

No. 23-60608

**In the United States Court of Appeals
for the Fifth Circuit**

MEMORIAL HERMANN ACCOUNTABLE CARE ORGANIZATION

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE

Appellee.

On Appeal from the United States Tax Court
Docket No. 4412-22X

ORIGINAL BRIEF OF PETITIONER-APPELLANT

Juan F. Vasquez, Jr. (Tex. #24033294)
Chamberlain, Hrdlicka, White,
Williams & Aughtry
1200 Smith Street, Suite 1400
Houston, Texas 77002-4401
Tel: (713) 658-1818; Fax: (713) 658-2553

Peter A. Lowy (Tex. #24038517)
Chamberlain, Hrdlicka, White,
Williams & Aughtry
1200 Smith Street, Suite 1400
Houston, Texas 77002-4401
Tel: (713) 658-1818; Fax: (713) 658-2553

David M. Medina (Tex. #88)
Chamberlain, Hrdlicka, White,
Williams & Aughtry
1200 Smith Street, Suite 1400
Houston, Texas 77002-4401
Tel: (713) 658-1818; Fax: (713) 658-2553

Tania P. Albuja (Tex. #24121220)
Chamberlain, Hrdlicka, White,
Williams & Aughtry
1200 Smith Street, Suite 1400
Houston, Texas 77002-4401
Tel: (713) 658-1818; Fax: (713) 658-2553

COUNSEL FOR APPELLANT

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record hereby certifies that the following listed persons have or may have an interest in the outcome of this case. These representations are made in order that the Judges of this Court may evaluate possible disqualifications or recusal.

Memorial Hermann Accountable Care Organization	Appellant
Memorial Hermann Health System	Appellant's Parent Corporation
Danny Werfel	Commissioner of Internal Revenue
Kathleen M. Kerrigan	Chief Judge, United States Tax Court

Counsel:

Juan F. Vasquez, Jr.	Attorney for Appellant
Peter A. Lowy	Attorney for Appellant
David M. Medina	Attorney for Appellant
Tania P. Albuja	Attorney for Appellant
Chamberlain, Hrdlicka, White, Williams & Aughtry	Law firm for Attorneys for Appellant
Marie E. Small	Attorney for Commissioner in Tax Court Proceeding
Mary Michelle M. McCarthy	Attorney for Commissioner in Tax Court Proceeding
Julie Ciamporcero Avetta	Attorney for Appellee Commissioner of the Internal Revenue Service
David A. Hubbert	Attorney for Appellee Commissioner of the Internal Revenue Service
William M. Paul	Attorney for Appellee Commissioner of the Internal Revenue Service

/s/ Juan F. Vasquez, Jr.
Juan F. Vasquez, Jr.
Attorney for Appellant

STATEMENT REGARDING ORAL ARGUMENT

Petitioner-Appellant Memorial Hermann Accountable Care Organization (“MHACO”) requests oral argument, as it believes it could significantly assist the decisional process in this case.

TABLE OF CONTENTS

CERTIFICATE OF INTERESTED PERSONS i

STATEMENT REGARDING ORAL ARGUMENT ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES..... vi

STATEMENT OF JURISDICTION1

ISSUES PRESENTED2

STATEMENT OF THE CASE3

I. COURSE OF PROCEEDINGS AND DISPOSITION IN THE COURT BELOW.....3

II. STATEMENT OF FACTS.....4

 A. MHACO is An Accountable Care Organization.....4

 B. MHACO’s Shared Savings Plans.....10

 C. MHACO’s Operations as an ACO.....12

SUMMARY OF THE ARGUMENT15

ARGUMENT21

I. STANDARD OF REVIEW.....21

II. THE TAX COURT ERRED BY ADOPTING THE “SUBSTANTIAL NON-EXEMPT PURPOSE” TEST RATHER THAN THE “PRIMARY PURPOSE” TEST IN DETERMINING MHACO’S QUALIFICATION UNDER 26 U.S.C. § 501(c)(4).22

A.	Introduction to the Standard For Exempt Qualification Under 26 U.S.C. § 501(c)(4)	23
B.	The Tax Court Erroneously Applied the Substantial Non-Exempt Purpose Test Applicable under 26 U.S.C. § 501(c)(3)	24
C.	Treasury Regulations Expressly Adopt the Primary Purpose Standard for § 501(c)(4).....	26
D.	The IRS Has A Long-Standing Position that the Primary Purpose Test Applies to Applications Under § 501(c)(4).....	28
E.	The Fifth Circuit Should Adopt the Primary Purpose Test for 26 U.S.C. § 501(c)(4) Exemption Applications.....	31
F.	The Tax Court’s Adoption of An Incorrect Standard for § 501(c)(4) Applications Is Reversible Error.....	32
III.	THE SUBSTANTIAL NON-EXEMPT PURPOSE STANDARD IS BEYOND THE SCOPE OF REVIEW AND NEW MATTER ON WHICH RESPONDENT BEARS THE BURDEN OF PROOF.....	34
IV.	THE TAX COURT ERRED BY ANALYZING MHACO’S NON-MSSP ACTIVITIES IN A VACUUM AND CONCLUDING SUCH ACTIVITIES BY THEMSELVES WERE DISQUALIFYING.....	36
V.	MHACO’S ACTIVITIES PRIMARILY PROMOTE THE GENERAL WELFARE OF THE GREATER HOUSTON COMMUNITY	42
A.	MHACO Is Part of the Solution to Higher Quality Health Care at Lower Costs.....	42
B.	MHACO’s Advancement of Higher Quality Health Care at Lower Costs Is Its Primary Purpose.....	45
C.	The Tax Court’s Statement That Only 18% Of Patient-Participants Are Medicare Beneficiaries Is Out Of Context And Irrelevant.....	48

D. The Tax Court Erred in Finding that MHACO Carried on a Business Similar to How Organizations Operate for Profit.....52

CONCLUSION.....56

CERTIFICATE OF SERVICE.....57

CERTIFICATE OF COMPLIANCE.....58

TABLE OF AUTHORITIES

CASES

Am. Realty Tr. v. United States, 498 F.2d 1194, 1198 (4th Cir. 1974).....22

Bailey v. Comm’r, 912 F.2d 44, 47 (2d Cir. 1990).....22

Better Business Bureau v. United States, 326 U.S. 279, 283 (1945)..... 15, 24, 26

Comm’r v. Lake Forest, 305 F.2d 814, 818 (4th Cir. 1962) 31, 32

Contracting Plumbers Coop. Restoration Corp. v. United States, 488 F.2d 684, 686 (2d Cir. 1973) 25, 31

Eden Hall Farm v. United States, 389 F. Supp. 858 (W.D. Pa. 1975).....24

Halliburton Co. v. Comm’r, 946 F.2d 395 (5th Cir.1991).....22

Hintz v. Comm’r, 712 F.2d 281, 286 (7th Cir.1983)21

In re Missionary Baptist Found., Inc., 712 F.2d 206, 209 (5th Cir. 1983) 22, 37

Jacobson v. Comm’r, 915 F.2d 832, 837 (2d Cir. 1990).....22

Monterey Pub. Parking Corp. v. United States, 321 F. Supp. 972, 975 n.3 (N.D. Cal. 1970, *aff’d*, 481 F.2d 175 (9th Cir. 1973) 24, 46, 48

Monterey Pub. Parking Corp. v. United States, 481 F.2d 175 (9th Cir. 1973).....23

Nationalist Movement v. Comm’r, 37 F.3d 216, 219 (5th Cir.1994).....21

People’s Educ. Camp Soc. v. Comm’r, 331 F.2d 923, 930 (2d Cir. 1964) 28, 32

Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980).....48

Presbyterian & Reformed Pub. Co. v. Comm’r, 743 F.2d 148 (3d Cir. 1984).....22

Senior Citizens Stores v. United States, 602 F.2d 711, 713 (5th Cir. 1979)21

<i>Sound Health Ass’n v. Comm’r</i> , 71 T.C. 158 (1978).....	42
<i>Superior Boat Works Inc. v. Mississippi State Tax Comm’n (In re Superior Boat Works Inc.)</i> , 122 Fed. Appx. 784 (5th Cir. 2005)	22
<i>Texas Learning Tech. Grp. v. Comm’r</i> , 958 F.2d 122, 124 (5th Cir.1992).....	21
<i>Theriault v. Silber</i> , 547 F.2d 1279, 1280 (5th Cir.1977).....	22, 36
<i>Vision Service Plan v. United States</i> , 2005 WL 3406321, at 1 (E.D. Cal. Dec. 12, 2005).....	31, 54

STATUTES

26 U.S.C. § 501(c)(4).....	23
26 U.S.C. § 7482	21
42 U.S.C. § 1899	50

LEGISLATIVE & ADMINISTRATIVE MATERIALS

155 Cong. Rec. S. 11132 (Nov. 5, 2009).....	39
155 Cong. Rec. S. 13181 (Dec. 14, 2009)	39
Centers for Medicare & Medicaid Services, <i>Medicare Shared Savings Program Saves Medicare More than \$1.6 Billion in 2021 and Continues to Deliver High-quality Care</i> (Aug. 30, 2022).	10
CONGRESSIONAL RESEARCH SERVICE (CRS), R41474, ACCOUNTABLE CARE ORGANIZATIONS AND THE MEDICARE SHARED SAVINGS PROGRAM, pp.2-3, 13, n.53 (2011).....	8, 40
David Nyweide et al., <i>Association of Pioneer Accountable Care Organizations vs Traditional Medicare Fee for Service With Spending, Utilization, and Patient Experience</i> , JAMA (June 2, 2015)	9

David Nyweide et al., <i>Association of Pioneer Accountable Care Organizations vs Traditional Medicare Fee for Service With Spending, Utilization, and Patient Experience</i> , JAMA (June 2, 2015).....	10
Department of Health and Human Services, 42 C.F.R. § 425, Fed. Reg. Vol. 67933 (Nov. 2, 2011).....	40
Gregory Pope et al., <i>Financial and Quality Impacts of the Medicare Physician Group Practice Demonstration</i> , Medicare & Medicaid Research Rev. (2014).....	9
H.R. 2959, 111th Cong.(2009-2010)	39
J. Michael McWilliams et al., <i>Early Performance of Accountable Care Organizations in Medicare</i> , New England J. Med. (June 16, 2016).....	9
John Kautter et al., <i>Evaluation of Medicare Physician Group Practice Demonstration: Final Report</i> , Centers for Medicare & Medicaid Services (Sep. 2012).....	9
Mark McClellan et al., <i>Growth of ACOs and Alternative Payment Models in 2017</i> , Health Affairs (June 28, 2017).....	9
MEDICARE PAYMENT ADVISORY COMMISSION, REPORT TO THE CONGRESS: IMPROVING INCENTIVES IN THE MEDICARE PROGRAM (June 2009)	6, 8, 38
PATIENT PROTECTION AND AFFORDABLE CARE ACT; ELDER JUSTICE ACT, 111 P.L. 148, Part 1 of 3, 124 Stat. 119, 395	5, 6

RULES

Fed. R. Civ. P. 52	21
Tax Court Rule 142(a)(1).....	35

TREASURY REGULATIONS

T.D. 6500, 25 F.R. 11737, Nov. 26, 1960	27
Treas. Reg. § 1.501(c)(3)-1(c)(1).....	15, 27
Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).....	16, 23, 26

IRS ADMINISTRATIVE GUIDANCE

I.R.M. § 7.25.4.6(2) (02-09-1999)..... 16, 29

IRS Gen. Couns. Mem. 37,789 (Dec. 18, 1978).....48

IRS Gen. Couns. Mem. 39296 (October 17, 1984)30

IRS Gen. Inf. Ltr. 2002-0021 (January 9, 2002).....47

IRS Letter 5228 (rev. Sept. 2013)..... 17, 30

IRS Notice 2011-20, 2011-16 I.R.B. 65240

P.L.R. 201031035 (May 13, 2010)..... 16, 30

P.L.R. 201123047 (Mar. 18, 2011)..... 16, 29

P.L.R. 201126040 (Apr. 8, 2011)46

Rev. Rul. 66-257, 1966-2 C.B. 21223

Rev. Rul. 68-455, 1968-2 C.B. 21530

Rev. Rul. 69-545, 1969-2 C.B. 11742

Rev. Rul. 70-4, 1970-1 C.B. 12623

Rev. Rul. 75-197, 1975-1 C.B. 15642

Rev. Rul. 75-386, 1975-2 C.B. 21130

Rev. Rul. 76-455, 1976-2 C.B.15042

Rev. Rul. 77-69, 1977-1 C.B. 14342

Rev. Rul. 78-131, 1978-1 C.B. 15623

Rev. Rul. 81-276, 1981-2 C.B. 12842

Rev. Rul. 87-126, 1987-2 C.B. 150	23
Rev. Rul. 97-21, 1997-1 C.B. 121	42, 47

STATEMENT OF JURISDICTION

In a final adverse determination letter dated December 14, 2021, the Commissioner of Internal Revenue (the “Commissioner”) denied MHACO exemption from federal income tax under 26 U.S.C. § 501 (a). ROA.75-76. MHACO exhausted its administrative remedies as required by 26 U.S.C. § 7428 (b)(2) and on March 10, 2022, timely filed a Petition with the U.S. Tax Court (the “Tax Court”) seeking a declaratory judgment that it is entitled to exempt status as an organization described under 26 U.S.C. § 501(c)(4). ROA.11-28.

The Tax Court issued a Memorandum Opinion on May 16, 2023, ROA.1201-1208, and a Decision on May 22, 2023 (“Tax Court Decision”; “Decision”). ROA.1209. Subsequently, on June 22, 2023, MHACO filed a Motion for Reconsideration of Findings and Opinion and Memorandum in Support, ROA.1233-1304, and a Motion for Reconsideration Based Upon Newly Discovered Evidence (collectively “MHACO’s Motions for Reconsideration”). ROA.1305-1387. On August 24, 2023, the Tax Court entered an Order denying MHACO’s Motions for Reconsideration. ROA.1484.

MHACO timely filed a notice of appeal on November 17, 2023, thereby giving this Court jurisdiction under 26 U.S.C. § 7482(a). ROA.1485-1490. Venue is proper in this Court under 26 U.S.C. § 7482(b)(1)(A) because MHACO’s legal place of business was in Texas at the time it filed the Tax Court Petition. ROA.1202.

ISSUES PRESENTED

The ultimate issue on appeal is MHACO's qualification as an organization under 26 U.S.C. § 501(c)(4). To reach a conclusion on this ultimate issue, this Court will need to address the following issues:

1. Whether the Tax Court erred as a matter of law in evaluating whether MHACO qualified as an organization under § 501(c)(4) by applying the "substantial non-exempt purpose" standard rather than the "primary purpose" standard required by Treasury Regulation § 1.501(c)(4)-1(a)(2)(i);

2. Whether the Tax Court's adoption of the "substantial non-exempt purpose" standard resulted in reversible error when the Tax Court's scope of review was limited to the administrative record developed under the primary purpose standard and when MHACO's exempt purposes plainly outweigh and are primary to any purported non-exempt purpose; and

3. Whether the Tax Court erred as a matter of law in analyzing MHACO's MSSP and non-MSSP activities separately and finding that MHACO's non-MSSP activities primarily benefit its commercial and health care participants, rather than the public.

STATEMENT OF THE CASE

I. COURSE OF PROCEEDINGS AND DISPOSITION IN THE COURT BELOW

MHACO filed Form 1024, Application for Recognition of Exemption Under Section 501(a), dated December 7, 2017, seeking recognition as an organization tax exempt under § 501(c)(4). ROA.79-86. On January 16, 2020, the Commissioner issued a proposed adverse determination letter concluding that MHACO is not described in § 501(c)(4). ROA.233-255. In the proposed adverse determination letter, the IRS asserted that MHACO does not qualify as an organization described under § 501(c)(4) because the activities it conducts under its non-MSSP programs do not serve the public. ROA.252-253. The proposed adverse determination letter further asserts MHACO's non-MSSP programs primarily benefit the insurance companies and healthcare providers with which MHACO contracts. ROA.253.

After MHACO filed a protest with the IRS Independent Office of Appeals ("Appeals") on March 16, 2020, ROA.258-300, Appeals issued to MHACO a final adverse determination letter stating that MHACO was "not organized and operated for the purposes of promoting the social welfare and providing a community benefit." ROA.27-28. On March 10, 2022, MHACO timely filed a Petition with the Tax Court seeking a declaratory judgment that it is entitled to exempt status as an organization described under § 501(c)(4). ROA.11-25. The Tax Court issued a Memorandum Opinion on May 16, 2023, ROA.1201-1208, and a Decision on May

22, 2023, ROA.1209. In its May 16, 2023 opinion, the Tax Court held that MHACO failed to establish it is an organization under § 501(c)(4) because MHACO's non-MSSP activities primarily benefit its commercial payor and health care provider participants, rather than the public, and therefore constitute a substantial non-exempt purpose. ROA.1208.

On June 22, 2023, MHACO filed a Motion for Reconsideration of Findings and Opinion and Memorandum in Support and a Motion for Reconsideration Based Upon Newly Discovered Evidence. ROA.1234-1315. On August 24, 2023, the Tax Court entered an Order denying MHACO's Motions for Reconsideration. ROA.1484. MHACO timely filed a notice of appeal on November 17, 2023. ROA.1485-1490.

II. STATEMENT OF FACTS

A. MHACO is An Accountable Care Organization

MHACO was formed as a Texas non-profit corporation on January 23, 2012. ROA.87. The sole member of MHACO is the Memorial Hermann Health System ("MHHS"). ROA.90. MHHS is a not-for-profit, community-based healthcare system and public charity, and is recognized under §§ 501(c)(3) and 509(a)(1). ROA.109. MHHS controls MHACO through its control of MHACO's Board of Directors; MHACO's bylaws reserve at least six spots on its ten-person board of directors for each of (i) MHHS's chief executive officer, (ii) MHHS's chief financial

officer, (iii) MHHS's chief clinical officer, (iv) the chair of Memorial Hermann Physician's Network ("MHMD"), a subsidiary of MHHS, and (v) two or more members of MHHS's own board of directors. ROA.346-347.

As set forth in its Certificate of Formation, MHACO's stated purpose is "to promote social welfare within the meaning of § 501(c)(4) of the Internal Revenue Code . . . , including but not limited to *operating an accountable care organization . . . that participates in the Medicare Shared Savings Program . . . and other similar accountable care programs.*" ROA.89. In accordance with its Certificate of Formation, MHACO has operated as an Accountable Care Organization ("ACO") since its inception. ROA.195-224.

ACOs originated in 2010 with the Patient Protection and Affordable Care Act ("ACA") *See* PATIENT PROTECTION AND AFFORDABLE CARE ACT; ELDER JUSTICE ACT, 111 P.L. 148, Part 1 of 3, 124 Stat. 119, 395. Congress enacted the ACA citing three main objectives known as the "Triple Aims" of the Act: the reduction of health care costs for individuals, improvement of patient access to quality care, and the improvement of patient health and health care experience. ROA.179. ACOs seek to achieve these goals by (1) reducing health care costs by, among other things, better coordinating patient care across doctors' offices to reduce duplicative or unnecessary medical tests and procedures, and (2) shifting the economy for medical services from a Fee-for-Services model ("FFS"), to a value-based purchasing model ("VBP").

ROA.490-584.

Among the numerous reasons for the United States having the most expensive health care in the world is the lack of communication and coordination between providers throughout the patient's care continuum, as well as, the prevalence of the FFS payment and delivery model among insurers and medical providers. ROA.516-521. Under this payment model, medical providers are compensated for each medical procedure or service, resulting in the incentive to offer and perform as many medical procedures as possible. ROA.538-540. This often leads to unnecessary health care spending and the waste of medical resources.

Under a VBP model, on the other hand, medical providers are paid an overall sum for the patient's care rather than being paid for each additional treatment or procedure performed for the patient. The VBP model removes the incentive to perform as many procedures as possible and rewards the providers through payment arrangements such as a shared-savings arrangement for providing efficient care. *See* ACA, sec. 1115A (encouraging the use of models that shift away from FFS); MEDICARE PAYMENT ADVISORY COMMISSION, REPORT TO THE CONGRESS: IMPROVING INCENTIVES IN THE MEDICARE PROGRAM (June 2009) ("The ACO's role

is to create a set of incentives strong enough to overcome the incentives in the FFS system to drive up volume without improving quality.”).¹

To illustrate a shared-savings arrangement, the insurance payor, either Medicare or a private insurer, establishes a benchmark for the cost of care for its patients. ROA.178-186. When the ACO successfully works with the medical providers to provide quality care at a cost lower than the established benchmark, the difference between the benchmark and the actual cost is cost savings, which the insurer will then pay a portion of to the medical provider as compensation for delivering care at lower costs. ROA.185-190. The result of this share-savings arrangement is lowered health care costs due to the provider being incentivized to provide efficient care to the patient and receive a share of the savings, as opposed to being incentivized to include as many procedures and treatment expenditures as possible in the course of the patient’s care under FFS.

When enacting the ACA, Congress understood that ACOs would have to include patients with private insurance to be successful. Congress recognized that ACOs would not be effective agents of change from the FFS model to value-based

¹ The FFS model has been widely regarded as a cause of the high cost of medical services in the United States. The Center for American Progress explains that the FFS model harms not only the individual patients paying under the FFS model but impacts the health care costs for the broader population. Report, Alternatives to Fee-for-Service Payments in Health Care, Center for American Progress (Sep 18, 2012) (“These costs raise premiums, deductibles, and cost-sharing for all health care consumers.”).

models if they participated only in the Medicare shared savings program² (“MSSP”) and expressly structured the ACA to permit ACOs to participate in non-MSSP programs. In this regard, the Congressional Research Service explains that “ACOs [may] change both the culture and practice patterns of providers and as these changes are institutionalized, all payors and all patients will benefit from the delivery of higher-quality, lower-cost, and better integrated services.” CONGRESSIONAL RESEARCH SERVICE (CRS), R41474, ACCOUNTABLE CARE ORGANIZATIONS AND THE MEDICARE SHARED SAVINGS PROGRAM, pp.2-3, 13, n.53 (2011). To accomplish this, the Medicare Payment Advisory Commission (“MedPAC”)³ report succinctly captures: “If all payors adopted an ACO model, the potential for it to constrain capacity growth [which would decrease costs] could be maximized.” MEDPAC, REPORT TO THE CONGRESS, at 52. “Without private payor involvement, the risk is that physicians’ incentives to increase capacity for their privately insured patients would more than offset any incentives that the Medicare ACO provided to constrain capacity.” *Id.* Therefore, ACOs must not limit themselves to contracting with Medicare providers and payors, and Congress intentionally did not impose any such

² The MSSP is a program created by the Secretary of the Department of Health and Human Services (HHS) to promote accountability for care of Medicare beneficiaries, improve the coordination of Medicare fee-for-service items and service, encourage investment in infrastructure, and redesign care processes for high quality and efficient service delivery. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3022, 124 Stat. 119, 395 (2010).

³ The MedPAC is an independent congressional agency established by the Balanced Budget Act of 1997 (P.L. 105–33).

limit.

ACOs have been markedly successful in furthering the ACA's purpose to improve health care experience and lower costs. ACOs have grown significantly since the passing of the ACA and now collectively manage the health care of at least 10% of the U.S. population. Mark McClellan et al., *Growth of ACOs and Alternative Payment Models in 2017*, Health Affairs (June 28, 2017). ACOs are consistently associated with reduced utilization of services, including reduced inpatient use and reduced emergency department use. John Kautter et al., *Evaluation of Medicare Physician Group Practice Demonstration: Final Report*, Centers for Medicare & Medicaid Services (Sep. 2012); Gregory Pope et al., *Financial and Quality Impacts of the Medicare Physician Group Practice Demonstration*, Medicare & Medicaid Research Rev. (2014). Primary care visits, preventable admissions for asthma, and intensive care unit use for cancer patients also saw reductions. David Nyweide et al., *Association of Pioneer Accountable Care Organizations vs Traditional Medicare Fee for Service With Spending, Utilization, and Patient Experience*, JAMA (June 2, 2015); J. Michael McWilliams et al., *Early Performance of Accountable Care Organizations in Medicare*, New England J. Med. (June 16, 2016). Patients of ACOs have reported higher mean scores for timely care and clinician communication when compared to non-ACO care delivery methods. David Nyweide et al., *Association of Pioneer Accountable Care Organizations vs*

Traditional Medicare Fee for Service With Spending, Utilization, and Patient Experience, JAMA (June 2, 2015). The positive service utilization and health care outcomes delivered by ACOs have led to significant savings to the MSSP. In 2021, the MSSP saved \$1.66 billion compared to spending targets. Centers for Medicare & Medicaid Services, *Medicare Shared Savings Program Saves Medicare More than \$1.6 Billion in 2021 and Continues to Deliver High-quality Care* (Aug. 30, 2022).

In short, the enactment of the ACA was brought about by the need to improve the cost and quality of medical services to all Americans (whether publicly insured, privately insured, or lacking insurance), to reign in the cost of Medicare, and control the Nation's deficit. ACOs, like MHACO, play a critical role in these overall objectives.

B. MHACO's Shared Savings Plans

1. MSSP Programs

As an ACO, MHACO participates in a number of shared savings programs involving the coordination of care for both Medicare and non-Medicare patients. MHACO has participated in MSSP since 2012. ROA.124-126. MHACO's services under the MSSP are accessible to all of the Greater Houston Community's Medicare beneficiaries, each of whom has the opportunity to elect into MHACO's population by designating one of MHACO's participating doctors as his or her primary care

provider. *See* 42 U.S.C. § 1899(c)(2)(B) (“ . . . the Secretary shall permit a Medicare fee-for-service beneficiary to voluntarily identify an ACO professional as the primary care provider of the beneficiary for purposes of assigning such beneficiary to an ACO, as determined by the Secretary.”). MHACO’s MSSP population grows when a Medicare fee-for-service beneficiary voluntarily selects one of MHACO’s professionals as their primary care provider, after which the Centers for Medicare & Medicaid Services (“CMS”) assigns the Medicare beneficiary to MHACO’s MSSP population.

If and only if MHACO is able to coordinate the work of the physicians and health care providers who are caring for the assigned beneficiaries so as to improve their health and their care while decreasing the cost of their care as determined against a benchmark set by CMS does MHACO receive a financial distribution from the MSSP program. ROA.264. Whether or not health and the quality of care have improved are assessed based on specific metrics set by CMS for the MSSP program. ROA.265-266. The financial return is a share of the amount saved on the cost of the beneficiaries’ health care as determined against the cost benchmark set by the Medicare program. ROA.263.

2. Non-MSSP

MHACO also has ACO agreements with several private payors. The contracts from non-Medicare programs mostly affect patients enrolled in self-funded

plans sponsored by employers in the Greater Houston Community. ROA.263.

MHACO's ACO agreements with private payors contain the same fundamental bargain for a set of the payer's enrollees who are assigned to the ACO that is made in the MSSP agreement for Medicare fee-for-service beneficiaries. ROA.264. Indeed, many of the assigned/attributed patients under several of the private payor contracts are also Medicare beneficiaries enrolled in Medicare Advantage. Although each payor specifies the metrics that must be satisfied to demonstrate an improvement in quality of health and quality of care for the assigned patients, the metrics used by each of the payors overlap substantially with the metrics used in the MSSP program. *Id.*

C. MHACO's Operations as an ACO

MHACO works systematically to identify best practices for improving the quality of care and the efficiency of care and disseminate those to the participating physicians and across the MHHS system. The clinically integrated network of physicians, MHMD, has created a Clinical Program Committee with more than 40 subcommittees, each focused on a particular aspect of care. ROA.269. More than 800 physicians participate in the committees, meeting at night when they have time after their days of patient care. *Id.*

Physicians participating in the ACO participate in many of the committees, especially the committees handling primary care areas like outpatient diabetes care.

The committees meet multiple times per year, and the head of the population health analytics function attends the meeting. ROA.269.

MHACO's activities promote health for the benefit of the southeast Texas community that Memorial Hermann serves. As of 2019, MHACO was responsible for roughly 450,000 people. ROA.273. More than half of the patients for whom MHACO has responsibility are in employer-sponsored health plans, reflecting the community it serves where approximately half of the covered population is in an employer-sponsored plan. *Id.*

MHACO's activities also affect care for patients who are not assigned to the ACO. Approximately 26.1% of the southeastern Texas community hospital related health care services are provided by Memorial Hermann. ROA.273. Memorial Hermann's hospitals are open to the community, including to the uninsured. Intensive and effective clinical integration between the hospitals and health care facilities in the system, the physicians who care for patients in the system, and the other health care professionals who help the patients in the system is essential to promoting better health for all of those patients and for making the system more efficient so that health care can be more affordable for everyone. MHACO is a key driver for that clinical integration. It provides the framework and the incentives that channel the efforts of 17 hospitals, eight Cancer Centers, three Heart & Vascular Institutes, 27 sports medicine and rehabilitation centers, 34 clinics, more than 300

patient care sites, 6,700 affiliated physicians and a team of nurses, pharmacists, social workers and community health workers numbering in the thousands as a combined team and spread across all these facilities in a unified direction. ROA.273-274.

MHACO serves as a learning laboratory for the system. The population health analytics team is in regular communication with physicians about the dashboards, data reports and other tools the physicians are provided. The Clinical Practice Committee and the physicians provide comments and criticisms and ask for adjustments or additions that will help them deliver care. By combining data from payors that would not otherwise be available and that provides a picture of all the patient's health care interactions, wherever they take place, with the insights gained from efforts at care coordination and continuous feedback from physicians, not only does MHACO continuously improve its care coordination protocols, dashboards for clinicians and support for assigned patients with complex health problems, the entire Memorial Hermann system improves what it does for patients. ROA.274.

SUMMARY OF THE ARGUMENT

In its May 16, 2023 opinion, the Tax Court held: “Petitioner fails to qualify as an organization described by section 501(c)(4) because its non-MSSP activities . . . constitute a substantial non-exempt purpose.” The Tax Court erred by: (1) adopting a substantial non-exempt purpose test, rather than the primary purpose test in Treasury Regulation § 1.501(c)(4)-1(a)(2)(i), and (2) determining that purported benefits of MHACO’s activities to commercial insurers and health care providers by themselves disqualify MHACO from tax-exempt status under § 501(c)(4).

1. The Tax Court Erred By Adopting the Substantial Non-exempt Test

In *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945), the U.S. Supreme Court determined that “a single non-[exempt] purpose, if substantial in nature, will destroy” an exemption under a predecessor of § 501(c)(3). Treasury regulations promulgated under § 501(c)(3) are consistent with this substantial non-exempt purpose standard: “An organization will not [qualify under section 501(c)(3)] if *more than an insubstantial part* of its activities is not in furtherance of an exempt purpose.” Treas. Reg. § 1.501(c)(3)-1(c)(1) (emphasis added).

In 1960, about fifteen years after the Supreme Court in *Better Business Bureau* adopted the substantial non-exempt purpose standard for purposes of § 501(c)(3), Treasury, undoubtedly aware of the § 501(c)(3) standard, promulgated regulations under § 501(c)(4) that eschew the substantial non-exempt purpose standard in favor

of a primary purpose standard: “An organization is operated exclusively for the promotion of social welfare if it is *primarily engaged* in promoting *in some way* the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

Consistent with these regulations, the Commissioner’s long-standing position has been that the primary purpose standard, and not the substantial non-exempt purpose standard, applies to evaluate a taxpayer’s qualifications for tax-exempt status under § 501(c)(4). In its Internal Revenue Manual (“IRM”), the Commissioner pointedly explains:

Organizations exempt under IRC 501(c)(4) are generally allowed greater latitude than that allowed to organizations exempt under IRC 501(c)(3). . . . Organizations exempt under IRC 501(c)(4) may engage in germane action organization activities described in Reg. 1.501-1(c)(3) other than intervention in a political campaign, without the restrictions imposed on IRC 501(c)(3) organizations. **Since the test for exemption under IRC 501(c)(4) is one of primary activities, an organization exempt under IRC 501(c)(4) may engage in substantial non-exempt activities.**

I.R.M. § 7.25.4.6(2) (02-09-1999) (emphasis added). *See also* P.L.R. 201123047 (Mar. 18, 2011) (denying tax-exempt status under § 501(c)(3) but granting tax-exempt status under § 501(c)(4), due to the application of the substantial non-exempt purpose test to the former but not the latter); P.L.R. 201031035 (May 13, 2010)

(same); IRS Letter 5228 (rev. Sept. 2013) (providing a “safe harbor” for certain organizations applying for expedited § 501(c)(4) status as long as at least 60% of their activities promoted social welfare).

Indeed, in response to MHACO’s protest at the administrative level, the Commissioner, under the heading “Standards for Exemption under IRC Section 501(c)(3) vs. Section IRC 501(c)(4),” stated: “While organizations exempt under IRC Section 501(c)(3) may not have a substantial non-exempt purpose, an organization exempt under IRC Section 501(c)(4) may engage in substantial non-exempt activities since the test for exemption under IRC Section 501(c)(4) is one of primary activities. *See* Treas. Reg. Section 1.501(c)(4)-1(a)(2).” ROA.629.

Contrary to these authorities, the Tax Court, in its May 16, 2023 opinion, adopted the § 501(c)(3) substantial non-exempt purpose test, relying primarily on *Better Business Bureau*. ROA.1208, (Decision at 8). The Tax Court repeatedly emphasized throughout its analysis what it perceived as an outcome determinative non-exempt purpose (the non-MSSP work), and concludes:

Petitioner’s non-MSSP activities primarily benefit commercial payors and healthcare providers and thereby constitute a substantial nonexempt purpose precluding petitioner from qualifying as an organization described by section 501(c)(4). Petitioner has not demonstrated that its non-MSSP activities promote the common good and general welfare of the community, nor has petitioner shown that its nonexempt activities otherwise benefit the public.

Although the Tax Court did cite Treasury Regulation § 1.501(c)(4)-1 and recite the regulation’s “primary purpose” language, it is clear from the Tax Court’s analysis that those references are mere lip service. The Tax Court focuses only on the non-MSSP aspects of MHACO’s health care model, and whether such activities constitute a substantial non-exempt purposes rather than promoting the general welfare. The Tax Court never engages in comparing MHACO’s MSSP activities, which indisputably serve exempt purposes, against the alleged non-exempt purposes to determine which purpose was primary. By failing to properly engage in a comparative analysis evaluating whether MHACO’s contributions to the general welfare outweighed the benefits the Tax Court perceived as being disqualifying, the Tax Court committed reversible error.

2. The Tax Court Erred By Analyzing MHACO’s Non-MSSP Activities in a Vacuum and Concluding Such Activities By Themselves Were Disqualifying

Under either standard—the substantial non-exempt purpose test or the primary purpose test—MHACO’s activities qualify for tax exempt status under § 501(c)(4), and the Tax Court’s decision to the contrary should be reversed.

First, the Tax Court, in holding that MHACO fails to qualify because its non-MSSP activities constitute a substantial non-exempt purpose, erred by artificially separating MHACO’s MSSP and non-MSSP activities and evaluating the latter’s purpose in a vacuum. As the MedPAC explained in reports to Congress leading to

the enactment of ACA, for ACO's to have their intended effect on shifting the medical services market from the FFS model to models that promote higher quality and lower-cost services, participation from private insurers was necessary to "achieve critical mass" so there is "sufficient market power" to compel the seismic shift in the market. Private participation is thus part of the public solution.

MHACO, an early adopter of the ACO model, established an integrated platform for both private and public insurers in accordance with the legislative intent behind Congress' enactment of ACA and its ACO component. The Tax Court's analysis of MHACO's non-MSSP activities in a vacuum conflicts with the history of ACA that non-MSSP activities are necessary to accomplish ACA's aims, and directly conflicts with Congressional intent by requiring some stand-alone social welfare purpose. Congress understood that third party benefits from ACOs were a necessary consequence rather than a purpose. Benefiting private insurance companies was no more Petitioner's purpose than it was Congress' in the first place when it made ACOs an instrument to advance ACA's goals.

Second, because the Tax Court did not apply the primary purpose test, it failed to conduct the comparative analysis required to evaluate whether MHACO's contributions to the general welfare outweighed the benefits the Tax Court perceived as being disqualifying. Had the Tax Court conducted such a weighing of the

evidence, it would have concluded that the benefits to the public welfare predominated.

Third, the Tax Court erred in finding that MHACO carried on a business with the general public in a manner similar to a for profit business. The evidence in the record supports a finding that MHACO is not engaged in a business remotely similar to a for-profit business with the general public or anyone else. No portion of MHACO's organizational structure or operations resembles the structure, intentions, or operations of a for profit business. MHACO's activities were driven by public health policy, not by profit.

For the reasons summarized above and discussed in greater detail in the next sections of this brief, MHACO respectfully submits that the Court should enter decision in its favor under a correct application of the primary purpose test to MHACO's facts, or alternatively, the Court should remand the case to the Tax Court to properly apply the primary purpose test to the facts of this case.

ARGUMENT

I. STANDARD OF REVIEW

26 U.S.C. § 7482(a)(1) provides that “The United States Courts of Appeals ... shall have exclusive jurisdiction to review the decisions of the Tax Court ... in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury....” In accordance with § 7482(a)(1), the Fifth Circuit has held it reviews findings of fact for clear error and legal conclusions *de novo*. See *Texas Learning Tech. Grp. v. Comm’r*, 958 F.2d 122, 124 (5th Cir.1992) (applying the *de novo* standard or review where a conclusion of law from the Tax Court’s decision in a declaratory judgment action was at issue); see also *Nationalist Movement v. Comm’r*, 37 F.3d 216, 219 (5th Cir.1994) (citing *Estate of Clayton v. Comm’r*, 976 F.2d 1486, 1490 (5th Cir.1992)).

This Court’s review is limited to the record before the Tax Court, and new evidence may not be submitted on appeal. See *Hintz v. Comm’r*, 712 F.2d 281, 286 (7th Cir.1983). In general, a finding that a corporation is not operated exclusively for charitable purposes cannot generally be disturbed unless clearly erroneous. Fed. R. Civ. P. 52; *Senior Citizens Stores v. United States*, 602 F.2d 711, 713 (5th Cir. 1979). However, when a factual finding is premised on an improper legal standard or a misapplication of a proper legal standard, the Court reviews such finding *de novo*. See *Superior Boat Works Inc. v. Mississippi State Tax Comm’n (In re Superior Boat*

Works Inc.), 122 Fed. Appx. 784 (5th Cir. 2005); *Presbyterian & Reformed Pub. Co. v. Comm'r*, 743 F.2d 148 (3d Cir. 1984) (“the Tax Court’s determination of P & R’s purpose under an incorrect legal standard is subject to plenary review by this Court”). Consistent with this rule, this Court has stated that whether the Tax Court applied the proper legal standard in making its findings of fact is subject to review *de novo*. See *Halliburton Co. v. Comm'r*, 946 F.2d 395, 398 (5th Cir.1991); see also *Jacobson v. Comm'r*, 915 F.2d 832, 837 (2d Cir. 1990) (citing *Sochin v. Comm'r*, 843 F.2d 351, 353 (9th Cir.), *cert. denied*, 488 U.S. 824, 109 S. Ct. 72, 102 L. Ed. 2d 49 (1988)); *Bailey v. Comm'r*, 912 F.2d 44, 47 (2d Cir. 1990); *Am. Realty Tr. v. United States*, 498 F.2d 1194, 1198 (4th Cir. 1974). Similarly, this Court has stated that when a finding of fact is premised on an improper legal standard, or a proper one improperly applied, that finding loses the insulation of the clearly erroneous rule. *Theriault v. Silber*, 547 F.2d 1279, 1280 (5th Cir.1977); *In re Missionary Baptist Found., Inc.*, 712 F.2d 206, 209 (5th Cir. 1983).

II. THE TAX COURT ERRED BY ADOPTING THE “SUBSTANTIAL NON-EXEMPT PURPOSE TEST” RATHER THAN THE “PRIMARY PURPOSE TEST” IN DETERMINING MHACO’S QUALIFICATION UNDER 26 U.S.C. § 501(C)(4).

The Tax Court erroneously applied the wrong standard in this case. The Tax Court should have applied the primary purpose test, a legal conclusion this Court reviews *de novo*. See *Halliburton*, 946 F.2d at 398; *Jacobson*, 915 F.2d at 837;

Bailey, 912 F.2d at 47; *Am. Realty Tr.*, 498 F.2d at 1198.

A. Introduction to the Standard For Exempt Qualification Under 26 U.S.C. § 501(c)(4)

26 U.S.C. § 501(c)(4) exempts nonprofit civic organizations that operate exclusively for the promotion of social welfare. Pursuant to Treasury Regulation § 1.501(c)(4)-1, an organization “is operated exclusively for the promotion of social welfare” under § 501(c)(4), “if it is *primarily* engaged in promoting in *some way* the common good and general welfare of the people of the community.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

The IRS has ruled that many different types of organizations qualify as tax exempt under § 501(c)(4), including for example, an organization that provided retirement benefits for firefighter-members, Rev. Rul. 87-126, 1987-2 C.B. 150; an organization that developed interest in art through a community art show, Rev. Rul. 78-131, 1978-1 C.B. 156; an organization promoting the health of the general public by promoting and regulating an amateur sport, Rev. Rul. 70-4, 1970-1 C.B. 126; and an organization providing employment assistance, Rev. Rul. 66-257, 1966-2 C.B. 212.

Courts have interpreted the term “social welfare” broadly and have likewise found that a wide range of organizations qualify for exemption under § 501(c)(4). *See, e.g., Monterey Pub. Parking Corp. v. United States*, 481 F.2d 175 (9th Cir. 1973) (organization formed by merchants to provide public off-street parking for

merchant customers qualified under § 501(c)(4)); *Eden Hall Farm v. United States*, 389 F. Supp. 858 (W.D. Pa. 1975) (organization that provided vacation and recreational opportunities for working women qualified under § 501(c)(4) even though 80% of women served were employees of company that founded the organization). The rule of “liberal construction” should be applied in favor of social welfare organizations under § 501(c)(4). *Monterey Pub. Parking Corp. v. United States*, 321 F. Supp. 972, 975 n.3 (N.D. Cal. 1970, *aff’d*, 481 F.2d 175 (9th Cir. 1973).

B. The Tax Court Erroneously Applied the Substantial Non-Exempt Purpose Test Applicable under 26 U.S.C. § 501(c)(3)

On page six of its opinion, the Tax Court, in interpreting the “operated exclusively” requirement of § 501(c)(4), correctly cites Treasury Regulation § 1.501(c)(4)-1’s primary purpose standard and provides that an organization will be found to *operate exclusively* for the promotion of social welfare “if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.” ROA.1206, (Decision at 6). The Tax Court, however, did not actually apply this primary purpose test that is applicable to § 501(c)(4) applications, and instead applies the substantial non-exempt purpose test that applied to § 501(c)(3) applications.

For an exemption under § 501(c)(3), even a single non-exempt purpose, will disqualify an applicant from § 501(c)(3) status. *See Better Business Bureau*, 326

U.S. at 283. On page 7 of its opinion, the Tax Court imports the substantial nonexempt purpose standard into its analysis and states: “courts have adopted the same standard and have held that a single substantial nonexempt purpose will preclude exemption as a social welfare organization.” ROA.1207, (Decision at 7). The Tax Court then cites decisional law under § 501(c)(3), including *Better Business Bureau, Inc.*, and *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973), to support the application of the substantial non-exempt purpose standard within the context of § 501(c)(4). *Id.*

To be sure, a review of the Tax Court’s analysis confirms that the Tax Court applied the substantial non-exempt purpose test and not the primary purpose test. The “Analysis” section of the Tax Court’s opinion focuses only on the non-MSSP activities which it purports is a disqualifying non-exempt purpose. The Tax Court states: “Petitioner fails to qualify as an organization described by § 501(c)(4) because its non-MSSP activities . . . constitute a substantial nonexempt purpose.” ROA.1208, (Decision at 8). The court further states: “petitioner has failed to demonstrate that its non-MSSP activities benefit the public” and “petitioner has not otherwise shown that its non-MSSP activities promote the common good and general welfare of the community” and “any benefit that the public may derive from petitioner's non-MSSP activities is incidental to the benefits received by the commercial payors and healthcare providers.” *Id.* Nowhere in the analysis is any

mention of MHACO’s MSSP activities, let alone of weighing of those activities against MHACO’s non-MSSP activities. Had the Tax Court conducted such a comparative analysis, it would have concluded that the benefits to the public welfare predominated.

C. Treasury Regulations Expressly Adopt the Primary Purpose Standard for § 501(c)(4)

In *Better Business Bureau*, the U.S. Supreme Court determined that “a single non-educational purpose, if substantial in nature, will destroy” an exemption under a predecessor of § 501(c)(3). *Better Bus. Bureau*, 326 U.S. at 283. Significantly, fifteen years later, when Treasury adopted a standard applicable to § 501(c)(4), it did not adopt the substantial nonexempt purpose test that the U.S. Supreme Court had adopted, and which had become settled law, for § 501(c)(3) cases. Instead, Treasury Regulation § 1.501(c)(4)-1 adopted a primary purpose test: “An organization is operated exclusively for the promotion of social welfare if it is *primarily engaged* in promoting in *some way* the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added). This contrasts with the Treasury Regulation under § 501(c)(3), which does incorporate the *Better Business Bureau* test into the requirements for qualification under § 501(c)(3). Treasury Regulation § 1.501(c)(3)-1 begins: “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 section 501(c)(3).” Treas. Reg. § 1.501(c)(3)-1(c)(1). The regulation, however, then qualifies: “An organization will not be so regarded if *more than an insubstantial part* of its activities is not in furtherance of an exempt purpose.” *Id.* (emphasis added).

Notably, both sets of regulations under §§ 501(c)(3) and 501(c)(4) were promulgated at the same time in 1960, with each regulation containing its separate and distinct test for qualification. T.D. 6500, 25 F.R. 11737, Nov. 26, 1960. Treasury expressly disqualified § 501(c)(3) applicants if “more than an insubstantial part of its activities” were for non-exempt purposes, and at the same time deemed satisfactory under § 501(c)(4) an applicant’s activities if they primarily promoted the general welfare “in some way.”

The regulation under § 501(c)(4) thus makes clear that, contrary to the Tax Court’s holding, a single substantial non-exempt purpose standard does *not* preclude exemption under § 501(c)(4) so long as the organization’s social welfare purposes are its primary purposes and advanced in some way.

Treasury’s decision to adopt a more lenient legal standard for entities seeking tax-exempt qualification under § 501(c)(4) rather than under § 501(c)(3) is well-founded due to the legislative intent in enacting § 501(c)(4) and differences in tax

treatments under the respective sections. The legislative history under § 501(c)(4) indicates that the section's enactment was "a result of a belief that the provision then exempting religious, charitable or educational organizations was not broad enough to cover many nonprofit organizations whose activities benefitted the general public." *People's Educ. Camp Soc. v. Comm'r*, 331 F.2d 923, 930 (2d Cir. 1964). Thus, § 501(c)(4) should arguably be construed more expansively than the pre-existing exemption for nonprofit organizations.

Organizations that qualify for exemption under § 501(c)(3) also receive more favorable tax treatment than those organized under § 501(c)(4) in the form of eligibility to receive tax-deductible contributions from donors under § 170(a), access to tax-exempt bond financing under § 145, and exemption from federal unemployment tax under §§ 3301 and 3306(c)(8) of the Internal Revenue Code. It is not unreasonable that an organization would be subject to heightened scrutiny in order to qualify for such favorable tax treatment, such that the standard to qualify under § 501(c)(3) is higher than other exempt categories with less risk for abuse.

D. The IRS Has A Long-Standing Position that the Primary Purpose Test Applies to Applications Under § 501(c)(4)

During the administrative phase of this case, the IRS conceded that the primary purpose test is applicable, and the substantial nonexempt purpose standard is inapplicable to the analysis under § 501(c)(4). ROA.629. In response to MHACO's protest, the IRS's Director of Exempt Organizations Rulings and

Agreements, under the heading “Standards for Exemption under IRC Section 501(c)(3) vs. Section IRC 501(c)(4),” stated:

While organizations exempt under IRC Section 501(c)(3) may not have a substantial non-exempt purpose, an organization exempt under IRC Section 501(c)(4) may engage in substantial non-exempt activities since the test for exemption under IRC Section 501(c)(4) is one of primary activities. See Treas. Reg. Section 1.501(c)(4)-1(a)(2).

Id. That statement should not be surprising because it merely restates the IRS’s long held view that organizations under § 501(c)(4) may possess substantial non-exempt purposes. Indeed, that is how the IRS trains its employees:

Organizations exempt under IRC 501(c)(4) are generally allowed greater latitude than that allowed to organizations exempt under IRC 501(c)(3). . . . Organizations exempt under IRC 501(c)(4) may engage in germane action organization activities described in Reg. 1.501-1(c)(3) other than intervention in a political campaign, without the restrictions imposed on IRC 501(c)(3) organizations. **Since the test for exemption under IRC 501(c)(4) is one of primary activities, an organization exempt under IRC 501(c)(4) may engage in substantial non-exempt activities.**

I.R.M. § 7.25.4.6(2) (02-09-1999) (emphasis added).

Of course, since that is how the IRS trains its employees, it is also no surprise that the IRS routinely gives organizations seeking exemption under § 501(c)(4) “greater latitude” (to use the terminology in the Internal Revenue Manual provision quoted above). For example, in P.L.R. 201123047 (Mar. 18, 2011), the IRS continued to recognize an organization under § 501(c)(4), while denying its request for recognition under § 501(c)(3) on the ground that “more than an insubstantial part

of your activities is not in furtherance of an exempt purpose.” In its explanation, the IRS provided that “[t]hus, the 501(c)(4) organization may have more than an incidental amount of social, or other non-exempt activities, and still qualify for exemption, as long as those activities are not primary.” *See also* P.L.R. 201031035 (May 13, 2010) (same); IRS Letter 5228 (rev. Sept. 2013) (providing a “safe harbor” for certain organizations applying for expedited § 501(c)(4) status as long as at least 60% of their activities promoted social welfare).

Indeed, since the time Treasury promulgated the primary purpose test in Treasury Regulation § 1.501(c)(4)-1, the IRS has consistently applied the primary purpose test to § 501(c)(4) applications. *E.g.*, IRS Gen. Couns. Mem. 39296 (October 17, 1984) (“Both the *** and the *** are social welfare organizations exempt from tax pursuant to section 501(c)(4). Accordingly, they must be primarily engaged in promoting in some way the common good and general welfare of the people of the community.”); Rev. Rul. 75-386, 1975-2 C.B. 211 (“An organization embraced within this section [§ 501(c)(4)] is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.”); Rev. Rul. 68-455, 1968-2 C.B. 215 (“Under these regulations [Treasury Regulation § 1.501(c)(4)-1], if the promotion of social welfare remained the primary activity of the organization described in Revenue Ruling 58-517, the organization would

qualify for exemption under section 501(c)(4) of the Code notwithstanding the business activities from which it derived the major part of its income.”).

E. The Fifth Circuit Should Adopt the Primary Purpose Test for 26 U.S.C. § 501(c)(4) Exemption Applications

The Fifth Circuit has never squarely decided the correct standard for reviewing § 501(c)(4) exemption applications. There are court cases from other jurisdictions that have cited to the substantial non-exempt purpose test in considering qualification under § 501(c)(4), however, those cases either do not control or made such statements in dicta.

In *Contracting Plumbers Coop. and Vision Service Plan v. United States*, 2005 WL 3406321, at 1 (E.D. Cal. Dec. 12, 2005), the courts referenced the substantial non-exempt purpose standard but ultimately rested their holding that the organizations failed to qualify for the exemption because the applicant’s primary purposes were non-exempt. *See Contracting Plumbers Coop.*, 488 F.2d at 687 (“we therefore cannot say that [the organization] is ‘primarily’ devoted to the common good as required by even the most liberal reading of section 501(c)(4)”); *Vision Serv. Plan*, 2005 WL 3406321 at 8 (Court considered whether the organization operated “primarily for the promotion of social welfare within the meaning of the tax regulations.”) (emphasis added). Similarly, in *Commissioner v. Lake Forest*, 305 F.2d 814, 818 (4th Cir. 1962), the court stated that it “need not decide” whether the existence alone of non-exempt activities “destroy the nonprofit aspect” because the

taxpayer failed to qualify under a “primary purpose” analysis. *Comm’r v. Lake Forest, Inc.*, 305 F.2d at 818.

Accordingly, this is an issue of first impression in the Fifth Circuit. For the reasons summarized above, applicable Treasury regulations and the IRS’s own long-standing practice support that the Court should adopt the primary purpose test for reviewing exemption applications under § 501(c)(4). In addition, adopting the primary purpose test squares with the legislative history under § 501(c)(4), which indicates that the section’s enactment was “a result of a belief that the provision then exempting religious, charitable or educational organizations was not broad enough to cover many nonprofit organizations whose activities benefitted the general public.” *People’s Educ. Camp Soc. v. Comm’r*, 331 F.2d at 930. The Tax Court’s decision, if allowed to stand, would contradict this legislative intent and disqualify worthy organizations that advance the public good from the wider ambit of qualifying organizations that Congress intended.

F. The Tax Court’s Adoption of An Incorrect Standard for § 501(c)(4) Applications Is Reversible Error

The Tax Court’s application of the incorrect standard resulted in the denial of MHACO’s tax-exempt application under § 501(c)(4), a result that the Tax Court would not have reached had it applied the primary purpose test to the facts of this case. Had the Tax Court applied the primary purpose test, the Tax Court would have engaged in a comparative analysis evaluating whether MHACO’s contributions to

the general welfare outweighed the benefits the Tax Court perceived as being disqualifying. By failing to conduct such a weighing of the public versus purported private benefits, the Tax Court committed reversible error.

Furthermore, the Tax Court's application of the substantial nonexempt purpose test resulted in a prejudicial outcome to MHACO as the administrative proceedings and record in this case were developed in contemplation of the application of the primary purpose test. A review of the administrative record illustrates this point and shows that MHACO introduced extensive evidence establishing that its primary purpose of improving health care primarily benefit the welfare of the Greater Houston Community, ROA.275-299, evidence that was completely disregarded after the Tax Court found what it thought was a single non-exempt purpose that prevented MHACO from qualification under § 501(c)(4). In doing so, the Tax Court committed reversible error.

For reasons discussed below, MHACO submits that the Court should enter decision in its favor under a correct application of the primary purpose test to MHACO's facts, or alternatively, the Court should remand the case to the Tax Court to apply the primary purpose test to the facts of this case.

III. THE SUBSTANTIAL NON-EXEMPT PURPOSE STANDARD IS BEYOND THE SCOPE OF REVIEW AND NEW MATTER ON WHICH RESPONDENT BEARS THE BURDEN OF PROOF

As the Tax Court explained in its opinion, the scope of the Tax Court’s inquiry is “limited to the propriety of the reasons given by the Commissioner for denying an organization’s application.” ROA.1206, (Decision at 6). The Tax Court then held that MHACO “fails to qualify as an organization described by section 501(c)(4) because its non-MSSP activities primarily benefit its commercial payor and health care provider participants, rather than the public, and therefore constitute a substantial non-exempt purpose.” ROA.1208, (Decision at 8). In doing so, the Tax Court violated the very scope of review it articulated because the existence of a substantial non-exempt purpose was not a reason the Commissioner’s final adverse determination letter gave for his rejection of MHACO’s exempt status.

Not only did the Commissioner not deny MHACO’s application on the theory that its non-MSSP activities were a disqualifying “substantial non-exempt purpose,” he expressly stated that MHACO may qualify under § 501(c)(4) *notwithstanding* whether it engaged in “substantial non-exempt activities.” In its final adverse determination letter (prior to MHACO’s case being transferred to IRS Appeals) the IRS explained:

While organizations exempt under IRC Section 501(c)(3) may not have a substantial non-exempt purpose, **an organization exempt under IRC Section 501(c)(4) may engage in substantial non-exempt**

activities since the test for exemption under IRC Section 501(c)(4) is one of primary activities. *See* Treas. Reg. Sec. 1.501(c)(4)-1(a)(2).

ROA.629 (emphasis added).

In denying MHACO's application, the Commissioner applied the primary purpose test, considering MHACO's MSSP and non-MSSP activities, and determined that MHACO: 1) does "not promote health in furtherance of social welfare"; 2) does not "primarily benefit the community as a whole" and 3) does "not primarily lessen the burdens of government". ROA.624-629 (quoting headings); ROA.233-255 (proposed adverse determination letter). The Commissioner, thus, had denied MHACO's application for the stated reason that MHACO failed the primary purpose test.

The Commissioner's argument before the Tax Court, that a "substantial non-exempt" purpose disqualified MHACO from exemption under § 501(c)(4), should not have been considered, given the Commissioner's contrary statements in the proceedings below and the limitation on the scope of the Tax Court's review.

In the alternative, even if the Court were to find the Tax Court properly allowed the Commissioner to add the substantial non-exempt purpose rationale here, that would have been a "new matter" for which the Tax Court should have imposed the burden of proof on the Commissioner. As a general matter, Tax Court Rule 142(a)(1) places the burden of proof on the petitioner, "except as otherwise provided

by statute...and except that, in respect of any new matter...it shall be upon the respondent.”

In this case, the Commissioner’s argument that the governing standard is the “single, substantial non-exempt purpose” directly conflicts with the IRS’s statement of the standard in the administrative proceedings. ROA.629. It also conflicts with the Commissioner’s primary purpose analysis in the determination letter. ROA.247-249; ROA.251-253. The Commissioner’s argument before the Tax Court that MHACO’s application should have been analyzed under the more rigorous substantial non-exempt purpose standard should have therefore been found to be a “new matter” for which the Tax Court should have imposed the burden of proof on the Commissioner.

To the extent the Court views the substantial non-exempt purpose standard as within the Tax Court’s scope of review, the Court should find the Tax Court erred by failing to shift the burden of proof to the Commissioner.

IV. THE TAX COURT ERRED BY ANALYZING MHACO’S NON-MSSP ACTIVITIES IN A VACUUM AND CONCLUDING SUCH ACTIVITIES BY THEMSELVES WERE DISQUALIFYING.

The Tax Court misapplied the legal standard and analyzed MHACO’s non-MSSP activities concluding that such activities by themselves were disqualifying, a legal conclusion this Court reviews *de novo* as it is premised on an improper legal standard, or improperly applied. *Theriault*, 547 F.2d at 1280; *In re Missionary*

Baptist Found., Inc., 712 F.2d at 209

In its opinion, the Tax Court held that MHACO “fails to qualify as an organization described by section 501(c)(4) because its non-MSSP activities primarily benefit its commercial payor and health care provider participants, rather than the public, and therefore constitute a substantial non-exempt purpose.” ROA.1208, (Decision at 8). The Tax Court erred in categorically defining MHACO’s non-MSSP activities as non-exempt, when such activities are part-and-parcel with and advance MHACO’s MSSP activities and exempt cause.

In classifying MHACO’s non-MSSP activities as disqualifying non-exempt activity, the Tax Court only considered whether the activities benefited private third parties. The Tax Court did not consider the fact that MHACO’s non-MSSP activities are necessary for it to succeed in its primary purpose of promoting social welfare, and that the non-MSSP activities further and are part-and-parcel of MHACO’s exempt purpose through its activities with MSSP providers and payors.

Critically, the Tax Court did not consider Congress’ intent for ACOs to promote health care reform in both the public and private sectors when it enacted the ACA. The history of the ACA shows Congress knew it would be necessary for an ACO’s successful establishment and achievement of its social welfare purpose of reforming health care to engage with private payors and providers. The Tax Court’s finding that the benefits obtained by MHACO’s “commercial payor and health care

provider participants” precludes eligibility under § 501(c)(4) undermines Congress’ very intent that tax exempt entities – working with such private actors - would serve as ACOs. If the benefits obtained by the private actors preclude exempt status, then an entity could not work with such private actors and maintain its exempt status.

As explained by the MedPAC in a report to Congress analyzing the successful implementation of ACOs, an ACO’s success in reforming the health care system by shifting the medical services market from the FFS pricing model to the desired value-based payment models largely depends on the ACO’s size. “To overcome incentives in FFS payment systems to expand capacity and volume, a large share of the patients in a physician’s practice would need to be in an ACO.” MEDPAC, REPORT TO THE CONGRESS: IMPROVING INCENTIVES IN THE MEDICARE PROGRAM, p.41. Otherwise, an ACO without a critical mass of patients under its care would not be able to provide sufficient incentive for medical providers in both the public and private sector to enter into value-based payment arrangements with the ACO that promote higher quality care and lower-cost services. “To achieve this critical mass, private insurers may have to join Medicare in providing ACO-type incentives to constrain capacity.” *Id.*

The Tax Court’s separation of MHACO’s MSSP and non-MSSP activities in order to analyze the non-MSSP activities in a vacuum also conflicts with Congress’ determination that non-MSSP activities are necessary to accomplish the “Triple

Aim” of the ACA, which includes: “(i) reducing the cost of health care for individuals, (ii) improving patient access to and quality of care, and (iii) improving population health and patient experience.” ROA.1159.

Leading up to the passing of the ACA, § (j)(4) of H.R. 2959 includes a section entitled, “Involvement in Private Pay Arrangements.” That section states: “Nothing in this section shall be construed as preventing qualifying ACOs participating in the pilot program from negotiating similar contracts with private payors.” H.R. 2959, 111th Cong.(2009-2010); *see also* 155 Cong. Rec. S. 11132 (Nov. 5, 2009) (“Accountable care organizations are extremely important in health care reform.”); 155 Cong. Rec. S. 13181 (Dec. 14, 2009) (“These ACOs allow medical providers to work in teams, to take responsibility for decision making, and they offer financial rewards for better health outcomes. Our amendments allow medical providers to align Medicare, Medicaid, and private sector strategies for improving care. Doing this will help ensure all Americans receive high quality care no matter how they are insured.”). Capturing these concepts shortly after the ACA’s enactment, the Congressional Research Service reported:

The rationale for ACOs emerges from the recognition that the current medical system tends to offer fragmented services across providers (an absence of coordinated care), pays for units of service rather than outcomes, and holds no one organization or individual responsible for either the quality or cost of care provided. ACOs are supposed to bring providers together under a single organization and create incentives for them to coordinate care, improve quality, and lower cost.

CRS, R41474, ACCOUNTABLE CARE ORGANIZATIONS AND THE MEDICARE SHARED SAVINGS PROGRAM, pp.2-3, 13, n.53.

In short, Congress understood that benefit to third parties from ACOs was a necessary consequence, rather than a purpose. Benefiting private insurance companies was no more MHACO's purpose than it was Congress' in the first place when it made ACOs an instrument to advance ACA's goals.

Consistent with this history, the CMS, in its Final Rule authorized by the ACA to establish ACO guidelines, emphasized:

Through the flexibility allowed in the governance requirements . . . we have left room for ACOs to engage with private payors. In addition, we may revisit our authority to award a preference to ACOs that participate in similar arrangements with other payors as we gain more experience with such arrangements through the Pioneer ACO Model.

Department of Health and Human Services, 42 C.F.R. § 425, Fed. Reg. Vol. 67933 (Nov. 2, 2011).

In addition to the history of ACA and related rulemaking, shortly after the ACA's passage, in IRS Notice 2011-20, the Service recognized that reducing Medicare costs served the charitable purpose of reducing a federal burden. "Congress established the MSSP to be conducted through ACOs in order to promote quality improvements and cost savings, thereby lessening the government's burden associated with providing Medicare benefits." IRS Notice 2011-20, 2011-16 I.R.B. 652. The Notice continues: "the IRS recognizes that certain non-MSSP activities

may further or be substantially related to an exempt purpose.” *Id.* In this instance, MHACO’s non-MSSP activities further and are substantially related to its exempt MSSP activities.

MHACO established an integrated platform for both private and public insurers, in accordance with the intent and literature behind Congress’ enactment of ACA and its ACO component. MHACO’s non-MSSP activities are in furtherance of both its MSSP activities, and the Triple Aim of the ACA. Indeed, MHACO’s non-MSSP activities are necessary for the success in its MSSP activities, and serves MHACO’s primary purpose of promoting social welfare through the health care reform intended by Congress through the ACA. Contracting with private payors to offer VBP arrangements increases the incentive to constrain capacity. Moreover, for ACOs to truly impact the cost and quality of health care to the general public by providing incentives to medical providers to switch from FFS practices to VBP practices, ACOs must engage with private payors to enter into VBP pricing arrangements in order achieve the necessary market power. Doing so not only enables ACOs to promote VBP arrangements in the private sector, but also to effectively promote VBP arrangements in the public sector.

V. MHACO’S ACTIVITIES PRIMARILY PROMOTE THE GENERAL WELFARE OF THE GREATER HOUSTON COMMUNITY

A. MHACO Is Part of the Solution to Higher Quality Health Care at Lower Costs

As an ACO, MHACO’s core function is to improve the quality and cost of health care to the community—by both bringing higher quality, lower cost medical services to the local community and promoting a broader shift from the FFS model to value-based models as Congress contemplated when enacting the ACA. Plainly, MHACO promotes the general welfare through its activities as an ACO.

The IRS has long recognized that organizations such as hospitals, regional health systems, health planning agencies, organ donation facilitators, quality reviewers of services provided to Medicare and Medicaid beneficiaries, and other similar organizations may qualify for tax-exempt status as organizations that promote health for the benefit of the community, so long as the activities of the organization are in furtherance of its exempt purpose, and even under the more restrictive standards in § 501(c)(3). *E.g.*, Rev. Rul. 69-545, 1969-2 C.B. 117; *see also* Rev. Rul. 97-21, 1997-1 C.B. 121; Rev. Rul. 76-455, 1976-2 C.B.150; Rev. Rul. 77-69, 1977-1 C.B. 143; Rev. Rul. 81-276, 1981-2 C.B. 128; Rev. Rul. 75-197, 1975-1 C.B. 156. *See also Sound Health Ass’n v. Comm’r*, 71 T.C. 158 (1978) (the Service had granted an exemption under § 501(c)(4) for a prepaid health plan but denied an exemption under § 501(c)(3), which the court reversed).

For frame of reference, courts have considered several factors under the more restrictive standards in § 501(c)(3) cases to evaluate whether an organization is operated exclusively for exempt purposes. *See, e.g., IHC Health Plans, Inc. v. Comm’r*, 325 F.3d 1188, 1197 n.16 (10th Cir. 2003). These factors include: (1) the size of the class eligible to benefit, (2) treatment of persons participating in governmental programs such as Medicare or Medicaid, (3) free or below-cost products or services, (4) use of surplus funds to improve facilities, equipment, patient care, and medical training, education, and research, and (5) a board of directors drawn from the community. *See Rev. Rul. 83-157, 1983-2 C.B. 94.*

It is clear from the record that MHACO satisfies each of these factors. ROA.93-94; ROA.489. MHACO is primarily operated to promote the common good and general welfare of the Greater Houston Community and to bring about civic betterments and social improvements within this community through activities that promote the health of the Greater Houston Community and that lessen the burdens of government within the meaning of § 501(c)(4). The size of the class eligible to benefit from MHACO’s services—the Greater Houston Community—is large and indefinite. Any individual, including Medicare and Medicaid participants, who wishes to utilize the organization’s services is free to do so; MHACO does not turn away any patients, regardless of insured status or any other characteristics. MHACO provides a wide array of free and below-cost services. ROA.113. In fact, MHACO

provides its programs and services to its population free of charge. *Id.* Instead, MHACO's activities are designed to save patients money by reducing expenses they might otherwise incur on unnecessary or avoidable procedures and health care visits (as well as, ultimately, through reduced insurance premiums, avoided copayments, and so forth). ROA.517, 534-539, 550, 750. MHACO uses any surplus funds to improve facilities, equipment, patient care, and medical training, education, and research, and its board of directors are drawn from the community. *Id.*

The entire Greater Houston Community benefits when MHACO facilitates the provision of more cost-effective health care to a significant segment of this community. MHACO also provides substantial indirect benefits to the entire Greater Houston Community by increasing access to quality of health care by engaging in activities that free up health care professionals' time and that avoid the over-utilization of medical resources. The Tax Court's statement that these activities amount to no more than an "admirable" goal that falls short of providing a benefit to the public in promotion of the common good and general welfare of the community is clearly misplaced. It is quite clear that the sole aim of each of MHACO's activities is to improve the general welfare of the community, and that it has been successful in achieving this result.

B. MHACO's Advancement of Higher Quality Health Care at Lower Costs Is Its Primary Purpose

MHACO's organizing documents expressly limit its activities to purposes that are permitted under § 501(c)(4). ROA.89. Further, as explained above, MHACO's primary activity is delivering the concerted effort of nurses, pharmacists, social workers, community health workers, and population health data experts, in conjunction with participating health care providers, to directly benefit as much of the Greater Houston Community as possible. Although cost savings to insurance companies and incentive payments to health care providers may constitute indirect benefits to unrelated third parties, they are merely incidental results that flow from MHACO's operations; MHACO does not operate to provide a benefit to insurance companies or health care providers.

Not unlike most tax-exempt nonprofit organizations, MHACO needs funding in order to deliver the health care services it is organized to provide the community, and MHACO's shared savings arrangements with the CMS and with private payors provide such funding. ROA.80, 113, 188, 225, 738, 746. MHACO obtains these funds through arm's-length contractual agreements with insurance companies that are willing to provide payments in proportion to the reduction in unnecessary health care spending that results when MHACO's objectives are met. As the IRS has noted, "[s]ocial welfare organizations are not precluded from engaging in business

activities per se, either as a means of providing direct community benefit or as a means of financing their social welfare programs.” P.L.R. 201126040 (Apr. 8, 2011).

Moreover, the commercial payors have no control over the way that MHACO operates or manages its affairs, and MHACO is not obligated to provide a return or growth of any capital to the commercial payors; the private shared savings payments that MHACO receives are objectively conditioned on improvements to community health. The cost savings to insurance companies are a direct result of the improved health of their insured, not the other way around.

Courts have also held that private benefits which are “indistinguishable” from benefits that reach the community generally are insubstantial. *See Monterey Public Parking Corp.*, 321 F. Supp. at 972 (benefits of the taxpayer’s operations which flowed specifically to unrelated third-party businesses—in the form of enhanced profits, increased property values, etc.—also flowed to other businesses generally, and were thus insubstantial). MHACO’s purported benefit to insurance companies—reduced health care costs—is the exact same benefit that flows to the Greater Houston Community generally. In fact, reducing the cost of its community’s health care is one of MHACO’s primary aims. MHACO was formed, after all, in the wake of the ACA, which included the accountable care model, with the “triple aim” of “(i) reducing the cost of health care for individuals, (ii) improving patient access to and quality of care, and (iii) improving population health and patient experience.”

ROA.179 (and citations therein). Furthermore, the Texas Health Council recognized that MHACO “serves to encourage the defragmentation of the various components of delivery and payment structures, ultimately reducing [health care] costs.” The health care cost savings stemming from MHACO’s activities for the community far exceed any purported private benefits flowing to insurance companies and doctors. As such, only the Greater Houston Community can reasonably be viewed as the “primary beneficiary” of MHACO’s activities.

Finally, MHACO’s agreements with commercial payors also advance MHACO’s social welfare aims in that the insurance companies are able to provide MHACO with the otherwise inaccessible patient-level data it requires to develop and implement the quality and cost-effectiveness metrics by which to judge the success of the community benefits it aims to deliver.

In a general information letter, the IRS wrote “there is no prohibition per se that prevents health care organizations from making incentive payments to physicians.” IRS Gen. Inf. Ltr. 2002-0021 (January 9, 2002). Even under the more stringent operational standards of § 501(c)(3), the IRS has ruled that the provision of incentives to third parties furthers the charitable purposes served by a hospital and is thus consistent with the requirements for exemption as an organization described in § 501(c)(3). *See* Rev. Rul. 97-21, 1997-1 C.B. 121 (in Situation 1, the Service deemed appropriate physician incentives such as the guarantee of a mortgage, the

reimbursement of professional liability insurance, provision of subsidized office space for a limited time, and the lending of start-up financial assistance to a physician in order to induce him to provide medical care in a community that needed the physician's services). *See also* IRS Gen. Couns. Mem. 37,789 (Dec. 18, 1978) (personal benefits that flowed to staff members of a hospital were a "necessary concomitant" to the hospital's public purposes). Notably, the payments and other incentives to physicians in a number of the authorities and guidance cited herein were found not to be inimical to organizations' qualifications for exemption under § 501(c)(3), which is subject to more stringent review as stated above.

In sum, MHACO's arrangements with private payors and health care providers alike "obviously bear[] a close and intimate relationship" to its exempt social welfare purposes, *Monterey Public Parking Corp.*, 321 F. Supp. at 977, and "are no more intrusive or indicative of private interests than the contractual, percentage arrangement[s] approved of in [numerous other section 501(c)(4) exemption recognition applications, as well as in Notice 2011-20]." *Plumstead Theatre Society, Inc. v. Commissioner*, 74 T.C. 1324 (1980).

C. The Tax Court's Statement That Only 18% Of Patient-Participants Are Medicare Beneficiaries Is Out Of Context And Irrelevant

In the "Background" section of the opinion, the Tax Court stated: "In total, 18% of MHACO patient participants are Medicare beneficiaries. The remaining

82%, or 371,391 patients, participating in MHACO receive health coverage from private payors.” This statement is out of context and irrelevant.

The Tax Court ignored the fact that 65% of MHACO’s revenue over the course of its life is revenue generated from MHACO’s MSSP activities. ROA.1129. The Commissioner selectively picked two years throughout MHACO’s existence in which MHACO’s revenues from non-MSSP activities were slightly more than 50% of its total revenue for that year, while ignoring the rest of the years in which MSSP revenues were the overwhelming majority of MHACO’s total revenue. ROA.1129-1130. Therefore, on a revenue generation basis, the record shows MHACO primarily engaged directly in MSSP activities.

In any event, the Tax Court should not have focused on any metric that splits MSSP from non-MSSP activities. As explained above, the activities are part-and-parcel of the same objective to promote higher quality, lower cost medical services to the local community and to impact the broader market away from the FFS model which encourages unnecessary and duplicative medical tests and procedures. Moreover, MHACO’s revenues are directly tied to the amount of health care savings it generates; therefore, the substantial majority of the medical savings MHACO has generated have been in the public health sector through the MSSP. This evidence strongly points toward the conclusion that MHACO’s MSSP activities are its primary activities.

In reality, the MSSP versus non-MSSP distribution of MHACO’s patient population is nothing more than a reflection of the population demographic within the community that MHACO serves. MHACO’s agreements with “commercial payors”—insurers of the population segment not enrolled in Medicare—simply constitute the private-sector counterpart to the MSSP and are wholly consistent with MHACO’s social welfare objectives intended to benefit the entire Greater Houston Community population, not just the Medicare recipients therein. The MSSP to non-MSSP metrics should have had no bearing on the Tax Court’s decision whether MHACO’s primary aim is the benefit of private parties or the promotion of the social welfare of the Greater Houston Community.

Moreover, MHACO’s ratio of patient-participants that are MSSP versus non-MSSP is not within MHACO’s control unless it intentionally limits itself and the number of members of the Greater Houston Community that it serves, to the direct detriment of its social welfare purpose. MHACO’s services under the MSSP are accessible to all of the Greater Houston Community’s Medicare beneficiaries, each of whom has the opportunity to elect into MHACO’s population by designating one of MHACO’s participating doctors as his or her primary care provider. 42 U.S.C. § 1899(c)(2)(B) (“ . . . the Secretary shall permit a Medicare fee-for-service beneficiary to voluntarily identify an ACO professional as the primary care provider of the beneficiary for purposes of assigning such beneficiary to an ACO, as determined by

the Secretary.”). MHACO’s MSSP population grows when a Medicare fee-for-service beneficiary voluntarily selects one of MHACO’s professionals as their primary care provider, after which CMS assigns the Medicare beneficiary to MHACO’s MSSP population. MHACO cannot deliberately grow its MSSP patient population through its own actions, as the beneficiaries enrolled in Medicare must voluntarily elect into its care.

Therefore, the only way that MHACO could actively increase its ratio of MSSP patients to non-MSSP would be to purposefully reduce its non-MSSP population, which would be in direct conflict with its primary social welfare purpose of providing affordable health care to the entire Greater Houston Community, and would reduce the benefits that stem from its size.

The ratio of MSSP to non-MSSP patients is not a result of MHACO’s supposed purpose to benefit private interests. It is a result of the mechanics of how CMS assigns MSSP beneficiaries to MHACO, in conjunction with MHACO’s successful efforts to service the Greater Houston Community’s population through both Medicare and private insurers in furthering its social welfare purpose. Therefore, the Tax Court erred in concluding that MHACO’s primary purpose was not the promotion of social welfare.

D. The Tax Court Erred in Finding that MHACO Carried on a Business Similar to How Organizations Operate for Profit

In its opinion, the Tax Court stated that MHACO “contravenes the requirements of section 501 by conducting business with the public in a manner similar to a for-profit business.” ROA.1208, (Decision at 8). This conclusion is unfounded because it is based on the finding that MHACO’s non-MSSP activities “benefit primarily . . . commercial payors and health care providers”. There is also nothing in the record that would support that for-profit businesses would have similar objectives, profit margins, and other characteristics and performance metrics that MHACO has.

The evidence in the record supports a finding that MHACO is not engaged in a business remotely similar to a for-profit business with the general public or anyone else. No portion of MHACO’s organizational structure or operations resembles the structure, intentions, or operations of a for-profit business. MHACO does not share the characteristics of organizations that carry on business with the general public. MHACO’s expenses relate to its social welfare activities and the majority of its employees are directly engaged in activities tied to patient care.

MHACO is not organized for profit, and it in fact lacks many of the hallmarks that are characteristic of organizations that carry on business with the general public. ROA.800. MHACO’s expenses relate to its social welfare activities, its officers and

directors are unpaid, and the majority of its employees are directly engaged in activities tied to patient care. ROA.913-914.

The sole member of MHACO is MHHS, a public charity health system recognized under §§ 501(c)(3) and 509(a)(1). ROA.912-913. As set out in its mission statement, MHHS is “a not-for-profit, community-owned, health care system with spiritual values, dedicated to providing high quality health services in order to improve the health of the people in Southeast Texas.” ROA.588. MHACO was not created by private persons to advance their own private interests, but rather by a public charity to serve public interests.

A comparison to the taxpayer in *Vision Service Plan*, the case cited as support for the Tax Court’s conclusion, ROA.1208, that MHACO conducts business with the public in a manner similar to a for-profit business, is illustrative. The *Vision Service Plan* court, found that the taxpayer behaved like a for-profit business on the basis of specific facts, including:

- (i) Less than 24% of the organization’s net income (and an even smaller portion of its gross income) was devoted to the activities on which it based its application for exemption,
- (ii) Under its articles of organization, the petitioner’s primary purpose was simply to establish a fund into which its private members could pay into and draw from to defray their own private vision care costs,
- (iii) Its workforce consisted primarily of brokers who worked on commission to bring in new clients, with the amount of commission specifically tied to the revenue its clients generated,
- (iv) It engaged in cost-cutting measures common to for-profit businesses,

- (v) It provided executives and officers with bonuses that were taken from net earnings,
- (vi) It paid its executives high salaries and other perquisites consistent with that of a for profit corporation, such as luxury company cars,
- (vii) It accumulated large surpluses and expanded its income producing facilities,

Vision Serv. Plan, 2005 WL 3406321 at 23-26.

MHACO's activities are entirely distinguishable from the commercial activities carried on by the taxpayer in *Vision Service Plan*. MHACO's primary activities—coordinating health care for patients, collecting, analyzing, and disseminating health care data to further advance community benefit, and working with physicians to promote adoption of best practices for evidence-based medicine—are all consistent with the organization's stated exempt primary purpose. MHACO does not pay anything to its officers and directors, let alone provide them any lavish incentives, ROA.744, and MHACO's "workforce" consists of fewer than ten managed-care-contracting professionals who are employed by MHHS and spend only a portion of their time negotiating ACO agreements or renewing MSSP participation. ROA.776, 745-746.

MHACO's cost-cutting and revenue-increasing measures are intended not to earn a profit for itself or anyone else, but to fund the benefits it provides to the Greater Houston Community in the same manner that its participation in the MSSP funds the benefits provided to Medicare beneficiaries within that community.

ROA.123, 193-194. Finally, any surplus earnings remaining after payment of participating physicians and expenses of managing the ACO are held as reserves to protect MHACO's ability to meet its payment obligations in the event it takes on risk. ROA.94, 96.

On the basis of the foregoing, MHACO submits that the evidence in the record clearly establishes that its activities primarily benefit the Greater Houston Community. The Tax Court's finding that MHACO's Non-MSSP activities primarily benefit MHACO's commercial payor and health care provider participants is premised on the Tax Court's incorrect analysis of MHACO's Non-MSSP activities separately from its MSSP activities and the misapplication of the legal standard. The Tax Court committed serious and reversible error. Accordingly, this Court should reverse the Tax Court's decision and find that MHACO qualifies under § 501(c)(4) because its activities primarily benefit the Greater Houston Community.

CONCLUSION

Based on the foregoing, MHACO respectfully urges this Court to reverse the Decision of the United States Tax Court in this matter and enter judgement in favor of MHACO, finding that MHACO is entitled to exempt status as an organization described under § 501(c)(4).

s/Juan F. Vasquez, Jr.
Juan F. Vasquez, Jr.
Chamberlain, Hrdlicka, White,
Williams & Aughtry
1200 Smith Street, Suite 1400
Houston, Texas 77002-4401
Tel: (713) 658-1818; Fax: (713) 658-2553

COUNSEL FOR APPELLANT

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing Appellant’s Brief has, this 15th day of February, 2024, been made on counsel for Appellee via CM/ECF to:

Counsel for Respondent-Appellee:

Ms. Julie C. Avetta
U.S. Department of Justice
Tax Division
P.O. Box 502
Washington, D.C. 20044

s/Juan F. Vasquez, Jr. _____
Juan F. Vasquez, Jr.

CERTIFICATE OF COMPLIANCE

1. This Appellate Brief complies with the type-volume limit of Fed. R. App. P. 32(a)(7)(B) because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this document contains 12,361 words.

2. This document complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because this document has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman size 14 with footnotes in Times New Roman size 12.

s/Juan F. Vasquez, Jr.
Juan F. Vasquez, Jr.
Chamberlain, Hrdlicka, White,
Williams & Aughtry
1200 Smith Street, Suite 1400
Houston, Texas 77002-4401
Tel: (713) 658-1818; Fax: (713) 658-2553

COUNSEL FOR APPELLANT

Dated: February 15, 2024