



In re Vision Service Plan Tax Litigation

2010 | Cited 0 times | S.D. Ohio | June 22, 2010

Judge Graham

Magistrate Judge Kemp

OPINION AND ORDER

At issue in this multidistrict litigation is whether plaintiffs, which are related entities operating in different states under the name of Vision Service Plan ("VSP"), are eligible for tax-exempt status under 26 U.S.C. § 501(c)(4) for the tax years 1994-2004. Section 501(c)(4) grants an income tax exemption to organizations that operate "exclusively for the promotion of social welfare." This court has jurisdiction under 28 U.S.C. § 1346(a)(1), which gives district courts jurisdiction of civil actions against the United States for recovery of internal-revenue tax alleged to have been erroneously or illegally assessed.

The VSP entities have sued for the recovery of federal income taxes they paid for the 1994-2004 tax years. Plaintiffs offer vision health care plans to employers, and they argue that they are entitled to a tax exemption because they arrange for their subscribing members to receive vision care services. According to plaintiffs, their operations promote the social welfare purpose of "health." Plaintiffs also contend that they are entitled to a tax exemption because they have engaged in considerable charity and community outreach work to non-subscribers.

Defendant United States moves for summary judgment on two grounds. First, it argues that plaintiffs are collaterally estopped from bringing these lawsuits because the tax issues under § 501(c)(4) were resolved in the United States' favor by the Ninth Circuit Court of Appeals in connection with plaintiffs' parent company. Second, the United States argues that, if the tax issues are reached, the facts demonstrate that each plaintiff operated as a for-profit business for the benefit of its paying subscribers and not exclusively for the general welfare of the community.

As discussed below, the court finds that plaintiffs are collaterally estopped from asserting their primary theory that they are entitled to tax exempt status based on their operational model of delivering vision care services to subscribing members. The Ninth Circuit squarely rejected the VSP parent's claim for tax exempt status on that theory. While plaintiffs are not estopped from arguing that their individual charity and community outreach efforts entitle them to a tax exemption, the undisputed evidence demonstrates that those efforts are so minimal in relation to plaintiffs' overall operations that plaintiffs cannot be said to be operating "exclusively for the promotion of social



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welfare."

I. Background

A. The Plaintiffs

There are six plaintiffs in this multidistrict litigation. Vision Service Plan Insurance Company ("VSPIC") is an Connecticut nonprofit corporation that filed suit in the United States District Court for the District of Connecticut for the recovery of federal income taxes assessed for the tax years of 1995 through 2003.

VSPIC also filed suit in the District of Connecticut as successor in interest to Vision Service Plan of the Southeast, Inc. ("VSPS"), a Georgia nonprofit corporation, for the recovery of federal income taxes assessed for 1994 through 1997.

Massachusetts Vision Service Plan, Inc. ("VSP Massachusetts") is a Massachusetts nonprofit corporation that filed suit in the District of Massachusetts for the recovery of federal income taxes assessed for 2002 through 2004.

Vision Service Plan, Inc. ("VSP Nevada") is a Nevada nonprofit corporation that filed suit in the District of Nevada for the recovery of federal income taxes assessed for 1994 through 2002.

Eastern Vision Service Plan ("EVSP") is a New York nonprofit corporation that filed suit in the Northern District of New York for the recovery of federal income taxes assessed for 1995 through 2003.

Vision Service Plan ("VSP Ohio") is an Ohio nonprofit corporation that filed suit in this court for the recovery of federal income taxes assessed for 1999 through 2003.

Vision Services Plan, Inc., Oklahoma ("VSP Oklahoma") is an Oklahoma nonprofit corporation that filed suit in the Western District of Oklahoma for the recovery of federal income taxes assessed for 2002 through 2004.

Each plaintiff was formed as a nonstock, nonprofit corporation, and each is wholly owned and controlled by parent Vision Service Plan, Inc. ("VSP" or the "parent"), a California nonprofit corporation. VSPIC converted to a stock corporation in 1994, and all of its stock is owned by the VSP parent. March 20, 2008 Decl. of Patricia Cochran, ¶ 4. The rest of the plaintiffs remain nonstock corporations that are controlled by the VSP parent as their sole corporate member. *Id.*, ¶¶ 5-8. Each plaintiff is licensed and regulated in its respective state: VSPIC as an insurance company; VSP Massachusetts as an optometric service corporation; VSP Nevada as a nonprofit medical service corporation; EVSP as a medical expense indemnity corporation; VSP Ohio as a supplemental health



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care issuer; and VSP Oklahoma as an accident and health insurer. Under their respective bylaws and articles of incorporation, each subsidiary is operated for the purpose of providing vision care services to paying subscribers. Cochran Decl., Exs. C, D, F, H, I.

VSP keeps the subsidiaries separate for accounting and tax purposes, and each subsidiary has its own financial statements and tax returns. Cochran Decl., ¶ 12. The administration of VSP and the subsidiaries is "centralized," such that VSP "operate[s] the entire company as if it were one company." Oct. 1, 2007 Dep. of Patricia Cochran ("Cochran Dep. I"), pp. 26, 29. It is undisputed that the subsidiaries "are directed and controlled by the parent," Cochran Decl., ¶ 3, and that "[t]he parent operates everything." Oct. 3, 2007 Dep. of Richard Steere, p.15. VSP and its subsidiaries share the same president, chief financial officer, treasurer, and secretary. See Cochran Decl., Ex. L; Oct. 10, 2007 Dep. of Patricia Cochran ("Cochran Dep. II"), p. 125; Oct. 5, 2005 Decl. of Patricia Cochran (filed as doc. 65 in Calif. case), Exs. A, B. The subsidiaries exist only in order to comply with the insurance regulations of the various states in which VSP operates. Cochran Dep. I, p. 110. The subsidiaries are not their own separate, functioning businesses and do not have their own employees. *Id.*; Oct. 3, 2007 Dep. of Richard Steere, p. 12. The subsidiaries "are not entities among themselves," but are "regulatory paper entit[ies]." Steere Dep., pp. 13, 15. When, for administrative purposes, a subsidiary needs cash to pay a claim, VSP will make a noninterest-bearing advance. Cochran Dep. I, pp. 26, 30.

B. VSP's Operations

Under VSP's articles of incorporation, "the specific and primary purpose for which [VSP] is formed is to defray and assume the costs of professional vision care, by establishing a fund from periodic payments by subscribers or beneficiaries, from which fund said costs may be paid." Feb. 29, 2008 Decl. of Pamela Grewal, Ex. 4 (Restated Articles of Incorporation of Vision Service Plan, § II). VSP is an arranger of vision care services. It contracts with subscribers, including businesses, labor unions, and political subdivisions, to provide vision care services to employees and eligible dependents. VSP arranges for the enrollees to receive care through a network of optometrists and ophthalmologists who have contracted with VSP to provide services.

VSP provides vision care through both prepaid medical care programs and self-funded care programs. "Under the prepaid programs, the subscriber pays premiums to VSP, and enrollees are entitled to receive specific vision care services from VSP providers. In these prepaid programs, VSP bears the risk of underwriting gains or losses. Under the self-funded programs, the subscriber pays VSP a negotiated discounted fee for specific vision care services as the services are rendered to enrollees, but the subscriber (not VSP) in effect bears the risk of any underwriting gains or losses. Under both prepaid and self-funded programs, VSP charges an administrative fee for the administrative costs associated with processing claims." Cochran Decl., ¶ 20.

The VSP plans are available to employers of all sizes. With respect to VSP's operations through the plaintiff subsidiaries, the percentage of subscribers that employed fewer than 50 employees ranged



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from 34% to 60% during the relevant tax years. Cochran Decl., ¶ 23. The percentage ranged from 45% to 71% for subscribers that employed under 100 employees.

VSP enrollees include participants in Medicaid, Medicare, and the State Children's Health Insurance Plan ("SCHIP"). VSP contracts with health care organizations "to provide the vision care portion of various states' Medicaid programs" and VSP contracts with health plans "to perform services for Medicare patients under supplemental insurance plans." Cochran Decl., ¶ 24. The percentage of Medicaid, Medicare, and SCHIP participants relative to the overall number of enrollees across the relevant tax years ranged from 0% (for VSPS) to 10% (for VSPIC) to 41% (for VSP Oklahoma). *Id.*, Ex. O. Because VSP discounted the fees it charged to such participants and also contracted to be paid below costs, VSP absorbed underwriting losses for providing vision care services to Medicaid, Medicare, and SCHIP participants. *Id.*, ¶¶ 25-28, Exs. P, Q, R.

In addition to VSP's provision of vision services through the prepaid medical care and self-funded care programs, it engages in charitable and community outreach programs. VSP operates a "Sight for Students" program in which it provides free eye examinations and corrective lenses to children in low-income families. In 2001, for example, about 33,350 claims were processed through the Sight for Students program in the states covered by the plaintiff subsidiaries. Cochran Decl., Ex. S. VSP also works with the American Red Cross to provide free eye exams and eyeglasses to disaster victims. In 2001, about 1800 claims were processed through this program in the states covered by the plaintiff subsidiaries. *Id.* VSP is also involved in various other community outreach programs, such as sponsoring the American Optometric Association's "Vision USA" program, contributing money to the "Health Care Vision" research project, conducting an eye awareness campaign for children called "Get Focused," publishing and distributing an "Eye on Health" newsletter to network doctors, and granting money to colleges of optometry for education, research, and scholarships. *Id.*, ¶¶ 30-37, Exs. U, V.

C. Tax Status of the Plaintiff Subsidiaries

In 1971, the Internal Revenue Service granted a tax exemption under § 501(c)(4) to VSP Ohio. The other plaintiff subsidiaries applied for the same exemption in the late 1980s and in the 1990s. Those applications were denied in 1998, and in 1999 the IRS revoked the tax exempt status of VSP Ohio. Each of the plaintiff subsidiaries timely paid the taxes assessed for the tax years at issue in this litigation. Cochran Decl., ¶¶ 54-78.

Plaintiffs filed amended tax returns claiming refunds under § 501(c)(4). In 2004, the IRS issued letters disallowing plaintiffs' claims. Plaintiffs filed their respective suits for recovery of tax in 2006, within the two-year limitations period of 26 U.S.C. § 6532(a)(1). The Judicial Panel on Multidistrict Litigation consolidated all of plaintiffs' suits before this court for pretrial proceedings under 28 U.S.C. § 1407.



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In 2008 and 2009, plaintiffs filed a second round of suits for recovery of corporate income taxes assessed and collected in tax years 2001 through 2004. Those suits too have been consolidated before this court.

D. The Parent VSP's Tax Litigation

In September 2004, the parent VSP filed suit in the U.S. District Court for the Eastern District of California, asserting a claim for recovery of corporate income taxes it paid for the 2003 tax year. VSP had been granted tax exempt status under Section 501(c)(4) in 1960, but the IRS revoked VSP's status beginning with the 2003 tax year.

VSP argued that it was entitled to an exemption under Section 501(c)(4) because its operational model promoted the social welfare purpose of "health." It promoted health, VSP argued, by arranging for high-quality vision care to be provided to millions of enrollees. See VSP's Mot. for Summ. J. in Calif. case (doc. 63), pp. 23-27. VSP stressed that its health plans reached "broad segments of the community," including small employers, the elderly, and low-income individuals, and that it provided services at a discount to participants in Medicaid and Medicare. See *id.*, pp. 27-30. VSP additionally argued that it was entitled to an exemption because of its charity work and community outreach efforts in California, including Sight for Students, disaster relief, Vision USA, Health Care Vision, and Get Focused.

The district court granted summary judgment to the United States. It found that VSP operated primarily for the benefit of its members, not for the community as a whole:

[E]ven though there may be aspects of the organization that greatly benefit society, if the majority of the organization's services benefit private members, the organization cannot qualify for an exemption under 501(c)(4). . . . [T]he fact that an organization promotes health care, or is part of the health care industry, does not, alone, ensure exempt status within the tax code. . . . [T]he court concludes that despite VSP's charity work, the membership-based structure as well as the types of services offered, demonstrate that VSP's primary activity is not the promotion of social welfare.

Vision Service Plan v. U.S., No. 04-cv-1993, 2005 WL 3406321, at *4 (E.D. Cal. Dec. 12, 2005) (case citations omitted). With respect to VSP's charity and community-outreach work, the court found those efforts to be "comparatively small" to VSP's core operations and that the amounts expended represented "a very small fraction of VSP's gross or net income." *Id.*, 2005 WL 3406321, at *7.

The Ninth Circuit affirmed on appeal. In a memorandum opinion, the court held as follows:

VSP is not operated exclusively for the promotion of social welfare because it is not primarily engaged in promoting the common good and general welfare of the community. See 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) ("An organization is operated exclusively for the promotion of social welfare if it is



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primarily engaged in promoting in some way the common good and general welfare of the people of the community.").

While VSP offers some public benefits, they are not enough for us to conclude that VSP is primarily engaged in promoting the common good and general welfare of the community. See, e.g., *Monterey Pub. Parking Corp. v. United States*, 481 F.2d 175, 177 (9th Cir. 1973) (noting that the district court made a quantitative comparison between the private and public benefits); see also *Comm'r v. Lake Forest, Inc.*, 305 F.2d 814, 818 (4th Cir. 1962) (noting that the public benefits of organization were too insubstantial to qualify the organization as exempt under Section 501(c)(4)); *Police Benevolent Ass'n of Richmond v. United States*, 661 F.Supp. 765, 772-73 (E.D. Va.), *aff'd*, 836 F.2d 547 (4th Cir. 1987) (per curiam) (unpublished opinion). Furthermore, VSP's own articles of incorporation state that the primary purpose of the corporation is to establish a fund from payments by subscribers to defray and assume the costs of vision care for those subscribers. This is a purpose that benefits VSP's subscribers rather than the general welfare of the community. See *Contracting Plumbers Co-op. Restoration Corp. v. United States*, 488 F.2d 684, 686-87 (2d Cir. 1973) (setting forth several factors to examine in deciding whether an organization qualifies for a Section 501(c)(4) exemption, including the bylaws of the organization).

Vision Service Plan, Inc. v. U.S., 265 Fed. App'x 650, 651-652, 2008 WL 268075, at *1 (9th Cir. Jan. 30, 2008).

VSP appealed the Ninth Circuit's decision to the Supreme Court, which denied certiorari in 2009. See *Vision Service Plan, Inc. v. U.S.*, 129 S.Ct. 898 (U.S. Jan. 12, 2009) (No. 08-164).

II. Summary Judgment Standard of Review

Under Fed. R. Civ. P. 56(c), summary judgment is proper "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." See *Longaberger Co. v. Kolt*, 586 F.3d 459, 465 (6th Cir. 2009). The moving party bears the burden of proving the absence of genuine issues of material fact and its entitlement to judgment as a matter of law, which may be accomplished by demonstrating that the nonmoving party lacks evidence to support an essential element of its case on which it would bear the burden of proof at trial. See *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986); *Walton v. Ford Motor Co.*, 424 F.3d 481, 485 (6th Cir. 2005).

The "mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986) (emphasis in original); see also *Longaberger*, 586 F.3d at 465. "Only disputed material facts, those 'that might affect the outcome of the suit under the governing law,' will preclude summary judgment." *Daugherty v. Sajar Plastics, Inc.*, 544 F.3d 696, 702 (6th Cir. 2008) (quoting *Anderson*, 477 U.S. at 248). Accordingly, the



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nonmoving party must present "significant probative evidence" to demonstrate that "there is [more than] some metaphysical doubt as to the material facts." *Moore v. Philip Morris Cos., Inc.*, 8 F.3d 335, 340 (6th Cir. 1993).

A district court considering a motion for summary judgment may not weigh evidence or make credibility determinations. *Daugherty*, 544 F.3d at 702; *Adams v. Metiva*, 31 F.3d 375, 379 (6th Cir. 1994). Rather, in reviewing a motion for summary judgment, a court must determine whether "the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson*, 477 U.S. at 251-52. The evidence, all facts, and any inferences that may permissibly be drawn from the facts must be viewed in the light most favorable to the nonmoving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 456 (1992). However, "[t]he mere existence of a scintilla of evidence in support of the plaintiff's position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff." *Anderson*, 477 U.S. at 252; see *Dominguez v. Corr. Med. Servs.*, 555 F.3d 543, 549 (6th Cir. 2009).

III. Issue Preclusion

The United States argues that the plaintiff subsidiaries should be collaterally estopped from bringing suit because they are in privity with the parent VSP and the issue of whether VSP is tax exempt under Section 501(c)(4) has been decided by the Ninth Circuit.

Issue preclusion, or collateral estoppel, "generally refers to the effect of a prior judgment in foreclosing successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment, whether or not the issue arises on the same or a different claim." *New Hampshire v. Maine*, 532 U.S. 742, 748-49 (2001); see also *Montana v. U.S.*, 440 U.S. 147, 153 (1979). Thus, "[c]ollateral estoppel precludes relitigation of issues between parties or their privies previously determined by a court of competent jurisdiction." *U.S. v. Vasilakos*, 508 F.3d 401, 406 (6th Cir. 2007) (citing *Montana*, 440 U.S. at 153). Collateral estoppel serves to "shield litigants (and the judicial system) from the burden of re-litigating identical issues and to avoid inconsistent results." *Gilbert v. Ferry*, 413 F.3d 578, 580 (6th Cir. 2005) (citing 18 Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction* § 4403 at 11-18).

In the Sixth Circuit, there are four requirements for the application of issue preclusion:

(1) the precise issue raised in the present case must have been raised and actually litigated in the prior proceeding; (2) determination of the issue must have been necessary to the outcome of the prior proceeding; (3) the prior proceeding must have resulted in a final judgment on the merits; and (4) the party against whom estoppel is sought must have had a full and fair opportunity to litigate the issue in the prior proceeding.



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Cobbins v. Tenn. Dep't of Transp., 566 F.3d 582, 589-90 (6th Cir. 2009); Hamilton's Bogarts, Inc. v. Michigan, 501 F.3d 644, 650 (6th Cir. 2007).

A. Operational Model Theory is Precluded

Plaintiffs' primary legal theory for why they are tax exempt under Section 501(c)(4) is an "operational model" argument. Plaintiffs argue that they promote the social welfare purpose of "health" by arranging for their members to receive vision services. They cite certain I.R.S. revenue rulings and manual guidelines for the proposition that generally promoting health is an exempt purpose. Under their model, vision care services are available to broad segments of the community because plans are open to employers of all sizes and because enrollees include participants in Medicaid, Medicare, and SCHIP. Plaintiffs contend that their model allows them to provide vision services to the elderly, low income individuals, and persons living in rural areas. See Pls.' Brief (doc. 23), pp. 21-30.

VSP raised the very same operational model theory in the California litigation. Citing the identical I.R.S. revenue rulings and manual guidelines as plaintiffs do here, VSP contended that it was "organized in a manner that promotes social welfare" and that its "operational characteristics" entitled it to tax exempt status. VSP argued that it promoted health by arranging for its members to receive vision care services and stressed that its model brought vision care to broad segments of the population, including employees of small employers, persons living in rural areas, and participants in Medicaid, Medicare, and SCHIP. See VSP's Mot. for Summ. J. in Calif. case (doc. 63), pp. 23-30.

An issue is actually litigated when it was properly raised, submitted for determination, and is determined by a court of competent jurisdiction. Gilbert, 413 F.3d at 581 (citing Restatement (Second) of Judgments § 27 cmt. d (1982)). Plaintiffs argue that the issue here is different because this litigation concerns different tax years than were at issue in the California action. In the tax context, "[e]ach [tax] year is the origin of a new liability and of a separate cause of action." Comm'r v. Sunnen, 333 U.S. 591, 598 (1948). That each tax year gives rise to a new claim is the reason why res judicata does not apply to the bulk of plaintiffs' claims, but it does not bar the application of issue preclusion. Issue preclusion may be applied in a tax case involving different tax years "where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged." Id., 333 U.S. at 599-600; see also Kennedy v. Comm'r, 876 F.2d 1251, 1257 (6th Cir. 1989). Thus, issue preclusion applies if the "controlling facts and legal principals have not changed significantly since [the] prior judgment." Garrison v. Comm'r, No. 97-1355, 1998 WL 69011, at *2 (6th Cir. Feb. 11, 1998); see also Ammex, Inc. v. United States, 384 F.3d 1368, 1371 (Fed. Cir. 2004); Corrigan v. United States, 82 Fed. Cl. 301, 307-308 (Fed. Cl. 2008).

Though plaintiffs' claims concern tax years largely different from the year for which VSP filed its lawsuit, the controlling facts and applicable legal rules, as they pertain to plaintiffs' organizational model theory, are the same in this litigation as they were in the California action. Plaintiffs have not



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pointed to any way in which their organizational model operated differently from the way the VSP parent operated in 2003. It is undisputed that the organizational model -- its mission, services, and structure -- is the same throughout the VSP system. See Cochran Dep. I, p. 26 (stating that entire VSP system is operated as "one company"), p. 29 (stating that administration of VSP system is centralized). Under the articles of incorporation of VSP and of the plaintiffs, the primary purpose of every VSP entity is to provide a benefit to subscribers. See Gilbert, 413 F.3d at 581 (first requirement of issue preclusion satisfied where plaintiffs presented "the same argument and evidence" in both lawsuits)

Plaintiffs additionally argue that the facts here are different because the exact percentages of small employers enrolled and Medicaid, Medicare, and SCHIP participants served vary from state to state and from year to year; thus, the percentages in this litigation necessarily are different from what they were in California in 2003. As a factual matter, the percentages of such populations served are almost always lower for the plaintiffs than for VSP in 2003. Compare Cochran Decl., ¶ 23 and Ex. O with Oct. 5, 2005 Decl. of Patricia Cochran, ¶¶ 15-17 (filed as doc. 65 in Calif. case). Regardless, issue preclusion applies if the controlling facts have not changed, and here they have not. The controlling fact in the California litigation was that the members of the various segments of society served were all subscribers. The district court recognized that "[w]hile VSP [did] in fact offer services to these groups," it was "operating primarily for the benefit of its subscribers rather than for the purpose of benefitting the community as a whole." *Vision Service Plan v. U.S.*, No. 04-cv-1993, 2005 WL 3406321, at *6 (E.D. Cal. Dec. 12, 2005) This fact, the court concluded, "preclude[d] VSP from exemption under 501(c)(4)." *Id.* Likewise the Ninth Circuit held: "VSP's own articles of incorporation state that the primary purpose of the corporation is to establish a fund from payments by subscribers to defray and assume the costs of vision care for those subscribers. This is a purpose that benefits VSP's subscribers rather than the general welfare of the community." *Vision Service Plan, Inc. v. U.S.*, 265 Fed. App'x 650, 651-652, 2008 WL 268075, at *1 (9th Cir. Jan. 30, 2008). So too here, the various small employers and Medicaid, Medicare, and SCHIP participants served by plaintiffs are all subscribers. The exact percentages are not what is controlling.

The next requirement for applying issue preclusion is that determination of the issue was necessary to the outcome of the prior proceeding. Both the California district court and the Ninth Circuit rejected VSP's operational model argument. The courts squarely held that VSP's delivery of vision services alone was not sufficient for a tax exemption because VSP's membership-based model worked to the primary benefit of subscribers and not to the general welfare of the community. Plaintiffs protest -- not that the district court and Ninth Circuit's determination of the issue was unnecessary to the outcome -- but that the determination was erroneous. In support of this argument, plaintiffs cite a couple of tax law practice newsletters criticizing the district court's analysis. Whether those courts got it wrong is of no consequence here. An issue actually determined in the original action "cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law." *Montana*, 440 U.S. at 162 (quoting *United States v. Moser*, 266 U.S. 236, 242 (1924)).



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The third requirement is a final judgment on the merits in the prior suit. Surprisingly, plaintiffs contend that "the proceedings in the California action are not complete" because the Ninth Circuit's "11/2 -page memorandum decision . . . fails to address much of the District Court's analysis." Pls.' Brief, p. 41. Regardless of the brevity of the Ninth Circuit's decision, it rejected the merits of VSP's operational model theory and affirmed the district court. The holding is no less final because the Ninth Circuit chose to refrain from exhaustively reviewing the district court's decision. Nor is the decision any less final because it was delivered in the form of an unpublished memorandum disposition. Under Ninth Circuit Rule 36-3(a), such dispositions do not have precedential value, "except when relevant under the doctrine of law of the case or rules of claim preclusion or issue preclusion." Further, VSP's petitions for rehearing en banc and for writ of certiorari were both denied. See *Vision Service Plan, Inc. v. U.S.*, No. 06-15269 (9th Cir. Apr. 9, 2008) (denying petition for rehearing en banc), cert denied 129 S.Ct. 898 (U.S. Jan. 12, 2009) (No. 08-164). Thus, the California action reached a final judgment on the merits.

Finally, the party against whom issue preclusion is sought must have had a full and fair opportunity to litigate the issue in the prior proceeding. Plaintiffs stress that they were not parties to the California litigation; however, issue preclusion applies if the party to be estopped is in privity with a party to the prior litigation. See *Montana*, 440 U.S. at 153; *United States v. Vasilakos*, 508 F.3d 401, 406 (6th Cir. 2007). "Privity is limited to 'a successor in interest to the party, one who controlled the earlier action, or one whose interests were adequately represented.'" *Vasilakos*, 508 F.3d at 406 (quoting *Sanders Confectionery Prods., Inc. v. Heller Fin., Inc.*, 973 F.2d 474, 481 (6th Cir. 1992)). A parent corporation and its wholly-owned subsidiaries have a relationship providing sufficient control, so long as they share a common legal interest in the outcome of the litigation. See *Living Care Alternatives of Kirkersville, Inc. v. United States*, 247 Fed. App'x 687, 697-98 (6th Cir. 2007); *In re Imperial Corp. of Am.*, 92 F.3d 1503, 1507 (9th Cir. 1996) (citing cases); *B-S Steel of Kansas, Inc. v. Texas Indus., Inc.*, 327 F.Supp.2d 1252, 1259 (D. Kan. 2004) (citing cases); *JSC Securities, Inc. v. Gebbia*, 4 F.Supp.2d 243, 251-52 (S.D.N.Y. 1998).

The evidence before the court establishes conclusively that the VSP subsidiaries are in privity with the parent. Plaintiffs are "paper entities" and the "parent company operates everything." Steere Dep., p. 15. According to VSP's chief financial officer, plaintiffs are "directed and controlled by the parent," and the whole VSP system is operated as one company. Cochran Decl., ¶ 3; Cochran Dep. I, p. 26. The complaints likewise state that each plaintiff is controlled and wholly owned by VSP and is integrated in the VSP system. See, e.g., Ohio Complaint, No. 2:06-cv-501, ¶¶ 10, 39; see also Cochran Decl., ¶¶ 4-8. VSP and the plaintiffs share the same president, chief financial officer, treasurer, and secretary, and plaintiffs do not have their own employees. See *Waddell & Reed Fin., Inc. v. Torchmark Corp.*, 223 F.R.D. 566, 619 (D. Kan. 2004) ((finding that privity existed where parent and wholly-owned subsidiary shared corporate officers and legal counsel); *Greenberg v. Potomac Health Systems, Inc.*, 869 F.Supp. 328, 331 (E.D. Pa. 1994) (finding that privity existed where parent and wholly-owned subsidiary shared corporate officers).



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The legal interests of VSP and its subsidiaries are aligned. Plaintiffs' complaints and summary judgment brief are very similar to, if not identical, to parallel filings by VSP in the California litigation. Further, plaintiffs and VSP are represented by the same legal counsel and have retained the same expert. See *Montana*, 440 U.S. at 157 (noting that the complaint in the second suit tracked "almost verbatim" the complaint in the prior suit); *Rymer Foods, Inc. v. Morey Fish Co.*, No. 96-4139, 1997 WL 358870, at *6 (7th Cir. June 23, 1997) (noting that same legal counsel represented parties in privity).

As the United States observes, this litigation has the look and feel of VSP trying to get a second chance at tax exempt status. This underscores the importance of applying issue preclusion. Were the court to agree with the merits of plaintiffs' operational model theory, such a ruling would directly conflict with the Ninth Circuit's decision. This court would be granting tax-exempt status to the subsidiaries on a basis for which the Ninth Circuit said the parent was not entitled to an exemption.

In that situation, VSP's operations in the plaintiffs' states would operate tax-free while the very same operation in California would not. Issue preclusion protects against such an inconsistent result. *Gilbert*, 413 F.3d at 580.

Finally, it should be noted that certain plaintiffs seek a tax exemption under § 501(c)(4) for the 2003 tax year, the same year for which the Ninth Circuit held that VSP was not entitled to a tax exemption under § 501(c)(4). These particular claims are barred by *res judicata*, under which a final judgment forecloses "successive litigation of the very same claim, whether or not relitigation of the claim raises the same issues as the earlier suit." *New Hampshire*, 532 U.S. at 748. The requirements for establishing claim preclusion are: "(1) a final decision on the merits by a court of competent jurisdiction; (2) a subsequent action between the same parties or their 'privies'; (3) an issue in the subsequent action which was litigated or which should have been litigated in the prior action; and (4) an identity of the causes of action." *Bittinger v. Tecumseh Prods. Co.*, 123 F.3d 877, 880 (6th Cir. 1997). For the reasons already discussed in the context of issue preclusion, these requirements are satisfied as to certain plaintiffs' claims for a tax exemption for 2003.

B. The Issue of Plaintiffs' Charitable Services to Non-Enrollees is not Precluded

Plaintiffs assert that even if their operational model alone does not entitle them to an exemption, their additional charitable and community outreach programs to non-enrollees qualify them for tax exempt status. Plaintiffs argue that they "provide substantial charity care to low income children and disaster victims, and promote eye care education and other programs to enhance the quality of eye care." Pls.' Brief, p. 9.

There is no doubt that VSP made the same type of argument in the California litigation. Specifically, VSP argued that its provision of free care to non-enrollees through charitable and community outreach programs qualified it for a tax exemption. The district court actually determined this issue,



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holding that those community benefits were "minimal" and "incidental" in relation to VSP's overall operations. The Ninth Circuit found too that the public benefits provided by VSP were "not enough."

Nonetheless, issue preclusion does not apply when "the relevant facts in the two cases are separable, even though they be similar or identical." *Sunnen*, 333 U.S. at 601.¹ The facts concerning plaintiffs' charitable and community outreach work to non-enrollees are separable from those facts in the California litigation. Plaintiffs offer evidence that they have made their own expenditures for charitable and community outreach work, separate from the expenditures of VSP. The tax implications of plaintiffs' expenditures was not actually litigated in the California case because the district court focused its inquiry on VSP's charitable expenditures in California. Unlike plaintiffs' first theory, where the relevant facts concern an operational model that is indistinguishable from VSP's model, plaintiffs' second theory for tax-exempt status relates to the amount of charity work done by each plaintiff. These amounts are distinguishable from the charity work done by VSP in California. Thus, plaintiffs are not precluded from litigating the issue of whether their charitable and community outreach work to nonenrollees entitles them to tax-exempt status.

IV. Charitable Services to Non-Enrollees are not Sufficient for Tax-Exempt Status

The tax code grants an income tax exemption to organizations that operate "exclusively for the promotion of social welfare." 26 U.S.C. § 501(c)(4). An organization is operated exclusively for the promotion of social welfare if "it is primarily engaged in promoting in some way the common good and general welfare of the people of the community." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i). In determining whether an organization is primarily engaged in promoting the general welfare, courts typically compare or weigh an organization's purported charitable activity against its non-exempt activity, which here is plaintiffs' delivery of vision care services to paying subscribers. See, e.g., *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945) ("[T]he presence of a single [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes."); *Harding Hospital, Inc. v. U.S.*, 505 F.2d 1068, 1072 (6th Cir. 1974) ("The term 'exclusively' . . . means that an organization is not exempt if it has any substantial noncharitable purpose."); *Ohio Teamsters Educational and Safety Training Trust Fund v. Comm'r*, 692 F.2d 432, 435 (6th Cir. 1982) (same).

Plaintiffs' charitable efforts have three main areas of focus, though not every plaintiff has engaged in every type of charity work mentioned. The first is the "Sight for Students" program through which free services, including eye examinations, eyeglasses, medically-necessary contact lenses, vision therapy and low vision treatment, are provided to children of families earning up to 200% of the poverty level and who do not otherwise participate in an eyecare insurance program. *Cochran Decl.*, ¶ 30. Every plaintiff has participated to some degree in this program. *Id.*, Ex. S.

The second area of focus is disaster relief, whereby plaintiffs coordinate with the American Red Cross to provide free exams and replacement glasses to disaster victims. *Id.*, ¶ 31. Every plaintiff but



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VSPS has participated to some degree in this program. Id., Ex. S.

The final area of focus is termed broadly as education and community outreach. Examples of such outreach include sponsoring the Vision USA program that matches low-income persons with volunteer optometrists providing free exams, contributing to the Health Care Vision project for research on eye disease, conducting the Get Focused public awareness campaign to promote regular eye exams for children, and donating money to colleges of optometry. Id., ¶¶ 32-37. The evidence shows that VSPIC and VSP Nevada had some participation in these programs during the relevant tax years but that VSPS, EVSP, and VSP Ohio did not. Id., Ex. V. Plaintiffs have not submitted any evidence to show whether VSP Massachusetts or VSP Oklahoma did or did not participate in those programs, but the complaints in those cases contain no allegations that they did.

The court, having reviewed all of the materials submitted by plaintiffs concerning this issue, finds that each plaintiff's charitable and community outreach efforts for each tax year are insubstantial in relation to each plaintiff's non-exempt activity. To provide a representative example, the combined number of individuals served by VSP Ohio in 2000 through Sight for Students and disaster relief represented just two-tenths of one percent of VSP Ohio's total paying enrollment. See Cochran Decl., Exs. O and S. The maximum such percentage achieved by any of the plaintiffs was eight-tenths of one percent by VSP Oklahoma in 2004. Id.

Looking at the dollar amounts expended, plaintiffs aspire to "spend up to 40% of excess net revenue annually to provide charity care." Cochran Decl., ¶ 29. This percentage appears to have been achieved by VSP Nevada in 2000, but a more representative example is VSPIC, which in 1999 spent 7% of its net income on Sight for Students, disaster relief, Vision USA, and donations to colleges of optometry. Id., Ex. V; Grewal Decl., Ex. I. To provide another example, EVSP spent 3% of its net income on Sight for Students in 1998. Id.

In summary, the United States has demonstrated that there is no genuine issue of fact as to whether plaintiffs' charitable and community outreach efforts were sufficient to qualify for a tax exemption. For each plaintiff and every tax year, those efforts were not the activity in which plaintiffs were primarily engaged. Rather, those efforts were minimal in relation to plaintiffs' non-exempt activity of providing vision services for subscribers.

V. Conclusion

For the reasons set forth above, the United States' motion for summary judgment (doc. 20) is GRANTED. Plaintiffs' motion for leave to file a supplemental brief (doc. 36) is GRANTED, but the arguments contained therein have no effect on the result of this litigation.

The Clerk of Court is instructed to enter judgment in favor of defendant. Costs are awarded against plaintiffs.



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1. Many courts have observed that the "separable facts" aspect of *Sunnen* is not good law except perhaps in the tax context. See, e.g., *Peck v. Comm'r*, 904 F.2d 525, 527 (9th Cir. 1990) (collecting cases).

