

Internal Revenue Service
Appeals Office
312 Elm Street, Suite 2330
Cincinnati, OH 45202-2763

Department of the Treasury

Taxpayer Identification Number:
E

Release Number: 201215019
Release Date: 4/13/2012
Date: 1/20/2012

Person to Contact:

Tel:
Fax:

A
B
C

Tax Period Ended:

UIL: 501.04-00

Dear

This is our final adverse determination regarding your request for recognition of exempt status under section 501(c)(4) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from federal income tax under section 501(c)(4) of the Code effective October 12, 2004, the date of your incorporation in the D.

Our adverse determination was made for the following reason:

Your proposed activities involve substantial commercial-type pharmaceutical sales. We have determined that the sales activity is your primary activity. Therefore, we have determined that you are not an organization operating for exempt social welfare purposes described in section 501(c)(4) of the Code.

You are required to file federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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.

Sincerely Yours,

Appeals Team Manager



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: **MAY 3 2011**

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

M = State
N = City, State
X = Date

UIL Number:

501.04-00
501.04-06

Dear

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(4). This letter supersedes our proposed adverse letter dated March 9, 2011 and incorporates your protest and our response to your protest. The basis for our conclusion is set forth below.

ISSUES:

- 1.) Do you qualify for exemption under IRC § 501(c)(4)? No, for the reasons described below.
- 2.) Are you excluded from qualifying from exemption because you are operated in a commercial manner? Yes, for the reasons described below.

FACTS:

You were incorporated on date X, pursuant to the nonprofit corporation statutes of the State of M. Your articles indicate that you were formed to operate a pharmacy on a non-profit basis to serve the economically disadvantaged and their families; to purchase medicine directly from manufacturers and sell at slightly above cost to those individuals who are needy and cannot afford to pay market costs of medications and are unqualified to obtain either private or governmental insurance for drugs; to solicit donations for the purpose of dispensing medications at no cost to the uninsured recipient individual who cannot afford to pay for such medications. Your articles also say that the lawful public or quasi-public objective which the above business

purpose will achieve is to provide medication to low income individuals, their families and other people who otherwise may not be able to afford necessary medication. Your articles go on to state that notwithstanding any other provision of this document, you will not carry on other activities not permitted to be carried on by an organization exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code, or by an organization contributions to which are deductible under Section 170(c)(2) of the Internal Revenue Code.

You previously applied for exemption under Section 501(c)(3) of the Internal Revenue Code, but you withdrew your application because you determined that you would not be qualified.

You are the successor to a for-profit pharmacy with a similar name. The for-profit pharmacy is not dissolved. You said it operates at the same location as you, but has had minimal to no activity over the last three years. You did not explain why you changed from a for-profit to a non-profit, or why you did not dissolve the for-profit entity. You stated you are currently a "retail pharmacy selling only fertility drugs." Your hours are Monday through Friday from 12pm – 4pm. You advertise through media published by non-profit organizations engaged in infertility counseling. You are not located at street level. You are operated out of a 3rd floor office. You employ four individuals, including a licensed pharmacist.

You indicated that in communities in which large families predominate, such as the Orthodox Jewish community, infertility carries both a physical and emotional stigma. To alleviate these conditions and help those afflicted, you were formed to aid all infertility patients to be able to procure the drugs they need. You also are in close contact with medical personnel and other organizations so you know the patient's needs.

You said for % of your sales each year, all charges for the fertility medications were waived. For uninsured customers you sell the drugs at cost. For insured customers you sell the drugs at the amount the applicable insurer will reimburse and you waive the copayment for the customer. You verify, through third parties, such as clergy, medical practitioners, and other charitable organizations, that the customer is very needy. In those cases with needy clients, you waive all charges for fertility drugs. You do not collect actual financial information from individuals to verify their financial situation, nor did you define "poor."

You submitted copies of the Forms 990 you have filed. The Form 990s show your only source of income is from the sale of fertility drugs. Between % of your total expenditures each year are used for advertising. Your excess revenue, as relative to your total revenue, for your first year of operations was %. The forms also include substantial "excess" revenues over expenses each year, as well as about a % of "charity" listed as program service expenses:

Year	Gross Sales	Cost of Goods Sold	Advertising Expenses	Program Service Expenses	Total Expenses	Excess Revenue
1	\$	\$	\$	\$	\$	\$
2	\$	\$	\$	\$	\$	\$
3	\$	\$	\$	\$	\$	\$

LAW

Section 501(c)(4) of the Code provides for the exemption from federal income taxation of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 6110(k)(3) of the Code states that a written determination may not be used or cited as precedent.

