



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Number: **201440020**  
Release Date: 10/3/2014

Date: July 8, 2014

UIL: 501.03-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

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. We also attempted unsuccessfully to contact the representative indicated in your application. 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.

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,

Tamera Ripperda  
Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Date: May 2, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

UIL: 501.03-00

Dear :

We have considered your application for recognition of exemption from Federal income tax under § 501(a) of the Internal Revenue Code. Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

**FACTS**

You were incorporated as a nonprofit, non-stock entity exclusively for charitable, educational and scientific purposes within the meaning of § 501(c)(3). Your articles also state more specific purposes "to promote and support, directly or indirectly, quality and cost improvements in pediatric health care, particularly pediatric healthcare provided to the Medicaid population." They contain all the necessary provisions for inurement, dissolution, and lobbying and political campaign activity.

As part of your application you filed a Form 5768 to make an election to apply § 501(h) to your first calendar year.

You are governed by a 28-person board of directors. Your by-laws describe the categories from which your directors are chosen:

1. Six physicians licensed in your state, who specialize in pediatric primary care and who practice in six defined regions of your state.
2. Six physicians licensed in your state who specialize in pediatric specialty care in various regions
3. Six representatives of pediatric hospitals or large-group practices in various regions
4. Eight at large directors who are knowledgeable about pediatric services
5. Three ex-officio directors: the President of your state's chapter of the American Academy of Pediatrics, with a vote; the immediate past president of that organization without a vote, and your executive director, without a vote.

Successors to the initial members of the board are elected by a majority of the members of the board then in office. You stated that the initial directors were "asked to join the Board by a self-selected group of interested pediatric care providers including tax-exempt hospitals" in your state.

You hope to improve the quality of and access to Medicaid services for children. You will meet with state agencies, pediatric providers, healthcare entities, payers and community representatives to generate support for improvements. You will draft and disseminate best practices guidelines and design demonstration projects. You described yourself as a collaboration between pediatric medical centers and pediatricians to improve child health care while minimizing the costs incurred by the state under the Medicaid program.

Your first such project attempts to reduce the number of emergency room visits, hospitalizations, and school absenteeism caused by asthma. One goal is to ensure that children with asthma are seen by a pediatrician who teaches the patient and his caregivers about the condition in the office, and puts an asthma management plan in place.

You will also lobby state legislators and agency staff and engage in grassroots efforts such as soliciting letters of support in efforts to comment on legislation that concerns quality or cost reforms in the Medicaid program, or other reforms to improve healthcare quality, improve access or improve efficiencies.

You will solicit foundation and government grants and individual donations. Two exempt organizations provide in-kind donations of employees. One provides the executive director and facilities and computers to carry out your daily operations. Another, a university, provides your chief medical officer who also serves as a director. You valued the in-kind donations for your first two fiscal years as less than \$500,000. You also rely on volunteers with clinical expertise to conduct demonstration projects. State agencies plan some meetings for you.

## LAW

Section 501(c)(3) states that an entity must be organized and operated exclusively for exempt purposes, including charitable, scientific and educational purposes to be recognized as exempt from federal income tax.

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

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 exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show 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.

Rev. Rul. 69-545, 1969-2 C.B. 117, states that that the promotion of health can be a charitable purpose under the general law of charity, and deemed beneficial to the community. A hospital that benefits a broad cross-section of its community by having an open medical staff and a board of trustees broadly representative of the community, operating an emergency room open to all regardless of ability to pay, and which otherwise admitted all patients able to pay, was operated to serve a public rather than a private interest.

Rev. Rul. 76-206, 1976-1 C.B. 154, illustrates that incidental private benefit will not destroy the qualification of an otherwise exempt organization; however, where an organization is serving both public and private interests the private benefit must be clearly incidental to the overriding public interest. A contrary finding will indicate that the organization is serving a private interest.

Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), held that the presence of a single nonexempt purpose, because it was substantial in nature, precluded tax exemption under section 501(c)(3) of the Code.

Lowry Hosp. Ass'n v. Commissioner, 66 T.C. 850, 859-60 (1976), concluded that a hospital could not be deemed to operate exclusively for charitable purposes, partly because of the "control and dominance" exercised by a single physician over the hospital's affairs. If private individuals or for-profit entities have either formal or effective control, it is presumed that the organization furthers the profit-seeking motivations of those private individuals or entities.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8<sup>th</sup> Cir. 1980), the court held that selling prescription pharmaceuticals to elderly persons at a discount promotes health in a general sense, but did not qualify for recognition of exemption under § 501(c)(3) because the pharmacy operated for a substantial commercial purpose.

In Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999), the Tax Court examined a joint venture between a for-profit hospital system and an exempt organization to own and operate an ambulatory surgery center, managed by a for-profit affiliate of the for-profit partner. The court stated:

An organization's purposes may be inferred from its manner of operations; its "activities provide a useful indicia of the organization's purpose or purposes." Living Faith, Inc. v. Commissioner, 950 F. 2d 365 (7<sup>th</sup> Cir. 1991), aff'd. T.C. Memo. 1990-84... To the extent that petitioner cedes control over its sole activity to for-profit parties having an independent economic interest in the same activity and having no obligation to put charitable purposes ahead of profit-making objectives, petitioner cannot be assured that the partnerships will in fact be operated in furtherance of charitable purposes.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Court held that genuine public benefit often provides an incidental benefit to private individuals. But if private interests are served other than incidentally, exemption is precluded. Qualitatively incidental means that the private benefit is a mere byproduct of the public benefit. For private benefit to be quantitatively incidental, it must be insubstantial in amount. The private benefit must be compared to the public benefit of the specific activity in question, not the public benefit provided

by all the organization's activities. The more exactly you can quantify the private benefit, the more likely it is to be non-incidental.

Living Faith, Inc. v. Commissioner, 950 F.2d. 365 (7<sup>th</sup> Cir. 1991), involved an organization established by the Seventh Day Adventist Church to carry out its "health ministry" through operation of two vegetarian restaurants and health food stores. The court stated that presumptively commercial activities are not a bar to exempt status because the test is whether an organization is operated for exempt purposes. However the activities must accomplish an exempt purpose, which the operation of the restaurant did not do.

## ANALYSIS

An organization must establish that it is both organized and operated exclusively for exempt purposes in order to be recognized as exempt from federal income taxes. Sections 501(c)(3) and 1.501(c)(3)-1(c)(1). While you have properly organized, the conflict of interest inherent in your structure prevents us from concluding that you will be operated exclusively for exempt purposes.

Promotion of health can be an exempt purpose, especially when it involves direct provision of health care in a manner that benefits the community. Rev. Rul. 69-545. Providing non-discriminatory healthcare to those covered by government programs such as Medicaid and Medicare is an indicator of community benefit. Activities other than direct provision of care can also promote health, but must primarily benefit the community, and only incidentally provide private benefit. Federation Pharmacy Services, 72 T.C. 687, Rev. Rul. 76-206. Even if an organization has substantial exempt purposes, a single substantial non-exempt purpose is sufficient to defeat exempt status. Better Business Bureau, 326 U.S. 279.

You have a very large board of directors. It was assembled by a self-selected group of "interested pediatric care providers" and will be self-perpetuating. It appears to be designed to reflect many segments of the pediatric health profession in your state. You have reserved director seats for persons representing general and specialty practices in different geographic areas, large and small practices, and facilities. One director seat goes to the president of your state's chapter of the American Academy of Pediatrics. None of the directors will represent the broad interests of the community. We must assume that if private individuals have control, the organization will further their profit-seeking motives. Lowry Hosp. Ass'n, 66 T.C. 850. All of your directors have an "independent economic interest in the same activity and [have] no obligation to put charitable purposes ahead of profit-making objectives." The same situation led the court in Redlands to agree that the Service could not be assured that the organization would be operated exclusively for exempt purposes. Redlands Surgical Services, 113 T.C. 47.

You intend to develop practice guidelines, conduct demonstration projects, lobby state legislators and agency staff on government regulation and reimbursement, quality and cost reforms in the Medicaid program. Some of your activities could promote health and education. However, it is the purpose for which the activities are conducted that determines whether an organization may be recognized as exempt. Living Faith, 950 F.2d. 365, 370.

The interests of your founders and directors in the cost of particular medical events or changes in professional roles and reimbursements may conflict with the interests of individual patients, and the community as a whole. You have not established any structural barrier to prevent your board from selecting the topics for research, its conduct, and the training and lobbying that will benefit their private financial interests.

Most charitable objectives require some private benefit in order to implement them. However the benefit to individuals, especially individuals with some control over the charitable organization, must be incidental. Rev. Rul. 76-206. The taxpayer has the burden of establishing substantial public benefit. Section 1.501(c)(3)-1(d)(1)(ii). This means that the benefits must be required to accomplish the charitable end, for example paying salaries to ministers or doctors. The private benefits must also be insubstantial compared to the public benefit. American Campaign Academy, 92 T.C. 1053.

It is not illegal or unethical for practitioners to organize for improvement of their practice area, or to lobby on issues concerning their profession. However, an entity with such a purpose is not permitted exemption under section 501(c)(3).

Therefore, we cannot find that you will operate exclusively for exempt purpose.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree 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 all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service  
TE/GE SE:T:EO:RA:T

1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Michael Seto  
Manager, EO Technical