



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:

Telephone Number:

Employer Identification Number:

UIL: 501.03-00; 513.00-00

Legend:

A =  
B =  
C =  
D =  
E =  
F =  
G =  
H =  
I =

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

We have considered your ruling request dated May 15, 2009, as amended on May 28, 2010 and December 8, 2010, regarding the tax consequences of a proposed hospital reorganization.

Facts

A is a public hospital authority established by the County of H, in the State of I, to provide healthcare services for residents of the County of H. A is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code (the "Code") and is not a private foundation within the meaning of section 509(a). Prior to the reorganization, A owned and operated a number of healthcare facilities, including hospitals and urgent care centers.

You are a corporation organized to carry out the purposes of A and other organizations which are operated for the benefit of A, and to otherwise support the delivery of healthcare services in the county of H and surrounding areas. You are exempt from taxation under section 501(c)(3) of the Code and are not a private foundation within the meaning of section 509(a).

B is a corporation organized and operated to provide cardiac healthcare services. B is exempt from federal taxation under section 501(c)(3) of the Code and is not a private foundation within the meaning of section 509(a). B will be merged with you and you will be the surviving

entity following the reorganization.

C was a corporation organized and operated to solicit funds for charitable purposes in connection with the operation of a facility owned by A, was exempt from federal taxation under section 501(c)(3) of the Code, and was not a private foundation within the meaning of section 509(a). C was dissolved and the proceeds of C were distributed to you and E, another organization exempt under section 501(c)(3) of the Code.

D is a taxable corporation organized and operated to further the goals of its members through management services, healthcare contracting and other healthcare-related services. D has three classes of members: A, B, and C. Class A and B members are physicians and specialists. The sole class C member prior to the reorganization was A.

E is a corporation organized as a supporting organization for you, and will operate as the parent entity after the reorganization. E is exempt from federal taxation under section 501(c)(3) of the Code and is not a private foundation within the meaning of section 509(a). E is a supporting organization within the meaning of section 509(a)(3).

F is a corporation organized to manage and operate emergency medical and ambulance service for the benefit of the general public and to carry out related healthcare activities. F is exempt from federal taxation under section 501(c)(3) of the Code and is not a private foundation within the meaning of section 509(a).

G is a corporation organized to hold title to property, collect income therefrom, and turn over the entire amount, less expenses, to E.

The purpose of the reorganization is to more effectively promote the health of the community by increasing the flexibility of the operation of the hospitals and utilization of related assets. Laws in the State of I restrict the ability of a hospital authority to expand geographically or to engage in certain activities. In particular, such laws limit the ability of A to possess a for-profit subsidiary, confine A's operation to the county of H, prevent A from having members residing outside the county of H, and restrict the ability of A to provide educational grants or indemnities. Transferring management and operation of the healthcare facilities from A to you and affiliated entities would obviate the requirement of compliance with the legal requirements for hospital authorities and thus help the reorganized hospital system expand its healthcare services in furtherance of the mission of A.

You were organized to operate A's hospitals and other healthcare facilities after the reorganization. E will operate as the parent of D, F, G and you. E will be a supporting organization for you and E is your sole member. In addition, E is the sole member of B, F, and G. E has also become the sole class C member of D. B will be merged with you in a statutory merger and you will be the surviving entity.

After the reorganization, A will continue to own the real property associated with its health care facilities, which includes hospitals and urgent care centers. A has leased this real property to you. A has transferred the personal property associated with that real property to you.

Pursuant to the lease agreement, you will operate the leased facilities to deliver healthcare services. The lease agreement requires that you operate the leased facilities for charitable, educational, and scientific purposes within the meaning of section 501(c)(3) of the Code and none of your income or assets shall inure to the benefit of private individuals. Under the terms of the lease between you and A, the hospitals are required to continue to operate emergency room facilities available to all citizens of the county of H, regardless of their ability to pay, to continue providing services to the indigent sick of the county of H, and to participate in Medicare and Medicaid programs. The lease also requires the hospitals to continue to provide the same level of services as formerly provided by A, unless an alteration in such services would benefit the citizens of the county of H.

#### Rulings Requested

1. The proposed transactions will not adversely affect your tax-exempt status as an organization described under section 501(c)(3) of the Code.
2. The proposed transactions will not adversely affect your status as other than a private foundation as an organization described under sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code.
3. The proposed transactions will not result in unrelated business taxable income to you.

#### 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, 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(a)(1) of the Treasury regulations ("regulations") states that to be described in section 501(c)(3) of the Code an organization must be both organized and operated exclusively for purposes specified in the regulations. If an organization fails to meet either test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities that are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations states that an organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the 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 §§ 368,

372 (1959); 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* §§ 368, 372 (4<sup>th</sup> ed. 1989).

Rev. Rul. 69-545, 1969-2 C.B. 117, held that a non-profit hospital that benefits a broad cross section of its community, operates a full-time emergency room open to all regardless of ability to pay, and otherwise admits all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare) may qualify as an organization described in section 501(c)(3) of the Code.

Section 509(a)(1) of the Code excludes from the definition of a 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 the principal purpose or functions of which are the providing of 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 sections 509(a)(1) or 509(a)(2).

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. Section 1.513-1(c) explains that "regularly carried on" refers 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 to be related, the production of the goods or performance of services from which the

gross income is derived must contribute importantly to the accomplishment of those purposes.

### Analysis

You are exempt under section 501(c)(3) of the Code and are not a private foundation because you are described in section 170(b)(1)(A)(iii) of the Code as an organization providing hospital or medical care. A is also exempt under section 501(c)(3) of the Code and is not a private foundation, because it is also described in section 170(b)(1)(A)(iii) of the Code. B is exempt under section 501(c)(3) and is not a private foundation because it is a supporting organization described in section 509(a)(3).

Pursuant to your organizing document and the lease between you and A, you will carry out the purposes of A in providing healthcare services in the county of H and the surrounding area. You and A are exempt from federal income tax under section 501(c)(3) of the Code as organizations organized and operated exclusively for the promotion of health. You will continue to be organized and operated exclusively for the promotion of health following the reorganization. The only change to your activities will be your expansion of the delivery of healthcare services in furtherance of your exempt purposes and the exempt purposes of A. You will therefore continue to be described in section 501(c)(3).

A, like you, is an organization that provides medical or hospital care described in section 170(b)(1)(A)(iii) of the Code. You will operate facilities owned by A in furtherance of A's exempt purposes and your exempt purposes, pursuant to your lease with A. Because you will provide medical or hospital care following the reorganization, you will continue to be described in section 170(b)(1)(A)(iii).

Your organizing document provides that one of your purposes is to further the mission of A and to otherwise support the delivery of healthcare services in the area. Following the reorganization, your provision of healthcare services by operating facilities leased to you by A will help to further those exempt purposes. Your operation of A's facilities pursuant to the lease agreement will contribute importantly to the accomplishment of your exempt purposes. Accordingly, your operation of the leased facilities following the reorganization is substantially related to the performance of your exempt purposes and will not constitute an unrelated trade or business within the meaning of section 513(a) of the Code. Therefore, the income you earn from the operation of the facilities of A will not result in unrelated business taxable income under section 512(a)(1).

You will merge with B, which provides cardiac healthcare services to patients in a hospital owned by A. B supported the purposes of A prior to the reorganization, and was organized and operated exclusively for the promotion of health, an exempt purpose. After the reorganization, you will take over B's exempt activities in addition to your own. Therefore, after your merger with B, you will continue to be described in section 501(c)(3) of the Code.

B provides cardiac healthcare services and is therefore described in section 170(b)(1)(A)(iii) of the Code. You are also described in section 170(b)(1)(A)(iii) of the Code. Because your merger with B will simply involve the addition of B's activities that are already

described in section 170(b)(1)(A)(iii) of the Code, you will continue to be so described following your merger with B.

B, as a supporting organization for A, was operated exclusively for exempt purposes, specifically for the promotion of health. Your merger with B will not affect your operation of A's facilities, which will be in furtherance of your exempt purposes, as discussed above. Also, as discussed above, your operation of A's facilities following the reorganization will not result in unrelated business taxable income to you under section 512(a)(1) of the Code.

### Conclusion

1. The proposed transactions will not adversely affect your tax-exempt status as an organization described under section 501(c)(3) of the Code.
2. The proposed transactions will not adversely affect your status as other than a private foundation as an organization described under sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code.
3. The proposed transactions will not result in unrelated business taxable income to you.

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.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. 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. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

/s/

Theodore R. Lieber  
Manager, Exempt Organizations  
Technical Group 3

Enclosure  
Notice 437