Treas. Reg. § 1.501(c)(4)-1(a) states:

- (1) A civic league or organization may be exempt as an organization described in Section 501(c)(4) if –
 - (i) It is not organized or operated for profit; and
 - (ii) It is operated exclusively for the promotion of social welfare.
- (2) Promotion of social welfare.
 - (i) In general. 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....
 - (ii) Nor is an organization operated primarily for the promotion of social welfare if its primary activity is ... carrying on a business with the general public in a manner similar to organizations which are operated for profit.

In Rev. Rul. 65-299, 1965-2 C.B. 165, a nonprofit organization formed to advise, counsel, and assist individuals in solving their financial difficulties, by budgeting their income and expenses and effecting an orderly program for the payment of their obligations, is entitled to exemption from Federal income tax as a social welfare organization described in section 501(c)(4) of the Internal Revenue Code of 1954.

Rev. Rul. 69-545, 1969-2 C.B. 117, states that the promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members of the community, provided that the class is not so small that its relief is not of benefit to the community. The fact that a hospital operates at an annual surplus of receipts over disbursements does not preclude its exemption. By using its surplus funds to improve the quality of patient care, expand its facilities, and advance its medical training, education, and research programs, the hospital is operating in furtherance of its exempt purposes.

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 under section 501(c)(4) of the Code. The 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. The fact that these services are being performed for tax exempt corporations does not change the business nature of the activity.

Rev. Rul. 72-369, 1972-2 C.B. 245, described an organization formed to provide management and consulting services at cost to unrelated exempt organizations. The organization applied for exemption under section 501(c)(3) of the Code. This ruling stated:

An organization is not exempt merely because its operations are not conducted for the purposes of producing a profit.... [P]roviding managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

In Rev. Rul. 73-349, 1973-2 C.B. 179, an organization was formed to purchase groceries for its membership at the lowest possible prices. It received orders from its members, consolidated them, and purchased the food in quantity. Each member paid for the cost of his food, and each member was assessed an equal monthly service charge for the monthly operating costs. Membership was open to all individuals in a particular community. This revenue ruling stated that the organization was a private cooperative enterprise for the economic benefit or convenience of its members. Citing Commissioner v. Lake Forest, Inc., *infra*, this ruling stated that the organization operated primarily for the private benefit of members. Any benefits to the community were not sufficient to meet the requirement of the regulations that the organization operate primarily for the common good and general welfare of the people of the community. Accordingly, it did not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 79-316, 1979-2 C.B. 228, found that a nonprofit organization whose purpose is to prevent liquid spills, primarily oil spills, within a city port area and to develop a program for the containment and cleanup of liquid spills that do occur is entitled to exemption as a social welfare organization under section 501(c)(4) of the Code provided that its services are equally available to members and nonmembers and both members and nonmembers are charged on the same basis for the cleanup services rendered. There are no commercial cleanup companies operating in the entire geographical region where the port is located. Although there are a few commercial organizations providing similar services in other geographical areas, previous studies show that operation of a commercial cleanup organization is not economically feasible in the port area served by the organization. By preventing and cleaning up liquid spills that endanger marine life and foul recreational beaches and shorefront property in the port area, the organization is primarily engaged in activities designed to benefit all inhabitants of the community served by it.

In Hassett v. Associated Hospital Service Corp. of Mass., 125 F.2d 611 (1st Cir. 1942), an organization requesting exemption under section 811(b)(8) of the Social Security Act of 1935 (relating to the exemption of charitable organizations from FICA taxes), instituted a "nonprofit hospital service plan" to provide health care to its subscribers at a set fee. Any surplus proceeds were used to reduce future subscription rates or increase services and the corporate officers performed their duties without compensation. But the corporation solicited no charitable contributions and its subscribers were required to pay the fee charged in order to receive its benefits. The Court held that such an arrangement was commercial in nature, and although the

rates were "as low as possible," the corporation was not organized and operated exclusively for a charitable purpose.

Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962), stated that while a social welfare organization necessarily benefits private individuals in the process of benefiting the community as a whole, even when the benefits are confined to a particular group of individuals, the organization may be exempt if the general community derives a substantial benefit. Conversely, an organization that benefits a large number of people will not necessarily be organized for social welfare purposes within the meaning of section 501(c)(4) because numbers are not necessarily determinative of social welfare objectives. Social welfare is the well being of persons as a community and classification depends upon the character as public or private – of the benefits bestowed, of the beneficiary, and of the benefactor. The court also concluded that Lake Forest did not meet the dictionary definition of "social" or "welfare," stating:

It does not propose to offer a service or program for the direct betterment or improvement of the community as a whole. It is not a charitable corporation in law or equity, for its contribution is neither to the public at large nor of a public character. Lake Forest does, of course, furnish housing to a certain group of citizens but it does not do so on a community basis. It is a public-spirited but privately-devoted endeavor. Its work in part incidentally redounds to society but this is not the "social welfare" of the tax statute.

In People's Educational Camp Soc., Inc. v. Commissioner, 39 T.C. 756 (1963), the petitioner corporation operated the largest and one of the most modern vacation resorts in the Commonwealth of Pennsylvania. It charged its guests substantial rates for the accommodations and activities there provided. Its total revenues for the taxable year, derived principally from the operation of the resort, were more than \$ and only a relatively small portion of the same was used for the promotion of social welfare. It had net assets, represented principally by accumulated earnings, of more than \$ million. Held, that the operation of said resort did not constitute the 'promotion of social welfare' within the meaning of section 501(c)(4) of the 1954 Code; that said operation was petitioner's primary activity; and that for the taxable year, petitioner was not exempt from income tax under said statute, as an organization 'operated exclusively for the promotion of social welfare.'

In Sonora Community Hospital v. Commissioner, 46 T.C. 519 (1966), petitioner corporation was organized by two doctors to own and operate a 42-bed hospital previously owned and operated by them. Petitioner applied for exemption under Section 501(c)(3) of the Code. They had no defined plan for dispensing charity, provided only a minimal amount of charitable care, and allowed the founding doctors to share in the substantial fees from the privately operated laboratory and X-ray departments within the hospital for which they performed no services of any consequence. Held, under the facts involved herein, petitioner was operated to a considerable extent for the benefit of the two founding doctors, and was not operated exclusively as a charitable organization. The Court found that certainly, failure or unwillingness to provide free or below cost service indicates a nonexempt commercial purpose.

In B. S. W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978) the Court stated that free or below cost service is only one of several factors to consider in making a determination. Others include the particular manner in which the organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. All of these must be considered, for no single factor alone is determinative. The Court concluded that the

petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial.

In Sound Health Association v. Commissioner, 71 T.C. 158, (1978) acq. 1981-2 C.B. 2, the organization had a primary, but not sole purpose to provide a wide range of health care services to its members. The Association's goal was to provide comprehensive health care services to all members and the community. Respondent ruled that petitioner was qualified as an organization described in section 501(c)(4), but denied petitioner's application to be granted 501(c)(3) status on the grounds that it served a private interest (its members) rather than the required public interest and that it provided a form of insurance. Held: In an action brought under sec. 7428 for a declaratory judgment on petitioner's qualifications under sections 501(a) and 501(c)(3), it is found that petitioner does serve a public interest and is not engaged in providing a form of insurance and is therefore organized and operated exclusively for charitable purposes. Consequently, petitioner qualifies as an organization described in section 501(c)(3).

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979) aff'd 625 F.2d 804 (8th Cir. 1980), the Tax Court stated that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for-profit. The court ruled that sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. The court said it is clear that petitioner's exclusive purpose for being is to sell drugs, an activity that is normally carried on by commercial profit making enterprises. The Tax Court said that they failed to see how the fact that it happened to deal in drugs could convert it to a section 501(c)(3) organization. If it could be so converted, then so could a store selling orthopedic shoes, crutches, health foods, or any other product beneficial to health. Virtually everything we buy has an effect, directly or indirectly, on our health. They concluded that they did not believe that the law requires that any organization whose purpose is to benefit health, however, remotely, is automatically entitled, without more, to the desired exemption.

APPLICATION OF LAW

You previously operated your pharmacy as a for-profit organization for several years. You then modified your name and applied for exemption as a 501(c)(3) organization. When you realized you would not qualify for exemption under section 501(c)(3), you withdrew your application for exemption. You then requested exemption as an organization described in section 501(c)(4) of the Code. There is considerable overlap between sections 501(c)(4) and 501(c)(3) of the Code. Many organizations could qualify for exempt status under either Code section. Unlike section 501(c)(3) of the Code, which includes both an organizational test and operational test, section 501(c)(4) has only an operational test. Thus, establishing whether an organization qualifies for exemption requires analysis of the organization's actual operations based on an examination of all of the relevant facts and circumstances.

Section 1.501(c)(4)-1(a) of the regulations states that an organization may be exempt as an organization described in Section 501(c)(4) if it is not organized or operated for profit and is operated exclusively for the promotion of social welfare. The promotion of social welfare includes being primarily engaged in promoting in some way the common good and general welfare of the people of the community. It further states that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with

the general public in a manner similar to organizations which are operated for profit. Your primary activity is the provision of fertility medication in a commercial manner. This type of pharmaceutical business activity is commonly conducted to produce a profit. Accordingly, you do not meet the definition of a social welfare organization as described in the regulations. The Tax Court in Commissioner v. Lake Forest, Inc., concluded the organization did not qualify for exemption because they did not propose to offer a service or program for the direct betterment or improvement of the community as a whole. You too are not promoting social welfare because you are not offering a service or program for the betterment of the community as a whole. Instead you operate very much in a commercial manner selling medications at or above cost.

Social welfare organizations are not precluded from engaging in business activities as a means of financing their social welfare programs. However, the regulations provide that an organization is not operated exclusively for the promotion of social welfare if its primary activity is carrying on a business with the general public. In Rev. Rul. 70-535 an organization that provided various services for low and moderate income housing projects for a fee was not exempt under section 501(c)(4) of the Code because its primary activity was carrying on a business in a manner similar to organizations operated for profit. In the same manner, your primary activity is carrying on a pharmaceutical business, and not promoting social welfare.

You operate a pharmacy that sells fertility medication at cost to the uninsured, and for insured customers you sell the drugs at the amount the applicable insurer will reimburse. You waive the copayment for the customer. In B.S.W. Group, Inc., the organization's purpose was to furnish consulting services to exempt and other not-for-profit organizations and they sought to be classified as a 501(c)(3) organization. As in Hassett v. Associated Hospital Service Corp of Mass. and Sonora Community Hospital, while giving some consideration to the client's ability to pay, the organizations planned to charge a sufficient fee which would enable it to recover their costs plus a small profit. The Tax Court pointed out that the corporations were engaged in a business normally pursued by commercial enterprises and appeared to be in competition with them, which is "strong evidence of the predominance of nonexempt commercial purposes." Your Forms 990 you submitted demonstrate that each year since your inception you have had substantial surplus of revenues over expenses. Other than giving away 1% of your medication, you do not sell the medication below cost. Although you waive the co pay, you charge the individual's insurance the amount they are willing to pay for the fertility medication, which is above cost. It is clear, therefore, you do not promote health, except to the same extent that any commercial pharmacy would.

Much like the organization described in People's Educational Camp Soc., you charge your clients substantial rates for your services provided. Your total revenues are derived principally from the operation of the pharmacy and only a relatively small portion of the revenues were used for the promotion of social welfare.

You are similar to the organization described in Rev. Rul. 72-369. You too are providing services on a regular basis for a fee, which is a trade or business ordinarily carried on for profit. Specifically, you provide fertility drugs in the same manner as a for-profit pharmacy. The fact that you waive co pays and give 1% of your medicine away does not cause your activities to further a social welfare purpose. You still incur substantial profits on the sales of the medications covered by the insurance payments you receive. Further, the commercial nature of your operations is demonstrated through your revenues and expenditures. You receive all of

your revenue from sales of medication and between % of your expenses for your first 3 years of operation are attributable to advertising.

You are similar to Rev. Rul. 73-349 because the benefits you provide to the community are also not sufficient to meet the requirement of the regulations that the organization operates primarily for the common good and general welfare of the people of the community. In the same manner, the provision of fertility medicine, similarly to a for-profit, is not promoting the common good and general welfare of the community.

Perhaps most applicable, is the organization described in the case of Federation Pharmacy Services, Inc. The Tax Court stated that virtually everything we buy has an effect, directly or indirectly, on our health. The Court further stated that they do not believe that the law requires any organization whose purpose is to benefit health, however, remotely, is automatically entitled, without more, to the desired exemption. The Tax Court also said the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for profit. Sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. In the same manner, the provision of fertility medication is a commercial business. Although it is beneficial to some individuals, and often at a discount, it is not an exempt function.

You have provided no information showing that you conduct your activity differently from a commercial entity. Your sole source of income is the sale of medicine. Although you provide some of your medicine free of charge and waive the co-pay, this is not enough to make your activity exempt. See Rev. Rul. 70-535. The Form 990s show three years of excess receipts over expenditures. The distribution of free drugs to a few customers was financed by selling drugs to other customers at above your cost.

APPLICANT'S POSITION

You state you provide for the alleviation of the medical and psychological stigmas and other problems resulting from infertility; the resultant community growth from births; and the creation and enhancement of the family unit, which are advanced by your free and discounted pharmacy programs and promote the common good and general welfare of the community as a whole. You say that like the organization in Rev. Rul. 65-229 [sic], which was an organization formed to advise, counsel and assist individuals in solving their financial difficulties by budgeting income and expenses, you are also promoting social welfare.

You further state that just because your activity is normally undertaken by a commercial for-profit entity does not necessarily preclude exemption, particularly if the entity offers its services for free or below cost, as in Sound Health Association.

You said you are distinguished from Federation Pharmacy Services Inc. because you extend free and discounted benefits to individuals financially unable to make the required payment, thus benefitting the community as a whole.

Furthermore, you said the standards for qualification should not be more stringent than the Service's evaluation of hospitals under Section 501(c)(3). The Service requires that a hospital provide a minimal level of "charity care". You cited Rev. Rul. 69-545 and said the Service

announced it will utilize the "community benefits standard", looking at the overall facts and circumstances in which the hospital's operations confer a community benefit.

You later elaborated on your position to say that infertility causes serious family, marital, physical, physiological and psychological programs affecting the community as a whole. You submitted a number of internet hyperlinks to articles written by professionals on the topic of infertility.

You said you believe that the "treatment of infertility falls within the ambit of social welfare under Section 501(c)(4)" of the Code. You said 501(c)(4) encompasses social welfare organizations such as yourself. You said:

The regulations under Section 501(c)(4) state that an organization qualifies as eligible if "it is primarily engaged in promoting in some way the common good and general welfare of the community." An organization that promotes social welfare directs its [sic] efforts towards providing benefits to the community. See Commissioner v. Lake Forest, Inc. in determining whether an organization is promoting the public welfare the activities of the organization must be examined to see who derives a benefit from them and the degree of benefit conferred. In People's Educational Camp Soc., Inc. the Court characterized the promotion of social welfare as involving the serving of a "purpose beneficial to the community as a whole," or the promotion of the "welfare of mankind" in the manner generally similar to the charitable, educational, and religious organization exempted by like provision of the Code. Rev. Rul. 79-316.

You also referenced Technical Advice Memorandum (TAM) 200829029. Per section 6110(k)(3) of the Code, a TAM cannot be cited as legal precedent.

You said the "alleviation of the medical, psychological, family, marital, and other problems resulting from infertility; the resultant community growth from births; and the creation and enhancement of the family unit, which are advanced by the free and discounted pharmacy programs, promote the common good, general welfare, and 'purposes beneficial to the community as a whole.'" People's Educational Camp Soc., Inc.

You said in one year you waived copayments totaling \$ _____ Additionally you saved clients in excess of \$ _____ by providing medications at cost, and paid physicians in excess of \$ _____ for treatment of certain needy individuals. As you previously stated, and reemphasized, in part:

In order to be eligible to receive discounted drugs, a patient either will not have any insurance coverage, or the medical insurance will not cover infertility treatment. Clients that receive free services are generally initiated by referral from clergyman, or other not-for-profit organization specializing in assisting infertile couples to receive the necessary treatments.

You said your professional staff also provides free counseling to any person, regardless of need, on the causes of infertility, medical and other treatment options, possible drug regimes, and coping with the debilitating effects of infertility adverted to above.

You go on to state that the fact an activity is normally undertaken by commercial for profit entities does not necessarily preclude tax exemption, particularly if the entity offers its services free or below cost, per Sound Health Association. You said the Court noted in this case that "the promotion of health may be deemed beneficial to the community if the class of beneficiaries is sufficiently large to benefit the community as a whole." You say your services are available to the entire community, and a sufficiently large class of beneficiaries.

You say the applicable standard of review should not be more stringent than the Service's evaluation of hospitals under Section 501(c)(3) in People's Educational Camp Soc., Inc. The Service requires a hospital to provide a minimal level of "charity care." In Rev. Rul. 69-545 the Service announced that it will utilize "community benefits standard," looking at the overall facts and circumstances in which the hospital's operations confer a community benefit. You say that it should be noted that Federation Pharmacy Services Inc. and Rev. Rul. 69-545 were issued in the context of 501(c)(3).

SERVICE'S RESPONSE TO APPLICANT'S POSITION

You cited several precedents, none of which granted exemption under Section 501(c)(4) of the Code to a pharmacy. Although you stated you are distinguished from Federation Pharmacy Services Inc. because you extend free and discounted benefits to individuals financially unable to make the required payment, you charge the insurance companies above-cost prices for the medication you provide. You only give away % of your medication and charge the insured at-cost prices. Insured individuals are not charged a copayment for their fertility medication, but their insurance is billed at normal commercial rates. In fact, in the case of Federation Pharmacy Services Inc., the court concluded that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for profit. Sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. In the same manner, the sale of fertility medication, even at a discount, is not furthering an exempt purpose.

