Geisinger Health Plan v. Commissioner, T.C. Memo. 1994-77

Under the integral part doctrine, an organization can derive tax-exempt status from a related exempt entity if its activities are essential to and further the exempt purposes of the related entity, and would not constitute an unrelated trade or business if conducted by the exempt entity itself.

Summary

Geisinger Health Plan (GHP), an HMO, sought tax-exempt status under section 501(c)(3) as an integral part of the Geisinger System, a network of tax-exempt healthcare organizations. The Tax Court, on remand from the Third Circuit, considered whether GHP's activities were an integral part of the Geisinger System's exempt purposes. The court concluded that while GHP was related to the exempt entities, its services primarily benefited its subscribers, not the charitable class served by the Geisinger System. Because GHP's activities were not considered integral to the exempt functions of the related entities and could constitute an unrelated trade or business if conducted by them, the court denied GHP tax-exempt status.

Facts

Geisinger Health Plan (GHP) was an HMO operating within the Geisinger System, a large network of healthcare organizations including hospitals (Geisinger Medical Center (GMC) and Geisinger Wyoming Valley Medical Center (GWV)), a clinic, and a foundation, all of which were tax-exempt. GHP provided healthcare services to enrolled subscribers for a prepaid fee. The Geisinger System formed GHP as a separate entity for regulatory and administrative reasons. GHP contracted with entities within the Geisinger System, primarily the clinic, GMC, and GWV, to provide medical services to its subscribers. A portion of GHP's subscribers resided in medically underserved areas. The IRS initially denied GHP tax-exempt status, arguing it merely arranged for healthcare services and was not integral to the exempt purposes of the Geisinger System.

Procedural History

The Tax Court initially ruled in favor of GHP, granting tax-exempt status. The Commissioner appealed to the Third Circuit Court of Appeals. The Third Circuit reversed, holding that GHP, standing alone, was not exempt. However, the Third Circuit remanded the case to the Tax Court to consider whether GHP qualified for exemption under the integral part doctrine as part of the Geisinger System. The Tax Court then reconsidered the case on remand.

Issue(s)

1. Whether Geisinger Health Plan qualifies for tax-exempt status under section 501(c)(3) as an integral part of the Geisinger System.

2. Whether GHP’s activities are essential to and further the exempt purposes of the Geisinger System’s tax-exempt entities.
3. Whether GHP’s activities would constitute an unrelated trade or business if conducted directly by the related exempt entities.

Holding

1. No, Geisinger Health Plan does not qualify for tax-exempt status as an integral part of the Geisinger System.
2. No, GHP’s activities are not sufficiently essential to and do not primarily further the exempt purposes of the Geisinger System’s tax-exempt entities, as they primarily serve its subscribers’ private interests.
3. Likely Yes, GHP’s HMO activities, if conducted directly by GMC or GWV (the hospitals), would likely constitute an unrelated trade or business when serving non-patients.

Court’s Reasoning

The court analyzed the integral part doctrine, noting it allows an organization to derive exempt status vicariously through related exempt organizations if its activities are integral to and further the exempt purposes of the related entities. The court referenced Treasury Regulation §1.502-1(b) and case law, including *Squire v. Students Book Corp.* and *Brundage v. Commissioner*. The court emphasized that for the integral part doctrine to apply, the subsidiary’s services must be essential to the parent’s exempt activities and primarily benefit the charitable class served by the parent. The court found that GHP, while related to the Geisinger System’s exempt entities, primarily served its own subscribers, not the broader charitable patient class of the hospitals or the educational mission of the clinic. The court distinguished cases involving hospital departments or medical school faculty practice groups, where services directly and primarily benefited the exempt entities’ patients or students. Regarding unrelated business income, the court noted that providing services to non-patients by a hospital generally constitutes unrelated business income. The court concluded that GHP’s activities, if conducted by the related hospitals, would likely be considered an unrelated trade or business to the extent they served non-patients (GHP subscribers who are not otherwise patients of the hospitals). Therefore, GHP failed to meet the requirements of the integral part doctrine and was denied tax-exempt status.

Practical Implications

This case clarifies the limitations of the integral part doctrine for HMOs seeking tax-exempt status through affiliation with exempt healthcare systems. It highlights that an HMO’s primary focus on serving its subscribers, even within a charitable system, may not be considered integral to the exempt purposes of related hospitals or clinics. Legal professionals should analyze the primary beneficiaries of an organization’s activities and the degree to which those activities directly and substantially further the exempt purposes of related entities when applying the integral part doctrine. The case underscores the importance of demonstrating that the subsidiary's activities are not merely commercially beneficial but are essential to and integrated with the charitable mission of the parent organization, and that the services provided are not akin to an unrelated trade or business if conducted by the parent. It suggests that HMOs operating within healthcare systems need to demonstrate a primary benefit to the charitable class served by the system, beyond merely providing managed care to subscribers, to qualify for tax exemption under the integral part doctrine.

