

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:TEGE:EOEG:E0
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UILC: 501.04-00

date: April 19, 2013

to: Commissioner
Tax Exempt & Government Entities

from: Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

subject: Tax Exemption under Section 501(c)(4) for X

You requested our views on whether Provision of the Tax Reform Act of 1986 created an exception for X from the requirements for federal tax exemption under § 501(c)(4), or whether it created an exception for X only from the limitations on commercial-type insurance under § 501(m).

This advice may not be used or cited as precedent.

LEGEND

X = [REDACTED]

Provision = [REDACTED]

Ruling A = [REDACTED]

N = [REDACTED]

S = [REDACTED]

U = [REDACTED]

Y = [REDACTED]

ISSUE

Whether Provision of the Tax Reform Act of 1986 created an exception for X from the requirements for federal tax exemption under § 501(c)(4).

CONCLUSION

We conclude that X would qualify for exemption under § 501(c)(4) only if X met the specific requirements of § 501(c)(4): the organization is not organized for profit and is operated exclusively for the promotion of social welfare. Provision of the Tax Reform Act of 1986 created an exception for X from § 501(m)'s proscriptions on commercial-type insurance. It did not create an exception from the threshold exemption requirements of § 501(c)(4).

BACKGROUND

Since N, the Service has recognized X as exempt under § 501(c)(4). S currently have exempt status. In general, X primarily arrange for the provision of a full range of Y on a discounted basis from a network of preferred providers. These Y generally are limited to premium-paying members. In general, membership predominantly is comprised of large employer groups. X generally do not provide any free or below cost services or educational programs to the community as a whole.

The court decisions in the Vision Service Plan ("VSP") litigation (discussed below) were issued starting in 2005, after X received favorable determination letters. These court opinions held that certain organizations whose principal activities were arranging or administering vision service benefits for their premium-paying members were not exempt under § 501(c)(4).

LAW

Section 501(c)(4)—Social Welfare Organizations

Section 501(c)(4) describes "organizations not organized for profit but operated exclusively for the promotion of social welfare." The regulations provide: "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." Treas. Reg. § 1.501(c)(4)-1(a)(2)(i). 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." Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

Vision Service Plan v. United States held that certain organizations arranging and administering vision care services for their members did not qualify for exemption under § 501(c)(4). *Vision Service Plan v. United States*, 96 A.F.T.R.2d 2005-7440 (E.D. Cal.), *aff'd mem.* 101 A.F.T.R.2d 2008-656 (9th Cir.); *cert. den.* 555 U.S. 1097 (2009). *Accord, In re Vision Service Plan Tax Litigation*, 105 A.F.T.R.2d 2010-2979 (S.D. Ohio). VSP's primary purpose was establishing a fund for vision care services for its members, generally an eye exam and discounts on lenses and frames. Its principal activity was contracting with very large employer groups, HMOs, insurance companies, and political subdivisions to arrange or administer vision-care services for its enrollees. It also administered the vision service benefits for participants in Medicare, Medicaid, and California's Healthy Families assistance program. VSP contracted with independent vision care professionals, such as optometrists, to provide these services. VSP was governed by a fifteen-member board, eleven of the members of which were optometrists or other eye care providers who had participating provider agreements with VSP or its affiliates.

The district court concluded that VSP's "membership-based structure as well as the types of services offered, demonstrate that VSP's primary activity is not the promotion of social welfare." It specifically found that "VSP's primary purpose is to serve VSP's paying members" and that its services were "most beneficial" to them, "rather than for the purpose of benefitting the community as a whole, [which] precludes VSP from exemption under 501(c)(4)."

The 9th Circuit affirmed, concluding that VSP's primary purpose of establishing a fund to pay for vision care services "benefits VSP's subscribers rather than the general welfare of the community." 101 A.F.T.R.2d 2008-656 (9th Cir.), *reh'g. denied* (Apr. 9, 2008). It also found that the public benefits VSP offers (*e.g.*, providing free eyeglasses for storm victims) "are not enough" to establish promotion of social welfare.

Section 501(m)—Commercial-Type Insurance

Section 1012(a) of the Tax Reform Act of 1986 added new subsection § 501(m) to the Code:

(a) IN GENERAL -- Section 501 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection: "(m) CERTAIN ORGANIZATIONS PROVIDING COMMERCIAL-TYPE INSURANCE NOT EXEMPT FROM TAX."

P.L. 99-514, 100 STAT. 2390.

Section 501(m)(1) provides:

An organization described in paragraph (3) or (4) of subsection (c) shall be exempt from tax under subsection (a) only if no substantial part of its activities consists of providing commercial-type insurance.

The legislative history explained § 501(m)'s purposes:

Congress was concerned that exempt charitable and social welfare organizations that engage in insurance activities are engaged in an activity whose nature and scope is inherently commercial rather than charitable; hence, tax-exempt status is inappropriate. Congress believed that the tax-exempt status of organizations engaged in insurance activities provided an unfair competitive advantage to these organizations.

General Explanation of the Tax Reform Act of 1986, Joint Committee on Taxation, JCS-10-87 (May 4, 1987), at 584.

Provision of the Tax Reform Act of 1986, 100 STAT. [REDACTED]
[REDACTED] provided in part:

[REDACTED]

The legislative history to § 1012 of the Tax Reform Act of 1986 stated:

[REDACTED]

Conference Report, Tax Reform Act of 1986, H.R. Rep. No. 99-841, 99th Cong. 2d Sess. (Sept. 18, 1986), at [REDACTED].

The Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647 (Nov. 11, 1988) [REDACTED]

[REDACTED] The House Ways and Means and the Senate Finance Committee reports to the technical corrections act stated: [REDACTED]

[REDACTED] Miscellaneous Revenue Act of 1988, Report of the Committee on Ways and Means, H.R. Rep. No. 100-795, 100th Cong., 2d Sess. (Jul. 26, 1988), [REDACTED]; Technical Corrections Act of 1988, Report of the Committee on Finance, S. Rep. No. 100-445, 100th Cong., 2d Sess. (Aug 3, 1988), [REDACTED]. The "Present Law" discussion of both reports stated: [REDACTED]

Id.

Each report titled the provision as § 1012 of the Tax Reform Act of 1986 and stated it as the express rule of § 501(m): "Under present law, an organization described in sections 501(c)(3) or (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance." H.R. Rep. No. 100-795, at 114; S. Rep. No. 100-445, at 120.

Ruling A and [REDACTED]

Ruling A and [REDACTED] each concluded that the organization was exempt under § 501(c)(4). Addressing Provision, Ruling A stated:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

ANALYSIS

Section 1012(a) of the Tax Reform Act of 1986 added new § 501(m) to the Code. Section 1012(a) did not amend § 501(c)(4) itself. Section 501(m) states that it applies to "[a]n organization described in paragraph (3) or (4) of subsection (c)." Section 501(m) further provides that an organization described in § 501(c)(4) "shall be exempt from tax under subsection (a) only if no substantial part of its activities consists of providing commercial-type insurance." Accordingly, by its express statutory terms § 501(m) only imposes an additional limitation or requirement on exemption for an organization otherwise described in § 501(c)(4). See *Nonprofits' Ins. Alliance of Calif. v. United States*, 32 Fed. Cl. 277, 292 (1994) ("Congress enacted section 501(m) to

restrict, not enlarge, the scope of organizations that qualify for tax-exempt status"); accord *Florida Hosp. Trust Fund v. Commissioner*, 103 T.C. 140, 156 (1994).¹

Provision of the Tax Reform Act of 1986 states specific circumstances in which "[t]he amendments made by this section shall not apply." As noted above, the amendments section 1012 made were to add § 501(m) to the Code.² [REDACTED]

Section 501(c)(4) enumerates a number of specific requirements. The organization must not be organized for profit. The organization must be "operated exclusively for the promotion of social welfare." The regulations add further explication. The organization must be "primarily engaged in promoting in some way the common good and general welfare of the people of the community." Treas. Reg. § 1.501(c)(4)-1(a)(2)(i). "[I]t's primary activity" must not be "carrying on a business with the general public in a manner similar to organizations which are operated for profit." Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). Each of these requirements are distinctive, and absent, from § 501(m). Moreover, Provision only describes the activities of X [REDACTED]. It does not cite § 501(c)(4), and it does not address whether these activities promote social welfare.

The statutory language itself contains no statement or indication that, by enacting § 1012 of the Tax Reform Act of 1986, Congress did (or intended) anything more than to provide an exception for X from the specific requirements of § 501(m). Provision did not amend § 501(c)(4). It does not state that X met the general requirements of § 501(c)(4), nor does it provide an exception for them from § 501(c)(4)'s requirements.

Both the legislative history to the Tax Reform Act of 1986 and to the 1988 technical corrections act describe Provision as an exception to § 501(m), not as an exception to § 501(c)(4). H.R. Rep. No. 99-841, at [REDACTED]; H.R. Rep. No. 100-795, [REDACTED]; S. Rep. No. 100-445, [REDACTED].

We therefore conclude Provision of the Tax Reform Act of 1986 did not create an exception for X from the requirements for federal tax exemption under § 501(c)(4). Provision only provides that § 501(m) does not apply to X. Ruling A and [REDACTED] interpreted Provision too broadly. Neither the express statutory language nor the legislative history supports a conclusion that the provision of Y by X *per se* promotes social welfare, or otherwise grants X automatic exemption under § 501(c)(4).

² Section 1012 of the Tax Reform Act of 1986, in subsection (b), also added new section 833 to the Code, which applies to Blue Cross and Blue Shield organizations and similar organizations. It is not pertinent to X.

Accordingly, X would qualify for exemption under § 501(c)(4) only if X are not organized for profit, and X operate exclusively for the promotion of social welfare. The determination is based on all the facts and circumstances of X, applying the statute, regulations and pertinent court cases (including *Vision Service Plan*). As discussed above, the VSP decisions, based on the particular facts and circumstances of those cases, held that certain organizations, whose principal activities were arranging or administering vision service benefits for their premium-paying members, were not exempt under § 501(c)(4). [REDACTED]

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

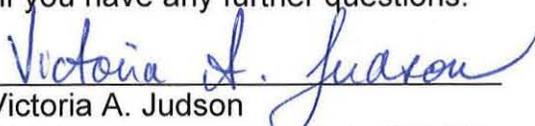
[REDACTED]

EFFECT ON OTHER RULINGS

[REDACTED]

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call me at (202) 622-6000 if you have any further questions.


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