TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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No Third Party Contact
UIL: 501.03-11

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:
A =
B =
C =
D =

Dear :

This is in response to your ruling request as to the tax consequences of the proposed reorganization described below.

A is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as hospital described in section 170(b)(1)(A)(iii). A's Board of Directors is appointed by B

B is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a supporting organization described in section 509(a)(3). B performs long range planning, management and coordination services for A, C and D.

C is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a supporting organization described in section 509(a)(3). C performs investment management and fundraising activities for A. C's Board of Directors is appointed by B.

D is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as an organization described in section 509(a)(2). D performs pediatric home healthcare services and is affiliated with A.

The proposed reorganization involves the dissolution of B and D, with the assets of those

entities being transferred to A. After the dissolution of B and D, A's primary function will continue to be the operation of a pediatric hospital, but management functions previously performed by B and the pediatric home healthcare services provided by D will be merged into A's operations. C will continue to perform its investment management and fundraising operations to support A. The simplification of the multi-entity corporate structure into a traditional parent-subsidiary relationship between A and C will enable A and C to operate in a more efficient and effective manner.

Following the reorganization, A will amend its governing instruments to provide that the election of its directors will be by the directors themselves rather than by B. Furthermore A's bylaws will be amended to facilitate increased planning between A and C by creating joint committees between the two organizations.

Following the reorganization, C will modify its governing instruments to provide for appointment of its directors by A, and to facilitate increased cooperation between the two entities through a shared committee structure. This will allow the two entities to better integrate the fundraising and investment responsibilities of C with the healthcare responsibilities of A..

. A , B, C and D are requesting the following rulings:

1) The proposed reorganization and transfer of assets to A from B and D will not give rise to unrelated business taxable income pursuant to sections 511 through 514 of the Code to A, B, or D.

2) A will continue to be described in section 501(c)(3) of the Code and classified as an organization described in sections 170(b)(1)(A)(iii) and 509(a)(1) of the Code, after the proposed reorganization.

3) The provision of home health care services by A following the proposed reorganization will not result in unrelated business taxable income attributable to A under sections 511 through 513 of the Code.

4) C, after amendments to its Articles of Incorporation and Amended and Restated Bylaws will not be a private foundation and will continue to qualify as a supporting organization of A pursuant to section 509(a)(3) of the Code.

5) After the proposed reorganization, the sharing of assets and services among A and C along with the related allocations of costs or other contractual arrangements for sharing assets and will give rise to unrelated trade or business taxable income to either A or C under sections 511 through 514 of the Code.

LAW

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of organizations that are organized and operated exclusively for religious, charitable, scientific, or educational purposes, provided no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations provides that an organization's assets will be considered dedicated for an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles be distributed for one or more exempt purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts, sections 368, 372; IV Scott on Trusts, sections 368, 372 (3rd ed. 1967); and Revenue Ruling 69-545, 1969-2 C.B. 117.

Section 509(a)(3) of the Code excludes from the definition of a private foundation an organization which is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or 509(a)(2).

Section 1.509(a)-4(c)(1) of the regulations provides that a supporting organization will satisfy the organizational test of section 509(a)(3)(A) if its articles limit the purposes of such organizations one or more of the purposes set forth in section 509(a)(3)(A); do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in (i) of the paragraph; state the specified public supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subparagraph (iii) of this subparagraph.

Section 1.509(a)- 4(e)(1) of the regulations provides that an organization will be operated exclusively to support one or more specified publicly supported organizations only if it engaged solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. Similarly an organization will be operated exclusively to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

Section 1.509(a)-4(e)(2) of the regulations provides in part, that in order to meet the operational test, an organization may engage in fundraising activities.

Section 1.509(a)-4(g)(1) of the regulations provides that each of the items operated by, supervised by, and controlled by, as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these

terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed by or elected by the governing body of one ore more publicly supported organizations.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions directly attributable to such business activity.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purpose or function constituting the basis for its exemption.

Section 1.513-1(a) of the regulations defines "unrelated business taxable income" to mean gross income from any unrelated trade or business regularly carried on. Section 1.513-1(b) states that the phrase "trade or business" includes activities carried on for the production of income and which possess the characteristics of a trade or business within the meaning of section 162 of the Code. Finally, section 1.513-1(c) explains that "regularly carried on" has reference to the frequency and continuity of the conduct of an activity and the manner in which the activity is pursued.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activity has a causal relationship to the achievement of any exempt purpose, and is "substantially related" for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 514 of the Code provides for the taxation under section 512 of the Code of income from debt-financed property. Section 514(b)(1)(A)(i) of the Code, however, provides that the definition of debt-financed property does not include any property substantially all the use of which is substantially related to the exercise or performance by such organization of its charitable purposes constituting the basis for its exemption under section 501.

Rev. Rul. 69-545, 1969-2 C.B. 117, sets forth standards under which a nonprofit hospital may qualify for recognition of exemption under section 501(c)(3) of the Code. This revenue ruling gave consideration to two separate hospitals, only one of which was determined to qualify for exempt status under section 501(c)(3). By weighing all the relevant facts and circumstances, the revenue ruling analyzed whether both the control and use of the hospitals

were for the benefit of the public or for the benefit of private interests. The hospital that qualified for exemption was found to be organized and operated to further the charitable purpose of promoting health by satisfying a community benefit standard that included, among other factors, a board of directors that broadly represented the interests of the community. The hospital that did not qualify for recognition of exemption was found to be operating for the private benefit of those who controlled it rather than for the benefit of the public.

Rev. Rul. 72-209, 1972-1 C.B. 148, provides that a nonprofit organization formed to provide low cost home health care for people of a community may qualify for exemption under section 501(c)(3) of the Code as a charitable organization. The revenue ruling concludes that by providing home nursing and therapeutic care in the manner described, the organization serves many of the same health care needs of the community that hospitals traditionally serve, and therefore is promoting health within the meaning of the general law of charity.

Rev. Rul. 78-41, 1978-1 C.B. 148, concludes that a trust created by a hospital to accumulate and hold funds to pay malpractice claims against the hospital qualified for exemption under section 501(c)(3) of the Code as an integral part of the hospital. The hospital provided the funds for the trust, and the banker-trustee was required to make payments to claimants at the direction of the hospital. The organization conducted an activity that the hospital could perform itself.

Issue 1

The transfer of assets to A from B and D are one time transfers and therefore will not possess the characteristics of a trade or business "regularly carried on." See section 512(a)(1), discussed supra. The transfer of assets will not subject A, B, or D to any tax on unrelated business income under sections 511-514 of the Code.

Issues 2 and 3

A will continue to operate the hospital after the reorganization. Its Articles of Incorporation will not be modified, and it will be governed in the same manner as prior to the reorganization. A will also provide home healthcare services that were provided by D, as an organization described in section 501(c)(3). These services further A's exempt purposes and will not subject A to the tax on unrelated business income under sections 511-514. See Rev. Rul. 72-209, supra. Therefore, its current tax-exempt status under section 501(c)(3) of the Code and classification as not a private foundation as a hospital will not be affected by the reorganization

Issue 4

After the reorganization, C will still conduct the same activities that it performed prior to the reorganization as an integral part of A's operations. See Rev. Rul. 78-41, supra. C is still described as a section 509(a)(3) organization because its organizing documents provide that it will support A, it is operated, supervised or controlled by A, and it is not controlled by any disqualified persons. See Sections 1.509(a)-4(e)(1), 1.509(a)-4(e)(2), and 1.509(a)-4(g)(1)(i),

supra.

Issue 5

Following the proposed reorganization, the sharing of services and facilities between A and C, whether or not a fee is charged, and transfers of assets between A and C will be substantially related to the exercise or performance of the exempt purposes of A and C and will, therefore, not constitute unrelated trade or business activities subject to tax. Therefore, A and C will be merely supplying a related charitable organization with a service or facility necessary for, and in the furtherance of, the performance of exempt functions under section 501(c)(3).

Based on all the facts and circumstances described above, we rule as follows:

1) The proposed reorganization and transfer of assets to A from B and D will not give rise to unrelated business taxable income attributable to either A, B or D under sections 511 through 514 of the Code.

2) A will continue to be described in section 501(c)(3) of the Code and classified and as an organization described in sections 170(b)(1)(A)(iii) and 509(a)(1) of the Code.

3) The provision of home health care services by A following the proposed reorganization will not result in unrelated business taxable income attributable to A under sections 511 through 514 of the Code.

4) C after amendments to its Articles of Incorporation and Amended and Restated Bylaws will not be a private foundation and will continue to qualify as a supporting organization of A pursuant to section 509(a)(3) of the Code.

5) After the proposed reorganization, the sharing of assets and services among A and C along with the related allocations of costs or other contractual arrangements for sharing assets and services will not give rise to unrelated trade or business taxable income to either A or C under sections 511 through 514 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Steven B. Grodnitzky
Acting Manager,
Exempt Organizations
Technical Group 1

Enclosure
Notice 437