You cited the Tax Court case Sound Health Association. This case refers to a 501(c)(3) applicant as opposed to a 501(c)(4) applicant. In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3rd Cir. 1993), the Third Circuit Court of Appeals stated:

First, the *Sound Health* court ventured too far when it reasoned that the presence of a subsidized dues program meant that the HMO in question served a large enough class that benefited the community. The court ruled that because there was no economic barrier to subscribership, 'the class of persons potentially benefitted [sic] by the Association is not so small that its relief is of no benefit to the community.' (Citations omitted). In doing so, the court misconstrued the relevant inquiry by focusing on whether the HMO benefited the community at all rather than whether it primarily benefited the community as an entity must in order to qualify for tax-exempt status.

Second, the *Sound Health* court need not have gone as far as it did. The presence of a subsidized dues program was not the only factor it considered when deciding that the HMO in question qualified for tax-exempt status. For example, the HMO in *Sound Health* 'in effect (ran) a substantial outpatient clinic as an important

ingredient if its medical care services. (Citation omitted.) It also provided free care even to persons who did not subscribe and offered educational programs to the public.

Finally, even considering the subsidized dues program, the amount of benefit GHP intends to confer on people other than paying subscribers is minuscule. GHP anticipates subsidizing approximately _____ people. We cannot say that GHP operates primarily to benefit the community at large rather than its subscribers by arranging for health care for only _____ people, who would not otherwise belong, as compared to more than _____ paying subscribers. GHP argues that the HMO in *Sound Health* had provided only \$ _____ in subsidies when it was granted tax-exempt status. This is true, but, as previously noted, the HMO in that case also benefited the community in other ways, most notably by providing free or reduced-cost care to people who were not subscribers. An HMO must primarily benefit the community, not its subscribers plus a few people, in order to qualify for tax-exempt status under section 501(c)(3).

In sum, GHP does not qualify for tax-exempt status under section 501(c)(3) since it does no more than arrange for its subscribers, many of whom are medically underserved, to receive health care services from health care providers. ... Arranging for the provision of medical services only to those who 'belong' is not necessarily charitable, particularly where, as here, the HMO has arranged to subsidize only a small number of persons. GHP, standing alone, is not entitled to tax-exempt status under section 501(c)(3).

You have no other activity other than operating a pharmacy. This activity is limited to the N area and is further limited to large Orthodox Jewish families, and then only to those persons who have fertility problems thus negating any sort of community benefit. A review of your Forms 990, showing only gross sales and no contributions, indicate you are similar to a for-profit pharmacy. Per Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii), an organization is not operated primarily for the promotion of social welfare if its primary activity is the carrying on a business in a manner similar to organizations which are operated for profit.

In Lake Forest, the court held that an organization operating low-income housing units was neither "civic" nor "promoting social welfare" but was a private cooperative organization. The respondent, Lake Forest, was a membership organization that was formed to operate a low-cost housing cooperative for its members. It did not offer any program or service to benefit the community. You are similar to Lake Forest in that your sales of pharmaceuticals at or above cost does not provide any benefit to the community at large.

You cite People's Educational Camp Society, stating that you alleviate medical, psychological, family, marital, and other problems resulting from fertility. The court said:

(W)e are satisfied that petitioner's activities in maintaining and operating the large resort at Tamiment, were not directed to, and did not result in, providing benefits either for the public at large, or for any community as a whole. Rather, the facilities and activities at said resort were devoted principally and primarily to providing living accommodations, meals, and a variety of recreational and cultural programs for the personal benefit of paying guests, who were attracted to the resort because it was an enjoyable and luxurious place for summer

vacations, and who were willing and able to pay the substantial daily or weekly overall rates which petitioner charged.

You are similar to the organization in People's Educational Camp Society in that your operation of a pharmacy, and your selling of pharmaceuticals at or above cost only to individuals with fertility problems, does not benefit the community as a whole.

In TAM 200829029, the organization's primary activity was the ensuring of public safety. The organization provided technical assistance, oversight, audit, review and onsite visits to verify compliance with a uniform safety code. The Service held that in performing such activities, the organization benefits the community as a whole even though it benefitted manufacturers, inspectors and repairers, they are incidental to the organization's primary activity of ensuring the public safety. The Service ruled that the organization did not qualify for exemption as a business league under section 501(c)(6) of the Code but did qualify as promoting social welfare under section 501(c)(4) of the Code. In contrast, your organization does not ensure public safety. Rather, you compete with for-profit pharmacies in the delivery of certain pharmaceuticals to a small portion of the community.

Although you cited Rev. Rul. 65-229, it appears that you intended to cite Rev. Rul. 65-299, as Rev. Rul. 65-229 does not refer to Subchapter F of the Code (i.e., Exempt Organizations). Regarding Rev. Rul. 65-299, you are dissimilar to the organization in this case as you are not operating exclusively for the benefit for the promotion of social welfare. You are operating in a manner similar to that of a commercial pharmacy. You do not provide counseling or other activities to individuals.

Unlike the hospitals described in Rev. Rul. 69-545, you are not providing a benefit to the community that promotes the general health and welfare of the public. Although exempt hospitals are only required to provide a "minimal amount" of charity care, they also promote community health. Your only activity is, and continues to be, the operation of a commercial pharmacy, not a hospital. Since the organization's primary activity is carrying on a business by operating a pharmacy in a manner similar to organizations operated for profit, the organization is not operated primarily for the promotion of social welfare. The fact that these services are being performed for free for 1% of your customers does not change the business nature of the activity.

You cited Rev. Rul. 79-316 as a rationale for the basis for your exemption. This ruling describes an organization that was found to be exempt under section 501(c)(4) of the Code. This ruling describes an organization that is very dissimilar to you. The organization described in this ruling tried to prevent liquid spills, primarily of oil, and to contain and clean up spills within a city port area. It provided services to members and nonmembers for the same fees. In addition, the organization trained members of the city fire department and personnel of its member organizations in their effective use of equipment it had acquired to clean up the spills. In the event of a spill, the U.S. Coast Guard called the organization to the scene while the fire department contained the spill. It was determined that since charges for the organization's services were sufficient only to cover the cost of labor, equipment, and supplies used, the organization was not carrying on business with the general public in a manner similar to organizations operated for profit. Unlike your organization, this organization was not carrying on a business with the general public similarly to those operated for profit. You are operating a

pharmacy, much like those that are operated for profit. In fact, you operated your pharmacy as a for-profit enterprise for several years and filed Forms 1120 as such.

APPLICANT'S PROTEST

You stated the Service's denial is incorrect for legal and factual reasons. You asserted you are "primarily engaged in promoting in some way the common good and general welfare of the community." Specifically, you stated the following:

- 1) The fact that you are a successor to a for-profit pharmacy of similar name is of no import. While the for-profit pharmacy (which was an interim step) has not been dissolved, it has had no operations for the last 4 years. You said you will consent to the dissolution of the for-profit corporation as a condition to securing the Section 501(c)(4) exemption.
- 2) In response to the analysis of your "excess revenue" relative to your total revenue in the proposed adverse letter, you stated that this focuses only on the first year of operation. Furthermore, the "excess revenue" from each year is a utilized reserve for future operations. You said you were not aware of any requirement under the Code or in the State of M's Not-For-Profit Corporation Law that a not-for-profit corporation have no excess revenue to be utilized as a reserve for future operations.
- 3) In response to our citation of Federation Pharmacy Services, you stated the decision in that case was limited to the fact that the sole service of the pharmacy was the sale of drugs at a discount. You state that you, on the other hand, provide other services including counseling. Similarly you state the Service's reliance on Rev. Rul. 72-369 is inapposite in that you do not operate in the same manner as the for-profit pharmacy, especially given your extensive counseling services and its payment of treatment costs for needy individuals. You stated you are not aware of any for-profit pharmacy that voluntarily makes payments to medical providers for needy individuals.
- 4) You stated the materials you previously provided demonstrate that advertising was not general commercial advertising but was limited to community publications published for and circulated primarily to infertile couples. You said this distinguishes you from a for-profit pharmacy. In fact, you say the advertising expense includes a generous contribution to a major organization which assists infertile couples.
- 5) You said you will, if we so require, as a condition of granting exemption, amend your business operations to sell all drugs at manufacturer's cost plus reasonable overhead. However, you believe this would be counter-intuitive to the charitable and community services you provide, which includes providing drugs at no or low cost for the truly needy, such as those without necessary insurance coverage. If you were to implement its understanding of the Service's intent, the cost of the drugs to the truly needy would increase. You said you do not believe this is the Service's intent.
- 6) You said the Service's reliance on the 3rd Circuit's holding which distinguished Geisinger's from the Tax Court decision in Sound Health decisions is misplaced. You say as the Service noted, Sound Health was a 501(c)(3) applicant; the language in

Section 501(c)(4) for the promotion of social welfare is not as restrictive as the requirements of Section 501(c)(3). Furthermore, unlike Geisinger's, which provided benefits only to 35 people in a group of 70,000 paying subscribers, you provide benefits to a majority of your clients. As the Geisinger court stated, the HMO in Sound Health "benefited the community in other ways, most notably by providing free or reduced cost care to people who are not subscribers." You said you are similar to Sound Health because there is no requirement that one be a member or otherwise belong to the applicant to receive benefits.

- 7) You said the Service is in error in noting that the activities were limited only to the city of N and to Orthodox Jewish families. In fact, you are well known outside of the city of N, and physicians specializing in fertility through the country refer patients to you. For last year, you provided the following numbers:

	<u>Clients</u>	<u>Referring Physicians</u>
City N	300	41
State M	78	42
Outside of State M	90	28

SERVICE'S RESPONSE TO PROTEST

Although you asserted you are "primarily engaged in promoting in some way the common good and general welfare of the community," you are still operating for a substantial non-exempt, commercial purpose. Specifically, your assertions are addressed point-by-point below:

- 1) Although you stated being a successor to a for-profit pharmacy of similar name is of no import, it establishes the basis of your formation – to operate a commercial pharmacy. Not only is the for-profit pharmacy (which you stated was an interim step) not yet dissolved, you said you will only consent to the dissolution of the for-profit corporation as a condition to securing the Section 501(c)(4) exemption. Realistically, the dissolution of the for-profit corporation has no direct impact on your exemption, as you are operating in a commercial manner.
- 2) We agree there is not a requirement under the Code for a not-for-profit corporation to have no excess revenue to be utilized as a reserve for future operations. However, you continue to charge above-cost to the majority of your clients and to their insurance companies. As stated in B.S.W. Group, one of the factors in determining whether an organization is operated for a non-exempt purpose is the existence and amount of annual or accumulated profits. You continually operate with excess revenues over expenses, which is typical of a commercial business.
- 3) You now say you offer counseling, unlike Federation Pharmacy Services. However, this does not eliminate the commercial manner in which you conduct your sales of fertility medicine, your primary activity. You state that unlike the organization described in Rev. Rul. 72-369, you do not operate in the same manner as the for-profit pharmacy, especially given your extensive counseling services and its payment of treatment costs for needy individuals. However, based on your revenues and expenses, you are operated primarily for the purpose of purchasing fertility medications and distributing

them in a manner similar to a for-profit pharmacy. As mentioned previously, even for-profit pharmacies provide some charitable distributions of medication. One element of charity does not negate the overall significance of your commercial operations.

- 4) Although you stated your advertising was not general commercial advertising and was limited to community publications for infertile couples, this does not distinguish you from a for-profit pharmacy. The manner in which you advertise does not eliminate the fact that you sell medication above cost. Although you provide discounted medication to needy individuals and give away about % of your medicine, it does not cause you to be operating exclusively for social welfare purposes.
- 5) You said if we so require, as a condition of granting exemption, you will amend your business operations to sell all drugs at manufacturer's cost plus reasonable overhead. This statement illustrates and emphasizes our position that you are operating a "business," not a social welfare organization. Per Rev. Rul. 72-369, an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption.
- 6) You noted the language in Section 501(c)(4) for the promotion of social welfare is not as restrictive as the requirements of Section 501(c)(3). While this is true, in order to qualify for exemption you must still be operated primarily for an exempt purpose. You are operating for the substantially non-exempt purpose of operating a pharmacy. You also said you are similar to Sound Health because there is no requirement that one be a member or otherwise belong to the applicant to receive benefits. However, even a commercial pharmacy does not require one to be a member to receive benefits. Again, under IRC § 501(c)(4), an organization is not operated for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.
- 7) You stated your activities are not limited only to the city of N and to Orthodox Jewish families and you are well known outside of the city of N. You said physicians specializing in fertility throughout the country refer patients to you. The physical location of your clients does not negate the commercial hue of your operations.

CONCLUSION

Based on the above facts and law, we conclude that you do not qualify for exemption under section 501(c)(4) of the IRC as outlined below.

- 1) The facts clearly show you are not primarily engaged in promoting the common good and general welfare of the community because you are primarily engaged in a commercial operation. Therefore, we conclude you do not qualify under section 501(c)(4) of the Code.
- 2) You were formed to provide fertility medication to individuals. You charge at or above cost to all but % of your customers. Your activity of providing fertility drugs does not differ from that of a commercial pharmacy. Therefore, you are excluded from qualifying from exemption because you are operated in commercial manner.

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. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in 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, Forms and Publications.

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 the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may 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.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure: Publication 892

cc: