Internal Revenue Service
TEGE Appeals Programs
300 N. Los Angeles Street
Los Angeles, CA 90012

Department of the Treasury

CERTIFIED

Release Number: **201615022**
Release Date: 4/8/2016
Date: January 15, 2016

Redaction legend:
A=
B=

C=

A

B

Taxpayer Identification Number:
C
Person to Contact:
****
Employee ID Number: ****
Tel: (**** Fax: ****
Refer Reply to:
****
In Re: Exempt status
Tax Years: 12/31/****and subsequent years
UIL Index:
501.03-00

Dear :

This is a final adverse determination as to your application for exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reasons:

1. You are not operated exclusively for exempt purposes within the meaning of Internal Revenue Code § 501(c)(3) and Treasury Regulation § 1.501(c)(3)-1(d). You do not engage primarily in activities that accomplish one or more of the exempt purposes specified in Internal Revenue Code § 501(c)(3). More than an insubstantial part of your activities are in furtherance of a non-exempt purpose.

2. You are not operated primarily for a public purpose as is required by Internal Revenue Code § 501(c)(3) and Treasury Regulation § 1.501(c)(3)-1(d)(1)(ii). You operate for the benefit of private interests.

In addition, because we have determined that you are not an organization described under § 501(c)(3), you cannot be classified as a public charity under § 509(a).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this final adverse determination of your exempt status, as required by Code section 6104(c).

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

Sincerely,

Nan Shimizu
Appeals Team Manager

Department of the Treasury
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Date: 8/25/2014

UIL Number: 501.03-05

Employer ID number:

Contact person/ ID number:

Contact telephone number:

Contact fax number:

Legend:

Date =
State =
System =

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code or "I.R.C."). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

Whether you are exempt under § 501(c)(3) and classified as a public charity under § 509(a)(3).

Facts

You were incorporated on Date in State as a nonprofit corporation for charitable, scientific or educational purposes within the meaning of § 501(c)(3) and specifically, "to promote and support, directly or indirectly, the interests and purposes of [System]." System is a not-for-profit healthcare corporation recognized as tax-exempt under § 501(c)(3) and classified as a public charity under § 509(a)(1).

You were formed by System in order to serve as the legal and operational vehicle for achieving clinical care integration, coordination, and accountability among both employed and independent physicians practicing throughout System affiliated facilities. You have submitted a Form 1023 Application requesting a determination that you are exempt under § 501(c)(3) and classified as a supporting organization under § 509(a)(3). You indicate that you are an Accountable Care Organization ("ACO"). You do not participate in the Medicare Shared Savings Program ("MSSP").

You do not engage in the direct delivery of medical care or provide health services to the general public. Rather, you indicate that all of your time and resources are dedicated to the furtherance of the "Triple Aim" health care reform goals established by the Patient Protection and Affordable Care Act ("PPACA"), namely: reducing the cost of health care for individuals, improving patient access to and the quality of care, and improving population health and patient experience. Your mission, goals, and activities are focused on the achievement of these Triple Aim goals.

You have formed a clinically integrated network of health care providers by entering into participation agreements with those providers who meet your eligibility and performance standards. The network participants include physicians employed by System and its facilities as well as those from independent practice groups who are members of the medical staff at System affiliated facilities and those practicing at other non-System affiliated hospitals and in other healthcare systems. Information included in your application materials indicates that approximately half of your participating physicians are in independent practices or affiliated with other hospitals and regional health systems.

You are developing and implementing performance measures to assess the care delivery of participating providers. You have established data infrastructure for collecting, aggregating and analyzing data, including an electronically integrated clinical information data warehouse and analysis, a patient satisfaction survey tool, and clinical network infrastructure necessary for tracking provider performance and sharing clinical data. You have developed and implemented financial incentives that motivate network providers to achieve improvement, tying payments to participating providers to their collective success at achieving the Triple Aim goals, as determined by your performance measures.

According to the terms of your participation agreements, you act as the representative for all participating providers, including the independent and other non- System affiliated physicians, in the negotiation and execution of certain agreements with third-party payers. These agreements link rewards and penalties for participants to their achievement of your performance measures in order to incentivize changes in participant behavior in furtherance of the Triple Aim goals. You have negotiated two such payor agreements so far on behalf of your participant practitioners.

Law

I.R.C. § 501(c)(3) provides that an organization may be exempted from tax if it is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and no part of the net earnings inures to the benefit of any private shareholder or individual.

I.R.C. § 509(a)(3) excludes from the definition of the term "private foundation" an organization which:

> (A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in §§ 509(a)(1) or 509(a)(2);
>
> (B) is operated, supervised, or controlled by or in connection with one or more organizations described in § 509(a)(1) or (2); and
>
> (C) is not controlled directly or indirectly by one or more disqualified persons (as defined in § 4946) other

than foundation managers and other than one or more organizations described in §§ 509(a)(1) or (2).

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order to be exempt under § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it does not qualify for exemption.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that 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 § 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.

Treas. Reg. § 1.501(c)(3)-1(c)(2) states that an organization is not operated exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Courts have interpreted the term "net earnings" as referring to an "advantage, profit, fruit, privilege, gain [or] interest" derived from the organization. Harding Hospital v. United States, 505 F.2d 1068, 1072 (6th Cir. 1964); Retired Teachers Legal Defense Fund v. Commissioner, 78 T.C. 280, 286 (1982).

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated for an exempt purpose unless it serves a public rather than a private interest. Even though an organization serves a public interest, it will not qualify for status under § 501(c)(3) if it also serves a private interest more than incidentally. Therefore, the organization has 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 interest. The private benefit prohibition of § 501(c)(3) applies to all kinds of persons and groups, not just to those "insiders" subject to the stricter inurnment proscription. Prohibited private benefit may include an "advantage; profit; fruit; privilege; gain or interest." Retired Teachers Legal Defense Fund, supra.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" as used in § 501(c)(3) includes its generally accepted legal sense and includes such purposes as relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; and lessening the burdens of government. The promotion of health has long been recognized as a charitable purpose. See Restatement (Third) Trusts § 28 (2012); 6 Austin W. Scott and William F. Fratcher, The Law of Trusts §§ 38.1, 38.5 (5th ed. 2013); and Revenue Ruling 69-545, 1969-2 C.B. 117.

However, not every activity that promotes health supports tax exemption under § 501(c)(3). For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone. Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980); see also IHC Health Plans, Inc. v. Commissioner, 325 F.3d 1188, 1197 (10th Cir. 2003) (noting that "engaging in an activity that promotes health, standing alone, offers an insufficient indicium of an organization's purpose," as "[n]umerous for-profit enterprises offer products or services that promote health"). Furthermore, "an institution for the promotion of health is not a charitable institution if it is privately owned and is run for the profit of the owners." Rev. Rul. 98-15.

Treas. Reg. 1.509(a)-4(b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of one of more specified publicly supported organizations." If it fails to meet either the organizational test or operational test, it cannot qualify as a supporting organization.

Treas. Reg. § 1.509(a)-4(e) provides that a supporting organization will be regarded as "operated exclusively to support one or more specified publicly supported organizations (hereinafter referred to as the "operational test" only if it engages solely in activates which support or benefit the specified publicly supported organizations.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. This case is the basis of § 1.501(c)(3)-1(c)(1), which provides that 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 § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

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 § 501(c)(3) 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."

An organization may provide benefits to private individuals provided those benefits are incidental quantitatively and qualitatively. To be qualitatively incidental, private benefit must be a necessary concomitant of an activity that 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, the private benefit must be insubstantial, measured in the context of the overall public benefit conferred by the activity. To illustrate the quantitatively incidental concept, compare Rev. Rul. 68-14, 1968-1 C.B. 243, with Rev. Rul. 75-286, 1975-2 C.B. 210.

In Rev. Rul. 68-14, an organization that helped beautify a city was exempt under § 501(c)(3) when it planted trees in public areas, cooperated with municipal authorities in tree plantings and programs to keep the city clean, and educated the public in advantages of tree planting.

In Rev. Rul. 75-286, an organization with similar activities did not qualify under § 501(c)(3) where its members consisted of residents and business operators of a city block and its activities were limited to that block. The facts in Rev. Rul. 75-286 indicate that the organization was organized and operated for the benefit of private interests by enhancing the value of members' property.

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, supra, 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.