



Department of the Treasury  
Internal Revenue Service

[Address]  
[City State Zip]

Release Number: 201451037

Release Date: 12/19/2014

UIL Code: 501.03-11

Date:

09/29/2014

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Third party communication:

Date:

Category:

Dear

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

We sent a copy of this letter to your representative as indicated in your power of attorney

Sincerely,

Enclosures:

Notice 437

Redacted Letter 4036, Proposed Adverse Determination under IRC Section 501(c)(3)

Redacted Letter 4038, Final Adverse Determination under IRC Section 501(c)(3) - No Protest

cc:



Department of the Treasury  
Internal Revenue Service  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

UIL Number: 501.03-11

Date: August 12, 2014

Employer ID number:

Contact person/ ID number:

Contact telephone number:

Contact fax number:

Legend:

State =  
Date 1 =  
Date 2 =  
Date 3 =  
Year 1 =  
Year 2 =  
City =  
Medical Center =

Dear

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code or "I.R.C."). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

**Issues**

Whether you are exempt under § 501(c)(3).

**Facts**

You were formed as non-profit corporation under the laws of State on Date 1. You were originally formed to operate a community hospital in City for the benefit of the residents of City and the surrounding communities. Your Articles of Incorporation set out that you are:

formed for the benevolent and charitable purpose of building, owning and operating a hospital or sanitarium for the treatment and cure of diseases by medicine and surgery and which shall be open to all reputable physicians and surgeons for the conduct of their business and practice and for the establishing, maintaining and conducting of a training school for nurses and medical attendants and for issuing diplomas and certificates of graduation therefrom...

You were recognized by the IRS as an organization exempt under § 501(c)(3). In Year 1 you leased the hospital facility to a third party, for-profit healthcare entity who took over operation of the hospital because you were facing financial difficulties. The lessee did not fulfill its obligations under the terms of the lease, and the hospital facility eventually closed in Year 2. You brought legal action against the lessee for eviction and to recoup your losses in order to re-open the hospital. During this period, your exempt status was automatically revoked, effective Date 2, because you failed to file Form 990 for three consecutive years.

You submitted a Form 1023 Application on Date 3 requesting reinstatement of exemption under § 501(c)(3). Your legal action against the lessee was successful and you found another for-profit healthcare organization to lease the facility, Medical Center, with whom you have negotiated another lease agreement. Under the terms of the new lease, Medical Center will have complete control over the management and operation of the facility. The lease provides that you will meet with Medical Center quarterly to review and monitor the quality and quantity of charitable and benevolent care delivered at the facility.

You intend to use the income from the lease for mortgage debt retirement, facility improvements, and for activities promoting community health, such as vaccination and blood drives and scholarships for medical training programs at the facility.

## Law

I.R.C. § 501(c)(3) provides that an organization may be exempted from tax if it is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and no part of the net earnings inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order to be exempt under § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section. If an organization fails to meet either the organizational test or the operational test, it does not qualify for exemption.

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

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Third) Trusts § 28 (2012); 6 Austin W. Scott and William F. Fratcher, The Law of Trusts §§ 38.1, 38.5 (5th ed. 2013); and Revenue Ruling 69-545, 1969-2 C.B. 117.

Rev. Rul. 69-463, 1969-2 C.B. 131, holds that the leasing of its adjacent office building, and the furnishing of certain office services, by an exempt hospital to a hospital based medical group is not unrelated trade or business under § 513 where the medical group performs important health services for the hospital.

Rev. Rul. 69-545, 1969-2 C.B. 117, holds that a non-profit hospital that benefits a broad cross section of its community by having an open medical staff and a board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting 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 § 501(c)(3).

Rev. Rul. 73-313, 1973-2 C.B. 174, holds that providing office facilities to attract a physician to a community that had no available medical services furthered the charitable purposes of promoting the health of the community. The ruling states that certain facts are particularly relevant: (1) the demonstrated need for a physician to avert a real and substantial threat to the community; (2) evidence that the lack of a suitable office had impeded efforts to attract a physician; (3) the arrangements were at completely arm's length; and (4) there was no relationship between any person connected with the organization and the recruited physician. The ruling states that, under all the circumstances, the arrangement used to induce the doctor to locate a practice in the area bears a reasonable relationship to promotion and protection of the health of the community and any private benefit to the physician is incidental to the public purpose achieved.

Rev. Rul. 80-309, 1980-1 C.B. 183, holds that an otherwise qualifying nonprofit organization that was created to construct, maintain and operate or lease a public hospital and related facilities for the benefit of a city and the surrounding communities is operated exclusively for charitable purposes and qualifies for exemption. After construction of these facilities, the organization's only activity was to lease such facilities to an association exempt from federal income tax under § 501(c)(3).

Rev. Rul. 98-15, 1998-12 I.R.B. 6, provides that for purposes of determining exemption under § 501(c)(3), the activities of a partnership, including an LLC treated as a partnership for federal tax purposes, are considered to be the activities of the partners. A § 501(c)(3) organization may form and participate in a partnership and meet the operational test if 1) participation in the partnership furthers a charitable purpose, and 2) the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners. The ruling applied the definition of "charitable" as noted in § 1.501(c)(3)-1(d)(2) and stated that not every activity that promotes health supports tax exemption under § 501(c)(3). For example, selling prescription pharmaceuticals certainly promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court considered an organization that provided consulting services to groups that were mostly § 501(c)(3) organizations. The organization charged fees for its services set at or close to its own cost. The court concluded that there was nothing to distinguish these activities from those of an ordinary commercial consulting enterprise, and affirmed the Service's denial of exemption under § 501(c)(3).

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), *aff'd*, 625 F.2d 804 (8th Cir. 1980), the court held that, while selling prescription pharmaceuticals to elderly persons at a discount promotes health, the pharmacy did not qualify for recognition of exemption under § 501(c)(3) on that basis alone. Because the pharmacy operated for a substantial commercial purpose, it did not qualify for exemption under § 501(c)(3).

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3rd Cir. 1993), the court held that a pre-paid health care organization that arranges for the provision of health care services only for its members, benefits its members, not the community as a whole. Under the community benefit standard, the organization must benefit the community as a whole to be recognized as promoting health in the charitable sense of § 501(c)(3).

IHC Health Plans, Inc. v. Commissioner, 325 F.3d 1188 (10th Cir. 2003), involved an operator of health maintenance organizations ("HMOs") that served approximately one-quarter of Utah's residents and

approximately one-half of its Medicaid population. The court held that the organization failed to meet the community benefit standard to qualify for exemption under § 501(c)(3) because its sole activity was arranging for health care services for its members, in exchange for a fee. The court said that providing health-care products or services to all in the community is necessary but not sufficient to meet the community benefit standard. Rather, the organization must provide some additional benefit that likely would not be provided in the community but for the tax exemption, and that this public benefit must be the primary purpose for which the organization operates.

### **Application of law**

To satisfy the operational test under § 1.501(c)(3)-1(c)(1), an organization must establish that it is operated exclusively for one or more exempt purposes. An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Under the operational test, the purpose towards which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a § 501(c)(3) organization. B.S.W. Group, supra. You are not primarily engaged in activities directed toward exempt purposes.

The promotion of health has long been recognized as a charitable purpose under common law. However, not every activity that generally promotes health furthers exclusively charitable purposes under § 501(c)(3). For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone. Federation Pharmacy Services, Inc., supra. Nor does a hospital primarily further a charitable purpose solely by offering health care services to the public in exchange for a fee. See Rev. Rul. 69-545, supra. Rather, a hospital must be organized and operated primarily for the benefit of the community, as evidenced by such factors as a board that represents the community, operation of an emergency room, provision of charity care, medical training, or medical research. For example, a health maintenance organization that is operated primarily for the purpose of benefiting its paying subscribers does not qualify for exemption solely because the community also derives health benefits from its activities. See Geisinger Health Plan, supra; and IHC Health Plans, Inc., supra.

You do not provide healthcare services directly to patients, unlike the hospital described in Rev. Rul. 69-545. Instead, your primary activities consist of the leasing of a hospital facility. Although your activities are related to providing health care, your primary activity of leasing of a hospital facility, in itself, does not promote health or benefit the community in a charitable manner. While Rev. Rul. 80-309, supra, provides that an organization may be exempt for building and leasing a hospital facility to an exempt hospital organization, you are leasing the facility to Medical Center, which is not an exempt organization.

In some instances, incentivizing physicians to practice in rural areas can further charitable purposes by promoting the health of a community. See Rev. Rul. 69-463, supra and Rev. Rul. 73-313, supra. However, you are distinguishable from the organizations described in these rulings. The organization described in Rev. Rul. 69-463 was a hospital organization exempt under § 501(c)(3), whereas you no longer operate the hospital facility. The organization in Rev. Rul. 73-313 provided medical office facilities to a physician in a rural, underserved community, which furthered the charitable purpose of promoting the health of the community. Although your facility is located in a rural, underserved community, you are leasing it to Medical Center, a for-profit partnership, which does not promote the health of the community in accordance with an exempt hospital described in Rev. Rul. 69-545. In particular, Medical Center does not have a community board of directors or an open medical staff. Although your proposed lease with Medical Center provides that you will monitor the charitable care provided by Medical Center, the terms of the agreement do not provide you with oversight

responsibility and ultimate authority over the charitable activities of the facility or assurance that charitable care will be provided in any substantial amount. You have not established that your lease activity furthers your exempt purpose, and only incidentally benefits Medical Center. See Rev. Rul. 98-15, *supra*. Therefore, although your primary activities may indirectly promote health in a general sense, they do not promote health in a charitable manner within the meaning of § 501(c)(3) and § 1.501(c)(3)-1(d)(2).

## Conclusion

Based on the information provided in your Form 1023 and supporting documentation, we conclude that you are not operated exclusively for exempt purposes described in § 501(c)(3). Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3).

## If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send us a statement within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

**For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

**For an authorized representative:**

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

## Where to send your protest

Please send your protest statement, any request for consideration by the Office of Appeals, Form 2848, if needed, and any supporting documents to the applicable address:

**US Mail:**

Internal Revenue Service  
SE:T:EO:RA:T:4

1111 Constitution Ave, N.W.  
Washington, D.C. 20224

**Street Address (delivery service):**

Internal Revenue Service  
SE:T:EO:RA:T:4

1111 Constitution Ave, N.W.  
Washington, D.C. 20224

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

### If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at [www.irs.gov/formspubs](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

We sent a copy of this letter to your representative as indicated on your power of attorney.

Sincerely,

Michael Seto  
Manager, EO Technical

cc: