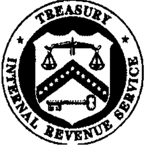


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201451033**
Release Date: 12/19/2014
Date: September 24, 2014

UIL:
501.00-00
501.04-00
501.04-02

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(4).

We made this determination for the following reason(s): You are not operated exclusively for promotion of social welfare within the meaning of § 501(c)(4).

You protested our proposed adverse ruling; however, you subsequently withdrew your protest. At the time that you withdrew your protest, we notified you of the opportunity to have your case reviewed by the Office of Appeals and gave you 30 days to request referral of your case to the Office of Appeals. As we did not receive a request to transfer your case to Office of Appeals within the requisite 30 days, the proposed adverse ruling is now final.

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,

Matthew A. Weir
Director, Exempt Organizations
Rulings and Agreements

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

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List Numbers:
501.00-00
501.04-00
501.04-02

December 5, 2013

Legend
A =
Parent =
Faculty Practice =
Exchange =
F =
G =
Hospital =
Medical School =
Nursing School =
ACO =
Q =
R =
S =
T =
County =
State =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Year 7 =
Year 8 =
$100x =
$100y =

Dear :

This letter supersedes our letter dated December 2, 2013.

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). The bases for our conclusion are set forth below.

Facts

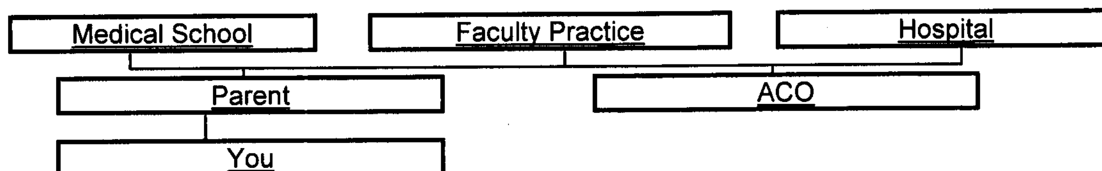
Formation and History

You filed Articles of Incorporation under State statutes pertaining to nonprofit insurance corporations. Your Articles of Incorporation provide that you were created exclusively to promote social welfare "by offering prepaid health care services that support the missions of research, education, community service and clinical expertise of A to the people of State and beyond by operation of a health maintenance organization and other activities incidental thereto . . . ."

You are a new corporation that will acquire the assets and assume the business of F by merging with F, and leaving you as the surviving entity.

F was formed in Year 1 as a for-profit HMO. Parent acquired F in Year 2. Parent will continue to control you, except that, after your merger with F, instead of holding shares in F, Parent will be your sole member.

A is an affiliated group of healthcare entities. Your relationship to other components of A can be graphically represented as follows:



Parent is a membership organization that is exempt under § 501(c)(3). Parent has the following three members:

- Medical School (a governmental unit within the meaning of § 170(b)(1)(v) and § 170(c)(1))
- Faculty Practice (an organization described in § 501(c)(3))
- Hospital (a public corporation which the State legislature created. It is also recognized as an organization described in § 501(c)(3))

A operates a medical school, clinics and hospitals in County. F serves a 20-county area in southern State, which includes County. F's subscribers have access to over 50 hospitals and clinics in the 20-county service area. You will assume and maintain F's service area and provider network.

Management

You have a seven-member Board of Directors. Hospital appoints three directors. Faculty Practice appoints two directors. An unrelated Federally Qualified Health Center, within the

meaning of Section 330 of the Public Health Service Act (42 USCS § 254b), appoints one director. Parent appoints one director from the community at large.

Your president will concurrently serve as an officer of Faculty Practice and will devote 90 percent of his or her time to duties performed for you, and 10 percent to duties performed for Faculty Practice. You and Faculty Practice will share the president's compensation ratably.

Your officers will be compensated for their services in accordance with policies and procedures employed by A and its constituent entities. Other than the president, who divides his or her time as described above, you will exclusively employ your other officers. They will not receive compensation from any other constituent of A.

Your Activities

Healthcare Plans

You will continue the business of F. In addition, you will offer healthcare plans through the Exchange (which implements the health insurance exchanges under Patient Protection and Affordable Care Act, P.L. 111-148, as amended ("ACA")). Your healthcare plans will be available to subscribers residing throughout the existing 20-county area served by F.

You allocated your estimated healthcare revenue for Year 3 among the following healthcare plans:

Table 1	
Plan	Revenues
HMO	$ x
Preferred Provider Organization Plans	$ x
Point of Service Plans	$ x
Medicare Select	<$ x
Medicaid	$ x
Total:	$ x

You also described the allocation of F's subscribers as follows:

Table 2	
Type of Subscriber	Share
Subscribers under employer provided group plans	%
State and local government/school districts – %	
For-profit employer – %	
Not-for profit employer – %	
Individual (non-group) subscribers	%
Medicaid-eligible subscribers	%
Medicare supplement subscribers	%
Total:	%

You further explained that you anticipate some reallocation among your plan offerings when the ACA takes effect in Year 4 and individuals begin purchasing plans through the Exchange. You described the anticipated allocation of your subscribers after implementation of the ACA as follows:

Table 3				
Subscribers	Year 5	Year 6	Year 7	Year 8
Subscribers under employer provided group plans*	%	%	%	%
Subscribers to individual plans sold through the Exchange – not qualifying for a subsidy	%	%	%	%
Low-income subscribers to individual plans sold through the Exchange – qualifying for a subsidy	%	%	%	%
Medicaid-eligible subscribers	%	%	%	%
Medicare supplement subscribers	%	%	%	%
	%	%	%	%
* No distinction is made among HMO, PPO and POS plans.				

Your specific activities in connection with the administration of your healthcare plans will include the following:

i. Arranging for prepaid healthcare services for subscribers through employer group plans and individual policies.

ii. Arranging for healthcare services to be provided to subscribers through Point of Service ("POS") and Preferred Provider Organization ("PPO") plans.

iii. Arranging for healthcare services to be provided to subscribers eligible for public health care assistance through programs administered by T (Medicaid plans).

iv. Arranging for medical services to be provided to subscribers through the Exchange.

v. Monitoring effectiveness of delivery of services by contracting healthcare providers using the Healthcare Effectiveness Data and Information Set to measure performance by healthcare providers and using the Consumer Assessment of Health Providers & Systems to measure patients' and families' satisfaction with healthcare provided.

vi. Designing and implementing pay-for-performance incentives with primary care providers.

You will continue to contract with medical service providers and facilities in A's service area (in County), as well as the remaining 19 counties of F's service area outside of County. In addition to your contracts with facilities and providers affiliated with A, you will enter into agreements to arrange for healthcare services to be provided by over 50 hospitals, over 800 primary care providers and over 1,500 specialty providers. You estimated that approximately 70 percent of your subscribers will reside within County,

with your remaining subscribers residing in the 19-counties you will serve that are outside the A service area.

Social Welfare Activities

The specific social welfare activities that you will undertake including the following:

i. Providing financial assistance to individuals and families who qualify for coverage through the Exchange, but who are unable to afford the premiums.

   Because federal regulations prohibit you from providing direct subsidies to qualifying subscribers through the Exchange, you will provide grant funds to S. S will use those funds to provide subsidies to qualifying individual subscribers through the Exchange, without regard to the provider chosen by the recipient of the subsidy.

ii. Making grants for the following purposes:

   (1) Population health research.

   (2) Support of a Federally Qualified Health Center and other community organizations.

   (3) Capital projects and programs at Medical School and Nursing School.

iii. Hosting mammography screening events open to women ages 40 to 69 and similar wellness events.

iv. Providing access to "clinically based education materials," some or all of which will be available to the general public through your website.

