Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Release copies to District

Date [redacted]

Surname [redacted]

[redacted]

Contact Person: [redacted]

Telephone Number: [redacted]

In Reference to: [redacted]

Date: [redacted]

Employer Identification Number: [redacted]
Key District:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4). Based on the information in your application, we have concluded that you do not qualify for exemption under section 501(c)(4). The basis for our conclusion is set forth below.

FACTS

You were incorporated in the state of [redacted] on [redacted]. Your articles of incorporation state that you will operate or negotiate for the establishment and operation of non-profit plan or plans for health care, including hospital care for its members, their employees and their dependents through contracts with physicians, medical societies, dentists, dental societies, optometrists, chiropractors, hospitals, clinics, and any other provider of health care and health care facilities.

On Form 1023, you state that you are composed of member employers who each have their own health care plan with their own insurance company administering the plan. The employers negotiate with and enter into pricing arrangements with the health care providers. If a provider accepts your fee schedule, the provider can be in your healthcare network. Your members' insurance contracts include a steerage provision to encourage members to use providers who agree to your fee schedule.

You work with the [redacted] Preferred Provider Network ([redacted]) to establish a network for [redacted] County. In a letter dated [redacted], you state that [redacted] will gather and analyze health care information and negotiate agreements with area health care providers. You do not have any agreements with employers, providers, or insurance companies. However, [redacted] owns provider, employer and insurance company agreements. You have utilized [redacted] generated data to evaluate local health services and provide education to the provider community and your member employers and their employees.

[redacted]

You have members who pay a $[redacted] one-time fee for membership and pay $[redacted] per employee per month for two years. Members are also required to have benefit plan steerage. You state that steerage enables local community care givers who provide quality service to garner additional commercially insured patient volume and revenue. You explain that community care providers use this revenue to invest in new health care technology and facilities, recruit physicians, provide quality care to uninsured individuals, offset losses from governmental programs, e.g. Medicare and Medicaid.

In addition, you also state that you hold regular educational seminars and meetings on local community health topics. You facilitate collaboration between area employers, the two major health systems, and independent health service providers on how to improve the quality, affordability and accessibility of health care services to the community and reduce duplication of expensive health care technology in the community.

You also collect and share information on community member opinions regarding health services as well as health service utilization and costs.

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, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines the words "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(4)-1(a)(1) of the regulations provides that an organization is described in section 501(c)(4) of the Code if (1) it is not organized or operated for profit and (2) it is operated exclusively for the promotion of social welfare. Section 1.501(c)(4)-1(a)(2)(i) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

Section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization is not operated primarily for the promotion

[redacted]

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 general, social welfare must benefit the general community as a whole and organizations exempt under section 501(c)(4) of the Code must be operated primarily to promote social welfare. Certain social welfare organizations serve only the community as a whole (pure public benefit) while others benefit a particular group of people but still primarily serve community interests. However, in instances where an organization limits its benefits to members, the organization is generally considered not to be operated for social welfare purposes.

There are a number of rulings that illustrate the distinction between organizations that serve the community and those that serve only their members or some other restricted class. See, e.g., Rev. Rul. 78-69, 1978-1 C.B. 156 (providing rush-hour bus service to members of the general public, where the bus service provided is subsidized by government and the regular bus service is not adequate or commercially available, constitutes a social welfare activity); and Rev. Rul. 78-429, 1978-2 C.B. 178 (an organization primarily promoted social welfare because it met a community need by operating an airport not otherwise available to the rural communities of the area). But see Rev. Rul. 75-199, 1975-1 C.B. 160, (an organization formed to provide sick and death benefits to members who are restricted to individuals of good moral character and health who belong to a particular ethnic group and reside in a stated geographical area provides only minor and incidental benefits to the community as a whole); and Rev. Rul. 55-311, 1955-1 C.B. 72 (providing bus service for a local association of employees, the membership of which is limited to employees of a particular corporation, is not a social welfare activity).

The distinction between "pure" public benefit and private benefit is illustrated by comparing Rev. Rul. 54-394, 1954-2 C.B. 131 (an organization does not primarily promote social welfare where it provides television reception on a cooperative basis) with Rev. Rul. 62-167, 1962-2 C.B. 142 (an organization retransmitting TV signals for the benefit of the entire community qualifies as a social welfare organization). See also Rev. Rul. 80-206, 1980-2 C.B. 185, (an organization formed to promote the legal rights of all tenants in a particular community qualifies as a social welfare organization) and Rev. Rul. 73-306, 1973-2 C.B. 179 (a similar organization, formed to protect the rights of tenants in one particular rental complex, was not primarily promoting social welfare).

[redacted]

Another example of an organization benefiting only its members is Rev. Rul. 66-148, 1966-1 C.B. 143, in which the Service held that an organization formed to establish and maintain a system for water storage and distribution was exempt under section 501(c)(4) of the Code. Although it was a membership organization, its activities resulted in an increase in the level of underground water, which benefited the entire community, irrespective of membership.

Therefore, when the services furnished by an organization are beneficial to the community and available to all members of the community on an equal basis irrespective of membership, a social welfare objective will generally be found to exist. However, where an organization limits its services and benefits to its members, the organization is not ordinarily operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4).

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 wellbeing 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. See Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962).

Therefore, the issue is whether the organization's activities result in so much private benefit as to preclude it from qualifying as a social welfare organization. The test in resolving this question with respect to exemption under section 501(c)(4) is "primarily," which, as used in the regulations, means that some amount of private benefit may be permissible so long as the organization's activities remain primarily social welfare. This necessarily requires weighing the extent to which an organization's activities are social welfare activities versus those that result in a private benefit. An example of the balancing between public and private benefits is Rev. Rul. 72-102, 1972-1 C.B. 149. In this ruling, a homeowner's association formed by a developer to administer and enforce covenants for preserving the architecture and appearance of a housing development and to own and maintain common green areas, streets and sidewalks for the use of development residents was held to be exempt under section 501(c)(4) of the Code even though there

[redacted]

existed some amount of private benefit to the developer and individual residents because these benefits were incidental to the benefit provided to the community as a whole.

A similar analysis has been applied in the case of organizations exempt under section 501(c)(3) of the Code. Although an organization's operations may be deemed to be beneficial to the public, if it also serves private interests other than incidentally, it is not entitled to exemption under section 501(c)(3). The word "incidental" has both qualitative and quantitative connotations. To be qualitatively incidental, any private benefit must be a necessary concomitant of the activity which benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting certain private individuals. To be quantitatively incidental, any private benefit must be insubstantial measured in the context of the overall public benefit conferred by the activity.

Accordingly, exemption under section 501(c)(4) of the Code depends on an organization's ability to serve in some manner the general welfare of the community rather than providing benefits primarily to its members or to other interested parties. In addition, as explained below, for an organization to be exempt under section 501(c)(4), it must be in compliance with section 501(m).

In Rev. Rul. 86-98, 1986-2 C.B. 75, an individual practice association (IPA) sought recognition of exemption under section 501(c)(4) of the Code. The IPA's purpose was to arrange for the delivery of health service through written agreements negotiated with health maintenance organizations (HMOs). Its membership was limited to licensed physicians who were members of a specified county medical society. The IPA's primary activities were to serve as a bargaining agent for its members in dealing with HMOs and to perform the administrative claims services required by the agreements with the HMOs.

The IPA in this revenue ruling was akin to a billing and collection service and a collective bargaining representative negotiating on behalf of its member physicians with HMOs. The IPA did not provide access to medical care which would not have been available but for the establishment of the IPA, nor did it provide such care at fees below what was customarily and reasonably charged by the member physicians in their private practices. As a result, the Internal Revenue Service concluded that the IPA operated in a manner similar to organizations carried on for profit, the primary beneficiaries of which are its member physicians, rather than the community as a whole. Therefore, the Service held that it was not operated exclusively

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for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

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.

## RATIONALE

Whether you are primarily engaged in promoting the common good and general welfare of the people of the community in accordance with section 501(c)(4)-1(a) of the regulations is determined from an examination of all of the relevant facts and circumstances.

One relevant fact is the character of your enrollment. If your enrollees are comprised primarily of persons who are considered medically underserved, this fact would tend to indicate that you are primarily benefiting the community as a whole. Persons are considered to be "medically underserved" if they are unable to obtain, or cannot afford to pay for, the health care services that you provide. Conversely, if your enrollees are comprised primarily of persons who are not considered medically underserved, this fact would tend to indicate that you are not primarily benefiting the community as a whole but rather providing health care services to the public on a commercial basis.

Another relevant fact is whether you are engaged to a substantial degree in social welfare and community benefit activities. If your social welfare and community benefit activities represent a substantial part of your overall activities, this would be a positive fact. Conversely, if your

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social welfare and community benefit activities represent only an incidental part of your overall activities, this would be a negative fact.

Each of these elements is discussed further below.

Enrollment

Exemption under section 501(c)(4) of the Code depends on an organization serving the general welfare of the community rather than providing benefits solely to its members or to parties in control of the organization. The revenue rulings discussed above illustrate the distinction between organizations that primarily serve the community versus those that primarily serve their members or some other restricted class. See, e.g., Rev. Rul. 75-199, supra. By offering health care benefits to employees of your members pursuant to contract requirements with [redacted], you are not providing a benefit to a medically underserved group. As a result, your activities do not primarily benefit the community as a whole but instead primarily benefit [redacted], your employer members and the health care providers in your community.

Community Benefit Activities

You also have not demonstrated that community benefit activities constitute your organization's primary activities. Instead, based on all the facts, it is reasonable to conclude that your primary activities consist of operating a commercial health care plan for the benefit of your employer members for a fee. There is no broad community benefit that results from such activities. Providing these services does not promote the public welfare but is an ordinary commercial activity. Because your organization is controlled, directly and indirectly, by your employer members whose financial interests are served by your activities, we have concluded that you are organized and operated to serve their private and commercial interests rather than the common good and general welfare of the people of the community as required by section 1.501(c)(4)-1(a)(2)(i) of the regulations. We have further concluded that the benefits flowing to the health care providers are not merely incidental in either a qualitative or quantitative sense because such disproportionate benefits to private interests are not a necessary means of accomplishing the goal of benefitting the community as a whole. Therefore, your activities result in disqualifying private benefit to your members, [redacted] and the health care providers.

[redacted]

Conclusion

For the reasons stated above, you do not qualify for exemption as an organization described in section 501(c)(4) of the Code and you must file federal income tax returns.

Based upon the financial information that you furnished, you should file returns on the form and for the tax years indicated above within 30 days from the date of this letter with your key District Director for exempt organization matters, shown above, unless you request and your key District Director grants an extension of time to file the returns. You should file returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you have any questions concerning the reasons for this ruling, please contact the person whose name and telephone number appear in the heading of this letter. You should address questions concerning the filing of returns to your key District Director.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representatives

Sincerely,

[redacted]

Chief, Exempt Organizations

[redacted]