Federation Pharmacy Services, Inc. v. Commissioner, 72 T. C. 687 (1979)

Selling goods at a discount, even to a charitable class, does not by itself constitute a charitable purpose under section 501(c)(3).

Summary

Federation Pharmacy Services, Inc. , sought exemption under section 501(c)(3) for selling discounted prescription drugs to the elderly and handicapped. The IRS denied the exemption, arguing that the organization operated primarily as a commercial enterprise. The Tax Court upheld this decision, ruling that Federation Pharmacy did not meet the criteria for exemption because its primary activity was selling drugs at a discount, a commercial rather than a charitable purpose. The court emphasized that to qualify as charitable, an organization must directly alleviate poverty or provide services at no or below cost, not merely sell at a discount.

Facts

Federation Pharmacy Services, Inc. , a nonprofit Minnesota corporation, was formed in 1976 to provide prescription drugs at discounted prices to the elderly and handicapped. It was established by the Metropolitan Senior Federation after their previous arrangement with a commercial pharmacy, Script Shoppes, Inc. , failed due to financial losses. Federation Pharmacy used volunteers and aimed to break even, intending to apply any excess funds to further reduce drug prices for its members. Membership was open to those holding VIP Buying Plan cards issued by the Metropolitan Senior Federation, and less than 2% of sales were made to the general public at full price.

Procedural History

Federation Pharmacy applied for tax-exempt status under section 501(c)(3) in 1977, which the IRS denied in 1978. The organization then sought a declaratory judgment from the Tax Court, which reviewed the case based on a stipulated administrative record and upheld the IRS's denial of exempt status in 1979.

Issue(s)

1. Whether Federation Pharmacy Services, Inc. , is organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3).

Holding

1. No, because the organization's primary activity of selling prescription drugs at a discount, even to the elderly and handicapped, is a commercial rather than a charitable purpose.

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Court’s Reasoning

The Tax Court applied the legal standard that an organization must be operated exclusively for an exempt purpose to qualify for section 501(c)(3) exemption. The court emphasized that the organization’s purpose, not merely the nature of its activities, must be charitable. Federation Pharmacy’s primary activity was selling drugs at a discount, which the court compared to a commercial cooperative. The court found that this activity did not directly alleviate poverty or provide services at no or below cost, which are hallmarks of charitable activity. The court cited previous cases where organizations providing health services were required to offer free or below-cost services to qualify as charitable. The court concluded that Federation Pharmacy’s operations were substantially commercial and did not meet the criteria for exemption. The court noted, “The selling of goods, health or otherwise, at a discount, is not, of itself, a charitable deed. “

Practical Implications

This decision clarifies that merely selling goods at a discount to a charitable class does not qualify an organization for tax-exempt status under section 501(c)(3). Organizations seeking such status must demonstrate that their primary purpose is charitable, typically by providing services at no or below cost to those in need. This ruling impacts how nonprofits structure their operations and pricing to ensure they meet the legal requirements for tax exemption. It also affects how similar cases are analyzed, emphasizing the importance of the organization’s purpose over the nature of its activities. Subsequent cases have applied this principle, requiring nonprofits to show direct charitable impact rather than indirect benefits through discounted sales.

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