



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200644045**

Release Date: 11/3/2006

UIL: 501.00-00

Date: May 24, 2006

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

1120

Tax Years:

Dear _____ :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. 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.



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In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

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,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosures:
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

Date: February 28, 2006

Contact Person:

Identification Number:

Contact Number:

FAX Number:

E Mail Address:

Employer Identification Number:

Legend:

L =

M =

X =

Y =

Dear _____ :

This letter supplements our letter to you dated December 16, 2005.

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)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion was set forth in our December 16, 2005 letter. An additional basis for our conclusion is set forth below.

FACTS

You were incorporated under the x Nonprofit Corporation Act on y by L, a nine-county government organization authorized by the state legislature.

According to your Articles of Incorporation, your purpose is to encourage community-focused health care delivery that improves the overall health and economic well being of the communities you serve; to offer small business and farm families a new option for healthcare coverage; and to support L in fulfilling the obligations of grants received from the x Department of Health and other federal, state and local government entities.

All of the members of your Board of Directors are members of L and are county commissioners from three of the nine counties that you serve.

You operate as a purchasing alliance under the authority of a state statute, the Community Purchasing Arrangements Act. You are a registered purchase alliance under applicable provisions of this law. The purchasing alliance concept is being used statewide for the purpose of filling the gap between those who qualify for government subsidized programs and those who have adequate employer-sponsored insurance coverage. The state statute permits a group of purchasers of any size to join together to negotiate with a licensed health plan for a community-focused product that is affordable to rural and small businesses, including businesses of one and farm families. The target population is the small employers, particularly the working uninsured and under-insured employees and their dependents. Under the laws of the state of x, except for a purchasing alliance, farm families and businesses consisting of one person can only purchase health insurance in the individual market, which does not offer guaranteed issue policies.

In essence your objective is to develop a regional solution to today's high health care costs that currently face small businesses, non-profits and farmers. You serve small businesses, industry, farmers, non-profits and local government entities in nine counties in southwest x, a mostly rural area with many low-income residents. Thus, you enable these employers to purchase health insurance that otherwise would not be available or affordable by the employers or by their employees.

Your revenues come from two sources: (1) an administrative fee paid by member employers at the rate of one percent of the premiums paid and (2) grants from the x Department of Health. Over a three-year period, you expect that the administrative fees will comprise about 42 percent of your total revenues and government grants will comprise about 58 percent.

In July 2003, you entered into a Health Care Delivery Program Agreement (the "Agreement") with M, a non-profit non-exempt health maintenance organization that is licensed by the State of x. Under the Agreement, which has a term of three years, employees of your employer members may join M and may purchase the healthcare insurance offered by M, which provides healthcare services performed by M's network of healthcare providers.

Your grant from the x Department of Health provides that you will develop a wellness and education plan for area businesses and clients. You state that you operate a Wellness Program under which you provide regular health education for employers and their employees so that you can increase the wellness of employees and minimize medical expenses.

LAW

An organization described in section 501(c)(3) of the Code, must, among other requirements, be organized and operated exclusively for certain purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states:

In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations states:

An organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1) of the regulations states:

(i) An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

. . . .

(b) Charitable,

. . . .

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. An organization that serves a private interest other than incidentally, is not entitled to exemption under section

501(c)(3). Thus, 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. The word "incidental" has both qualitative and quantitative connotations.

For a benefit to be qualitatively incidental, it must be a necessary concomitant of the activity which benefits the public at large. That is, the benefit to the public cannot be achieved without necessarily benefiting certain private individuals. For example, in Rev. Rul. 70-186, 1970-1 C.B. 128, an organization was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. Although the organization clearly benefited the public at large, there necessarily was also significant benefit to the private individuals who owned lake front property. In this ruling, the IRS determined that the private benefit was incidental in a qualitative sense, stating:

The benefits to be derived from the organization's activities flow principally to the general public through the maintenance and improvement of public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

There is also a quantitative connotation to the term "incidental." For example, in Rev. Rul. 76-152, 1976-1 C.B. 151, a group of art patrons formed an organization to promote community understanding of modern art trends. The organization selected modern art works of local artists for exhibit as its gallery, which was open to the public, and for possible sale. If an art work was sold, the gallery retained a commission of ten percent and paid the remainder to the artist. In this ruling, the IRS concluded that since ninety percent of all sales proceeds are turned over to the individual artists, such direct benefits are substantial and the organization's provision of these benefits is not merely incidental to its other purposes and activities.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court held that an organization that as its primary activity operated a school to train individuals for careers as political campaign professionals was not operated exclusively for exempt purposes as described in section 501(c)(3) of the Code because the school's activities conferred impermissible private benefit. The court defined "private benefit" as "nonincidental benefits conferred on disinterested persons that serve private interests."

RATIONALE

Your primary activity consists of facilitating access to health insurance by your member employers and their employees. You contract with M, a health maintenance organization, to offer your members and their employees and dependents access to health insurance at affordable rates. Many of your member employers, primarily individual businesses and small employers, could not afford to purchase health insurance for themselves or for their employees. By pooling a large group of these employers and contracting with M, you enable these employers to purchase health insurance for themselves and their employees and their

dependents. In return for these services, your member employers pay you a fee of one percent of the premiums paid.

Thus, you enable your members, the owners of small businesses, to purchase low-cost health insurance for its employees, thereby reducing the business' healthcare expenses and improving its profits. By enabling a business to offer this benefit to its employees, this enables the business to attract and retain qualified employees, which also is likely to improve its profits. This potential for improved profits constitutes a benefit to these businesses that is more than incidental. Thus, similar to the organizations in Rev. Rul. 70-186, supra; Rev. Rul. 76-152, supra; and in American Campaign Academy v. Commissioner, supra, you violate the prohibition against impermissible private benefit in section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

The economic benefit that you provide to your members is no different than a purchasing alliance that enables small businesses to purchase any necessary product or service at a lower cost. The fact that the services here consist of healthcare insurance does not change the conclusion that your activities result in providing your members with an impermissible private benefit, contrary to the prohibition in the regulations.

Conclusions

Based on all the facts and circumstances, we conclude that your activities do not further an exempt purpose under section 1.501(c)(3)-1(a)(1) of the regulations. Therefore, you do not operate exclusively for an exempt purpose as required under section 1.501(c)(3)-1(c).

Accordingly, you do not qualify for exemption under section 501(a) of the Code as an organization described in section 501(c)(3) and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within thirty (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 proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, and do not intend to protest our denial of exempt status, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If you also disagree with our proposed deletions, you should send your comments on the deletions with your protest statement, and not to the address shown in Notice 437.

Internal Revenue Service

SE:T:EO:RA:T:1
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

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 representative.

Sincerely,

Steven B. Grodnitzky
Acting Manager
Exempt Organizations
Technical Group 1