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Date 7/24/88

Surname [REDACTED]

INTERNAL REVENUE SERVICE
CINCINNATI, OH 45201

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EP/EO DIVISION

Dear Applicant:

We have considered your application for exemption from Federal income tax under section 511(c)(2) of the Internal Revenue Code.

The information submitted shows that you were incorporated on [REDACTED], under the nonprofit laws of the State of [REDACTED]. Your stated purpose is to establish and provide a local health care delivery system; to ensure high-quality, cost effective health-care; and to promote social welfare by sustaining high quality health care.

The information you submitted shows further that you are a cooperative network of three local employers [REDACTED]

[REDACTED] health care providers [REDACTED] [REDACTED] use insurance company [REDACTED]. Your organization is controlled by the employers acting as one center; the health care organizations acting as 2 centers and the insurance company as your fourth center. Your centers each elect four representatives to your Board of Directors.

To insure the health care delivery system, you will offer at least five different options. The five options include (1) a traditional insurance product that does not restrict provider access; (2) a preferred provider network that is an expansion of an existing preferred provider product in which members utilize the services of selected contract providers for most of their care; (3) a second preferred provider policy using a new contract or second contract various benefit options; (4) an HMO product with services provided exclusively through the organization under which the employer can tailor a package to suit the individual needs and budget of each employee; or (5) an alternative third alternative medical coverage to patients of participating employers.

You will have the right to your services only to your employer [REDACTED]. In addition, the health care providers [REDACTED] appear to be [REDACTED]. The information about other employees [REDACTED] [REDACTED] [REDACTED].

You have also submitted sample contracts for physicians and hospitals to provide health care to your enrollees. These contracts provide for a maximum fee for the different services rendered. In addition, there are provisions in each contract for incentive pools. Any cost overruns appear to be paid from your established risk pools and perhaps by various reinsurance arrangements. Ultimately, you are responsible for any uncovered losses.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(3)-1(a)(2)(i) of the Income Tax 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. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Rev. Rul. 75-100, 1975-1 C.B. 160, provides that an organization furnishing aid and death benefits to its members does not qualify for exempt status under section 501(c)(3) of the Code as a social welfare organization.

Rev. Rul. 68-704, 1968-2 C.B. 121, provides that a community television which as an organization whose sole activity is providing television reception to its members does not qualify as a social welfare organization.

Section 501(c)(1) of the Code provides that an organization described in section 501(c)(1) or (2) of the Code will be eligible for recognition of exemption under section 501(a) of the Code "only if no substantial part of its activities consists of providing commercial-type insurance."

Section 501(c)(3)(B) of the Code provides that the term "commercial-type insurance" shall not include incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations. In addition, section 501(b)(2) of the Code lists certain other exclusions to the term "commercial-type insurance."

Allied Fidelity Corp. v. Commissioner, 572 F.2d 1180, 1193; (1977), citing 1 Couch on Insurance 2d §1:2 (1980), states that the common definition for insurance is an agreement to protect the insured against a direct or indirect economic loss arising from a defined contingency whereby the insurer undertakes no present duty of performance but stands ready to assume the financial burden of any covered loss.

1 Couch on Insurance 2d §1:2 (1980), states that it is characteristic of insurance that a number of risks are accepted, some of which will involve losses and that such losses are spread over all the risks so as to enable the insurer to accept each risk at a slight fraction of the liability upon it.

Rev. Rul. 77-317, 1977-2 C.B. 31, 35, provides that the sharing and distribution of insurance risk by all the parties insured is essential. Thus, when there is not sharing or distribution of risk, there is no insurance arrangement.

Based on the information submitted on Schedule that you are essentially a mutual, self-interest type of organization. Your income is used to provide direct economic benefits to your subscribers (participating employee members) and sponsoring employers. Any benefits to the larger community are direct and incidental to the economic benefits to your participating members. Since you are limiting your benefits primarily to employees and employers and benefitting the community as whole incidentally, you are not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(7) of the Code. The fact that individual coverage is offered to those persons that separate from a sponsoring employer group would not change the above result.

In addition, the information submitted shows that the risk of medical expense due to anticipated illness or the need for medical care has been shifted from your subscribers to you. Since you are ultimately responsible for any cost overruns, you are paying for services on a fee-for-service basis in an identical manner to taxable insurance companies. Since your are operating essentially on a fee-for-service basis and are not operating your own health care facilities, you are operating in a manner indistinguishable from Blue Cross and Blue Shield type organizations. You do not plan to provide your insurance at below cost and you do not plan to provide significant consideration for the insured. The element of risk has been distributed across the band of your enrollees. Accordingly, it is our conclusion that you are providing commercial-type insurance within the meaning of section 501(c) of the Code. The fact that you may enter into a reinsurance agreement to prevent your risk of loss would not affect the above conclusion.

The information submitted shows that you are providing some preventative health care. However, the insurance aspects of your plan predominate over your health care services. Thus, the exclusion of section 501(c)(7)(B) of the Code is not applicable to your organization. In addition, none of the other exclusions of section 501(c)(7) of the Code are applicable to your organization.

Accordingly, it is our conclusion that a substantial part of your activities consists of providing commercial-type insurance within the meaning of section 501(c) of the Code. Thus, for this reason, you do not qualify for exempt status for those taxable years beginning after [REDACTED].

Accordingly, we conclude that you do not qualify for exception from Federal income tax under section 501(c)(4) of the Code. You are therefore required to file Federal income tax returns.

[REDACTED]

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your Key District Director in Cincinnati. Thereafter, any questions about your Criminal Income Tax status should be addressed to that office.

Sincerely yours,

[REDACTED]
Director, Except Examinations
Technical Division

cc: [REDACTED]

cc: [REDACTED]

cc: [REDACTED]
[REDACTED]