc. v. Commissioner, 325 F.3d 1188 (10<sup>th</sup> Cir. 2003), involved an operator of health maintenance organizations (HMOs), one of which served approximately one-quarter of Utah's residents and approximately one-half of its Medicaid population. The court held that the HMOs failed to qualify for exemption under section 501(c)(3) of the Code because their sole activity was arranging for health care services for its members, in exchange for a fee. In reaching this conclusion, the court noted that "engaging in an activity that promotes health, standing alone, offers an insufficient indicium of an organization's purpose," as "[n]umerous for-profit enterprises offer products or services that promote health." Id. at 1197.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C. 2003), the court concluded that an organization did not qualify for tax-exemption under section 501(c)(3) of the Code because it was operated for non-exempt commercial purposes rather than for exempt purposes. Among the major factors the court considered in reaching this conclusion was the organization's competition with for-profit commercial entities, the extent and degree of below cost services provided, the pricing policies, and the reasonableness of financial reserves. Additional factors included whether the organization used commercial promotional methods, such as advertising, and the extent to which the organization received charitable donations.

### **Rationale**

Based on the information in your Form 1023 Application, the additional information you submitted in subsequent correspondence, and the information that appears on your two Internet websites, we have concluded that you do not qualify as an organization described in section 501(c)(3) of the Code because:

- You are not operated exclusively for charitable, educational, or any other exempt purposes within the meaning of section 501(c)(3) of the Code;
- More than an insubstantial part of your activities is not in furtherance of a tax-exempt purpose, as prohibited by section 1.501(c)(3)-1(c)(1) of the regulations.

### Promotion of Health

The promotion of health has long been recognized as a charitable purpose under common law. See *Restatement (Second) of Trusts*, §§ 368, 372 (1959); 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* §§ 368, 372 (4th ed. 1989). However, not every activity that generally promotes health furthers exclusively charitable purposes under section 501(c)(3) of the Code. For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under section 501(c)(3) on that basis alone. Fed'n Pharmacy Services, Inc., supra. Nor does a hospital primarily further a charitable purpose solely by offering health care services to the public in exchange for a fee. See IHC Health Plans, supra; Rev. Rul. 98-15, supra; Rev. Rul. 69-545, supra. Rather, a hospital or other health-promoting organization must be organized and operated primarily for the benefit of the community, as evidenced by such factors as a board that represents the community, operation of an emergency room, provision of charity care, medical training, or medical research. Rev. Rul. 69-545, supra; see also IHC Health Plans, supra (applying the same "community benefit" standard to HMOs); Geisinger Health Plan, supra (applying the same "community benefit" standard to HMOs).

You describe your activities in your application, in subsequent correspondence, and on your two Internet websites. In addition, the services you plan to provide to your paying clients are described in the three agreements discussed above. These activities consist of providing management, advisory and consulting services in return for fees to foreign hospitals and foreign governments to assist them in designing, developing and operating healthcare facilities in foreign countries. You are not an owner or operator of these healthcare facilities, but rather a vendor of management, advisory, and consulting services to their owners and operators. Merely because your activities involve healthcare does not, *per se*, constitute the promotion of health for a charitable purpose within the meaning of section 501(c)(3) of the Code. See IHC Health Plans, supra; Federation Pharmacy Services, Inc., supra; Rev. Rul. 98-15, supra; Rev. Rul. 69-545, supra. You do not provide healthcare services directly to patients, as do the hospitals in Rev. Rul. 69-545. Instead, you provide managerial, advisory, and consulting services to your paying clients. Although the services you perform may incidentally result in benefiting a community through the improvement of healthcare services, your primary purpose is to provide your paying clients with management, advisory and consulting services, which are not inherently charitable activities. See B.S.W. Group, Inc., supra; Rev. Rul. 72-369, supra. Therefore, your activities do not primarily promote health for a charitable purpose within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(d)(2) of the regulations.

### Education

Furthering education is also an exempt purpose within the meaning of section 501(c)(3) of the Code. The regulations explain that the term "educational" in section 501(c)(3) of the Code

includes the instruction or training of the individual for the purpose of improving or developing his or her capabilities or the instruction of the public on subjects useful to the individual and beneficial to the community. See section 1.501(c)(3)-1(d)(3)(i) of the regulations.

The management, advisory and consulting services you provide in return for fees to foreign hospitals and foreign governments to assist them in designing, developing and operating healthcare facilities in foreign countries include a certain amount of training for the employees of your clients. With respect to some of this training, the primary beneficiaries are the institutional clients paying for the services, not the individuals receiving the training or the public in general. The Tax Court has made clear that "where the training of individuals is focused on furthering a particular targeted private interest, the conferred secondary benefit" constitutes a nonincidental private benefit inconsistent with tax-exemption under section 501(c)(3). American Campaign Academy, supra at 1074.

Additionally, the training is but a minor component of the overall management, advisory and consulting services that you provide to your clients. Thus, even if these activities were considered to instruct individuals or the public within the meaning of section 1.501(c)(3)-1(d)(3)(i), they are not your primary activity because they constitute only an incidental portion of your overall activities. For this reason, they are distinguishable from the educational program conducted by the organization in Rev. Rul. 68-504, supra, which was its sole activity.

Therefore, your primary activities do not further education within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

#### Substantial Non-Exempt Purpose

An organization is 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. See section 1.501(c)(3)-1(c)(1) of the regulations.

An organization may qualify under section 501(c)(3) of the Code even though it operates a trade or business as a substantial part of its activities, as long as the trade or business furthers its exempt purpose and it is not operated for the primary purpose of carrying on an unrelated trade or business. In making this determination, one factor that is considered is the size and extent of the trade or business in relation to the size and extent of the activities that further an exempt purpose. See section 1.501(c)(3)-1(e)(1) of the regulations.

Your activities -- providing management, advisory and consulting services in return for fees to foreign hospitals and foreign governments to assist them in designing, developing and operating healthcare facilities in foreign countries -- are not inherently charitable or educational. B.S.W. Group, Inc., supra. Rather, "[p]roviding managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit." Rev. Rul. 72-369, supra. Moreover, you have represented that you will not charge substantially below cost for these services, nor will you limit the provision of services to organization that are the equivalent of governmental and charitable organizations. As such, your furnishing of the services "lacks the

donative element necessary to establish this activity as charitable." Rev. Rul. 72-369, supra. Thus, your primary activities do not further charitable or other exempt purposes within the meaning of section 501(c)(3).

Moreover, the facts that you are (1) providing services for a fee that are characteristic of for-profit management and consulting companies, (2) not providing free or below-cost services, (3) receiving the vast majority of your revenues from service fees rather than from voluntary contributions from the public, and (4) not limiting your clientele to organizations that are themselves section 501(c)(3) exempt organizations, all indicate that you are primarily operated for non-exempt commercial purposes rather than exempt purposes. B.S.W. Group, Inc., supra; Airlie Found., supra. The presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Better Business Bureau of Washington D.C., supra. Your substantial non-exempt purposes are thus inconsistent with tax exemption under section 501(c)(3).

Therefore you have not established that you are organized and operated for exempt purposes within the meaning of section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree 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 all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service  
\*\*\*\*\*  
1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Thank you for your cooperation. We have sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations