Geisinger Health Plan v. Commissioner, 100 T. C. 394 (1993)

An organization is not exempt under the integral part doctrine if its activities would constitute an unrelated trade or business if conducted by its tax-exempt affiliate.

Summary

Geisinger Health Plan (GHP) sought tax-exempt status as an integral part of the Geisinger System, a network of tax-exempt health care providers. The Tax Court, following remand from the Third Circuit, examined whether GHP's activities as a health maintenance organization (HMO) would be an unrelated trade or business if conducted by its affiliates. The court determined that GHP's services extended to subscribers who were not necessarily patients of the Geisinger System's hospitals, and thus, GHP could not be considered an integral part of the system. The ruling emphasized the importance of the direct relationship between the activities of a subsidiary and the exempt purposes of its parent organization for tax-exempt status.

Facts

Geisinger Health Plan (GHP) was established as a health maintenance organization (HMO) within the Geisinger System, a network of tax-exempt health care entities in Pennsylvania. GHP's subscribers received services from Geisinger Medical Center (GMC), Geisinger Wyoming Valley Medical Center (GWV), and the Geisinger Clinic, but also from 20 other hospitals not part of the Geisinger System. GHP's operations were closely linked with the Geisinger System, with the Geisinger Foundation appointing GHP's corporate members and the Geisinger System providing essential services to GHP's subscribers. However, 20% of hospital services to GHP's subscribers were provided by non-Geisinger hospitals, and the record did not clarify the extent to which this was necessary or minimal.

Procedural History

GHP initially applied for tax-exempt status under section 501(c)(3) as a standalone entity, which was denied. The Tax Court initially granted exemption, but the Third Circuit reversed, finding GHP did not qualify on its own merits. The case was remanded for consideration under the integral part doctrine. On remand, the Tax Court again denied GHP's exemption, concluding that GHP's activities would constitute an unrelated trade or business if conducted by its affiliates.

Issue(s)

1. Whether Geisinger Health Plan's activities would be considered an unrelated trade or business if conducted by its tax-exempt affiliates within the Geisinger System?

Holding

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1. No, because GHP’s activities extended to subscribers who were not necessarily patients of the Geisinger System’s hospitals, and the record did not establish that services from non-Geisinger hospitals were insubstantial or necessary.

Court’s Reasoning

The Tax Court applied the integral part doctrine, which requires that a subsidiary’s activities be an essential part of its parent’s exempt activities and not constitute an unrelated trade or business if conducted by the parent. The court relied on section 513(a) defining an unrelated trade or business and noted that revenue rulings and cases consider income from services to non-patients of the exempt entity. The court found that GHP’s subscribers did not automatically become patients of the Geisinger System’s hospitals merely by subscribing to GHP’s HMO. The court emphasized the need for a direct and substantial relationship between the subsidiary’s activities and the exempt purposes of its parent, citing cases like *Squire v. Students Book Corp.* and *Brundage v. Commissioner* where such a relationship was evident. However, the court determined that GHP’s operations served private interests of its members, not the exempt purposes of its affiliates.

Practical Implications

This decision clarifies that for a subsidiary to qualify for tax-exempt status under the integral part doctrine, its activities must be closely and substantially related to the exempt purposes of its parent. Legal practitioners should ensure that any subsidiary’s activities directly benefit the parent’s exempt activities and avoid serving unrelated parties to a significant extent. For health care networks, this ruling suggests careful structuring of HMOs to ensure their operations do not stray into unrelated business activities. Subsequent cases and IRS guidance may further refine the application of the integral part doctrine, particularly in complex organizational structures.

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