

THE ROLE OF ACCESS IN CHARITABLE TAX EXEMPTION

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I. INTRODUCTION: EXEMPTION IN A COMMERCIALY—ORIENTED WORLD

Every year when I teach my course on tax-exempt organizations, I begin by asking my students to name their paradigm charity. Every year, the usual suspects emerge: the Salvation Army, the Red Cross, C.A.R.E. and other poor-relief organizations top the list. Relief of the poor has long been a major justification for tax exemption and in fact is one of the charitable purposes specifically listed in the Internal Revenue Regulations under I.R.C. § 501(c)(3), which is the statutory grant of exemption to charitable organizations.¹

Nevertheless, a host of organizations that do not engage in significant relief of the poor also are eligible for exemption. Religious organizations, for example, are not required to engage in poor-relief to be tax-exempt; neither are educational organizations.² Within this broad category of organizations eligible for exemption on grounds other than relief of the poor are a particularly vexing category of organizations whose services appear strikingly similar to those provided by for-profit institutions. Health care organizations perhaps are the paradigm for this category. Although relief of the poor was the basis for exemption of hospitals prior to 1969, in that year the IRS adopted what has become known as the “community-benefit” standard for exemption, which did not require a hospital to treat indigent patients in order to qualify for exemption.³ Instead, the IRS concluded that providing health care for the general

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1. Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990) (“[T]he term ‘charitable’ . . . include[s]: Relief of the poor and distressed . . .”).

2. Religious organizations and educational organizations are specifically enumerated in § 501(c)(3) as being presumptively exempt entities. Although all organizations applying for exempt status under § 501(c)(3) must meet the common-law definitions of “charity” in order to qualify for exemption, *Bob Jones University v. United States*, 461 U.S. 574, 586 (1983), religious and educational organizations historically have been considered charitable entities at least since the 1601 Elizabethan Statute of Charitable Uses based upon their primary purpose (e.g., disseminating religious doctrine, educating the public) without regard to whether their target beneficiaries were poor. *See generally* JOHN D. COLOMBO & MARK A. HALL, *THE CHARITABLE TAX EXEMPTION* 3–5, 19–21 (1995).

3. Rev. Rul. 69-545, 1969-2 C.B. 117. *See infra* notes 14–19 and accompanying text.

benefit of the community could be a charitable purpose, even if indigents were not served.⁴

Since that time, a number of empirical studies of health care providers generally have found that—if one controls for government-owned hospitals and major-research hospitals—private nonprofit, tax-exempt hospitals do not operate much differently from for-profit counterparts in similar geographic areas.⁵ These studies confirm that the levels of “uncompensated care” differ little between exempt and for-profit providers; that the range of services provided by both are similar; and that under current measures of quality assessment there is little difference between the two.⁶

One natural reaction to this state of affairs (it has certainly been mine) is to simply dismiss exemption for nonprofit health care providers as a wrong-headed anachronism. Yet one has the uneasy feeling that such dismissal would be wrong in particular cases. For example, even though a private nonprofit hospital in a rural area may have an economic patient mix and range of services that is not much different from a for-profit big-city counterpart, it might still have a legitimate claim to exempt status based on the argument that it is the sole provider for its population, and that for-profit providers are singularly uninterested in serving low-density rural areas.⁷ In short, the rural, community-based hospital might be

4. *Id.*

5. For a summary of the recent empirical evidence on these points, see Frank A. Sloan, *Commercialism in Nonprofit Hospitals*, in *TO PROFIT OR NOT TO PROFIT* 151, 151–68 (Burton Weisbrod ed., 1998). See also M. Gregg Bloche, *Health Policy Below the Waterline: Medical Care and the Charitable Exemption*, 80 *MINN. L. REV.* 299, 315–19 (1995) (arguing that propositions that nonprofit hospitals provide more in the way of public goods, such as medical education or uncompensated care, “are highly suspect.”); sources cited *infra* note 6. But see Jill R. Horwitz, *Why We Need the Independent Sector: the Behavior, Law, and Ethics of Not-for-Profit Hospitals*, 50 *UCLA L. REV.* 1345 (2003) (explaining that empirical study done by author supports claim that nonprofit hospitals offer more unprofitable services typically needed by the poor).

6. Sloan, *supra* note 5, at 156–63; Bloche, *supra* note 5 at 315–19. See also Mark McClellan & Douglas Staiger, *Comparing Hospital Quality at For-Profit and Not-for-Profit Hospitals*, in *THE CHANGING HOSPITAL INDUSTRY* 93, 104–11 (David M. Cutler ed., 2000) (finding that within particular markets there is some evidence that for-profits actually have higher quality than nonprofits, but that overall not-for-profits had a slight advantage in the treatment of elderly patients with heart disease, and concluding there is “an enormous amount of variation in hospital quality within the for-profit and not-for-profit groups.”); William M. Gentry & John R. Penrod, *The Tax Benefits of Not-for-Profit Hospitals*, in *THE CHANGING HOSPITAL INDUSTRY* 285, 294–98, 321 (David M. Cutler ed., 2000) (noting some differences in service mix between small, under 75-bed, for-profit and nonprofit hospitals, but among larger hospitals differences were not statistically significant. “Patient characteristics . . . are remarkably similar for FP and NFP hospitals.”).

7. See Edward C. Norton & Douglas O. Staiger, *How Hospital Ownership Affects Access to Care for the Uninsured*, 25 *RAND J. ECON.* 171, 172 (1994) (presenting evidence that for-profits strategically locate in more affluent areas where population is well-insured).

providing access to health services for a group that otherwise would be underserved by the for-profit market.

The health care industry, however, is hardly the only one in which the nagging issue of the differences between exempt and for-profit providers cloud exempt status. Take arts organizations, for example. It is not unusual for an exempt nonprofit art gallery or community theater to serve the same geographic area as for-profit galleries or theaters. Both galleries sell art and both theaters charge admission.⁸ So what justifies exemption for the nonprofit? Is it simply their decision to organize as a nonprofit entity?⁹ The IRS also has held that “public-interest” law firms can be tax-exempt even though they do not offer services to the poor.¹⁰ Why? What really differentiates these law firms from the many for-profit firms that daily litigate class action lawsuits, often involving major issues of public policy? Similarly, the IRS has approved exemption for certain “community-development” organizations that seem to provide essentially the same services as for-profit investment bankers or real-estate developers.¹¹ So when is an investment banker or real-estate developer “charitable” and when is it not?

The central thesis of this Article is that the criterion that can and should be used to judge exempt status in these cases of “commercial similarity” is whether the organization provides access to services for previously-underserved populations or provides specific services to the majority population that otherwise are not provided by the private sector. Using “enhancing access” as the main criterion in judging an organization’s entitlement to exemption makes considerable sense; after all, a major rationale for granting charitable tax exemption is to recognize the

8. *See, e.g.*, *Plumstead Theater Soc’y v. Comm’r*, 74 T.C. 1324, 1332–33 (1980) (“Admittedly, the line between commercial enterprises which produce and present theatrical performances and nonprofit, tax-exempt organizations that do the same is not always easy to draw . . .”); *Goldsboro Art League v. Comm’r*, 75 T.C. 337 (1980) (analyzing differences between taxpayer’s services and those of commercial art galleries).

9. At least one academic theory of exemption suggests that the decision to form as a nonprofit evidences an altruistic goal, and that this should be enough to justify exemption. Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501 (1990).

10. Rev. Proc. 92-59, 1992-2 C.B. 411 (listing requirements for exemption of public-interest law firm).

11. Rev. Rul. 74-587, 1974-2 C.B. 162 (finding that an organization that used resources to stimulate economic development in low-income urban area was exempt; its activities consisted primarily of loaning money to for-profit businesses willing to locate in urban area); Rev. Rul. 70-585, 1970-2 C.B. 115 (discussing exempt status of several different organizations formed to provide low- or moderate-income housing; organizations that provided low-income housing for poor or moderate-income housing for minority groups are exempt; organization formed to provide moderate-income housing in high-income, expensive community not exempt because its program “is not designed to provide relief to the poor or to carry out any other charitable purpose.”).

pluralism-enhancing nature of such enterprises.¹² Organizations that provide expanded access to services for those unable to obtain them as a result of economic, geographic, or other constraints enhance the pluralism objective; exemption becomes the reward for doing so. The access criterion also fits nicely with the major economic explanations for exemption, which posit that exemption helps overcome an undersupply of services at the intersection of private-market failure and government failure.¹³ Moreover, making access a central theme of exemption would force organizations to explain their mission in access terms—a process that in and of itself could help focus such organizations on why they differ from for-profit counterparts and what they should do to highlight that difference.

This Article makes the case for using access as the central criterion for exemption in these cases in four subsequent parts. Part II reviews how IRS rulings and court decisions in the healthcare area already contain access-based language and concepts. Part III expands the analysis of Part II to other cases in which exempt organizations arguably do things similar to for-profit counterparts such as community-development organizations, public-interest law firms, and certain kinds of “arts” organizations. Part IV then presents the policy case for using access as a primary criterion for judging exemption by arguing that the criterion is consistent with both economic and sociological explanations for exemption and the existence of nonprofit organizations.

Part V explores the practicalities of an access-based test by developing in more detail the doctrinal implementation of such a test and analyzing how using access as a primary exemption criterion would affect the analysis of exempt status for a variety of organizations that arguably compete with for-profit providers of similar services. Again this part focuses heavily on health care organizations, but also applies an access criterion to organizations outside the health sector. The Article concludes that using “enhancing access” as a primary criterion for exempt status would simplify current doctrine, would still be consistent with theoretical underpinnings of exemption, and would help provide a focus point for the mission of nonprofit organizations that provide commercial-type services.

12. See *infra* notes 84–90 and accompanying text.

13. See *infra* notes 91–95 and accompanying text.

II. ACCESS IN HEALTH CARE TAX EXEMPTION

A. Access and the Basic Community-Benefit Standard

Prior to 1969, a hospital could qualify for charitable tax exemption under I.R.C. § 501(c)(3) only if it operated “to the extent of its financial ability” to provide services to individuals unable to pay for them.¹⁴ Although this “charity-care” standard¹⁵ was grounded in IRS regulations defining “charitable” for tax exemption purposes to include “relief of the poor,”¹⁶ in a broader sense the charity-care standard itself reflected an underlying policy of providing access to health services for a particular group, the indigent, that otherwise did not have access to such services.

In 1969, however, the IRS adopted a rule providing alternate standard for exempting health care providers. In what has become known as the “community-benefit” standard for exemption,¹⁷ the IRS in Rev. Rul. 69-545 held that a nonprofit hospital could qualify for charitable tax exemption by providing health services for the general benefit of the community even though the hospital limited services to patients who could pay.¹⁸ As noted below,¹⁹ the problems with this community-benefit formulation have been legendary. Standing alone, the test offers little guidance to distinguish “charitable” health care providers from non-charitable ones; after all, even for-profit hospitals treat all patients in the community who can afford to pay.

But there is a different way to look at the purported adoption of the community-benefit test in the 1969 ruling. Although the ruling never mentions the word “access,” and does not explicitly make access a central criterion of exemption, a close reading of this ruling indicates that access is, in fact, the common theme underlying the Service’s position. For

14. Rev. Rul. 56-185, 1956-1 C.B. 202. See generally JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS, CASES & MATERIALS* 384–85 (2d ed. 2000) [hereinafter FISHMAN & SCHWARZ, *NONPROFIT ORGS.*]; THOMAS K. HYATT & BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT HEALTHCARE ORGANIZATIONS* 15, 529–32 (2d ed. 2001); DOUGLAS M. MANCINO, *TAXATION OF HOSPITALS AND HEALTH CARE ORGANIZATIONS* § 2.04[2][b] (2001); Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 320 (1991).

15. Grounding exemption for healthcare providers on free care for those unable to pay has become known as the “charity-care” standard. See HYATT & HOPKINS, *supra* note 14, at 15, 530–31.

16. Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990).

17. See FISHMAN & SCHWARZ, *NONPROFIT ORGS.*, *supra* note 14, at 384; HYATT & HOPKINS, *supra* note 14, at 532.

18. Rev. Rul. 69-545, 1969-2 C.B. 117.

19. See *infra* text accompanying notes 99–103. For an extended critique of the community benefit test of exemption see COLOMBO & HALL, *supra* note 2, at 63–82 and sources cited therein.

example, in the ruling the IRS stressed four factors that distinguished an exempt hospital from a non-exempt one. These four factors were (1) a community board, (2) the operation of an emergency room open even to indigent patients, (3) an open-staff policy, and (4) treatment of Medicare/Medicaid patients.²⁰ All four of these factors could be viewed as related to access. A community board, for example, would help ensure that a hospital did not ignore the health care needs of large segments of the community and provide access to services for the community as a whole. Similarly, a requirement of an open staff would keep a hospital open to patients of all qualified physicians ensuring broad community access to the hospital's services. The requirement of an open emergency room that would treat even indigent patients is, of course, directly access-related because it ensures that primary emergency care is available to all members of the community. Finally, the treatment of Medicaid patients would ensure access by a large group of the poor via a government-reimbursement program.

In fact, there is some evidence in the history of Rev. Rul. 69-545 that these four criteria were intentionally chosen to reflect underlying concerns regarding access to medical care. The ruling was authored by Robert Bromberg, at the time a young staff attorney in the IRS, who believed that enactment of the Medicare and Medicaid programs in the late 1960s had made the charity-care standard for hospital tax exemption an anachronism.²¹ In this light, one could view the factors listed in Rev. Rul. 69-545, particularly the factors relating to an open emergency room and treatment of Medicare/Medicaid patients, as Bromberg's reformulation of an access-based-exemption standard borne of the notion that the prior access-based standard (charity care) would no longer serve its purpose.²²

20. Rev. Rul. 69-545, 1969-2 C.B. 117.

21. Daniel M. Fox & Daniel C. Schaffer, *Tax Administration as Health Policy: Hospitals, The Internal Revenue Service, and the Courts*, 16 J. HEALTH POL., POL'Y & L. 251, 269-70 (1991).

22. Fox and Schaffer stated:

Bromberg recalls that officials at "other agencies" had convinced him that hospitals would only care for the poor if they participated in Medicare and Medicaid.

.....

... Bromberg concluded that existing tax law, with its requirement of free or below-cost care, was obsolete. . . . [B]ecause he had learned from his reading and interviews that increasing numbers of patients enter hospitals through emergency rooms, [Bromberg] "put into the ruling the requirement of admission to the hospital's emergency room without regard to ability to pay."

Id. at 261-62; See also Robert Bromberg, *Charity and Change: Current Problems of Tax-Exempt Health and Welfare Organizations in Perspective*, in TAX PROBLEMS OF NON-PROFIT ORGANIZATIONS 249 (G. Webster & J. Lehrfield eds., 1970).

Indeed, as an attorney representing the American Hospital Association some years later, Bromberg crafted and filed a brief in the *Eastern Kentucky Welfare Rights* case²³ taking the position that the 1969 ruling made treatment of Medicaid patients a requirement in order to replace the outmoded charity-care standard with a more effective access mechanism. Moreover, even the D.C. Circuit seemed to adopt the view that the new ruling would impose a more effective access requirement than the old charity-care standard by stating “in the final analysis, Revenue Ruling 69-545 may be of greater benefit to the poor than its predecessor.”²⁴ Thus, it is not much of a stretch to conclude that Rev. Rul. 69-545 embodies access to health services as the central core of its rationale. This conclusion, moreover, is buttressed by subsequent IRS rulings that recognized that hospitals providing specialized treatment could be exempt—even without an open emergency room—as long as they provided their specialized services for the general benefit of the community²⁵ (e.g., provided *access* to such services by the general community).

B. Access in Other Health Care Rulings

Rev. Rul. 69-545 is hardly the only IRS ruling on exemption for health care providers that contains overtones of access as a central criterion for exemption. By the early 1990s, for example, the IRS was facing a dramatically different health care landscape than it had in 1969. A strong trend toward vertical integration in health care delivery systems and in managed care raised issues regarding the exempt status of the parent-holding companies of “integrated delivery systems” (“IDS”s), health maintenance organizations (“HMO”s), and joint-venture arrangements between hospitals and their staff doctors.²⁶ Physician recruitment incentives became a major issue as rival integrated networks competed for the best doctors in their service areas or attempted to lure physicians from

23. *E. Ky. Welfare Rights Org. v. Simon*, 426 U.S. 26 (1976), *rev'g* 506 F.2d 1278 (D.C. Cir. 1970), *rev'g* 370 F. Supp. 325 (D. D.C. 1973). The plaintiffs in *Eastern Kentucky* were individuals who claimed that they had been refused treatment by tax-exempt hospitals for lack of ability to pay. *Id.* at 26. They sued the IRS to overrule Rev. Rul. 69-545 and reimpose a charity-care requirement for tax exemption. *Id.* at 33. The plaintiffs won at the district level; before the D.C. Circuit, Bromberg submitted an amicus brief on behalf of the American Hospital Association that claimed that the 1969 ruling *required* an open emergency room and treatment of Medicaid patients as a condition of exemption. The court of appeals overruled the district court decision, but the Supreme Court dismissed the case for lack of standing. *Id.* at 26.

24. *Simon*, 506 F.2d at 1289.

25. Rev. Rul. 83-157, 1983-2 C.B. 94, 95.

26. John D. Colombo, *Health Care Reform and Federal Tax Exemption: Rethinking the Issues*, 29 WAKE FOREST L. REV. 215, 228-40 (1994).

other locations to improve patient admissions and provide adequate service coverage.²⁷ Although the IRS responded to these changes by attempting to apply the basic tests of Rev. Rul. 69-545, as the discussion below sets forth, many of the rulings on health care exemption throughout the 1990s reflect concerns about access on two planes: access by traditionally underserved populations to general health care services and access by the general population to specific services or procedures that may otherwise have been unavailable.

In the area of IDSs and HMOs, for example, the IRS rulings all have an access-oriented flavor. The first of the IDS rulings, involving Friendly Hills Healthcare Network, focused almost exclusively on access-related-operational characteristics to support exemption.²⁸ These characteristics included many of the same themes in Rev. Rul. 69-545: an open emergency room providing emergency care even for those unable to pay, a community board, an open medical staff and treatment of Medicaid patients. The language used by the IRS in this ruling, however, is remarkably forthright in its access orientation. Thus, in discussing the requirements for exemption, the IRS noted in the ruling that an open medical staff would “make [the organization’s] services *as readily accessible to the community as possible*.”²⁹ Similarly, in discussing Friendly Hills’ Medicaid participation, the IRS stressed the organization’s participation in these programs “in a nondiscriminatory manner” making available “to Medicare and Medi-Cal beneficiaries all primary, specialty, and diagnostic care made available to other patients.”³⁰ The IRS also noted that Friendly Hills would “arrange for adequate physician participation in [its] clinics *to ensure access* to Medicare and Medi-Cal beneficiaries.”³¹

Two subsequent IDS rulings, *Facey Medical Foundation*³² and *Harriman Jones Medical Foundation*,³³ contained similar access-laden language but with a new twist. In each ruling, the IRS emphasized that the exempt foundation had committed to a set amount of charity care (\$400,000 per year for Facey; \$750,000 per year for Harriman).³⁴ The use

27. See, e.g., MANCINO, *supra* note 14, at § 20.01.

28. *Friendly Hills Exemption Ruling*, reprinted in 7 EXEMPT ORG. TAX REV. 490, 490–92 (1993).

29. *Id.* at 491 (emphasis added).

30. *Id.*

31. *Id.* (emphasis added).

32. *Facey Medical Foundation Exemption Ruling*, reprinted in 7 EXEMPT ORG. TAX REV. 828 (1993) [hereinafter, *Facey Ruling*].

33. *Harriman Jones Medical Foundation Exemption Ruling*, reprinted in 9 EXEMPT ORG. TAX REV. 719 (1994) [hereinafter, *Harriman Ruling*].

34. *Facey Ruling*, *supra* note 32, at 830; *Harriman Ruling*, *supra* note 33, at 720.

of charity care as a criterion for exempting Facey and Harriman is curious in light of the IRS having officially jettisoned charity care as a requirement for exemption in Rev. Rul. 69-545. Nevertheless, as indicated below, the renewed emphasis on charity care tracked positions the IRS was taking at the same time in litigation dealing with the exempt status of HMOs, and was a clear signal that access to health services was a major factor in granting exemption.

The renewed emphasis on access displayed in the IDS rulings cited above is mirrored in other healthcare cases and rulings released during the 1990s. At about the same time that the IRS was issuing the first of its IDS rulings, for example, the IRS General Counsel's Office was considering the exemption effects of certain joint-venture arrangements between hospitals and doctors designed to improve patient utilization (and hence profits) in certain outpatient facilities. These "revenue-stream-sale" situations involved a common fact pattern.³⁵ A hospital with an underutilized facility, such as an outpatient surgery facility, would form a partnership with staff doctors. The partnership would then purchase the "revenue stream" from the outpatient facility for its current discounted present value based upon an outside appraisal. This purchase in essence paid the hospital full fair-market value for the current revenue stream produced by the facility. Since doctors now had a direct stake in the financial success of the joint venture, however, the joint-venture arrangement presumably would prod the doctors into referring additional patients to the underused facility—thus generating revenues greater than the current stream. These new revenues, which represented a profit over and above what the joint venture paid for the "old" revenue stream, would then be split between the hospital and doctors in whatever percentage was negotiated.³⁶

After approving several of these transactions in the late 1980s, the IRS undertook a review of these arrangements culminating in a General Counsel's Memorandum issued in 1991 that completely reversed the IRS's

35. For a general overview of the revenue-stream, joint-venture transactions, see HYATT & HOPKINS, *supra* note 14, at 82–83; MANCINO, *supra* note 14, at ¶ 19.04[3].

36. Because the going venture had purchased the "old" revenue stream at fair market value, the only scenario in which the venture would be profitable would be for the post-sale revenues to exceed the purchase price of the "old" revenue stream. In this scenario, the net profit above what the joint venture had to pay for the "old" revenue stream would be shared according to the terms of the joint venture. In one of the transactions reviewed, for example, the hospital retained 51% of the ownership of the joint venture, with 49% being offered for sale to individual medical staff. See MANCINO, *supra* note 14, at ¶ 19.04[3].

position.³⁷ While the General Counsel's Memorandum opined that these arrangements violated both the private inurement and private-benefit proscriptions of tax exemption,³⁸ one of the most interesting aspects of the Memorandum is its suggestion that certain kinds of joint-venture arrangements between doctors and hospitals would still pass exemption muster. These joint ventures included those that would establish a new health care provider, service or resource made available to the community, or that would measurably improve service levels or quality of service provided to the community.³⁹ In other words, joint ventures that were based upon *expanding access* to health services would still be approved; joint ventures that did nothing but realign the economic incentives and sharing for *existing* services, however, would not be approved.

A similar access-based theme occurred in court cases dealing with the application of the unrelated business income tax ("UBIT") to certain health services provided by hospitals. Though the general position of the IRS has been that the UBIT applies to certain health services (such as pharmaceutical sales or diagnostic tests) provided by a hospital to the non-patient general public,⁴⁰ the IRS later recognized that when the hospital was the sole provider of such services in a geographic area the UBIT

37. Gen. Couns. Mem. 39,862 (Nov. 22, 1991).

38. One of the requirements of exempt status stated in § 501(c)(3) is that "no part of the earnings [of the organization] inure to the benefit of any private shareholder or individual." I.R.C. § 501(c)(3) (2000). The "no inurement" prohibition has been interpreted to mean that an exempt organization cannot "siphon off" the economic benefits of exemption to insiders by, for example, paying excessive salaries or providing below-market loans to such insiders. See FRANCES R. HILL & DOUGLAS M. MANCINO, *TAXATION OF EXEMPT ORGANIZATIONS* ¶ 4.03 (2002); *United Cancer Council v. Comm'r*, 165 F.3d 1173, 1176 (7th Cir. 1999). The private-benefit limitation is more complex; at common law it referred to the fact that a "charity" must serve a large charitable class, not a single individual or even an identifiable small group of individuals. Recent IRS interpretations of private benefit, however, have expanded the doctrine beyond its common law roots into a broad limitation on how much benefit an exempt organization can confer on a small, identifiable group of individuals even if those individuals are not "insiders" and even if the benefits arguably are at arms length. Thus the issue of private benefit often arises in joint-venture arrangements between a hospital and a group of doctors, for example. See generally HYATT & HOPKINS, *supra* note 14, at 84–86; MANCINO, *supra* note 14, at 19–18 to 19–19; John D. Colombo, *Private Benefit, Joint Ventures, and the Death of Healthcare as an Exempt Purpose*, 34 J. HEALTH L. 505 (2001).

39. Gen. Couns. Mem. 39,862 (Nov. 22, 1992) ("We recognize that there may well be legitimate purposes for joint ventures, whether analyzed under the anti-kickback statute or the Tax Code. These may include raising needed capital; bringing new services or a new provider to a hospital's community; sharing the risk inherent in a new activity, or pooling diverse areas of expertise."); See generally HILL & MANCINO, *supra* note 38, at ¶ 29.04[3][c]; Colombo, *supra* note 26, at 230.

40. Rev. Rul. 68-374, 1968-2 C.B. 242. See *Carle Found. v. United States*, 611 F.2d 1192 (7th Cir. 1979) (upholding IRS determination that pharmacy sales by Carle Hospital to general public constituted unrelated income). See generally HYATT & HOPKINS, *supra* note 14, at 447–52; MANCINO, *supra* note 14, at 15–33 to 15–40.

would not apply.⁴¹ The UBIT is designed to tax business income from an exempt entity when the income results from an activity unrelated to the entity's charitable purpose. Therefore, the recognition by the courts and IRS that the UBIT will not apply when a hospital is providing services otherwise unavailable to the general public is an acknowledgement of the charitable nature of providing such services in those circumstances, and is further support for the notion that enhancing access is a major component of exemption analysis.

A final major ruling by the IRS in the health care arena that appears to incorporate access concerns physician recruitment by hospitals and other exempt providers. Physician recruitment incentives such as free office space, payments for malpractice insurance coverage, and so forth, have long been exemption problems.⁴² Viewed in isolation, these incentives could violate the proscription in § 501(c)(3) that “no part of the net earnings [of an exempt organization] . . . [may] inure to the benefit of any private individual or shareholder”⁴³—that is, recruitment incentives could be viewed as improperly “siphoning off” the economic benefits of exemption to a private party instead of dedicating those benefits to a broad charitable class.⁴⁴

After some twenty-five years of sporadic consideration of physician recruitment, the IRS addressed the issue comprehensively in Rev. Rul. 97-21.⁴⁵ The ruling considered five different recruitment cases; four of these were considered consistent with exempt status. While the details of the four approved situations differed in many respects, all four carried one common element: the recruiting hospital demonstrated a need to recruit the physician in order to provide previously-unavailable services to the community, or to maintain the quality of existing services. Thus in Situation 1, a community hospital in a rural area with no other hospitals recruited a doctor to establish an OB/GYN practice in the geographic area where none existed. In Situation 2, an inner-city hospital recruited a doctor to establish a private pediatrics practice in the area. In Situation 3, an

41. Rev. Rul. 85-110, 1985-2 C.B. 166 (indicating that laboratory testing services performed for non-patients ordinarily would be subject to UBIT, but UBIT would not apply “if other laboratories are not available within a reasonable distance from the area served by the hospital or are clearly unable or inadequate to conduct tests needed by nonpatients.”).

42. For a general discussion of physician recruitment tools and an historical overview of the IRS's positions on physician recruitment, see HYATT & HOPKINS, *supra* note 14, at 490-99; MANCINO, *supra* note 14, at ¶ 20.03.

43. I.R.C. § 501(c)(3) (2000).

44. See generally HYATT & HOPKINS, *supra* note 14, at 485-90; MANCINO, *supra* note 14, § 20.02[3].

45. Rev. Rul. 97-21, 1997-1 C.B. 121.

inner-city hospital offered incentives to a doctor already on staff to expand an existing obstetrics practice to treat more Medicaid and indigent patients. In Situation 4, a private hospital in a metropolitan area recruited a diagnostic radiologist in order to provide adequate service coverage and quality for its radiology department. In short, all four of the situations in which the IRS approved recruitment incentives keyed on access to services as a major exemption criterion.

C. Mixed Signals on Access: Federation Pharmacy Services and the HMO Cases

While the above analysis indicates that most of the major IRS rulings in the health care sector carry heavy overtones of access as the primary criterion for judging exempt status, at least one health care precedent arguably contradicts an access-based model, and IRS litigating positions on HMO exemption appear to both support and contradict an access test. With respect to the former, in *Federation Pharmacy Services, Inc. v. Commissioner*,⁴⁶ the IRS denied exemption to a pharmacy that sold drugs and medical supplies to the poor and elderly at cost. The IRS's view, affirmed by the Eighth Circuit, was that a pharmacy was an inherently commercial enterprise and therefore could not be "charitable."⁴⁷ The Eighth Circuit also focused on the fact that the pharmacy did not offer free drugs to the poor or sell below cost to deserving populations—that is, the pharmacy in question was not giving away any services.⁴⁸ But this analysis obviously contradicts Rev. Rul. 69-545 and the analysis of exemption for hospitals: nonprofit hospitals are also "inherently commercial" in the sense that their primary purpose is to provide health services for a fee and that their overall operations are designed to produce a financial surplus. More importantly for the thesis of this Article, one could certainly argue that the whole purpose of Federation Pharmacy Services was to increase access to

46. *Fed'n Pharmacy Services, Inc. v. Comm'r*, 625 F.2d 804 (8th Cir. 1980), *aff'g*, 72 T.C. 687 (1979).

47. *Fed'n Pharmacy Services, Inc. v. Comm'r*, 72 T.C. 687, 690 (1980). The Tax Court explained the Commissioner's position:

In this respect, respondent's [IRS] ruling states in pertinent part: "The sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for profit. Sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose."

Id.

48. *Fed'n Pharmacy Services*, 625 F.2d at 807 ("An organization which does not extend some of its benefits to individuals financially unable to make the required payments reflects a commercial activity rather than a charitable one.").

pharmaceuticals and medical equipment for a population (the poor and elderly) that historically has had insufficient access to health care. The record in the case, for example, showed that the organization had been formed by a senior-citizens organization in Minneapolis-St. Paul only after arrangements with for-profit pharmacies to offer drugs at a substantial discount to the elderly fell through.⁴⁹ Accordingly, the result in *Federation Pharmacy* appears to be generally at odds with an access-oriented test of exemption.

The IRS positions and court opinions on the exempt status of HMOs, on the other hand, illustrate both sides of access-as-an-exemption criterion. Though an early case had held that a staff-model HMO that provided services similar to a general-acute-care hospital would be tax exempt, the IRS continued to litigate exempt status for “contract-model” HMO’s.⁵⁰ In the early 1990s, for example, the IRS challenged the exempt status of Geisinger Health Plan (“GHP”)⁵¹ an HMO formed by a large integrated delivery system (the Geisinger System) to enhance health care delivery to its service area, mostly rural north-eastern and north-central Pennsylvania.⁵² Although GHP had an open enrollment policy, at the time of the litigation GHP did not enroll any Medicaid recipients because it had not yet negotiated the necessary contracts with the Pennsylvania Department of Public Welfare.⁵³ GHP also had adopted a subsidized dues

49. *Id.* at 805; *accord* 72 T.C. at 700 (Tietjens, J., dissenting). For further analysis of the *Federation Pharmacy* case under an access-based test, see *infra* text accompanying notes 125–30.

50. *Sound Health Ass’n v. Comm’r*, 71 T.C. 158 (1978). I use the phrase “contract model” to refer to a structure in which the HMO does not actually employ health care professionals like doctors directly or own health care facilities; instead, the HMO contracts with doctors and hospitals to provide these services to its members. Other commentators have referred to this model as an “IPA” model, or, when contracts are executed with sibling members of an integrated network, a “group” model. *See, e.g.*, HYATT & HOPKINS, *supra* note 14, at 185–92; BARRY R. FURROW ET AL., *HEALTH LAW* 54 (2d ed. 2000). An HMO that does employ its own doctors and service professionals is often called a “staff” model. HYATT & HOPKINS, *supra* note 14, at 182.

51. The *Geisinger* litigation consisted of two major rounds. The initial challenge to tax-exempt status was rejected by the Tax Court in *Geisinger Health Plan v. Commissioner* (Geisinger I), 62 T.C.M. (CCH) 1656 (1991). The IRS appealed this decision to the Third Circuit, which reversed the Tax Court on the exemption issue. *Geisinger Health Plan v. Comm’r*, 985 F.2d 1210 (3d Cir. 1993). GHP, however, had argued in this initial round of litigation that if it failed exemption as a stand-alone entity, it nevertheless was entitled to exemption as an “integral part” of an exempt integrated health care system. This issue was remanded by the Third Circuit to the Tax Court, which held in the second round of litigation that GHP was not entitled to this derivative exemption. *Geisinger Health Plan v. Comm’r* (Geisinger II), 100 T.C. 394 (1993). The Tax Court’s opinion in Geisinger II was upheld by the Third Circuit on appeal. *Geisinger Health Plan v. Comm’r*, 30 F.3d 494 (3d Cir. 1994).

52. *Geisinger I*, 62 T.C.M. (CCH) at 1656.

53. *Id.* at 1659–60.

program for indigent families in its service area, but had not implemented that program as of the date of litigation because of financial constraints.⁵⁴

GHP's argument for exemption was that it promoted health for the general benefit of the community pursuant to the test laid out in Rev. Rul. 69-545. The IRS's arguments, on the other hand, reflected broad access-based themes. The IRS relied on two main points in attacking exemption for GHP. The first was that GHP improperly limited its membership to health patients who could afford its enrollment fees, citing the HMO's lack of Medicaid service and virtual lack of charity care.⁵⁵ Second, the IRS claimed that there was a significant difference between a "staff" model HMO, in which the provider actually employed health professionals and operated health care facilities, and a "contract" HMO (like GHP) in which the HMO did not operate any health facilities directly and all health services were provided by contracts with third parties.⁵⁶ Both these positions fairly could be summarized as reflecting a conclusion that GHP did nothing to enhance access to health services beyond what was already available from other sources in the area: providing contractual health services for folks who can already pay for services does not enhance access by underserved groups, and providing services by contract with providers that already exist brings nothing new to the table in the way of expanded services. These positions, moreover, were upheld by the Third Circuit on appeal, which reversed the Tax Court's earlier grant of exemption.⁵⁷ Like the IRS, the Third Circuit appeared swayed by the fact that GHP brought little to the health services table that did not already exist, particularly in the area of charity care and service to Medicaid patients.⁵⁸

54. *Id.* at 1660.

55. *Geisinger*, 985 F.2d at 1219.

56. *Geisinger I*, 62 T.C.M. (CCH) at 1663.

57. *Geisinger*, 985 F.2d at 1210.

58. The Third Circuit stated:

Viewed in this light, GHP standing alone does not merit tax-exempt status . . . GHP cannot say that it provides any health care services itself. Nor does it ensure that people who are not GHP subscribers have access to health care or information about health care . . . [I]t neither conducts research nor offers educational programs, much less educational programs open to the public.

Id. at 1219. More recently, the Tax Court and Tenth Circuit upheld the IRS's denial of exemption to HMOs operated as part of the Intermountain Health Care integrated system on similar grounds:

In this case, we deal with organizations that do not provide health-care services directly. . . . Where, as here, "it is difficult to distinguish the plaintiff corporation from a mutual insurance company," we must carefully scrutinize the organization's operation. The fact that an activity is normally undertaken by commercial for-profit entities does not necessarily preclude tax exemption, particularly where the entity offers its services at or below-cost. But petitioners

Unfortunately, *Geisinger* also is a perfect illustration of why the failure to focus on access as an explicit exemption criterion creates some problems. Both the Tax Court and the Third Circuit noted in their opinions that GHP had been formed by the Geisinger System primarily to enhance access to medical services in areas that were underserved.⁵⁹ Despite statistics in the Tax Court's opinion showing that 23% of GHP's subscribers resided in medically-underserved areas and 65% resided in counties containing medically-underserved areas,⁶⁰ neither the IRS nor the Third Circuit paid much attention to this aspect of access as a case for exemption. Accordingly, while there are certainly access-based themes in the IRS positions in *Geisinger*, the failure to explicitly recognize access as an independent criterion that supports exemption meant that neither the IRS nor the courts seriously analyzed whether serving otherwise-underserved populations constituted sufficient grounds for exemption.

Nevertheless, the IRS has continued its attack on contract-model HMOs using virtually the same arguments as in *Geisinger*. The agency's most recent success in *IHC Health Plans, Inc. v. Commissioner*,⁶¹ continued to reflect the themes that contract-model HMOs without significant charity-care programs failed to bring anything "extra" to the table in providing health services; and the Tenth Circuit, like the Third before it, has agreed with these points.⁶² Access themes, therefore, remain a key component of the analysis of exempt status for HMOs, though (again like the Third Circuit before it) the Tenth Circuit in *IHC Health Plans* failed to recognize access as an explicit exemption criterion.

provide virtually no free or below-cost health-care services . . . Further, the fact that petitioners in no way subsidize dues for those who cannot afford subscribership distinguishes this case from the HMOs in *Sound Health Ass'n v. C.I.R.*, 71 T.C. 158 (1979), and *Geisinger I*, 985 F.2d at 1219.

IHC Health Plans, Inc. v. Comm'r, 325 F.3d 1188, 1199–1200 (10th Cir. 2003) (citations and footnotes omitted).

59. *Id.* at 1212; *Geisinger I*, 62 T.C.M. (CCH) at 1659.

60. *Geisinger I*, 62 T.C.M. (CCH) at 1659.

61. *IHC Health Plans, Inc. v. Comm'r*, 325 F.3d 1188 (10th Cir. 2003).

62. The IHC cases dealt with the exempt status of three HMO corporate subsidiaries of Intermountain Health Care, Inc. In each case, the IRS ruled that the subsidiaries were not exempt, and in each case the Tax Court agreed, citing particularly the fact that the HMOs in question did not provide free care or a subsidized dues program for the needy, provide free education programs, or do medical research. *See, e.g.*, *IHC Health Plans v. Comm'r*, 82 T.C.M. (CCH) 593, 605 (2001); *IHC Group, Inc. v. Comm'r* 82 T.C.M. (CCH) 606, 615 (2001); *IHC Care, Inc. v. Comm'r*, 82 T.C.M. (CCH) 617, 625 (2001). On appeal, the 10th Circuit upheld the denial of exemption on essentially the same grounds: that the HMOs in question offered no charity care or subsidized dues programs, did not do significant medical research, nor offer free education programs. *IHC Health Plans, Inc. v. Comm'r*, 325 F.3d 1188, 1199–1203 (10th Cir. 2003). In short, the HMO's really did nothing that might be considered as enhancing access to medical care in their community.

III. ACCESS IN OTHER EXEMPTION RULINGS

While the cases and rulings in the health care arena present perhaps the strongest evidence of an unstated access criterion for exemption, issues of access also crop up in a number of other exemption areas. In this part, I examine IRS positions and cases in three areas in which, like health care organizations, the entities involved arguably perform services that are similar in scope to for-profit providers. Those three areas are arts organizations, such as community theaters or nonprofit art galleries; community-development organizations; and public-interest law firms.

A. Arts Organizations

Just as exempt nonprofit hospitals often co-exist in the same geographic market as for-profit competitors, exempt arts organizations often co-exist with for-profit firms that, at least on the surface, appear to provide similar services. Exempt nonprofit art galleries and community theaters often are found blocks (or feet) from for-profit galleries and theaters. Like their for-profit counterparts, moreover, nonprofit galleries often sell art and nonprofit theaters charge admission. Accordingly, unless we are prepared to accept the proposition that merely adopting nonprofit form is sufficient to justify tax exemption, we must find some core difference in operations to justify exemption for these entities.

The traditional analysis employed by the IRS and courts in these cases has been to focus on whether the activities of the organization in question are imbued with a “commercial hue”; too much of this hue and the activities are no longer charitable, which results in a loss of exempt status.⁶³ Like the community-benefit analysis employed in the health care field, the “commercial-hue” formulation provides little concrete guidance for deciding cases. For example, the Tax Court has emphasized the presence of substantial profits, use of commercial-pricing methods, and direct competition with for-profit firms as the key indicia of impermissible commercial hue;⁶⁴ but the Third Circuit noted in a famous case that “success in terms of audience reached and influence exerted, in and of itself, should not jeopardize the tax-exempt status of organizations which remain true to their stated goals.”⁶⁵

63. See, e.g., *Living Faith, Inc. v. Comm’r*, 950 F.2d 365, 373–76 (7th Cir. 1991); *Presbyterian & Reformed Publ’g v. Comm’r*, 79 T.C. 1070, 1083 (1982), *rev’d*, 743 F.2d 148 (3d Cir. 1984).

64. *Presbyterian & Reformed Publ’g v. Comm’r*, 79 T.C. at 1083–85.

65. *Presbyterian & Reformed Publ’g v. Comm’r*, 743 F.2d at 158.

As with health care providers, however, a close reading of the actual analysis employed to decide the cases has a decidedly access-based flavor. In *Goldsboro Art League v. Commissioner*,⁶⁶ the IRS challenged the exempt status of a nonprofit organization that operated two public art galleries and made sales from each. The IRS argued that Goldsboro essentially did nothing different from a commercial art gallery and therefore was not entitled to exempt status. However, the Tax Court disagreed:

In the instant case, since there are no other art museums or galleries in the area, petitioner has found difficulty attracting artists to exhibit their work without the incentive of the Art Gallery and Art Market. Petitioner has a jury to select which works will be displayed, and we find it significant that the works are chosen not for their salability but for their representation of modern trends. Exhibiting an artist's more daring works in a part of the country where there are no nearby art museums or galleries illustrates that petitioner's purpose is primarily to educate rather than to sell.⁶⁷

In short, the Tax Court appeared to focus on the fact that the two art galleries provided increased access to art for the community on two fronts. First, since there were no other galleries in the community, the galleries played a critical role in providing access by the community to the works of artists. This observation tracks precedents in the health care area cited above in which the IRS and courts have held that providing a community with health services that previously were unavailable in the private market is a key factor in assessing exempt status for joint-venture transactions and in applying the UBIT.⁶⁸ Second, the works exhibited were chosen as the best representations of their styles—that is, they were chosen on the basis of giving the public better access to particular artistic genres and not for commercial potential.

These same access themes of providing the public access to artistic works that otherwise would not be available in the private market also surfaced in *Plumstead Theater Society v. Commissioner*,⁶⁹ a decision most often cited for its analysis of the effects of joint-venture participations on exempt status. In *Plumstead*, the IRS argued that a nonprofit community theater's decision to enter into a joint venture with for-profit investors to

66. *Goldsboro Art League v. Comm'r*, 75 T.C. 337 (1980).

67. *Id.* at 344.

68. *See supra* text accompanying notes 37–41.

69. *Plumstead Theater Soc'y v. Comm'r*, 74 T.C. 1324 (1980).

fund a commercial play (*First Monday in October*) was inconsistent with exempt status. In rejecting the IRS's challenge, the Tax Court again analyzed how exempt community theaters differed from their commercial counterparts, even though both charged admission:

Commercial theaters . . . choose plays having the greatest mass audience appeal. Generally, they run the plays so long as they can attract a crowd . . . [and] do not encourage and instruct relatively unknown playwrights and actors. . . . Tax-exempt organizations . . . fulfill their artistic and community obligations by focusing on the highest possible standards of performance; . . . by developing new and original works; and by providing . . . opportunities for new talent. Thus, they keep the great classics of the theater alive and are willing to experiment with new forms of dramatic writing, acting, and staging.⁷⁰

The court also noted that, unlike their commercial counterparts, community theaters “keep ticket prices at a level which is affordable to most of the community.”⁷¹

Like the analysis in *Goldsboro*, this summary of the essential differences between for-profit and exempt theaters focuses on issues of access. Admission prices are purposefully kept below costs in order to maximize the accessibility of the production to the community; the works performed, like the art displayed in *Goldsboro*, are chosen not for their commercial potential, but to give the community access to both the new and the old and expose the community to “new forms of writing, acting and staging” as well as new talent.⁷² In short, in each case the organization involved could claim on the facts that its mission was oriented toward providing increased community access to artistic works that otherwise would have been unavailable to the community—and not toward commercial exploitation of art. Although not couched specifically as an access-based test, the concepts explored by the Tax Court in both these cases support the “enhancing access” criterion as the touchstone of exemption.

70. *Id.* at 1332–33.

71. *Id.* at 1333.

72. *Id.*

B. Community-Development Organizations

Another area of “commercial similarity” occurs with respect to organizations formed to foster community development or housing projects. Typical activities of the community-development organizations are providing capital to businesses willing to locate in low-income areas either through low-interest loans or the outright purchase of equity interests in the business.⁷³ Housing projects typically involve the renovation or construction of housing resold to low and moderate income families at subsidized rates.⁷⁴ As is the case with the other organizations discussed so far, these services have analogs in the commercial for-profit world. Making loans and arranging equity financing are usually the bailiwick of banks and investment bankers; housing projects are created by for-profit real estate developers. So how do these community-redevelopment organizations differ from their commercial counterparts?

Again, although the rulings do not specifically employ access analysis, enhancing access is the key criterion. In discussing exemption for a community-development organization, the IRS stressed in Rev. Rul. 74-587 that the organization would loan funds and provide equity financing “to corporations or individual proprietors who are not able to obtain funds from conventional-commercial sources.”⁷⁵ In that same ruling the IRS also noted that in dispensing funds, “[p]reference is given to businesses that will provide training and employment opportunities for the unemployed or under-employed residents of the area.”⁷⁶ Both of these statements are access-oriented. Exemption is available to a community-development organization despite the commercial similarity of its services because those services are specifically directed at enhancing access—that is, providing access to monetary assistance for businesses that otherwise would not have access to those services or funds and providing access for members of the community to employment opportunities/training that otherwise would be unavailable.

Similar themes underlie the housing development area. Although providing housing for the poor would qualify for exemption under traditional “relief of the poor” concepts, the IRS has extended exemption to organizations that provide moderate income housing under access-

73. See Rev. Rul. 74-587, 1974-2 C.B. 162.

74. See Rev. Rul. 70-585, 1970-2 C.B. 115.

75. Rev. Rul. 74-587, 1974-2 C.B. 162.

76. *Id.* at 163.

oriented circumstances.⁷⁷ Thus in Rev. Rul. 70-585, the IRS found that providing access to housing for moderate-income families who could not otherwise acquire it either because of racial discrimination or general community deterioration constituted qualifying exempt purposes.⁷⁸

As with health care, however, the failure to focus on access as the central criterion of exemption results in some arguably contradictory results. For example, in the same housing ruling cited above, the IRS found that a group formed to provide moderate-income housing in a high-income neighborhood for those who could not generally afford the high housing costs in that neighborhood would *not* be an exempt purpose.⁷⁹ That is, the ruling focused on the role of discrimination rather than the role of access in determining exempt status. As discussed below, had access been the controlling criterion for exemption, the result might well have been different.

C. Public-Interest Law Firms

Traditional “legal aid” services for the poor have long been recognized as tax-exempt because they limit their services to individuals who cannot afford legal representation.⁸⁰ But the IRS has also granted exemption to “public-interest” law firms that do not serve the poor. In fact, many of the lawsuits brought by such law firms are “class actions in the public interest, suits for injunction against action by government[,] . . . similar representation before administrative boards and agencies, test suits where the private interest is small, and the like.”⁸¹ Similarly, in Revenue Ruling 75-74 the IRS commented that “charitability rests not upon the particular positions advocated by the firm, but upon the provision of a facility for the resolution of issues of broad public importance.”⁸²

As in the other cases examined above, the legal services provided by public-interest law firms have commercial counterparts. For-profit law firms often litigate major class-action suits that can be characterized as “in the public interest”—witness the class actions over asbestos exposure, the Dalkon Shield, and the recent tobacco litigation, just to name a few. But just as in the areas previously discussed, the factors used by the IRS in

77. Rev. Rul. 70-585, 1970-2 C.B. 115.

78. *Id.* at 116.

79. *Id.*

80. *See* Rev. Rul. 69-161, 1969-1 C.B. 149; *see also* Rev. Rul. 78-428, 1978-2 C.B. 177 (amplifying Rev. Ru. 69-161).

81. Rev. Proc. 71-39, 1971-2 C.B. 575, 576.

82. Rev. Rul. 75-74, 1975-1 C.B. 152, 153.

determining exemption for public-interest law firms have a distinct access flavor. In further explaining its rationale for granting exempt status to public-interest law firms in Rev. Rul. 75-74 the IRS noted:

It is generally recognized that public interest representation is not ordinarily provided on a continuing basis by private law firms . . . primarily due to the fact that this type of representation is not economically feasible for private firms. In the typical public interest case, no individual plaintiff has a sufficient economic interest to warrant his bearing the cost of retaining private counsel . . . this lack of economic feasibility in public interest cases is an essential characteristic distinguishing the work of public interest law firms from that of private firms and is a prerequisite of charitable recognition.⁸³

The IRS requirement of a lack of economic feasibility for private litigants to pursue public-interest litigation is at its core an access-based concept. True, the access here is not for specific individuals to specific services (as in the cases of exempt health care organizations, exempt arts organizations or community-development organizations) but rather the ability for specific legal positions and ideas to have access to the court system. Without the public-interest-law-firm representation, these particular cases, and the positions they represent, would not have access to legal resolution. This is access of a qualitatively different kind, to be sure, but it is an access concept nonetheless.

IV. THE POLICY CASE FOR ACCESS

The above discussion illustrates that although IRS and court decisions do not specifically analyze exemption on the basis of enhancing access, this concept is in fact a central criterion in many of the decisions and rulings in these areas of commercial similarity. This part of the Article explores the policy case for making “enhancing access” the *explicit* main criterion of exemption in these cases. First, the Article examines how access fits with the major theoretical underpinnings of exemption and then the Article illustrates how making access the central exemption criterion would provide better “mission focus” for nonprofit entities seeking exempt status in areas of commercial similarity.

83. *Id.* at 153.

A. Access and the Theories of Tax Exemption

Over the past two decades, scholars in both law and social sciences have isolated several possible theories for why charitable organizations are tax-exempt. While all of these theories have their unique aspects, they generally break into two very broad groups: the sociological/political theories and the economic theories.⁸⁴ The main unifying theme of the sociological/political theories of exemption is that of pluralism. Thus under these theories, the justification for tax exemption ultimately lies in the fact that nonprofit entities enhance a pluralistic society by bringing to the table points of view and ways of doing things—a special “nonprofit ethic”—that otherwise would not exist. “America needs voluntary, nonprofit groups, not just because of what they do, but because of what

84. The two theories of exemption that do not fit quite as neatly into this dichotomy are the “relief of government burden,” or “quid pro quo” theory, and the Bittker/Rahdert tax-base theory. Both of these theories, however, have been fairly convincingly discredited as an effective explanation for exemption. The “relief of government burden” theory posits that exemption is granted to organizations that perform services that the government otherwise would have to perform in their absence. Thus, exemption is a rough “quid pro quo” to these organizations for relieving government from the necessity to do so (and presumably the necessity to collect tax revenues to do so). This theory, however, simply does not explain the scope of tax exemption. Religious institutions, for example, certainly cannot be characterized as “relieving a government burden” since the government is constitutionally prohibited from promoting religion. Traditional private schools might fit the “quid pro quo” theory since government-funded public schools presumably would incur the educational cost for students attending these private schools, but modern exemption rulings have extended exemption far beyond traditional public education to include zoos, planetariums, continuing legal education and other professional skills training programs, a jazz festival, and various counseling services that quite clearly are not within the realm of services one would expect the government to provide in the absence of the nonprofit sector. *See generally* COLOMBO & HALL, *supra* note 2, at 45–46, 230–31.

The Bittker/Rahdert tax-base theory opines that tax exemption for charitable organizations is the result of the inability of our taxing system to measure income for these organizations. Boris I. Bittker & George F. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 *YALE L.J.* 299 (1976). For example, donations to charitable entities would not be income but rather gifts excluded from gross income under § 102 of the Internal Revenue Code. Similarly, program expenditures by charitable organizations might not be deductible under § 162 because an entity that does not seek to make a profit generally is not considered to be engaged in a trade or business—a requirement of the § 162 deduction. However, many (if not most) charitable organizations derive the bulk of their income from fees for services provided or goods sold; these “commercial” nonprofits (of which hospitals are a primary example) would have little trouble fitting into the traditional tax models. *See generally* COLOMBO & HALL, *supra* note 2, at 24–25. Even poor-relief charities could do so: “Tiffany’s net income available for distribution to its stockholders is arguably different from the Red Cross’s distributions of donations to flood victims, but the two could be made subject to tax with roughly equal convenience.” Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Synthesis*, in *RATIONALES FOR FEDERAL INCOME TAX EXEMPTION* 27 (1991) (consisting of a collection of papers prepared for the 1991 National Center on Philanthropy & the Law’s conference at New York University).

they are, because their very existence is a guarantee of the diversity that protects the freedom of all of us.”⁸⁵

The notion that tax exemption is a government subsidy (or at least a means of non-interference) for organizations that promote the values of a pluralistic society is reflected in a number of court opinions and both traditional and academic theories of exemption. In 1970, the Supreme Court in *Walz v. Tax Commissioner* stated, “[c]ertain entities that exist in a harmonious relationship to the community at large, and that foster its ‘moral or mental improvement,’ should not be inhibited in their activities by property taxation.”⁸⁶ In his concurrence in *Bob Jones University v. United States*, Justice Powell echoed the pluralism theme by criticizing the majority’s characterization of the rationale for exemption as too narrow:

Even more troubling to me is the element of conformity that appears to inform the Court’s analysis. . . . In my opinion, such a view of §501(c)(3) ignores the important role played by tax exemptions in encouraging diverse, indeed often sharply conflicting, activities and viewpoints. As Justice Brennan has observed, private, nonprofit groups receive tax exemptions because “each group contributes to the diversity of association, viewpoint, and enterprise essential to a vigorous, pluralistic society.” Far from representing an effort to reinforce any perceived “common community conscience,” the provision of tax exemptions to nonprofit groups is one indispensable means of limiting the influence of governmental orthodoxy on important areas of community life.⁸⁷

The pluralism rationale also surfaces in some academic theories that have been proposed to explain tax exemption. Peter Swords defended property-tax exemption on pluralistic grounds by recognizing “the

85. Nicholas P. Cafardi, *The Third Sector*, reprinted in NICHOLAS P. CAFARDI & JACLYN FABEAN CHERRY, *TAX EXEMPT ORGANIZATIONS: CASES AND MATERIALS* 90, 92 (2003). Commentators as far back as Alexis DeTocqueville observed that voluntary associations were both endemic to and a unique feature of U.S. society. See 2 ALEXIS DETOCQUEVILLE, *DEMOCRACY IN AMERICA* 106–10 (P. Bradley ed., Alfred A. Knopf 1966) (1835). See also LESTER M. SALAMON, *AMERICA’S NONPROFIT SECTOR: A PRIMER* 14 (2d ed. 1999). Chauncey Belknap, writing on the history of tax exemption for the famous Filer Commission Reports, captured the pluralism rationale by noting that “government relieves from the tax burden religious, educational, and charitable activities because it wishes to encourage them as representing the highest and noblest achievements of mankind.” Chauncey Belknap, *The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy*, in RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS 2025, 2033–35 (U.S. Dept. of the Treasury ed., 1977).

86. *Walz v. Tax Commissioner*, 397 U.S. 664, 672–73 (1970).

87. *Bob Jones Univ. v. United States*, 461 U.S. 574, 609 (Powell, J., concurring) (quoting Justice Brennan’s concurrence in *Walz v. Tax Commissioner*, 397 U.S. 664, 689 (1970)).

advantages of pluralism that flow from having a voluntary sector of charitable organizations.”⁸⁸ Professor Rob Atkinson has opined that exemption is an appropriate way to recognize and encourage altruism in our society—a kind of “metabenefit” resulting from the nonprofit form that should be valued in its own right for its contribution to “what is ultimately good” in society.⁸⁹ More recently, Evelyn Brody explained tax exemption as recognition of the role of a “third sovereign” (the nonprofit sector) in our society. Brody’s theory is that exemption is the federal and state government’s way of recognizing (within limits) the legitimacy of nonprofit organizations and not interfering with their day-to-day operations.⁹⁰ Although Brody does not specifically ground her theory in the pluralism-enhancing function of nonprofits, the sovereignty perspective is consistent with recognizing the pluralistic contributions of charitable organizations.

The economic theories, on the other hand, focus less on the end product—the role of nonprofits in enhancing pluralism—and more on the underlying reasons for the formation and existence of nonprofits. The common theme of these economic theories is that nonprofits form as a result of market failure: both the failure of private markets to produce certain goods and services demanded by a segment of the population and coincident failure of the government to provide these services through its taxing authority.⁹¹ When this twin failure occurs, nonprofit organizations step in to supply a desired service. Exemption for these entities is justified in a number of ways. Henry Hansmann explained exemption as a method to help nonprofit organizations with capital formation, since nonprofits cannot by definition access the public-equity-capital markets.⁹² Nina Crimm takes the position that exemption compensates nonprofits for undertaking entrepreneurial risk, which in the private market ordinarily would be compensated by return-on-investment.⁹³ Exemption provides a

88. PETER SWORDS, CHARITABLE REAL PROPERTY TAX EXEMPTIONS IN NEW YORK STATE 18 (1981).

89. Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 628–30 (1990).

90. Evelyn Brody, *Legal Theories of Tax Exemption: A Sovereignty Perspective*, in PROPERTY TAX EXEMPTION FOR CHARITIES 145, 146 (Evelyn Brody ed., 2002). See also Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585 (1998).

91. See, e.g., SALAMON, *supra* note 85, at 11–13; John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 696–98 (2001). The classic explanation of the market failure hypothesis is in Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980).

92. Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Federal Income Taxation*, 91 YALE L.J. 54 (1981).

93. Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419, 452–54 (1998).

sort of “floor” economic return for organizations providing public goods that otherwise could not hope to make the normal entrepreneurial economic return.⁹⁴ Mark Hall and I suggested that exemption is necessary to overcome the chronic underfunding of nonprofit organizations that results from individuals free-riding on services provided by nonprofits to their charitable beneficiaries.⁹⁵ All three of these theories, however, share the common theme that exemption is a method of providing financial resources to overcome the twin failures that cause nonprofit organizations to step in to fill the service gaps.

The most interesting aspect of a doctrinal test for exemption based upon “enhancing access” is that the access criterion appears to bridge these two broad theoretical categories. Take health care organizations, for example, and assume that exemption required these organizations to prove that they substantially enhanced access to medical services either by providing services to previously-underserved segments of a community or else by providing the general community with specific services that otherwise were unavailable. In either of these situations, the organization meets the pluralism explanation of exemption: the organization in question has brought to the table new services and ways of delivering services that did not exist before, the essence of the pluralistic view of exemption. At the same time, the access criterion meets the economic explanations of exemption. By tying exemption to expansion of services to groups that otherwise were underserved, or to providing services otherwise unavailable to the general public, the organization has stepped in to cover a twin failure since the services were not previously provided either by the government or by the private market.

This same analysis could be applied to the other kinds of “commercial similarity” cases analyzed above. For example, limiting exemption to arts organizations that can prove they are enhancing access satisfies the pluralism criterion by requiring an organization to somehow present an artistic viewpoint to groups that currently do not have access to that viewpoint. At the same time, these groups could be said to suffer from a twin failure in that neither the private market nor the government is providing access to that artistic viewpoint for them. Hence, using “enhancing access” as the chief criterion to award tax exemption in these cases furthers the pluralistic ideal and at the same time satisfies the economic explanations for the exemption.

94. *Id.* at 462.

95. COLOMBO & HALL, *supra* note 2, at 100–13.

B. Using Access to Focus Charitable Mission

A second benefit of an access-based test for exemption in commercial-similarity cases comes in the form of what I will refer to as “mission focus.” One significant problem with nonprofit organizations engaging in commercial activity or providing commercial-like services is the “diversion” problem. As nonprofit managers become more involved with commercial or commercial-like services, a danger exists that the core values of “altruism, pluralism and community”⁹⁶ will erode, and that managers of charitable enterprises will become “equally likely as for-profit managers to cheat the consumer or donor with respect to output characteristics that are not readily observable. In effect, true nonprofits may be turned into ‘for-profits in disguise’ as a result of the managerial selection process.”⁹⁷ Another similar take on this problem is that nonprofit managers will become “empire builders” focused more on competing with for-profit counterparts than on delivering charitable services. “Management’s sense of identity and focus shifts when [commercial] activities are present . . . because of the irresistible attractions of empirebuilding.”⁹⁸

Evidence of this “mission failure” already exists. Professor Burton Weisbrod noted that the reorganization of the National Geographic Society in the late 1990s may have resulted in greater emphasis on profitable activities such as cable television partnerships and documentary films at the expense of field research.⁹⁹ The health care arena, however, may provide the best example of this mission failure. As the Introduction to this Article indicated, empirical studies generally find few differences between the services provided by nonprofit and for-profit entities—including few differences in uncompensated care rates or quality of care.¹⁰⁰ The reasons for this convergence are not difficult to understand. Since the early 1980s both private insurers and the government under Medicare and Medicaid have squeezed reimbursement rates for services to virtually eliminate the possibility that hospitals and other health care providers could use profits generated by reimbursements to these covered patients to subsidize

96. Janne Gallagher, *Peddling Products: The Need to Limit Commercial Behavior by Nonprofit Organizations*, 12 EXEMPT ORG. TAX REV. 1007, 1014 (1995).

97. Estelle James, *Commercialism Among Nonprofits: Objectives, Opportunities and Constraints*, in TO PROFIT OR NOT TO PROFIT, *supra* note 5, at 271, 281.

98. Ellen P. Aprill, *Lessons from the UBIT Debate*, 45 TAX NOTES 1105, 1108 (1989).

99. Burton A. Weisbrod, *Conclusions and Public-Policy Issues: Commercialism and the Road Ahead*, in TO PROFIT OR NOT TO PROFIT, *supra* note 5, at 288, 294.

100. See *supra* text accompanying notes 5–6.

services to the uninsured.¹⁰¹ As a result, both nonprofit and for-profit hospitals have undertaken similar strategies to control costs and entice paying patients to their facilities.¹⁰²

At the same time, the community-benefit formulation of tax exemption under Rev. Rul. 69-545 provided virtually no incentive for exempt health care providers to implement specific, identifiable mission-based differences in services to distinguish themselves from for-profit counterparts.¹⁰³ The problem of identifying specific “community benefits” became so severe that supporters of the nonprofit, exempt hospital industry published a number of articles in the early 1990s warning of the need to quantify these other community benefits to preserve exemption, and trade associations such as the Voluntary Hospitals of America and the Catholic Health Association developed detailed community-benefit assessment and reporting programs.¹⁰⁴ As noted in Part II, above, under Rev. Rul. 69-545 the touchstone of exemption was providing health care services to a broad cross-section of the community—accepting all paying patients, even if indigent patients were excluded. This, of course, is exactly what for-profit hospitals and other providers do.¹⁰⁵ Moreover,

101. See Bloche, *supra* note 5, at 356–57; Sloan, *supra* note 5, at 159–60, 162 (noting that whatever the ability of hospitals to cost-shift in the past, this ability would be seriously limited in the future; “[c]hanges in hospital payment, increased competition, and cuts in the growth of public budgets will reduce provision of [charity] care by all types of hospitals. . .”).

102. See, e.g., David Shactman & Stuart Altman, *The Conversion of Hospitals from Not-for-profit to For-profit Status*, Council on the Economic Impact of Health System Change 18–26 (1996), available at <http://sihp.brandeis.edu/council/> (last viewed Sept. 1, 2004) (“NFP [not-for-profit] hospitals have been forced to act more like their FP counterparts by responding to increased cost and price pressures of managed care purchasers and to stringent financial requirements of capital markets.”); see also Richard G. Frank & David S. Salkever, *Market Forces, Diversification of Activity and the Mission of Not-for-Profit Hospitals*, in *THE CHANGING HOSPITAL INDUSTRY* 195 (David S. Cutler ed., 2000) (detailing nonprofit hospitals’ diversification trends in response to financial pressure).

103. See David A. Hyman, *The Conundrum of Charitability: Reassessing Tax Exemption for Hospitals*, 16 AM. J.L. & MED. 327, 375 (1990) (“However, community benefit is a nebulous concept because it involves many intangible elements Even the most vigorous proponents of community benefit are unable to develop anything more than a thirty-two page checklist which provides no way to judge which factors are most important, or how many positive response are needed. . .”).

104. Bloche, *supra* note 5, at 384 nn.320–22 and sources cited therein. David Seay and Bruce Vladeck have commented:

To some extent . . . the malaise exhibited towards nonprofit health care institutions has appeared in the institutions themselves. . . . This paper identifies a rationale—indeed a series of rationales—for the special role of voluntary, not-for-profit health care institutions.

. . . That every single voluntary institution is not living up to these ideals, however, is obvious.

J. DAVID SEAY & BRUCE C. VLADECK, *UNITED HOSP. FUND OF N.Y.*, *MISSION MATTERS* 8 (1987).

105. See Hyman, *supra* note 103, at 376 (“How then does nonprofit Hospital A [in Rev. Rul. 69-545] differ from the for-profit hospital down the street that does the same thing?”).

many services that nonprofit hospitals pointed to as “community benefits” had commercial potential: outreach programs, for example, such as community education and health screening “may serve marketing and other promotional purposes for hospitals, just as sponsorship of sporting events or the arts does for many for-profit corporations.”¹⁰⁶

In fact, as Part II notes, the resulting inability of the IRS to distinguish exempt health care providers from non-exempt ones under the general holding of Rev. Rul. 69-545 is what gradually led the IRS to require other indicia of “charitableness” when dealing with health care providers other than traditional acute-care hospitals, such as requiring a minimum level of charity care in the early IDS rulings¹⁰⁷ and stressing the lack of charity care in the litigated HMO cases.¹⁰⁸ The resulting test, however, became an amorphous “health services plus” test that required a health care provider seeking exemption to show that it did more than simply provide health care services to paying patients, but failed to define the “more” in any meaningful way.¹⁰⁹

Adopting a test that focused on access, however, would give health care providers and other nonprofit providers of commercially-similar services a well-defined target for delineating mission-based services that distinguish the nonprofit from their for-profit counterparts. Testing exemption against an access criterion obviously would encourage nonprofit providers to focus their mission on providing services to previously-underserved populations or bringing previously-unavailable

106. Bloche, *supra* note 5, at 385.

107. *See supra* text accompanying notes 32–34.

108. *See supra* text accompanying notes 50–61.

109. The Tenth Circuit’s recent statement in the *IHC Health Plans* decision perfectly captures the uncertain nature of the current test for exempting health care providers. In analyzing the current test for exemption, the court noted:

Although providing health-care products or services to all in the community is necessary under those rulings, it is insufficient, standing alone, to qualify for tax exemption under section 501(c)(3). Rather, the organization must provide some additional “plus.” This plus is perhaps best characterized as “a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues.” *Bob Jones Univ.*, 461 U.S. at 591. Concerning the former, the IRS rulings provide a number of examples: providing free or below-cost services, *see* Rev. Rul. 56-185; maintaining an emergency room open to all, regardless of ability to pay, *see* Rev. Rul. 69-545; and devoting surpluses to research, education, and medical training, *see* Rev. Rul. 83-157.

IHC Health Plans, 325 F.3d at 1197–98. In short, the Tenth Circuit recognized that in order to be exempt a health care provider must demonstrate some significant difference in its mission-related services from for-profit counterparts, but found a number of possible items that could fulfill this requirement. An access-based test, on the other hand, would define the “plus” far more precisely as set forth in Part V, below.

services to the general population, thus differentiating them from for-profit firms providing similar services. Providing such a mission-specific target would go a long way towards combating the possibility that nonprofit providers of commercial-like services will become “for-profits in disguise” as their services become ever-more indistinguishable from for-profit counterparts.

V. THE PRACTICALITIES: DOCTRINE AND RESULTS

A. *Forming a Doctrinal Test of “Enhancing Access”*

So far, this Article has laid out the legal and theoretical case for having the IRS formally adopt “enhancing access” as the central criterion for granting exemption in “commercial-similarity” cases. The legal case is based on the argument that access already is the major criterion in exemption decisions in these cases; the IRS simply has not formally recognized it as such. The theoretical case is that an access test bridges the two main theoretical explanations for exemption: the sociological explanation of promoting pluralism and the economic explanation of addressing market failure. The final piece of the argument for adopting an access-based test for exemption is to describe the specific doctrinal criteria that would govern exemption under this approach.

The basic doctrinal test already has been set forth in the discussion in Parts II and III, above. Drawing from the decisions outlined in those parts, an access-based test would require an entity seeking exemption to show that it enhances access either by providing general services (of a type that may be virtually indistinguishable from services provided by for-profit providers) to previously-underserved populations or by showing that it provides services to the general population that were not previously provided by for-profit entities. To again use the health care world as an example, an HMO might seek exemption by bringing general-health services to areas that previously were medically underserved. These services might not look any different from the range of services provided by for-profit HMOs to different populations, but the population served would be different. On the other hand, a specialty-cancer treatment hospital might seek exemption on the basis that it provides unique services to the general population that were otherwise unavailable from for-profit providers.

The objective indicia needed to establish exemption under this broad test fall into two general categories. The first category would be process-based factors. For example, consistent with the observation in Part IV, that

an access-based test can help focus a nonprofit's mission and avoid the slide into a "for-profit in disguise," an entity seeking exemption should have a specific, board-approved, written mission-based plan for how it will enhance access. This plan should spell-out what market or service the nonprofit seeks to provide that the private market has failed to address, and provide specific implementation plans and benchmarks for addressing this access failure. Other process-based factors might include a governing board that is representative of the general community¹¹⁰ or regular meetings with community leaders to engage the community regarding its access needs.

I would not let process alone carry the analysis, however. At the end of the day an entity seeking exemption should be required to demonstrate that its processes have actually produced results. Accordingly, the second broad category would involve outputs measurements. As the Tenth Circuit noted recently, quantification is an ever-present problem,¹¹¹ but an appropriate test must identify in some quantifiable way how well the entity is executing its access mission in order to gain exempt status.

I suggest that this outputs side of the equation has two basic components. The first, which ought to be obvious (but is often overlooked in the community-benefit test currently applied to health-care providers), is that the organization claiming exempt status must prove that it is doing more to enhance access than its for-profit counterparts do. If a hospital or HMO claiming exemption does so on the basis of providing enhanced access via services to the poor, then as a minimum baseline it must show that it provides substantially more of such services than for-profits do—that is, that its uncompensated-care rate is significantly higher than rates for similarly-situated for-profit providers.¹¹² Alternatively, one might be

110. In fact, a community board is already a virtual requirement of exemption in commercial similarity cases, particularly in health services. *See* Rev. Rul. 69-545, 1969-2 C.B. 117, discussed *supra* notes 17–25.

111. *IHC Health Plans*, 325 F.3d at 1198.

112. I have used "uncompensated care" rather than the more amorphous "charity care" in this sentence for a specific reason, which helps demonstrate the point in the text. All health-care providers have some non-paying patients. For-profit firms generally refer to these non-paying patients as bad-debt cases, while nonprofits tend to want to classify them as charity care—regardless whether they attempt collection proceedings or not. For this reason, total "uncompensated care" is the measure used in modern-empirical studies to compare nonprofit and for-profit providers. *See, e.g., Sloan, supra* note 5, at 161–62 (using "uncompensated care" as the relevant measure). Even using this measure, of course, one can argue that a nonprofit may still not be doing enough to "earn" exemption. For example, if a for-profit organization provides \$1 million in uncompensated care and also pays \$3 million annually in taxes, while a nonprofit provides \$1.5 million in uncompensated care but pays no taxes, one might claim that the nonprofit is still \$2.5 million "better off" than the for-profit after having escaped the tax burden. In such a case, one might also claim that the community would be

able to show that particular nonprofit hospitals offer a different mix of services than for-profit counterparts that target otherwise-underserved populations. For example, in a recent article Professor Jill Horwitz claimed that an empirical study of nonprofit, for-profit, and government hospitals demonstrated that nonprofit hospitals generally provided more unprofitable services than similar for-profit hospitals (though less than similar government-owned hospitals).¹¹³ If true, this would be a strong basis for claiming exemption under the proposed-access test. Similarly, if a nonprofit art gallery claims exemption on the basis of bringing styles of art to the public that it otherwise generally would not have access to, the gallery better be able to prove that the for-profit competitor down the street does not show and sell similar artistic genres.

Second, the entity seeking exemption must demonstrate that a substantial portion of its resources are being used to implement its access-enhancing mission. In many cases this factor would be obvious: a community theater that produced only plays unavailable from commercial counterparts is using 100% of its resources on its access-based mission; ditto for an HMO that serves only underserved populations. But other cases might require more analysis. If the community theater does productions of *Phantom of the Opera* and *Our Town* along with its obscure artistic productions, it needs to be able to show that revenues from the commercial productions are being used to cross-subsidize the rest of its program.

Of course, the final question in both these recommendations is defining what “substantial” means. Is it “substantial” if a nonprofit hospital provides 10% more uncompensated care than a for-profit competitor? Is it substantial if a community theater devotes 10% of its resources to obscure artistic productions while using the other 90% to reproduce Rodgers & Hammerstein musicals? The answer to these questions probably should

better off collecting the tax dollars and redistributing them to the poor so that they could purchase services from the for-profit providers. See Hyman, *supra* note 103, at 361 (“In fact, one underestimates the contribution of for-profits if the sole benchmark is a comparison of charity care.”); see also Gary Claxton et al., *Public Policy Issues in Nonprofit Conversions: An Overview*, HEALTH AFFAIRS, Mar.–Apr. 1997, at 9, 18 (“[I]f taxes paid by for-profit hospitals are counted as community benefits, . . . the benefits provided by for-profit hospitals would exceed those of nonprofits.”). But this scenario assumes that the government would, in fact, redistribute the tax dollars collected in this way; remember that the access-based test starts by requiring the nonprofit to provide general services to populations not currently receiving access from either the private sector or the government, or specific services not being provided by the private sector or government. Hence the starting point for the access-based test is that government is not addressing the access issues and—because of the vagaries of majoritarian politics—may never do so. See COLOMBO & HALL, *supra* note 2, at 107–08.

113. Horwitz, *supra* note 5, at 1367.

begin with the observation that neither the courts nor the IRS have been willing to adopt a mechanical-numerical test to determine when an organization engaged in commercial activity has a primary purpose that is charitable. As early as 1964 the IRS concluded that while a comparison of expenditures on charitable activities versus business activities was certainly relevant to the primary purpose test, an entity would only meet the test if, after considering such expenditures, “an organization is shown in fact to be carrying on a real and substantial charitable program commensurate in financial scope with its financial resources and its income from business activities and other sources.”¹¹⁴ The test of primary purpose is “a test of whether there is a real, bona fide or genuine charitable purpose . . . and not a mathematical measuring”¹¹⁵ A more recent exposition of this balancing approach is in the Tenth Circuit’s recent *IHC Health Plans* decision. Relying on the Treasury Regulations’ admonition that an exempt organization must be engaged “primarily” in charitable activities, the court opined that the community benefit provided by the exempt organization cannot be merely “incidental”; rather, it must be of “sufficient magnitude” that one can fairly infer that the primary purpose of the organization is dedicated to the charitable mission.¹¹⁶

If one adapts the language of the IRS and courts cited above to an access-based test, one might formulate the test as follows: in order to be exempt, the organization must create a factual record of outputs to show that access issues are a bona fide primary goal of the organization and not simply a *de minimis* “sideshow” or after-effect of pursuing a commercial enterprise. This obviously would involve some kind of numerical comparisons with for-profit providers to demonstrate the significance of the outputs, including the revenues dedicated to the access mission, the number of employees/staff involved in executing the access mission, and even the number of services provided or individuals served—but would not use a “magic number” like 51% to identify the line at which access efforts become “substantial.”

114. Gen. Couns. Mem. 32,689 (Oct. 9, 1963) (quoting the Exempt Organization Council’s analysis, attached as an appendix to Gen. Couns. Mem. 32,689).

115. *Id.*

116. *IHC Health Plans*, 325 F.3d at 1198 (“[T]he existence of some incidental community benefit is insufficient. Rather, the magnitude of the community benefit conferred must be sufficient to give rise to a strong inference that the organization operates primarily for the purpose of benefiting the community.”) (emphasis omitted).

B. The Results of an Access-Based Test

1. Health Care

As detailed above,¹¹⁷ since 1969 the IRS purportedly has followed the “community-benefit” standard of exemption enunciated in Rev. Rul. 69-545. But the community-benefit standard’s greatest weakness is that it does not provide any outputs-based method for judging when a provider should be exempt. If exemption is based on providing health care for the general benefit of the community, and if the services provided by for-profit and nonprofits are similar, pricing structures are similar, and uncompensated care rates are similar, what distinguishes a provider that deserves tax exemption from one that does not? How can one follow a standard that emphasizes providing health care “for the general benefit of the community” and then try to draw lines between contract-model and staff-model HMOs when both provide similar services at similar rates to the general public?

An access-based standard might well provide the key. As Part II illustrates, the IRS and courts already have used access themes to make these distinctions. The main criteria of Rev. Rul. 69-545 (a community board, open staff policy, treatment of Medicaid patients, and an open emergency room) are certainly factors that would tend to support an access-based mission,¹¹⁸ and both the IRS and courts have continued to rely on charity care as a distinguishing characteristic of exempt health care providers despite the IRS’s official “dumping” of charity care as the basis for exemption in 1969.¹¹⁹

But while these informal access criteria are certainly helpful in examining exempt status (and would be part of the process side of the access test outlined above), adopting access as an explicit criterion of exemption would provide concrete guidance for difficult cases that the current community-benefit standard simply lacks. For example, an explicit focus on access might provide a structured way to distinguish between rural nonprofit hospitals and those in major metropolitan areas—even if their services were substantially similar and neither was providing much in the way of charity care. From an access standpoint, a nonprofit hospital serving a rural community might well have a credible case that without the financial benefits of exemption it would close its doors, thus shutting off

117. See *supra* text accompanying notes 14–25.

118. See *supra* text accompanying notes 20–25.

119. See *supra* text accompanying notes 35–62.

access for its service community.¹²⁰ A similar nonprofit in a major metropolitan area served by for-profit providers might not have such a case;¹²¹ thus, the rural hospital would get exemption while the metropolitan one would not.

Similarly, an access-based test would provide a rationale to distinguish between exempt HMOs and non-exempt ones and could provide an explanation for the IRS's insistence that a contract-model HMO has less of a claim to exemption than a staff model. With respect to the baseline test for exemption, an HMO—like any other health service provider—would need to show that either it brings substantial new services to the community that previously were unavailable from for-profit providers or else that it serves a target population that otherwise was underserved.

With respect to the contract-model versus staff-model debate, under the current community-benefit test any distinction in exempt status between these two models of HMOs is necessarily arbitrary. If the test for exemption really is a focus on providing health care to a broad cross-section of the community, which is what Rev. Rul. 69-545 tells us, then both contract-model HMOs and staff models do this equally.¹²² If one focuses on access, however, then the distinction might make some sense. Since a contract-model HMO provides services wholly through contracts with existing providers, by definition a contract model HMO brings nothing new to the table in the way of access unless it targets services at a particular underserved population. On the other hand, one might argue that a staff-model HMO, which employs its own doctors and staff and operates its own facilities, does expand the access pie by creating a whole new provider system (and might also bring new services to the community by directly hiring new doctors to fill new service niches). This analysis in turn would be consistent with the IRS's observations in General Counsel Memorandum 39,862 that joint-venture arrangements, which bring new services (expanded access) to a community or demonstrably improve the quality of care (and therefore improve existing access), are consistent with

120. This case obviously would have to be credible on the facts. Factors that might impact such an argument would include whether a for-profit firm had made inquiries regarding this specific market or had operations in similar markets; whether the rural hospital operates at a significant surplus or not; and, if it does not operate at a significant surplus, whether it regularly relies on donations or government grants to make up operating deficits.

121. Contrastly, Prof. Horwitz claims that nonprofit hospitals provide more unprofitable services likely to be needed by the poor and uninsured than for-profit counterparts. See Horwitz, *supra* note 5, at 1407. If true, this claim would support exemption under an access-based test.

122. See, e.g., *IHC Health Plans*, 325 F.3d at 1203-04 n.35 (“We recognize that when we consider petitioners standing alone, drawing a distinction between a ‘staff-model HMO’ (as in *Sound Health*) and a ‘contract HMO’ (as in *Geisinger* and here) may not make sense.”).

exempt status; while those that simply involve contractual rearrangements of existing services do not.¹²³

Speaking of joint ventures, an access-based rationale could also help bring order to this area of chaos as well. Though I have serious doubts that the IRS's fixation on, and special analysis of, joint-venture arrangements is justified under current law,¹²⁴ an access-based test would at least bring some level of sanity to the area. In general, this test would simply follow the guidelines set forth in General Counsel Memorandum 39,862: joint ventures that bring new services to the population—or that are necessary to keep current service levels from eroding—further the purposes of exemption and provide grounds for exemption; those that simply rearrange the chairs on the deck to make seating arrangements more pleasurable do not.

An access standard, however, will require the IRS to revise its views of exemption qualification in certain cases. Thus, even contract-model HMOs might qualify for exemption if they can make a credible case that they bring services to underserved areas or populations. Under an access-based standard for exemption, for example, one might well conclude that Geisinger Health Plan should have been exempt because of this very rationale.¹²⁵ Similarly, a pharmacy organized to provide services to the poor and elderly at cost almost certainly has a strong case that it enhances access for two chronically underserved populations; ergo, the IRS and court decisions in *Federation Pharmacy Services* might need to be reversed under an access test.¹²⁶

Federation provides a particularly good example of how an access-based test would provide far easier analysis of the issues than is currently the case. Under its articles of incorporation, Federation Pharmacy Services was organized for the purposes of operating a nonprofit pharmaceutical service for the general public, with special discount rates for senior and handicapped citizens in the Minneapolis-St. Paul area.¹²⁷ In its application for exemption, Federation proposed selling items to these groups at 5% below the lowest charge in the twin-city area.¹²⁸ However, others would

123. See *supra* notes 37–39 and accompanying text.

124. See John D. Colombo, *A Framework for Analyzing Exemption and UBIT Effects of Joint Ventures*, 34 EXEMPT ORG. TAX REV. 187 (2001).

125. *Geisinger*, 985 F.2d at 1210. See *supra* notes 57–58 and accompanying text (noting that 23% of Geisinger's subscribers lived in medically underserved areas, and another 65% resided in counties that contained medically underserved areas).

126. See *Fed'n Pharmacy Services*, 625 F.2d at 804.

127. *Id.* at 805.

128. *Id.* at 806.

pay prevailing prices.¹²⁹ In upholding the IRS's denial of an exemption to Federation, the Eighth Circuit noted that Federation had no plan to provide free drugs to the poor or to sell items *below cost*, which it found crucial to establishing that Federation operated for a charitable purpose.¹³⁰ Essentially, the Eighth Circuit adopted a "charity-care" standard to differentiate an ordinary pharmacy from a charitable one and concluded that there was no evidence Federation did anything that distinguished it from an ordinary pharmacy.

But the facts quite clearly demonstrate the access-based mission of Federation. Federation was formed by the Metropolitan Senior Federation—itsself a nonprofit organization whose purpose was to enhance the well-being of senior citizens in the Minneapolis-St. Paul area.¹³¹ Moreover, Federation was organized only *after* a discount-sale arrangement with a commercial pharmacy failed.¹³² This latter factor is one that I find most compelling: the service provided by Federation in nonprofit form was the direct result of the failure of a similar program negotiated with a for-profit provider. This is as clear an example of the failure of the private market (and government, which at the time of the case did not have a prescription drug benefit under Medicare or Medicaid for senior citizens) to provide an adequate service as one could possibly ask for. Thus had the Eighth Circuit focused on the access-enhancing mission of Federation, instead of the commercial nature of the services provided (sales of drugs), this case quite clearly would have come out the other way. Moreover, approval of exemption in this case is completely consistent with both the pluralism and economic theories of exemption discussed above: Federation Pharmacy not only filled a private market/government failure, but also brought a completely unique volunteer-based method of selling pharmaceuticals to the commercially-dominated pharmacy world.

Finally, I realize that an access-based test might result in a "race" to provide services in which the winner gets tax exemption while the entity coming in second does not. For example, an access-based test might support exemption for the first HMO to provide a broad range of health services to a medically underserved area but might not support the second or third HMO that simply replicates the services of the first. I view this result, however, as perfectly appropriate; after all, there are worse things

129. *Id.*

130. *Id.* at 808.

131. *Id.* at 805.

132. *Id.*

than having tax policy align incentives so that organizations race each other to provide new services to a given population. If this test results in the winner getting the spoils of exemption, so be it.

2. *Arts Organizations, Community-Development Organizations, and Public-Interest Law Firms*

As noted in Part III, the “enhancing access” test also is completely consistent with the opinions and results in the classic *Goldsboro* and *Plumstead Theater* cases discussed above as well as IRS rulings regarding exemption for community-development organizations and public-interest law firms.¹³³ Adopting “enhancing access” as the main test for exemption in these and other commercial similarity cases, however, would make the analysis in these cases far simpler. Courts such as those in *Goldsboro* and *Plumstead* would no longer have to hand-wring over whether these organizations are engaged in commercial activity; instead, the focus of the analysis would be on the organizations that were providing services previously unavailable from for-profit firms or serving populations otherwise ignored by the for-profit sector. In *Goldsboro*, this mission was obvious: bringing artistic works to the public that otherwise were not available via commercial galleries.¹³⁴

Plumstead, however, offers an opportunity to explore the mission-focus benefits of an access-based test. Though the opinion in *Plumstead* noted the significant differences between the mission of a community theater and a for-profit one,¹³⁵ in fact, Plumstead’s first theatrical venture was the production of a commercial play (*First Monday in October*, starring Henry Fonda).¹³⁶ Nevertheless, there was significant evidence in the Plumstead case that detailed the theater’s access-based mission. The court noted, for example, that Plumstead’s board consisted of “a diversified group of individuals interested in the performing arts.”¹³⁷ The record showed that Plumstead had already made arrangements with the Ambassador Foundation to use facilities at Ambassador College “as the site for its resident theatre with the hope of rebuilding the theatre audiences from Glendale, San Gabriel, Orange County, and San Bernadino County

133. *Goldsboro Art League*, 75 T.C. at 337; *Plumstead Theater Soc’y*, 74 T.C. at 1324. See discussion *supra* Part III.B–C.

134. See *supra* text at notes 66–67.

135. *Plumstead Theater Soc’y*, 74 T.C. at 1324, 1332–33.

136. *Id.* at 1328, 1331.

137. *Id.* at 1326.

...”¹³⁸ Plumstead also had formed a committee “to review and select appropriate dramatic plays in accordance with the highest literary and artistic standards”¹³⁹ and planned to form a workshop in the Los Angeles area for new American playwrights as well as a fund to assist new playwrights in writing and producing new plays.¹⁴⁰ In short, the record in *Plumstead* presents a perfect model of an organization that seriously focused on its access-based mission, with specific plans for executing that mission.

Similarly, an access test would provide clear exemption guidelines for community-development organizations and public-interest law firms that would be generally consistent with the IRS’s current positions. As with the analysis of *Goldsboro* and *Plumstead* above, an access-based test would take us away from analyzing the commercial nature of the exact services provided and instead focus on the access-enhancing end result. Hence, community redevelopment organizations could act like a bank (providing loans) or investment banker (providing equity investments) or real estate developer (providing housing) as long as those services are directed at populations not currently served by the private market. This analysis is perfectly consistent with Rev. Rul. 74-587 discussed above;¹⁴¹ ditto for public-interest law firms, which would be limited to litigating cases that otherwise would not be litigated by private-law firms (e.g., providing access to the courts for cases and legal positions that otherwise would be unrepresented). This approach is also completely consistent with the IRS’s “economic viability” criterion stated in Rev. Rul. 75-74.¹⁴² On the other hand, using access as the key exemption criterion would call into question the IRS’s ruling that an organization formed to provide affordable moderate-income housing in a high-income neighborhood did not qualify for exemption because the organization was neither helping the poor nor addressing discrimination.¹⁴³ An access-based test is broader than simply serving the poor or combating discrimination; if the focus of exemption is on bringing access to populations not currently served by the private market, then an organization providing moderate-income housing in an area that has none certainly is promoting that mission, just as much as a

138. *Id.* at 1327.

139. *Id.* at 1331.

140. *Id.* at 1326.

141. Rev. Rul. 74-587, 1974-2 C.B. 162; *see* discussion *supra* Part III.B.

142. Rev. Rul. 75-74, 1975-1 C.B. 152; *see* discussion *supra* Part III.C.

143. Rev. Rul. 70-585, 1970-2 C.B. 115, 116; *see* discussion *supra* Part III.B.

specialty-treatment hospital (such as a cancer center) that serves only paying patients.¹⁴⁴

3. *Religious Publishing and Craft Sales*

Another historic trouble spot for exempting commercially-similar services arises in cases dealing with exempt publishers and organizations that engage in the sales of handcrafts to help a specifically-designated group. With respect to publishers, the two classic cases in this area (both involving religious publishers) reached opposite results on virtually identical facts. In *Scripture Press Foundation v. United States*,¹⁴⁵ the taxpayer, Scripture Press, was formed primarily to improve the quality of teaching texts for protestant Sunday Schools.¹⁴⁶ Soon the company found itself highly successful in preparing and selling a variety of religious literature, accumulating over \$1.6 million in surplus earnings by 1957.¹⁴⁷ As a result, the IRS revoked exempt status for the organization claiming that it, in effect, was nothing more than a for-profit publisher and hence no longer was operated primarily for charitable purposes. The Claims Court agreed with the IRS, noting that Scripture Press priced its products similarly to for-profit competitors and amassed significant profits.¹⁴⁸ Though it had an educational program aimed at promoting and expanding Sunday School instruction, the court found that expenditures on educational activities were “unaccountably small” in comparison to the surplus that Scripture Press accumulated annually.¹⁴⁹ Accordingly, the court concluded that Scripture Press was not operated “primarily” for charitable purposes.¹⁵⁰ Subsequently, the Tax Court and federal district courts upheld the IRS’s revocation of exemption in a number of other publishing cases.¹⁵¹

But in 1984, the Third Circuit reversed the revocation of exempt status for a religious publisher in *Presbyterian & Reformed Publishing v.*

144. Rev. Rul. 83-157, 1983-2 C.B. 94; see discussion *supra* Part II.A.

145. *Scripture Press Found.*, 285 F.2d 800 (Ct. Cl. 1961), *cert. denied*, 368 U.S. 985 (1962).

146. *Id.* at 803.

147. *Id.* at 804.

148. *Id.* at 804–05.

149. *Id.*

150. *Id.* at 806.

151. *Inc. Tr. of Gospel Worker Soc’y v. United States*, 510 F. Supp. 374, 381 (D. D.C. 1981), *aff’d*, 672 F.2d 894 (D.C. Cir. 1981); *Elisian Guild, Inc. v. United States*, 292 F. Supp. 219 (D. Mass. 1968), *rev’d*, 412 F.2d 121, 125 (1st Cir. 1969); *Fides Publishers Ass’n v. United States*, 263 F. Supp. 924 (N.D. Ind. 1967); *Presbyterian & Reformed Publ’g Co. v. Comm’r*, 79 T.C. 1070 (1982), *rev’d*, 743 F.2d 148 (3d Cir. 1984).

Commissioner,¹⁵² a case substantially similar to *Scripture Press*. The taxpayer in *Presbyterian & Reformed Publishing* was a highly profitable nondenominational religious publisher that priced its products at market. Though the Tax Court upheld an IRS revocation of exempt status on the ground of impermissible commercial hue based primarily on the large profits generated by the taxpayer's publishing business,¹⁵³ the Third Circuit reversed, noting that "success in terms of audience reached and influence exerted, in and of itself, should not jeopardize the tax-exempt status of organizations that remain true to their stated goals."¹⁵⁴ A charitable organization, according to the Third Circuit, should be able to make money to expand its audience and influence and doing so does not make the organization any less charitable. Similarly, the Tax Court approved exemption in several "resale shop" cases—situations in which a nonprofit enterprise primarily operated a business selling crafts produced by a particular group. In the late 1970s, for example, the Tax Court approved exemption for an organization that imported, purchased and sold artists' crafts,¹⁵⁵ and an organization that purchased and sold products manufactured by blind individuals.¹⁵⁶

Once again, a focus on access is the best way to harmonize these cases. Rather than focusing on vague indicia of "commercial hue," courts might better employ their energies in determining whether the publisher offered a product otherwise unavailable from the private market. In both *Scripture Press* and *Presbyterian & Reformed Publishing*, for example, the record indicated that both organizations were formed because of a failure of the private market to supply the types of religious texts that they published.¹⁵⁷ Similarly, the eligibility of "craft stores" for exemption could be measured

152. *Presbyterian & Reformed Publ'g*, 743 F.2d at 148.

153. *Presbyterian & Reformed Publ'g*, 79 T.C. at 1070.

154. *Presbyterian & Reformed Publ'g*, 743 F.2d at 158.

155. *Aid to Artisans, Inc. v. Comm'r*, 71 T.C. 202 (1978). The organization claimed that its charitable purposes were "(1) helping disadvantaged artisans in poverty stricken countries to subsist and to preserve their craft; and (2) furnishing services to tax-exempt museums by providing museum stores with representative handicrafts from disadvantaged countries." *Id.* at 209.

156. *Industrial Aid for the Blind v. Comm'r*, 73 T.C. 96 (1979). The charitable purpose was to provide employment for the blind and thus came within the regulations' statement that a charitable purpose includes "relief of the poor and distressed or underprivileged." *Id.* at 100–01. See Treas. Reg. § 1.501(c)(3)-1(d) (2002).

157. See *Scripture Press Found.*, 285 F.2d at 803 (noting that Scripture Press had been formed to address "the poor quality of existing teaching materials for Bible instruction in Sunday schools."); *Presbyterian & Reformed Publ'g*, 743 F.2d at 151 (independent publishers characterized P&R's books as "lacking in 'common ground' with the 'nonreformed mind' and 'offensive' to all but the 'truly reformed.'").

by whether such organizations made goods available to the public from a unique source that previously were unavailable.

4. *Two Final Examples: The Religious Health Foods Store and the Downtown Y*

Two final examples help seal the case for how an access-based test would make analyzing exemption for commercial similarity cases much simpler. The first involves a case that is routinely part of teaching materials on tax-exempt organizations; the second, involves a perennial problem that has not yet been litigated or formally ruled upon by the IRS.

In *Living Faith, Inc. v. Commissioner*,¹⁵⁸ the organization seeking exemption (Living Faith, Inc.) operated two vegetarian restaurants and health food stores in Illinois. Living Faith based its application for exemption on the grounds that it was formed to promote the religious doctrines of the Seventh-Day Adventist Church, which “believe that the concept of health is permeated with religious meaning”; “[g]ood health, according to Seventh-Day Adventists, promotes virtuous conduct and is furthered by a vegetarian diet and abstention from tobacco, alcohol, and caffeine.”¹⁵⁹ In short, Living Faith claimed that its activities were wholly consistent with being a “religious” organization and promoting the Seventh-Day Adventist faith.¹⁶⁰

The Seventh Circuit disagreed. Its analysis, however, focused on the commercial nature of Living Faith’s activities; the court noted that Living Faith’s operations were essentially identical to for-profit restaurants and health food stores, including their pricing schedule, location in shopping centers, similar hours, and use of advertising.¹⁶¹ Much of the opinion is devoted to distinguishing Living Faith’s activities from other cases in which businesses operated by churches or church-based organizations were held not to interfere with exempt status.¹⁶²

Under an access-based test, this case would have been far simpler to decide. Put simply, Living Faith had no access-based mission. Its restaurants and stores did not serve populations that otherwise could not access a vegetarian diet or health foods. It did not provide services (sale of

158. *Living Faith, Inc. v. Comm’r*, 950 F.2d 365 (7th Cir. 1991).

159. *Id.* at 367.

160. *Living Faith v. Comm’r*, 950 F.2d at 369–70 (“Living Faith contends that it operates its restaurants and health food stores with the exclusive, tax-exempt purpose of furthering the religious work of the Seventh-day Adventist Church as a health ministry.”).

161. *Id.* at 373–74.

162. *Id.* at 373–76.

health foods and vegetarian meals) that were unavailable in the private market; indeed, the opinion noted that Living Faith's stores directly competed with for-profit restaurants and health food suppliers. Its revenues from its business operations did not appear devoted to an evangelistic mission or increasing access to Seventh-Day Adventist religious doctrine. Living Faith simply had no mission of enhancing access; thus, under an access-based test, the organization would have been denied exemption without such extensive analysis of the "commercial hue" of its activities or lengthy explanations of how its commercial operations differed in scope from commercial operations carried on by other churches or religious organizations.

The second example is what those of us who teach in the nonprofit area sometimes refer to as the "Downtown Y."¹⁶³ The general problem is this. Suppose that a YMCA (traditionally an exempt charity) operates a facility near the center-business district of a major city. It offers all the amenities of several for-profit competitors in the same general geographic area and charges similar fees for admission. Should the Y be tax-exempt? Under the traditional analysis, exemption has been granted or denied to health clubs based upon a variety of factors mirroring the community-benefit test applied to health care: whether the facilities were open to all members of the community; whether the organization provided fitness education programs; and whether there were specific programs for the poor.¹⁶⁴

As with health care, the analysis of exempt status for the downtown Y would be more focused if the IRS and courts recognized that they are really applying an access-based test. Thus when the Y has an access-based mission, providing open facilities for the general community and programs particularly targeted at underserved groups (e.g., youth, the elderly, the poor), the Y qualifies for exemption notwithstanding its commercially-similar services. However, without these access programs the Y is nothing more than another health club providing services that are already available to those who can already purchase them and exemption is not warranted.

163. See FISHMAN & SCHWARZ, *NONPROFIT ORGS.*, *supra* note 14, at 478; JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS: TEACHER'S MANUAL 77-79* (2000) [hereinafter FISHMAN & SCHWARZ, *TEACHER'S MANUAL*].

164. See, e.g., *Clubs of Cal. for Fair Competitions v. County Tax Assessor*, 9 Cal. Rptr. 2d 247 (Cal. Ct. App. 1992) (upholding property tax exemption for Oakland, CA YMCA); Janne G. Gallagher, *Oakland YMCA Wins Property Tax Exemption*, 6 EXEMPT ORG. TAX REV. 511 (1992); Cf. *Young Men's Christian Ass'n of Columbia-Willamette v. Dept. of Revenue*, 784 P.2d 1086 (1989) (upholding Oregon Department of Revenue decision to deny exemption to downtown Portland YMCA). The Portland decision was later reversed by the Oregon Department of Revenue after the Portland Y initiated programs aimed at family and youth as well as other services for the surrounding community. See FISHMAN & SCHWARZ, *TEACHER'S MANUAL*, *supra* note 163, at 78.

The Downtown Y situation, moreover, is another excellent example of how basing exemption in commercial-similarity cases on enhancing access would force nonprofits that provide commercial services to focus their charitable mission: if the Downtown Y wants tax exemption, it will have to demonstrate a commitment to programs for traditionally underserved groups (youth, the elderly, the poor) and public access to its facilities.

C. Access in Other Exemption Analysis

Although a doctrinal test of “enhancing access” has its most direct application to the problem of identifying exempt organizations in cases of “commercial similarity,” the access concept might help explain some other doctrines surrounding exempt status that affect non-commercial organizations as well. For example, in *Bob Jones University v. United States* the Supreme Court held that a school that discriminated against racial minorities could not be tax-exempt on the grounds that discrimination violated “fundamental public policy.”¹⁶⁵ The public policy doctrine, however, has raised a host of unresolved issues. Justice Powell, concurring in *Bob Jones*, warned that a focus on whether an organization’s activities conformed to government policy “ignores the important role played by tax exemptions in encouraging diverse, indeed often sharply conflicting, activities and viewpoints.”¹⁶⁶ In addition, the Court’s opinion fails to give much guidance regarding when a policy is “fundamental,” leaving open questions whether exempt organizations might be able to discriminate on the basis of gender, sexual orientation, or other classifications.¹⁶⁷ Indeed, even the question of racial discrimination is a slippery one: for example, is it contrary to fundamental public policy to discriminate *in favor of* minority students?¹⁶⁸

If, however, one jettisoned the notion of “fundamental public policy” and embraced an access-based analysis, then many of these questions

165. *Bob Jones Univ.*, 461 U.S. at 592–94 (1983) (holding organization not charitable when it violates fundamental public policy; policy against racial discrimination is “fundamental.”).

166. *Id.* at 609 (Powell, J., concurring).

167. See, e.g., HILL & MANCINO, *supra* note 38, ¶ 7.05[3]; David A. Brennan, *Charities and the Constitution: Evaluating the Role of Constitutional Principles in Determining the Scope of Tax Law’s Public Policy Limitation for Charities*, 5 FLA. TAX. REV. 779 (2002); Martin Ginsburg, *Sex Discrimination and the IRS: Public Policy and the Charitable Deduction*, 10 TAX NOTES 27 (1980); J. Christine Harris, *Should Boy Scouts’ Policy on Gays Preclude Tax-Exempt Status?*, 31 EXEMPT ORG. TAX REV. 32, 32–33 (2001).

168. See David A. Brennan, *The Power of the Treasury: Racial Discrimination, Public Policy and “Charity” In Contemporary Society*, 33 U.C. DAVIS L. REV. 389 (2000); HILL & MANCINO, *supra* note 38, ¶ 7.04[4].

would go away. At the very least, a focus on access as a central criterion of exemption would mean that an organization must permit access by all members of the community; or put conversely, an organization that denies access to a specific group will be denied exemption. Such a position, of course, would cut a very wide swath through current exempt organizations—denying exemption to private single-gender schools, for example¹⁶⁹—but it would end the current uncertainty regarding the application of the fundamental public policy test and the potential for “forced conformity” to the majority view that so worried Justice Powell.

VI. GENERAL SUMMARY

When nonprofit organizations provide services that are similar to those provided by for-profit organizations, the decision whether the nonprofit is eligible for tax-exemption has often involved tortured analysis regarding the “commercial hue” of the services provided by the nonprofit and/or the resulting “community benefits.” As this Article has demonstrated, however, most of the analysis undertaken by the IRS and courts in these cases of commercial similarity is consistent with an overriding principle of enhancing access: either by serving traditionally-underserved populations or by bringing services to the general population that were previously unavailable from the for-profit sector. Making “enhancing access” the main test of exemption would simply make explicit what already is largely implicit, which in turn would both simplify the analysis of these cases and help make sense of some IRS positions (particularly in the health care field) that do not make any sense under the current community-benefit test. An access test, moreover, is both consistent with the major theoretical underpinnings of exemption and would have the salutary effect of forcing exempt organizations that engage in commercial services to focus their mission to differentiate themselves from their for-profit counterparts.

An access-based test of exemption, of course, will not solve all the analytical problems regarding eligibility for exempt status. An access-based test, for example, would provide little help in defining what is a “religious organization” or an “educational organization” under § 501(c)(3). Even in these cases, however, recognizing the underlying role of access in exemption analysis might help explain certain exemption decisions—such as the denial of exemption to organizations (e.g., racially

169. One should remember that this Article is concerned only with federal income tax exemption; purely private single-gender schools could still legally exist—they just would not be granted tax exemption.

segregated schools) that specifically deny access to certain groups. In any event, focusing on access as the central criterion for exemption in commercial-similarity cases would greatly improve the legal environment for dealing with these peculiarly difficult exemption cases, and this benefit alone is enough of a reason for the IRS and courts to consider this approach.