G, a division internal to you, will administer your social welfare activities.

Other Activities

You will share health information that you obtain regarding your subscribers with R. R is a data warehousing initiative that A formed. You will use the data warehouse for your own purposes, and accordingly you will bear a proportionate share of the operating expenses related to the administration, maintenance, and development of the data warehouse. In addition, because data relating to your subscribers will reside in the data warehouse, that data is available to researchers and clinicians affiliated with R.

F uses the same data warehouse as other entities affiliated with A. F is the only payor whose core healthcare plan processing system resides within the same electronic health record system as A uses. This connection facilitates delivery of data derived from F subscribers to Medical School for use in its academic mission, and to clinical faculty for use in their research. However, you disclose that the electronic health record system from which Medical School derives health data for clinical and research purposes also receives data from payors other than F, indicating that Faculty Practice obtains health

data from many external sources. Supporting information provided by Medical School specifically states that the electronic health records system that Medical School uses does not differentiate among patients based upon their payors. The patient data and "de-identified data" from F subscribers comprises a fraction of the data available to Medical School for clinical and research purposes.

You will provide financial support to Q through G. Q is conducted within Medical School. The goal of Q is to design, implement, and evaluate strategies to improve health care delivery. Q obtains data about the Medicare population from the Centers for Medicare Services ("CMS"). Information that you provide broadens the pool of data available to Q to include your private paying subscribers, as well as your Medicaid subscribers.

You will contribute to the education of students of Medical School because a portion of your subscribers will obtain primary, specialty or in-patient care at facilities affiliated with A. In addition, you make grants to Medical School. Your financial contribution is coordinated through G.

We asked you to provide examples of marketing materials you would use to solicit subscribers. You stated that such materials are not currently available.

Contractual Relationships among Entities Affiliated with A

You state that, in the years since F was acquired by Parent, F has integrated its "mission, management philosophy and approach to community health care in an effort to become part of a fully integrated health care delivery system." When you merge with F, you will enter into a broad range of contractual agreements with entities affiliated with A. In general, most of the contracts relate to administrative services that A provides to you to arrange for services to be provided to your subscribers. The contracts with affiliates of A are based upon cost and are not designed to generate a profit for either contracting party. You describe various ways in which your activities intersect with those of entities affiliated with A. For example, your medical director, two associate medical directors, and your director of health services will be shared with Faculty Practice or Hospital. Each person's compensation will be allocated ratably between you and the affiliate of A to which the individual devotes his or her remaining time, in accordance with administrative services agreements between you and the applicable affiliate of A.

You contract with Faculty Practice for medical management services. You state that contracting for medical management services from Faculty Practice, instead of having those decisions made by one of your direct employees, makes you similar to a tax-exempt staff model HMO. You further state that you contract with Hospital to provide pharmacy management services. You state that this operational model benefits subscribers because pharmacy services provided to your subscribers are founded on "the evidence based practice of medicine and sound clinical decisions." In addition, pharmacy data relating to your subscribers is shared with other components of A for research purposes.

Your Anticipated Revenues and Expenditures

You state that substantially all of your revenues will be from premiums charged to

subscribers of your healthcare plans. You estimate your revenues from healthcare plans for the periods below as follows:

Table 4		
	Year 3	Year 4
Healthcare plan revenues	$ x	$ y
Investment income	<$ x	<$ y
Total:	~$ x	~$ y

The allocation of premiums among different healthcare plans, and the expected shift of that allocation subsequent to the implementation of ACA are shown in Table 3 above.

You allocated your anticipated expenditures across the following categories:

Table 5	
Expenditures	Percent
Healthcare provided to subscribers under employer-provided group plans	%
Healthcare provided to individual subscribers	%
Healthcare provided to Medicaid subscribers	%
Healthcare provided to Medicare Supplemental Plan subscribers	%
Programs administered through G	%
Broker commissions	%
Other business expenses	%
Total:	%

Law

Social Welfare Organizations

Section 501(a) of the Code provides that an organization described in § 501(c) will be exempt from taxation unless exemption is denied under §§ 502 or 503.

Section 501(c)(4)(A) describes "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare."

Section 1.501(c)(4)-1(a) of the Income Tax Regulations states:

(1) In general. 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.

Rev. Rul. 54-394, 1954-2 C.B. 131, describes an organization whose sole activity was to provide television reception for its members on a cooperative basis in an area not readily adaptable to ordinary reception. Members of the organization paid service and installation fees. Nonmember households could not derive any benefit from the organization's activities. In concluding that the organization did not qualify for exemption under § 501(c)(4), the Revenue Ruling explained as follows:

> When an organization's only activity is to provide television reception on a cooperative basis to its members, who contract and pay for such services, such organization is held to operate for the benefit of its members rather than for the promotion of the welfare of mankind.

Rev. Rul. 62-167, 1962-2 C.B. 142, describes an organization created for the purpose of constructing and maintaining a reflector-type television station, capable of receiving signals of television stations and reproducing the signals, so that satisfactory television reception would be available to the community at large. All persons in the community could become members. The organization derived its revenues from a combination of membership fees and donations. The reflector-type equipment received signals from three television stations and retransmitted the signals into the community. Any television in the community could receive the signals retransmitted by the organization's equipment. The organization in this Revenue Ruling is distinguishable from the organization described in Rev. Rul. 54-394. In the earlier Revenue Ruling, only members who entered into a contract with that organization and paid installation and service fees could access its services. In contrast, the organization described in this Revenue Ruling operated its system for the benefit of the community at large. Members paid a fee or made donations to this organization voluntarily. The same benefits could be enjoyed by members of the community who opt not to pay the membership fee. Accordingly, the organization described in this Revenue Ruling qualified for exemption under § 501(c)(4).

Rev. Rul. 73-349, 1973-2 C.B. 179, describes an organization formed to purchase groceries for its members at the lowest possible prices. Membership was open to the entire community; however, the benefits of the organization were available only to members. Each member paid a ratable share of the organization's administrative expenses. The organization was held not to qualify for exemption under § 501(c)(4) because it was "operated primarily for the private benefit of members and any benefits to the community [were] not sufficient to meet the requirement of the regulations that the organization be operated primarily for the common good and general

welfare of the people of the community.

Rev. Rul. 75-199, 1975-1 C.B. 160, describes an organization that provided sick benefits for its members and paid death benefits to the beneficiaries of deceased members. The organization restricted membership to individuals of good moral character and health who belonged to a particular ethnic group and who resided in a specific geographical area. The organization held monthly meetings and maintained an established system for the payment of sick and death benefits. Revenues were derived primarily from membership dues, which were used to pay benefits to members and to pay miscellaneous operating expenses. In concluding that the organization did not qualify for exemption under § 501(c)(4), the Revenue Ruling found that the organization was principally a mutual, self-interest organization that used its income to provide direct economic benefits to members. Any benefit to the community at large was minor and incidental.

Rev. Rul. 78-69, 1978-1 C.B. 136, describes an organization created by residents of a suburban community to provide bus transportation during rush hours between the community and the major employment centers in the metropolitan area. During rush hour periods, regular bus service was inadequate. The organization contracted for buses and drivers, planned their routes and schedules and arranged for volunteers to collect the fares on each trip. Although anyone could ride the organization's buses for the established fare, ridership was drawn almost entirely from the community. Revenues from fares sometimes fell short of the amount needed to cover the organization's expenses. The organization covered the short-fall through grants from governmental units. The organization was found to provide a useful service to all members of the community. The organization provided bus service to the area that was not otherwise commercially available, and paid for the service through fares and subsidies from governmental units. Access to the organization's bus service was available to anyone and community residents and volunteers assist the organization to carry out its activities. This method of operation distinguished the organization from commercial bus services that carried on business with the public and operated for profit. As a result, because the organization promoted the common good and general welfare of the community, the organization qualified for exemption under § 501(c)(4).

Rev. Rul. 81-58, 1981-1 C.B. 331, describes a membership organization formed to benefit police officers in a community. The organization supplemented civil service retirement and death benefits provided by the political subdivision in which the police officers were employed. Benefits were limited to members (or their beneficiaries). The organization's income was used to provide direct economic benefits to members. Therefore, although the class of employees benefited by the organization consisted of police officers engaged in the performance of essential and hazardous public services, the organization was principally "a mutual, self-interest type of organization" that provided only an incidental benefit to the larger community. Accordingly, the organization did not qualify for exemption as a social welfare organization under § 501(c)(4).

In Christian Echoes Nat'l. Ministry v. U.S., 470 F.2d 849 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973), citing Dickinson v. U.S., 346 U.S. 389 (1953), the court held that an organization claiming exemption must bear the burden of establishing its entitlement to exempt status.

Commissioner v. Lake Forest Inc., 305 F.2d 814 (4th Cir. 1962), denied exemption under

§ 501(c)(4) to a nonprofit membership corporation that purchased two multi-family housing projects (consisting of over 500 residential units) from the federal government. The organization made units available to its members under perpetual-use contracts. Preference for membership was granted to inadequately housed veterans of World War II (first) and veterans of World War I (second). However, in the absence of purchasers in these categories, the organization could sell perpetual-use contracts to other individuals approved by the organization.

The Court of Appeals held that the organization failed to qualify for exemption under § 501(c)(4) because its activities did not meet the dictionary definition of "civic." Even though the benefits provided by the organization were "available to all citizens eligible for membership, the benefits were not municipal or public in nature." The Court of Appeals also concluded that the organization failed to fall within the dictionary definition of "social" or "welfare," because the organization "did not propose to offer a service or program for the direct betterment or improvement of the community as a whole." Members, and not the public, derived a substantial private benefit from their purchase of perpetual-use contracts, including the right to the equitable ownership of the value of their units and the ability to pass the perpetual use contracts to family members at death.

In People's Educational Camp Society, Inc. v. Commissioner, 39 T.C. 756 (1963), aff'd, 331 F.2d 923 (2nd Cir. 1964), the Tax Court affirmed revocation of the exempt status of an organization that was created to acquire real property where the organization would conduct studies and develop certain liberal and progressive social programs. The organization initially engaged in activities that promoted social welfare within the meaning of § 501(c)(4) and was recognized as exempt from tax. However, some years after its formation, the organization opened the premises to the public and commenced to operate a financially lucrative vacation resort that competed with for-profit resorts. The organization continued to engage in the activities that provided the basis for its exempt status; however, by the time that the organization's exemption was revoked, the organization expended less than 2 percent of its revenues on the conduct of its exempt activities. Furthermore, in the context of the resort operations, various art and educational programming that originally furthered the organization's exempt purpose had, over time, acquired entertainment value that enhanced the commercial resort function. When considered in relation to its activities as a whole, operation of the resort precluded the organization from qualifying for exemption under § 501(c)(4). Operation of the resort did not "exclusively" or even "principally" promote social welfare within the meaning of § 501(c)(4). Operation of the resort had become the organization's primary activity. The Tax Court found that the organization's commercial activities overshadowed all of its other activities.

In American Women Buyers Club, Inc. v. U.S., 338 F.2d 526 (2d Cir. 1964), the Court of Appeals concluded that the organization was not tax-exempt under § 501(c)(4) because the majority of the benefits were for its members and it did not promote social welfare.

In Contracting Plumbers Cooperative Restoration Corp. v. U.S., 488 F.2d 684 (2d Cir. 1973), the Court of Appeals concluded that a plumbers cooperative was not tax-exempt under § 501(c)(4) because the benefits to the members were proportional to their financial involvement, and therefore, it operated primarily for the benefit of its members, rather than for the purpose of benefiting the community as a whole.

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3d Cir. 1993) (remanded to Tax

Court on a separate issue) ("Geisinger I"), the Court of Appeals considered whether an organization that provided healthcare benefits only to its subscribers could qualify for exemption under § 501(c)(3). The court focused its analysis on whether the activities of Geisinger Health Plan ("GHP") provided a community benefit. Id. at 1219. The court concluded that providing healthcare benefits to the population limited to GHP's paying subscribers did not result in a benefit to the community at large. Even though the Court of Appeals was considering the application of § 501(c)(3), rather than § 501(c)(4), this case also assists our analysis, because in order to qualify for exemption under § 501(c)(4), the organization in question also must show that its operations benefit the community as a whole.

In Vision Service Plan v. U.S., 2005 U.S. Dist. LEXIS 38812 (E.D. Calif.), aff'd mem., 2008 U.S. App. LEXIS 2388 (9th Cir. 2008), reh'g. denied (Apr. 9, 2008); cert. denied (Jan. 12, 2009) (hereinafter, "VSP v. USA"), Vision Service Plan ("VSP") contracted with employers, HMOs, insurance companies and political subdivisions (collectively, "Subscribers") to arrange for the provision of certain vision care services to Subscribers' employees or members (collectively, "Enrollees"). VSP arranged for these services to be provided to Enrollees by contracting with independent optometrists and ophthalmologists ("Participating Providers"). VSP operated a prepaid vision care program and a self-funded program. Under the prepaid program, Subscribers contracted with VSP, agreeing to pay a fixed monthly amount to VSP in return for which Subscribers' Enrollees are entitled to receive the contracted vision care benefits from VSP's Participating Providers. Under the self-funded program, VSP provided administrative services, such as processing and paying claims, in exchange for an administrative fee. Most of VSP's Enrollees were employed by its large Subscribers. VSP's Subscribers include small and rural employers and HMOs enrolling beneficiaries under Medicare, Medicaid, and California Health Families Child Health Assistance Program. Members of the general public could not receive VSP's services without being an employee or member of a Subscriber. Individuals who were not Enrollees were not eligible for VSP's services and could not receive vision care benefits under VSP's prepaid program or self-funded program. VSP's gross revenue for 2003 was $425 million and its net income was $34 million. VSP arranged for free vision services to non-Enrollees, paid for the provision of vision services to low-income children, and incurred expenditures for community outreach and community educational programs. In relation to VSP's revenue and accumulated surplus, these expenditures were minor.

The District Court determined that VSP did not qualify for exemption under § 501(c)(4), holding that VSP's primary activity was not the promotion of social welfare. VSP did not offer its vision care plans to the general public; rather, its services were available only to employees or members of a subscribing employer, political subdivisions, or other groups with which VSP contracted. Further, the services it provided through its charity programs to non-Enrollees were comparatively insubstantial. The court concluded that VSP was not "primarily engaged in the promotion of social welfare," but instead provided public benefits that were "incidental" to the "primary purpose" of "serv[ing] [its] paying members." The court also concluded that ". . . [D]espite VSP's charity work, the membership-based structure as well as the types of services offered, demonstrate that VSP's primary activity is not the promotion of social welfare."

The Court of Appeals affirmed the District Court, holding that VSP is not entitled to tax-exempt status because "it is not primarily engaged in promoting the common good and general welfare of the community." The court also found that VSP's primary purpose, establishing a fund from

payments by its subscribers to defray and assume their costs of vision care, "benefits VSP's subscribers rather than the general welfare of the community."

Exempt Status Based Upon the Integral-Part Test

Section 502 provides that, "an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under § 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under § 501."

