



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Contact Person:

Identification Number:

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Dear \_\_\_\_\_ :

This is in response to a letter from your authorized representative requesting rulings on your behalf regarding a proposed statutory merger and its effect under sections 501(c)(3), 509(a), and 511 through 514 of the Internal Revenue Code.

Facts

B is exempt from federal income tax under section 501(c)(3) of the Code, and is classified as a public charity pursuant to section 509(a)(3). B is the parent organization of an integrated health system composed primarily of tax-exempt health care provider organizations of which B is the sole member. It is organized and operated exclusively for the support of these organizations, which are exempt from federal income tax under section 501(c)(3) and are classified as public charities pursuant to sections 509(a)(1) or 509(a)(2). B provides centralized management, strategic planning coordination, and bond financing coordination for each of these health care provider organizations. Two of these health care provider organizations are C and D.

C is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a public charity pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii). C's primary purpose is to provide, maintain, operate, and support the provision, maintenance, and operation of in-patient and out-patient hospital facilities and health care services throughout the greater E community, for all persons who are acutely ill or otherwise require medical care and services. Its mission is to learn, teach, heal the sick, and conserve health.

C is governed by a Board of Directors appointed by B, its sole member. Its Board of Directors consists of a majority of directors who are independent of C and the B system, and are

representative of the community. Its Bylaws require a quorum of the Board to consist of a majority of board members who are not members of the C medical staff. C does not have an executive committee.

C operates an F-bed hospital. This hospital has an emergency room that is available to all patients regardless of their ability to pay. C has adopted and carries out a Charity Care Policy and an Uninsured Discount Policy. C communicates these policies to all individuals who are potentially eligible for benefits under either policy. C maintains brochures at its treatment facilities that detail the options available to C's financially challenged patients. Also, C's financial counselors work with patients to ensure that they will receive the optimum amount of charity care or uninsured discount that is available to them. Approximately fifty percent of C's patients are Medicaid or Medicare beneficiaries.

C has also adopted a conflicts of interest policy requiring its Board of Directors or a committee thereof to review and approve any transactions between C and interested persons. C's compensation committee reviews and approves executive compensation annually, using executive compensation surveys and the services of a consulting firm to ensure reasonableness. Salary data and salary surveys are also used to determine the compensation of non-executive and physician employees of C.

C determines whether to have an open medical staff or to restrict its medical staff privileges to a limited group of physicians on a department-by-department basis, according to its medical staff development plan. Approximately two-thirds of C's departments have open medical staffs. The other C departments restrict staff membership based on factors such as board certification, experience, employment with C, agreements with third party physicians groups, and academic appointments at G.

C engages in research involving the neurosciences, medical oncology, human genetics, cardiovascular and pulmonary diseases, orthopedics, and trauma. C's hospital also serves as a campus of G.

Prior to its merger with C, D was exempt from federal income tax under section 501(c)(3) of the Code and was classified as a public charity pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii). Its sole member was B. D operated a 154-bed hospital.

On date h, D merged with C pursuant to a Plan of Merger approved by the State of I ("Statutory Merger"). Upon this Statutory Merger, all assets and liabilities of D were merged with and into C, the surviving entity (referred to hereafter as "Post-Merger C"), and the separate corporate existence of D ceased. Pursuant to the Plan of Merger, Post-Merger C is to use all assets of D in continuation of its tax-exempt purposes. Post-Merger C has continued to perform its activities and those of D that C and D performed prior to the Statutory Merger.

The purposes of the Statutory Merger are to expand C's acute care services to a broader community, eliminate duplication of services within the B system, and create a more synergistic integration of the respective hospitals' strengths for the benefit of residents of the areas served by the hospitals.

Post-Merger C continues to be governed by a Board of Directors comprised of a majority of members who are appointed by B, independent of C and the B system, and representative of the community. It continues to maintain a compensation committee that approves executive compensation and reviews its reasonableness. Post-Merger C also continues to maintain its Conflicts of Interest Policy, Charity Care Policy, and Uninsured Discount Policy, and continues

to make available and promote its Charity Care Policy and Uninsured Discount Policy to all patients regardless of their ability to pay. It continues to maintain an open medical staff for a majority of its departments, and to impose reasonable eligibility criteria for medical staff members of other departments. Post-Merger C also continues to maintain emergency rooms at its C hospital and the former D hospital, which are available to all patients regardless of their ability to pay.

B continues, post-merger, to be organized and operated exclusively for the support of the health care provider public charities of which it is the sole member.

### Rulings Requested

1. The Statutory Merger of D with and into C does not adversely affect the tax-exempt status of C, B, or Post-Merger C, as the surviving corporation, under section 501(c)(3) of the Code.
2. The Statutory Merger of D with and into C does not adversely affect the non-private foundation status of C, B, or Post-Merger C, as the surviving corporation, under section 509(a) of the Code.
3. The transfer of assets and liabilities from D to C pursuant to the Plan of Merger does not produce unrelated business income to C, B, or Post-Merger 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 charitable, educational or scientific purposes, provided no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term charitable is used in section 501(c)(3) of the Code 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; Rev. Rul. 69-545, 1969-2 C. B. 117.

Section 509(a) of the Code provides that all organizations described in section 501(c)(3) are private foundations except those described in sections 509(a)(1), (2), (3), or (4).

Section 509(a)(1) of the Code excludes from the term private foundation an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)).

Section 170(b)(1)(A)(iii) of the Code describes an organization whose principal purpose or functions include providing medical or hospital care or medical education or medical research.

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), and is organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of such organizations.

Section 511(a) of the Code imposes a tax on the unrelated business income of organizations

described in section 501(c)(3).

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

Section 1.513-1(c) of the regulations describes a “regularly carried on” activity as one that is carried on frequently and continuously.

Section 513(a) of the Code defines unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the organization’s need for funds or the use it makes of the profits derived) to the exercise of the organization's exempt purposes.

Rev. Rul. 69-545, 1969-2 C.B. 117, acknowledges that the promotion of health is a charitable purpose within the meaning of section 501(c)(3) of the Code. It states that a hospital must primarily benefit the community to qualify for exemption under this code section. One method of establishing a community benefit is through a charity care policy. This policy provides free or subsidized care to the indigent in the community. Such a policy must be communicated to the general public. This ruling also states that when a majority of the board of directors of a hospital consists of independent members of the local community, no inurement has occurred.

### Analysis

Post-merger C continues to carry on the activities of each of its predecessor organizations, C and D, providing health care services to the greater E community in furtherance of its tax exempt purposes.

The Board of Post-Merger C continues to be composed of a majority of independent directors who are representative of the community. Post-Merger C continues to maintain and promote its Charity Care Policy and Uninsured Discount Policy. It continues to maintain its Conflicts of Interest Policy, and will annually review the compensation of its employees to ensure reasonableness. The hospitals owned by Post-Merger C, including the hospital transferred from D to C upon their merger, continue to have emergency rooms that are available to all patients regardless of their ability to pay. Post Merger-C also continues to have an open medical staff in a majority of its hospitals’ departments. Therefore, Post-Merger C continues to satisfy the community benefit standard set forth in Rev. Proc. 69-545.

Thus, Post-Merger C continues to promote health in a charitable manner in furtherance of its tax exempt purposes and those of B, and consistent with section 501(c)(3) of the Code and section 1.501(c)(3)-1(d)(2) of the regulations. Therefore, the classification of Post-Merger C as a tax-exempt public charity pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code is not adversely affected by the Statutory Merger.

B will continue, post-merger, to be organized and operated exclusively for exempt purposes, in support of the health care provider organizations of which B is the sole member, including Post-Merger C. B’s supported organizations are exempt from federal income tax under section 501(c)(3) of the Code, and classified as public charities pursuant to sections 509(a)(1) or 509(a)(2) of the Code. Accordingly, the classification of B as a tax-exempt public charity pursuant to section 509(a)(3) of the Code will not be adversely affected by the Statutory Merger.

The transfer of assets and liabilities from D to C was a one-time event that occurred upon the merger of D into C. Accordingly, this activity was not and is not “regularly carried on” under section 512(a)(1) of the Code or section 1.513-1(c) of the regulations. Thus, such transfer does not generate unrelated business taxable income under sections 511-514 of the Code.

### Rulings

1. The Statutory Merger of D with and into C does not adversely affect the tax-exempt status of C, B, or Post-Merger C, as the surviving corporation, under section 501(c)(3) of the Code.
2. The Statutory Merger of D with and into C does not adversely affect the non-private foundation status of C, B, or Post-Merger C, as the surviving corporation, under section 509(a) of the Code.
3. The transfer of assets and liabilities from D to C pursuant to the Plan of Merger does not produce unrelated business income to C, B, or Post-Merger C, under sections 511 through 514 of the Code.

However, we are not ruling on whether any of the assets that D transferred to C may, some time after completion of the merger, generate unrelated business income to Post-Merger C.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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 Grodnitzky  
Manager  
Exempt Organizations,

Technical Group 1

Enclosure: Notice 437

cc: