TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Release Date: 6/3/05

Date: 02/18/05

U.I.L. Number:
501.06-00
501.06-01

Employer Identification Number:

LEGEND:

M =
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Dear :

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)(6). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated in the state of M. Your Articles of Incorporation (Articles) state that the purposes for which you are organized are to contract with hospitals and healthcare payors on behalf of participating physicians and to engage in any other lawful act or activity.

You describe yourself as a network of physicians in a specific county area of M, which contracts directly with local self-insured employers for their health benefits. You state that the marketing of your health plan is only in the specific County area. You

explain that keeping administrative costs to a minimum for the employer, the providers and the patients, is a major goal of your direct contracting.

Your Bylaws set forth the following as qualifications for admission to membership:

1. Those admitted as Primary Care members must be Participating Physicians practicing exclusively in the areas of family practice, general internal medicine or general pediatrics; and,
2. Those admitted as Specialist members must be Participating Physicians practicing in areas other than family practice, general internal medicine or general pediatrics.

Your Bylaws define a "Participating Physician" as being a physician who (a) has received an M.D. or D.O. degree; (b) has an unrestricted license to practice medicine in the state of M; (c) is actively engaged in the practice of medicine in M; (d) has executed a Participating Physician Agreement with you; and, (e) has met other criteria as may required by your directors, Articles, or Bylaws.

You furnished a copy of your "Group Practice Participation Agreement". The agreement states that you have established, maintain, and coordinate a network of health care providers available to provide community physician-directed and managed delivery of health care services on a cost competitive basis, and provide marketing, administrative, and other services to the network (the "Network Program"). The agreement further states that you have entered, or will enter, into agreements with certain employers which have adopted one or more self-funded plans to provide medical benefits to certain of their eligible employees and the eligible dependents of such employees.

A practice and its employed and contracted physicians desiring to participate in the Network Program enter into an agreement with you. The provisions of the agreement include the following:

1. You are appointed as attorney-in-fact with the authority to act on behalf of the practice and physicians to enter into Fee-For-Service Contracts for physician services in accordance with the agreement. You accept managed care contracts on behalf of the practice and the practice and physicians are bound by the agreement.
2. The practice is required to have physicians maintain sufficient personnel and facilities to meet physicians' responsibilities under the agreement, and to provide efficient, cost-effective, and convenient service to individuals eligible for and properly enrolled under a plan contracturally affiliated with you.
3. The practice is required to have physicians provide covered services in accordance with the terms of the agreement. You are to make available to the practice and physicians a description of the terms, definitions, and operational issues related to the covered services for each employer.

4. You are obligated to use reasonable efforts to negotiate fee-for-service contracts that contain financial penalties in cases where employers do not pay the practice within thirty days from the date a clean claim is submitted to the employer. Where there have been repeated late payments of claims by an employer, you are to take reasonable measures to ensure the employer's timely payment of claims.

5. In the case of referrals for covered services, a practice is to use its best efforts to require physicians to utilize your contracted health care providers before using participating health care providers (a health care provider who has contracted with the employer to provide covered services but is not your contracted health care provider).

The agreement provides for a fee schedule that sets the maximum allowable charges payable to the practice for covered services. You submitted a sample fee schedule, which you stated the majority of physicians accepted. For those practices that did not accept the fee schedule and which were needed in your network in order for you to be competitive, you negotiated separate fee schedules. You explained that these fee schedules were negotiated to be competitive with their other Preferred Provider Organization (PPO) contracts.

You identified the following as being advantages received by employers who participate in your program:

1. A large and comprehensive provider panel;
2. A competitive fee schedule for providers, hospitals and ancillary services;
3. A Medical Management Committee to work and communicate with employers on how to enhance the quality, value and patient satisfaction of their health plan;
4 Reduced administrative fees; and,
5. A local participating medical director to communicate and educate the providers on decisions made by the employer and the network on their benefit plan.
6. Accountability from the providers for the performance of the health plan.

An additional advantage identified by you concerns satisfying the common goals for employers, providers and patients without any of the three parties extracting profits from the employer's health plan.

As part of your direct contracting arrangement, you recommend a benefit design to employers. You negotiate with each employer to adopt your standard benefit design and policies and procedures with limited variation. You state that while an employer is free to "tweak" the plan design, if the employer chooses to vary widely from your design, you probably would opt not to participate. You explain that if an employer does not take advantage of working with your physicians to collaborate on all aspects of their health plan, then direct employer contracting offers them no additional benefits, and they should simply "rent" a competing PPO network. You further explain that stop loss carriers will offer the employers better premiums if they adopt a plan design close to your recommended design.

The most substantial source of your financial support has been membership dues from physician members. Each participating physician pays one-time dues of $a. The risk management fees received from your medical malpractice insurer is a second source of income. You state that the insurer realizes a reduction of malpractice risk through the programs you have/will put in place with network physicians to better educate, collaborate and communicate with one another. In addition, Client employers pay a "Network Access Fee" of approximately $b per employee per month to access your provider network. You state that once you achieve a critical mass of covered employees, network access fees paid by the client employer and withholds placed on physicians' claims will provide the majority of your financial support. The network access fees will cover your on-going overhead.

You provided the financial information for the years 2000-2002. Among the revenue reflected in the financial statement were risk management fees paid by O in 2000 with amounts budgeted for 2001 and 2002.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated.

In Growers Cold Storage Warehouse Co. v. Commissioner, 17 B.T.A. 1279 (1929), an organization that operated a cold storage warehouse for its members on a cooperative basis was denied exemption under section 231(7) of the Revenue Act of 1921 [which corresponds to section 501(c)(6) of the Internal Revenue Code of 1986] because the organization's primary activities were found to constitute the performance of particular services for individual persons. The Court found that even though the organization was not organized for profit and no part of the net earnings inured to the

benefit of any private stockholder or member, the members' combining in order to save expenses did not constitute a business league.

In Produce Exchange Stock Clearing Association v. Helvering, 71 F.2d 142 (2nd Cir. 1934), a stock clearing association was denied exemption as a business league where its purpose was to provide a business economy or convenience for individual traders. Noting that serving as a convenience to members is not a shared characteristic of entities seeking recognition of exemption from federal income tax as business leagues, the Court specifically stated that it found no reason apparent for exempting an association that serves each member as a convenience or economy in his business.

In Apartment Operators Association v. Commissioner, 136 F.2d 435 (9th Cir. 1943), exemption as a business league was denied to an organization formed to facilitate the purchase of supplies and equipment and to supply management services for its members. The court found that the organization did not appear to answer the description of a business league. Among other things, the organization performed particular services for individual persons, as witnessed by activities that included the furnishing of credit information, the supplying of an apartment shopping service, the making of arrangements for direct purchases by members at discount, and similar activities.

In Evanston-North Shore Board of Realtors v. United States, 320 F.2d 375 (Ct. Cl. 1963), cert. denied, 376 U.S. 931 (1964), the Court of Claims held that a real estate board whose primary purpose and activity was the operation of a multiple listing service for its members was not exempt under section 501(c)(6) of the Code. The court stated that where such a "service is operated primarily for individual members as a convenience and economy in the conduct of their respective businesses, rather than for the improvement of business conditions within the [industry] generally . . . the operation is not an activity warranting an exemption under the statute."

In Indiana Retail Hardware Association, Inc. v. United States, 366 F.2d 998 (Ct. Cl. 1966), an organization formed to facilitate the purchase of supplies and equipment and to supply management services for its members was found not to be exempt under section 501(c)(6) of the Code. It was held by the court that the high percentage of income obtained by the organization from performing particular services for individuals as a convenience and economy in their business, along with its other income-producing activities, and the amount of time devoted by employees of the organization to the performance of these services was sufficiently substantial so that the income-producing activities cannot be said to be merely incidental activities of the organization. In arriving at this conclusion, the court looked at the time devoted to these activities by the organization's employees as compared with that spent on activities for the common benefit.

Louisiana Credit Union League v. U.S., 693 F.2d 525 (5th Cir. 1982), involved a business league formed to promote the common business interests of its members by advancing the credit union movement. The organization endorsed and provided administrative services in connection with insurance, data processing, and debt collection for its member credit unions. According to the court, "it is the distinctiveness of the activity that cements the substantial relationship" between the activity and the exempt function. The types of services provided to the organization's members, however, were not unique but rather were available commercially. Moreover, all of the services involved individual rather than group benefits because the benefits accrued only to the members who chose the services. Because they were neither unique in character nor inherently group oriented, the services provided to its members were not substantially related to the organization's exempt purposes.

In MIB, Inc. v. Commissioner of Internal Revenue Service, 734 F.2d 71 (1st Cir. 1984), in denying exemption as a business league to an organization whose activities consisted of providing particular services to its members in the form of transmitting information that would be used in decisions affecting their business operations, the court held that the ultimate inquiry was whether the association's activities advanced the members' interests generally by virtue of their membership in the industry, or whether they assist members in the pursuit of their individual businesses. The fact that there may have been indirect and intangible benefits for the industry as a whole did not change the fact that the organization's services were in form and substance "particular services" for the members. The court reasoned that without the exchange members would themselves have to check insurance applications for their accuracy. It concluded that MIB performed particular services for individual persons, rather than for members collectively, and was not exempt from income tax as a business league. The organization was distinguished from "classical" business leagues of chambers of commerce and boards of trades, groups that chiefly perform services for members collectively rather than perform specific services for their members.

Rev. Rul. 56-65, 1956-1 C.B. 199, holds that an organization whose principal activity consists of furnishing particular information and specialized individual service to its individual members, through publications and other means to effect economies in the operation of their businesses, is performing particular services for its members.

Rev. Rul. 66-338, 1966-2 C.B. 226, holds that an organization's activities that provide members with an economy and convenience in the conduct of their individual businesses by enabling them to secure supplies, equipment, and services more cheaply than if they had to secure them on an individual basis constitute the performance of particular services for individual persons as distinguished from activities aimed at the improvement of business conditions in their trade as a whole. The activities also constitute a business of a kind ordinarily carried on for profit even though they are conducted on a cooperative basis and produce only sufficient

income to be self-sustaining. Such an organization is not exempt under section 501(c)(6) of the Code.

Rev. Rul. 68-264, 1968-2 C.B. 264, explains that the services provided to members and nonmembers, which result in savings and simplified operations, constitute the performance of particular services for individual persons. The organization received income from several sources, including fees from the services that it provided to members and nonmembers.

Rev. Rul. 74-81, 1974-1 C.B. 135, holds that an organization whose principal activity was to provide its members with group workmen's compensation insurance that was underwritten by a private insurance company was not exempt under section 501(c)(6) of the Code. In carrying out this activity, the organization relieved its members of having to obtain insurance on an individual basis, resulting in a convenience in the conduct of their businesses. The organization rendered particular services for individual persons as distinguished from the improvement of business conditions in the contracting and related industries generally.

Rev. Rul. 86-98, 1986-2 C.B. 74, describes an individual practice association that provided health services through written agreements with health maintenance organizations (HMO's). The organization was denied exemption from federal income tax as a social welfare organization under section 501(c)(4) of the Code and as a business league under section 501(c)(6). Membership in the association was limited to licensed physicians engaged in the active practice of medicine and who were members of a specified county medical society. Members of the association generally maintained a private medical practice in addition to performing services for the association. All members were required to enter into written service contracts which required (1) members to provide their professional services to the HMO patients in accordance with a compensation agreement negotiated between the association and the HMOs; (2) members to share medical and other records, equipment, and staff; and (3) members to limit referrals of HMO patients, to the extent feasible, to other participating members. The Service found that the main function of the association was to provide an available pool of physicians who would abide by its fee schedule when rendering medical services to the subscribers of an HMO, and to provide its members with access to a large group of patients who generally may not be referred to nonmember-physicians. The Service stated that the association was akin to a billing and collection service, and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs. Additionally, the Service stated that the association did not provide medical care to HMO patients that would not have been available but for the establishment of the association, nor did it provide such care at fees below what was customarily and reasonably charged by members in their private practices. The Service concluded that the manner in which the association was operated was similar to organizations carried on for profit, and its primary beneficiaries were its member-physicians rather than members of the community as a whole.

We find that you are not an organization described in section 501(c)(6) of the Code for the following reasons: (1) your activities are primarily directed to the performance of particular services for individual persons rather than the improvement of business conditions of one or more lines of business; and (2) your purpose is to engage in a regular business of a kind ordinarily carried on for profit (even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining) rather than to promote a common business interest of your members.

You have failed to establish that you have been organized so that your activities will serve to advance the interests of one or more lines of business rather the private interests of your members.

You have been created expressly for the purpose of contracting with hospitals and healthcare payors on behalf of participating physicians who are your members. You state that a major goal of your direct contracting arrangement is to keep administrative costs to a minimum. In furtherance of this goal, you engage in activities that provide a convenience through an economy of scale and the performance of particular services for certain individuals.

Section 1.501(c)(6)-1, supra, provides that activities conducted by organizations recognized as exempt as under section 501(c)(6) of the Code are to be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. Providing a convenience or an economy of scale through membership is not a shared characteristic of organizations exempt under section 501(c)(6), and the Service and the courts have consistently rejected this as a valid purpose for recognizing organizations for exemption under this Code section. See, Produce Exchange Stock Clearing Association, supra; Growers Cold Storage Warehouse Co., supra; Evanston-North Shore Board of Realtors, supra; Rev. Rul. 56-65, supra; Rev. Rul. 66-338, supra.

You are similar in your purposes and the nature of your activities to the organization described in Rev. Rul. 86-98, supra. In order to qualify for membership, a physician must participate in the network of health care providers that you have established. As Participating Physicians, your member physicians are required to enter into contracts to provide professional services under specific terms and for fees that you have negotiated as part of the health plans that you develop for employers. In the revenue ruling, the Service found the association to be comparable to a billing and collection service, and to a collective bargaining representative negotiating on behalf of its member-physicians.

In relieving your member physicians of having to conduct certain aspects of their businesses on their own, you provide them with particular services. You market their services. You negotiate the terms of the fee-for-service contracts under which your member physicians provide their services, as well as the compensation they are to receive, directly with employers. In some cases, the negotiation of fees is done for the individual members so that they will receive reimbursement comparable to that received from other PPO's. Through your network, member physicians are able to contract with patients that otherwise might not be available to them. The system for making referrals to other physicians within your network further expands the number of patients to which they have access. And, in addition to negotiating terms for timely payment of claims by the employer, you intercede when the employer fails to meet this obligation. See, Apartment Operators Association, supra; Indiana Retail Hardware Association, Inc. supra; MIB, Inc., supra; Rev. Rul. 74-81, supra.

The employers who participate in your direct contracting arrangement are also the recipients of particular services that assist them in the operation of their businesses. On their behalf, you use your resources to negotiate competitive fees under the fee-for-services contract; make available a large and comprehensive provider panel; establish a referral system for medical services; make available a local participating medical director to serve as an intermediary with the providers; and, assist them in developing a benefit design for their health plans. If an employer adopts your benefit plan, he is able to reduce his costs of operation by receiving better premiums from stop loss carriers. See, Louisiana Credit Union League, supra;
Rev. Rul. 66-338, supra.

In addition, you engage in activities that provide services to your malpractice insurer for which you are paid risk management fees. These activities do not further an exempt purpose within the meaning of section 501(c)(6) of the Code. See, Rev. Rul. 68-264, supra.

Finally, while you refer to educational activities that you plan to conduct, you have not clearly described any significant educational services that you have provided that serve to promote the common interests of a line of business.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(6) of the Code and you must file federal income tax returns.

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 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 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.

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, 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 it is convenient, you may fax your reply using the fax number shown in the heading of this letter. If you fax your reply, please contact the person identified in the heading of this letter by telephone to confirm that your fax was received.

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.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437