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# QUALIFYING AS A TAX EXEMPT COOPERATIVE HOSPITAL SERVICE ORGANIZATION

*James Peirce Tuthill\**

## I. Introduction

Senator Carlson, upon introducing an amendment to the Revenue and Expenditure Control Act of 1968,<sup>1</sup> made the following remarks:

The seriousness of the ever-rising cost of hospital care is of grave concern to all of us, and has been made the subject of almost continuous discussion by leading members of the health field. Testimony before the Congress last year, at the time of the social security amendments, disclosed that hospital costs have risen some 15 percent per year and will continue to do so for at least a few years.<sup>2</sup>

To ameliorate this situation, § 109 of the Revenue and Expenditure Control Act of 1968<sup>3</sup> was enacted as § 501(e) of the Internal Revenue Code of 1954<sup>4</sup> to

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\* Member of the Illinois Bar.

1 82 Stat. 251 (1968).

2 114 CONG. REC. 8111 (1968) (remarks of Senator Carlson).

3 82 Stat. 251 (1968).

4 INT. REV. CODE OF 1954, § 501(e) [hereinafter cited as CODE] provides:

**COOPERATIVE HOSPITAL SERVICE ORGANIZATIONS.**—For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a) would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 503 (b)(5).

provide federal income taxation exemption for organizations providing services on a joint basis to tax exempt hospitals.

Since its passage, § 501(e) has remained in as much obscurity as it did in the committee reports.<sup>5</sup> There are no regulations,<sup>6</sup> no cases,<sup>7</sup> no law review articles,<sup>8</sup> and only three revenue rulings on the subject.<sup>9</sup> As a consequence, the practitioner finds himself in the uncomfortable position of planning with nothing more to consult than the section itself. This results in questions difficult to resolve: Is a § 501(e) entity subject to the unrelated business income provision of § 511? Is a § 501(e) organization treated as a "charitable organization" under § 501(c)(3)?<sup>10</sup> If the latter question can be answered, any others which might arise may be resolved because one could simply follow the regulations and rulings under § 501(c)(3). Although § 501(e) states that a qualifying organization shall be treated as organized and operated exclusively for charitable purposes,<sup>11</sup> it is a hybrid rather than pure § 501(c)(3) entity. Certain attributes of § 501(c)(3) are applicable to § 501(e); others are not.

5 The only legislative material which treats the provision other than summarizing it is S. REP. N. 744, 90th Cong., 1st Sess. 200 (1967), which deals with the forerunner to § 501(e).

6 The author attended a seminar on exempt organizations in January of 1973 in Washington, D.C., and spoke informally with the Chief of the Regulations section for exempt organizations of the Internal Revenue Service and was informed at that time, that it is most unlikely that any regulations will be promulgated for § 501(e). It is to be noted that the section has been in existence for five years, a year longer than the Tax Reform Act of 1969, for which there are regulations.

7 *Hosp. Bureau of Standards & Supplies v. United States*, 158 F. Supp. 560 (Ct. Cl. 1958) is a pre-§ 501(e) case which is discussed *infra*. Since this article was written a court on July 18, 1974, in *United Hospitals Services, Inc., v. United States* — F. Supp. — (S.D. Ind. 1974) held on the facts present there that an organization which provides joint laundry services solely to public and not-for-profit private hospitals is exempt from taxation under § 501(c)(3) irrespective of § 501(e). The court stated that "the clearly expressed Congressional purpose behind the enactment of Section 501(e) was to enlarge the category of charitable organizations under Section 501(c)(3) . . . and not to narrow or restrict the reach of Section 501(c)(3)." — F. Supp. at —.

8 This statement is not entirely true. Section 501(e) is discussed, but given short shrift, in 47 TAXES 524, 532 (1969); the examination is hardly more than a summation of the provision.

9 Rev. Rul. 69-160, 1969-1 CUM. BULL. 147; Rev. Rul. 69-633, 1969-2 CUM. BULL. 121; Rev. Rul. 72-329, 1972-2 CUM. BULL. 226.

10 Section 501(c)(3) designates the following as exempt organizations:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

11 Section 501(e) commences with the following phrase: "For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes . . ." (emphasis supplied). Section 501(c)(3) in pertinent part provides "corporations, and any community chest, fund, or foundation, organized and operated exclusively for . . . charitable purposes . . ." (emphasis supplied). Since Congress incorporated the language of § 501(c)(3) into § 501(e), it is reasonable to conclude that it intended the § 501(e) organization to be treated as a § 501(c)(3) organization. This determination is buttressed by the last sentence of section 501(e): "For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) . . ." (emphasis supplied).

## II. History and Summary of § 501(e)

The legislative history of § 501(e) discloses the basic distinction between § 501(c)(3) and § 501(e). The Senate Committee in its report<sup>12</sup> on the Social Security Amendments of 1967 recognized the need for statutory authority for a cooperative hospital service organization:

[I]f two or more tax exempt hospitals join together in creating an entity to perform services for hospitals, the Internal Revenue Service takes the position that the entity constitutes a "feeder organization" and is not entitled to income tax exemption because of a special provision of the code applicable to such organizations. . . . In spite of this position of the Service, the leading case in point held such an entity furnishing services to hospitals to be exempt.<sup>13</sup>

As a result of the Service's position, hospitals were reluctant to form group associations to provide services on a joint basis and potential donors were hesitant to make grants.<sup>14</sup>

The need for such organizations and the doubts present under the then existing law prompted a Senate amendment providing for exemption of cooperative hospital service organizations furnishing services on a joint basis solely for exempt hospitals.<sup>15</sup> Note that, at this stage in the development of § 501(e),

12 S. REP. No. 744, 90th Cong., 1st Sess. 200 (1967).

13 *Id.* at 200-01.

14 *Id.* at 201.

15 The amendment provided in part:

SEC. 502. (a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from tax on corporations, etc.) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

(e) COOPERATIVE HOSPITAL SERVICE ORGANIZATIONS.—For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated exclusively to perform services—

(A) of a type which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a) would constitute an integral part of its exempt activities; and

(B) solely for hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing:

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in subsection 503(b)(5).

The Senate added this amendment to the bill which it passed.

exemption from taxation would not have been predicated upon the performance of specific services. The test for exemption would simply have been whether or not the service performed jointly by the organization would, if performed by a single hospital for itself, constitute an integral part of the exempt activities of the hospital.<sup>16</sup> Unfortunately, the Senate amendment was dropped from the bill.<sup>17</sup> As a result, hospitals and the ultimate intended beneficiary of the provision—the patient—had to wait another year.

An amendment to the Revenue and Expenditure Control Act of 1968<sup>18</sup> by Senator Carlson<sup>19</sup> was almost identical to the section as passed by the Senate in 1967.<sup>20</sup> But it contained substantial changes as enacted by Congress. Notably, § 501(e) specified the services which the cooperative hospital service organization would be permitted to perform if it were to obtain exemption: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel services.<sup>21</sup> Indeed it might appear that a tax exempt cooperative hospital service organization would be able to perform just about any function which its patrons might desire. However, one important function—laundry services—is conspicuously absent despite the fact that no other service was deemed more necessary or bene-

16 The operative language, which is set out in the previous footnote in full, states that the entity would constitute an integral part of its exempt activities.

17 CONF. COMM. REP. NO. 1030, 90th Cong., 1st Sess. 73 (1967).

18 See note 1 *supra*.

19 114 CONG. REC. 8111 (1968).

20 The amendment "Tax Exempt Status of Certain Hospital Service Organizations" provided in part:

(a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from tax on corporations, etc.) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

(e) COOPERATIVE HOSPITALS SERVICE ORGANIZATION described in subsection (c) (3) and organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated exclusively to perform services—

(A) of a type which, if performed on its own behalf by a hospital which is an organization described in subsection (c) (3) and exempt from taxation under subsection (a), would constitute an integral part of its exempt activities; and

(B) solely for hospitals each of which is—

(i) an organization described in subsection (c) (3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c) (3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c) (3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons. For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c) (3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 503(b) (5).

(b) The amendments made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

114 CONG. REC. 8111 (1968).

21 CODE § 501(e).

ficial for the patrons of a service organization.<sup>22</sup> It is this limitation (permissible services which can be performed) which is the primary distinction between the § 501(c)(3) organization organized and operated exclusively for charitable purposes and the § 501(e) organization. Section 501(c)(3), unlike § 501(e), does not specify which services can be performed by a charitable organization.<sup>23</sup>

The one applicable case, *Hospital Bureau of Standards & Supplies v. United States*,<sup>24</sup> decided prior to the enactment of § 501(e), is no more enlightening than the section's legislative history. The issue of income taxation exemption for an organization performing services for not-for-profit hospitals arose in a suit brought by Hospital Bureau to recover income taxes which it had paid. The organization claimed exemption under § 101(6) of the Internal Revenue Code of 1939<sup>25</sup> because it was organized and operated exclusively for charitable purposes (all of its patrons were not-for-profit hospitals). The Service took the position that Hospital Bureau performed no hospital services and therefore was not entitled to exemption. The Court rejected this argument, relying upon *Squire v. Students Book Corp.*,<sup>26</sup> which had held that an organization (a student book shop) which was an integral part of an exempt entity (an educational institution) to be itself exempt even though the book shop did not render educational services. The analogy was sound: Hospital Bureau, whether it performed "hospital services" or not, was entitled to exemption as a charitable organization by demonstrating that it was an integral part of hospital functions.<sup>27</sup>

### III. Analysis of the Section

This concept of "integrally related" served as the foundation for both the unsuccessful predecessor to § 501(e) and the section itself. The concept is inferred from the explicit listing of the "integrally related" services which a § 501(e) organization may perform. Paradoxically, this particularity, as opposed to the generality of both § 501(c)(3) and the predecessor to subsection (e), creates the problem of uncertainty in its application.

Section 501(e)<sup>28</sup> provides that an organization will be considered organized and operated exclusively for charitable purposes if it is operated solely to perform on a centralized basis one or more of certain described services which would constitute activities which could be performed by a tax exempt hospital in the exercise of its tax exempt purposes. To qualify for exemption under § 501(e),

22 Senator Carlson, in his address to the Senate, had the following to say: "[T]his is a substantial area for joint enterprises for hospitals. I am aware that in Los Angeles, Calif., seven area hospitals anticipate savings of \$300,000 a year, by establishing a cooperative central laundry service." 114 Cong. Rec. 8112 (1968).

23 Treas. Reg. § 1.501(c)(3)-1(d)(2) (1959) defines charitable as meaning "its generally accepted legal sense." There is no specification of the services which a charitable organization may perform.

24 158 F. Supp. 560 (Ct. Cl. 1958).

25 Section 101(6) of the 1939 Code is presently § 501(c)(3) of the 1954 Code. The only differences are that "testing for public safety" has been added, together with a restriction that the organization may not participate in political campaigns.

26 191 F.2d 1018 (9th Cir. 1951).

27 158 F. Supp. at 562-63. The Bureau's "integral services" consisted of evaluating and purchasing supplies for member hospitals, all of which were exempt as charitable organizations.

28 See note 3 *supra* for the full text of § 501(e).

an organization must perform the enumerated services only for two or more qualifying hospitals.

The most restrictive requirement of § 501(e) is that the organization be organized and operated solely to perform on a centralized basis one or more of the specified services. The word "solely" limits the organization to performing only those services listed in the section. In sharp contrast with such restrictive language is that of § 501(c)(3):

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.<sup>29</sup>

Despite the obvious contrast, some language of § 501(c)(3) appears in § 501(e): An organization which qualifies for exemption thereunder "shall be treated as an organization organized and operated exclusively for charitable purposes" (emphasis supplied). The incorporation of the italicized language of § 501(c)(3) into § 501(e) creates the problem of the applicability of the unrelated business income tax provisions to § 501(e). On the one hand, a § 501(c)(3) organization qualifies for exemption if it is organized and operated exclusively for charitable purposes. If a § 501(c)(3) organization, in addition to performing the function constituting the basis for its exemption, regularly carries on a "trade or business . . . not substantially related" to its charitable function,<sup>30</sup> it will not lose its exemption but rather will be taxed on unrelated business income under § 511.<sup>31</sup> However, the § 501(e) organization which regularly carries on a business not substantially related to its exempt function probably will not be able to retain its exemption and be taxed only on the unrelated business income. Instead, it will be in danger of not qualifying for the exemption.

Revenue Ruling 69-160<sup>32</sup> substantiates the position suggested in the preceding paragraph. The taxpayer had requested advice as to whether an organization which performed services solely for exempt hospitals qualified for exemption where it provided personnel, data processing, purchasing, and *laundry services*. The Service ruled that the organization did not meet the requirements of § 501(e) and consequently could not obtain exempt status. It pointed out that the Conference Committee Report had stated that § 501(e) did not grant exempt status if the hospital service organization performed any service other than those specified in the subsection, specifically citing laundry services as an example.<sup>33</sup>

29 CODE § 501(c)(3).

30 CODE § 513(a). The test for the imposition of the unrelated business income tax is two-pronged: a business activity which is (1) regularly carried on and (2) not substantially related to the exempt purposes of the organization.

31 CODE § 511.

32 Rev. Rul. 69-160, 1969-1 CUM. BULL. 147.

33 See also Rev. Rul. 69-633, 1969-2 CUM. BULL. 121.

In addition to the limitation of permissible services, the § 501(e) entity is also restricted that it may perform services

solely for two or more hospitals each of which is—

(i) an organization described in subsection (c) (3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c) (3), which is exempt . . . and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c) (3), or

(iii) owned and operated by the United States, a State . . . or a political subdivision or any agency or instrumentality of any of the foregoing.<sup>34</sup>

Examples of the above three classifications respectively would be (1) a not-for-profit hospital, (2) a hospital operated by a not-for-profit college or university which, if operated as a separate entity, would be exempt, and (3) a county hospital.

In planning a cooperative hospital service organization questions may arise concerning the performance of services for proprietary hospitals or health related organizations. Such entities would disqualify the service organization for exemption since proprietary hospitals do not meet the requirements of subparagraphs (i), (ii), or (iii), and health related organizations are not "hospitals." Membership of such organizations should be permissible where they are not voting members and do not receive any of the services of the § 501(e) entity.

Three other requirements of § 501(e) are worth special mention. First, the § 501(e) organization must allocate or pay to its patrons within 8½ months after the close of its taxable year, all of its net earnings on the basis of services performed. It is suggested that this requirement be incorporated into the by-laws.<sup>35</sup> Secondly, if the organization has issued stock, all of it must be owned by the organization's "patrons." Although the term "patron" is not defined, it refers to those entities described in subparagraphs (i), (ii), and (iii). Finally, the last sentence of § 501(e) makes an understanding of the provision still more difficult: "For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c) (3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b) (1) (A) (3)." It, like the first sentence of the section discussed earlier, seems to equate an organization qualifying under § 501(e) with a § 501(c) (3) organization. Yet, as already noted, an organization which qualifies for exemption under § 501(c) (3) may perform services not substantially related to its exempt purposes and will be subject to tax on unrelated business income under § 511<sup>36</sup> but will not necessarily imperil its tax exemption.

<sup>34</sup> CODE § 501(e).

<sup>35</sup> According to Treas. Reg. § 1.501(c)(3)-1(b)(4) (1959), a charitable organization is required upon its dissolution to distribute its assets to charitable organizations which are tax exempt. The regulations state that this requirement is satisfied if it is incorporated into the by-laws of the organization. Although, as previously indicated, there are no regulations under subsection (e), it would seem advisable to follow the procedure under subsection (c) (3) regarding the payout requirement so as to satisfy the I.R.S.

<sup>36</sup> CODE § 511.



Where an organization acquires its tax exempt status under § 501(e), the performance of any service unrelated to its tax exempt purposes would, if discovered, almost surely cause it to lose its exemption. Thus an organization exempt under § 501(e) cannot be truly equated with a § 501(c)(3) organization since the concept of unrelated business income, applicable to the latter, does not apply to the former.

It seems likely that the references to § 501(c)(3) were incorporated into § 501(e) to avoid amending § 501(a) which grants exemption from taxation to organizations described in § 501(c)(3). However, it would have been better to have deleted the reference to § 501(c)(3) in § 501(e) and to have amended § 501(a) by including a reference to § 501(e). Secondly, the sentence states that a § 501(e) entity "shall be treated as a hospital" and a tax exempt hospital clearly may be subjected to the unrelated business income tax. For example, Revenue Ruling 68-374<sup>37</sup> specifies the circumstances under which the sale of pharmaceutical supplies to the general public by the pharmacy of an exempt hospital results in unrelated business income.

Another problem is whether a § 501(e) entity is subject to § 508. Section 508 requires that notice be given the Secretary of the Treasury of any organization seeking recognition of § 501(c)(3) status. A § 501(e) organization is a § 501(c)(3) organization for this purpose. Treasury Regulation § 1.508-2 states that notice is filed by submitting a properly completed and executed Form 1023 (Exemption Application). IRS Publication 557<sup>38</sup> indicates that a cooperative hospital service organization should use Form 1023 for recognition of exemption from income tax.

Section 508 also provides that a § 501(c)(3) organization which does not notify the Secretary that it is not a private foundation shall be presumed to be a private foundation. By definition, a § 501(e) entity is not a private foundation because the cooperative hospital service organization "shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii)."<sup>39</sup> This, however, does not entirely resolve the question of whether or not the cooperative hospital service organization is required to file Form 4653 (Notification Concerning Foundation Status).<sup>40</sup> If it is not necessary for the § 501(e) entity to file the form there can be little consequence. A failure to file the form, if required, raises the presumption that the organization is a private foundation.<sup>41</sup> Therefore, Form 4653 should be filed even though the local Internal Revenue Service office may suggest that it is not necessary.

Finally, as a result of the last sentence of § 501(e), contributions to the cooperative hospital service organization are tax deductible by donors. Under § 170,<sup>42</sup> deductions are allowed for contributions to organizations described in subsection (b)(1)(A)(iii), primarily hospitals. Because of the explicit desig-

37 Rev. Rul. 68-374, 1968-2 CUM. BULL. 242.

38 See 4 CCH 1974 STAND. FED. TAX REP. ¶ 3025.0815.

39 CODE § 501(e).

40 Treas. Reg. § 1.508-1(b) (1973).

41 A discussion of private foundations is beyond the scope of this article. The reader is referred to CODE § 4941.

42 CODE § 170.

nation in § 501(e) of the cooperative hospital service organization as "an organization referred to in Section 170(b)(1)(A)(iii)," there can be little doubt as to the tax deductibility of contributions to it.

#### IV. Conclusion

Although there are problems for an organization desiring an exemption under § 501(e), the benefits are real. First, the exemption of an entity providing services on a joint basis solely to exempt hospitals has been recognized and, accordingly, foundation grants and gifts would be available. Secondly, the cooperative hospital service organization is not subjected to some of the difficulties faced by a § 501(c)(3) organization. A § 501(c)(3) entity may wander beyond its exempt function and perform services or carry on activities which subject it to the unrelated business income tax or even jeopardize its exemption. A determination of what is in furtherance of a § 501(c)(3) exemption is anything but precise. The § 501(e) organization knows exactly what it can and cannot do; planning with certainty can therefore be accomplished.

In addition, even though a § 501(c)(3) organization may perform services on a joint basis, such as management consulting, the Service has taken the position that an organization which provides management consulting services at cost solely to tax exempt entities is not tax exempt under § 501(c)(3);<sup>43</sup> however, where the services are provided "substantially below cost," the organization may obtain exemption under § 501(c)(3) because there exists a "donative element."<sup>44</sup> Whether or not this ruling would stand judicial scrutiny is less important than the fact that the § 501(e) organization is not thus confined. It may provide the services below costs, at cost, or even above cost since it must "allocate or pay" all of its net profit to its patrons. Simply stated, the § 501(e) organization is not required to perform with a "donative element."

As with any organization seeking tax exemption under the Internal Revenue Code, careful practice is required. If the organization is a corporation, the articles of incorporation and bylaws must be appropriately drafted or amended so as to comply with the section. They should specify the services the organization will perform and the patrons it will serve. Likewise, the payout or allocation requirement should be included in the bylaws. A review of the organization's operating procedures both prior to and after obtaining exemption is essential. It is easy to draft a legal document conforming to statutory requirements; it is difficult, however, for a going concern in its day-to-day operations to be as attentive to detail.

The potential of the cooperative hospital service organization has not been realized and its tangible benefits are as yet untapped. One can envision, however, all hospitals in a large metropolitan area sharing data processing, purchasing, warehousing, and all the other permitted services. The cost savings and improved efficiency to the individual hospital and, ultimately, the patient are obvious.

43 Rev. Rul. 72-369, 1972-2 CUM. BULL. 245.

44 Rev. Rul. 71-529, 1971-2 CUM. BULL. 234.