Section 1.502-1(b) provides the framework for derivative or vicarious exemption for a subsidiary organization of a tax-exempt organization that is an integral part of the parent organization. The subsidiary organization's exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization. For example, an entity created to provide electrical power solely to its parent organization to enable the parent to conduct its exempt activity may qualify for exemption as an integral part of the parent organization. Such an organization would not qualify for exemption on this basis if it were to provide electrical services primarily to customers other than its parent. The subsidiary organization will not qualify for exemption if its primary purpose is to carry on a trade or business that would be an unrelated trade or business if engaged in by the parent.

Rev. Rul. 58-194, 1958-1 C.B. 240, holds that an organization operating a book and supply store and a cafeteria and restaurant on the campus of a state university for the convenience of the student body and faculty qualifies for exemption under § 501(c)(3). The facilities of the organization are available to everyone connected with the university, and the profits are used solely for the benefit of the students and faculty of the university. Because the organization serves almost exclusively the members of the faculty and student body and since it is performing functions for their benefit and convenience and in furtherance of the university's educational program, it is an integral part of the university.

Rev. Rul. 78-41, 1978-1 C.B. 148, describes a trust created to satisfy a specific exempt hospital's malpractice claims. The trust was created by the hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital. The hospital controlled the trust, whose trustee acted upon direction from the hospital as to the payment of claims. The trust satisfied the hospital's obligation under state law to provide for malpractice claims and is an activity that the hospital could do directly. By serving as a repository for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust operated as an integral part of the hospital and was exempt under § 501(c)(3).

Squire v. Students Book Corp., 191 F. 2d 1018 (9th Cir. 1951), held that an organization that operated a bookstore on the premises of a college for the accommodation of students and faculty, and which was controlled by the college, qualified for exemption because it bore a "close and intimate relationship" to the functioning of the college itself.

B.H.W. Anesthesia Foundation Inc. v. Commissioner, 72 T.C. 681 (1979), held that the Harvard Medical School faculty clinical practice organization created by the anesthesiology department of Harvard Medical School qualified for exemption under § 501(c)(3). A clinician could qualify for membership in the organization only so long as he or she was a clinical faculty member at

Harvard Medical School. Control of the organization rested directly or indirectly with the chairman of the Harvard Medical School department of anesthesiology. The patients served by the organization were limited to patients of the teaching hospital. Although the organization's revenues were used to supplement compensation paid to the members of the faculty practice, compensation was capped at an amount that the Tax Court held was reasonable and was less than the clinical faculty member would likely obtain in private practice. Accordingly, the organization comprised an integral part of Harvard Medical School and its teaching hospital, the Boston Hospital for Women. No private benefit accrued to the clinical faculty members of the organization, which would otherwise disqualify it from exempt status.

University of Massachusetts Medical School Group Practice v. Commissioner, 74 T.C. 1299 (1980), acq. 1980-2 C.B. 1, held that the organization serving as the clinical faculty practice group comprised exclusively of clinical faculty of the University of Massachusetts Medical School, was an integral part of the medical school and its teaching hospital. Members of the organization participated in the clinical teaching program at the teaching hospital and divided their time between academic pursuits (teaching and research) and clinical duties at the teaching hospital and other smaller affiliated state hospitals. The opportunity for students to observe and assist in the actual treatment of patients was considered to be a vital and necessary part of their medical education. Accordingly, the faculty members' patient care activities at the hospital were inseparable from the faculty members' teaching function. Members of the organization were required to hold academic appointments at the medical school and to be engaged to some degree in clinical practice. State conflict of interest laws precluded clinical faculty from personally billing patients or third party payors for their clinical services. The organization collected the fees generated by the faculty clinical services, deposited those funds into a trust fund pursuant to statute, and expended in the funds for legislatively mandated purposes. Although amounts generated through the clinical practice enhanced a clinician's overall compensation, total compensation paid to the clinicians was subject to the same institutional regulations as the clinician's academic salary. The provisions regulating the allocation of clinical fees among the practicing clinicians prevented the organization from serving the private interests of the clinicians. The Tax Court found that the organization provided vital clinical training for medical students, interns, and residents, comprised an integral component of the medical school and the university hospital and, therefore, qualified for exemption.

University of Maryland Physicians, P. A. v. Commissioner, T.C. Memo. 1981-23, found that the medical practice comprised exclusively of clinical faculty of the cardiology, nephrology, pulmonary diseases, and nuclear medicine departments of the University of Maryland Medical School qualified for exemption as an integral part of the medical school and its teaching hospital. The organization's members provided clinical services exclusively to patients at the medical school teaching hospital and were precluded from holding concurrent positions at any other medical facility or with any other practice groups.

The Tax Court found that clinical instruction is an indispensable primary component of training undergraduate and graduate students at the medical school. The clinical practice group's organizing documents limited its activities to serving the interests of the medical school and teaching hospital. The organization's clinical practice revenues were subject to the control of the medical school. Although each clinician owned shares in the stock in the organization, a shareholder could obtain no more than the nominal par value for his or her shares upon leaving the practice group. These factors precluded the faculty members from deriving an

impermissible private benefit from the organization's operations. Accordingly, the organization qualified for exempt status as an integral part of the University of Maryland Medical School.

Geisinger Health Plan v. Commissioner, 30 F.3d 494 (3rd Cir. 1994) ("Geisinger II") held that Geisinger Health Plan ("GHP") could not qualify for exemption as an integral part of a health system comprised of eight separate healthcare organizations, each of which was exempt from tax under one or more sections of the Internal Revenue Code. Geisinger II analyzed the basis on which a subordinate organization could qualify for tax-exempt status because of its relationship with one or more exempt parent organizations. The Court of Appeals rejected an analysis based upon a hypothetical merger of GHP into the parent organization. Id. at 499. Instead, Geisinger II developed the following guidelines to evaluate whether a subsidiary may be entitled to exempt status as an integral part of the exempt parent:

> (1) The subsidiary does not carry on a trade or business which would be an unrelated trade or business if regularly carried on by the parent, and
>
> (2) The relationship between the subsidiary and the parent enhances in some way the subsidiary's own exempt character to the point that, when the "boost provided by the parent is added to the contribution made by the subsidiary itself," the subsidiary would be entitled to exemption.

Id. at 501.

The Court of Appeals noted that the electric company described in § 1.502-1(b) served a charitable purpose solely because it provided an essential service (electric power) exclusively to a tax-exempt university. Providing electric power to paying customers is not, in itself, an exempt purpose. However, the power company described in the Treasury Regulation possessed an exclusive relationship with the university. The power company was a wholly owned subsidiary of the university to which it supplied power. The university's educational mission effectively became the mission of the power company. Id. at 501-2.

Geisinger II noted that GHP served a broader clientele than its parent healthcare system. In addition (citing to Geisinger I, 985 F.2d at 1219-20), the Appeals Court noted that the population served by GHP was largely limited to its paying subscribers. Accordingly, GHP was distinguishable from the types of organizations that could qualify for exemption as integral parts of their respective parent organizations. See, e.g., § 1.502-1(b); Squire v. Students Book Corp., 191 F. 2d 1018 (9th Cir. 1951); Rev. Rul. 58-194, supra.

Redlands Surgical Services v. Commissioner., 113 T.C. 47 (1999), analyzed the relationship between an exempt hospital and an ambulatory surgery center operated as a partnership between an affiliate of the exempt hospital and a for-profit entity. Among the arguments considered by the Tax Court was that the organization was an integral part of the exempt hospital. In finding that the surgical center was not an integral part of the hospital, the Tax Court found that there was no substantial overlap between the patients of the hospital and the patients of the organization. In addition, the hospital continued to maintain its own ambulatory surgical center, even after its affiliate joined with the for-profit entity to create the organization.