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

Date: MAR 2 0 2000

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ID Number:

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OP:E:EO:T1

Significant Index Nos:

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| 501.02-00 | 509.01-02 | 512.10-00 |
| 501.03-00 | 509.02-01 | 513.00-00 |
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Dear Sir or Madam:

This is in response to your ruling request concerning the tax implications under section 501(c)(3), and other applicable sections, of the Internal Revenue Code of the transaction described below.

B is an integrated health care delivery system. B changed its name to C and has recently changed its name to D. D was formed to facilitate a merger of four tax-exempt hospital systems, and the parent organizations of two of those systems, into a single integrated delivery system. D's transformation into an integrated delivery system occurred through three mergers: the Hospital Merger, the Licensed Home Care Services Agency Merger (Licensed Merger) and the Certified Home Health Agency Merger (Certified Home Merger).

**Licensed Merger**

The Licensed Merger entities included E, F, G, and H (collectively known as "Licensed Entities"). E, F and H are exempt from taxes under section 501(c)(3) of the Code and maintain a section 509(a)(2) foundation status. G is exempt from taxes under section 501(c)(4) of the Code.

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After the Licensed Merger, E remained as the sole surviving corporation. E will continue to operate as an organization described in section 501(c)(3). More specifically, E will operate as a licensed home care services agency and maintain a section 509(a)(2) foundation status.

**Certified Home Health Agency Merger**

The Certified Home Health Agency Merger entities included J and K (collectively known as "Certified Entities"). Both organizations were exempt from federal income tax under section 501(c)(3) of the Code and maintained a section 509(a)(2) foundation status.

After the Certified Health Agency Home Merger, J remained as the sole surviving corporation. J will continue to operate as an organization described in section 501(c)(3). More specifically, J will continue to operate a certified home health agency and provide long term home health care as licensed by the State of pp. J will continue to maintain a section 509(a)(2) foundation status.

**Hospital Merger**

The Hospital Merger was the final stage in creating the integrated delivery system. The Hospital Merger was completed upon the filing of a Certificate of Merger with the pp Secretary of State. The Hospital Merger entities included D, L, M, N, O, P, and A (collectively known as "Hospital Entities").

Hospital Entities are exempt from taxation under section 501(c)(3) of the Internal Revenue Code. D, M and P are public charities pursuant to section 509(a)(3). L, N, O and A are not private foundations pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii).

As a result of the Hospital Merger, D remained as the sole surviving corporation. Effective nn, D took over all of the operations, assets and liabilities of the Hospital Entities. D's amended activities include, but are not limited to, establishing and maintaining a multi-location hospital and health care delivery system, promoting the health and welfare of the community, engaging in scientific research, conducting public outreach programs promoting health and welfare, operating programs for the mentally disabled, maintaining nursing homes, operating educational programs for children and other persons with illness or disabilities, providing educational programs in health related professions, and providing facilities for educational programs for medical students at the School of Medicine and Biomedical Sciences of mm.

Currently, D operates inpatient hospital facilities at five sites, skilled nursing facilities, and various outpatient centers, primary care clinics and research programs. D is a major teaching affiliate of the School of Medicine and Biomedical Sciences at mm. D maintains accredited residency programs in a number of medical specialties.

No more than one-third of D's Board of Directors is comprised of licensed physicians. D's President serves as an ex officio, voting member of the Board. All remaining directors are selected from the community. D's Board has adopted a conflicts of interest policy based on the guidelines established by the Internal Revenue Service.

The Hospital merger resulted in D becoming the sole or controlling corporate member of several tax-exempt organizations. These entities include R, S, T, U, V, W, X, E, J, Y, Z, aa, bb, cc, dd, ee, ff, gg, hh, jj, and kk (collectively known as "Member Entities").

Member Entities are exempt from taxation under sections 501(c)(3), 501(c)(4) or 501(c)(2) of the Code. Member Entities have amended their corporate documents to reflect D as the sole corporate member.

Each of D's hospital sites operates a full-time emergency room open to all persons regardless of their ability to pay. D participates, in a nondiscriminatory manner, in the Medicare and Medicaid programs and renders meaningful charity care to the community, including the operation of primary health care centers aimed specifically at the needs of socioeconomically disadvantaged and minority groups. D's hospital admitting privileges are available to all qualified physicians in the area who apply for them.

D is the 100% sole owner of several for-profit subsidiaries: qq, rr, tt, and uu.

qq owns and operates real estate holdings and conducts a professional resource center that provides management services to private physician practices. qq's President, Vice-President, Treasurer and Secretary are also officers of D. qq is also the sole shareholder of a second-tier subsidiary, vv. vv provides information technological services to D entities and to other health care providers.

rr provides management services to third parties. rr is the sole shareholder of a second tier subsidiary, xx. xx provides billing and collection services, and it is one of the two members of a second tier limited liability company, yy. yy owns retail pharmacies on hospital and hospital related sites. yy's President, Treasurer and Secretary are also officers of D.

tt owns real property. tt's President, Treasurer and Secretary are also officers of D.

uu currently has no active operations and may be merged into rr. uu's President, Treasurer and Secretary are also officers of D.

As an insubstantial part of their activities, D and Member Entities may furnish assets, services and/or personnel to the taxable subsidiaries in arm's-length sales.

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Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for charitable, educational or scientific purposes.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(2) that are organized exclusively to hold title to property, collect income therefrom, and turn over the entire amount thereof, less expenses, to an organization which itself is exempt under section 501(a).

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(4), including organizations that are organized exclusively for the promotion of social welfare.

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 170(b)(1)(A)(vi) of the Code describes, in part, an organization created in the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes and which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public.

Section 509(a)(2) of the Code describes an organization which normally receives not more than one-third of its support in each taxable year from gross investment income and unrelated business taxable income and normally receives in each taxable year more than one-third of its support from any combination of gifts, grants, contributions, membership fees, and gross receipts from admissions, sales or merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, from governmental units described in section 170(c)(1), organizations described in section 170(b)(1)(A)(other than clauses (vii) and (viii)) and persons other than disqualified persons.

Section 511(a) of the Code imposes a tax on the unrelated business income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines unrelated business taxable income as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the

carrying on of the trade or business. Furthermore, unrelated business taxable income is computed with the modifications provided in subsection (b).

Section 512(b)(1) of the Code provides that dividends are excluded when calculating the unrelated business taxable income of subsection (a)(1).

Section 513(a) of the Code defines an unrelated trade or business as any trade or business the conduct of which is not substantially related to the exercise of the organization's exempt purposes or functions.

Section 1.513-1(d)(2) of the Income Tax regulations provides, in part, that a trade or business is related to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes; and it is substantially related for purposes of section 513 of the Code 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 goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes.

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.

Section 1.509(a)-4(b)(1) of the regulations provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of" one or more specified publicly supported organizations. If an organization fails to meet either the organizational or the operational test, it cannot qualify as a supporting organization.

Section 1.509(a)-4(c)(1) of the regulations provides that an organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization:

(i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);

(ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;

(iii) State the specified publicly supported organizations on whose behalf such organization is to be operated; and

(iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Section 1.509(a)-4(d)(2)(i)(a) of the regulations describes supporting organizations that are "operated, supervised or controlled by" (within the meaning of section 1.509(a)-4(g)) or "supervised or controlled in connection with" (within the meaning of section 1.509(a)-4(h)) one or more publicly supported organizations.

Section 1.509(a)-4(d)(3)(i) of the regulations provides that:

if the requirements of subparagraph (2)(i)(a) are satisfied, a supporting organization will not be considered as failing the test of being organized for the benefit of "specified" organizations solely because its articles:

(i) Permit the substitution of one publicly supported organization within a designated class for another publicly supported organization either in the same or a different class designated in the articles.

Section 1.509(a)-4(e)(1) of the regulations provides that a supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations only if it engages solely in activities which support or benefit the specified publicly supported organizations.

In the general law of charity, the promotion of health is considered to be a charitable purpose. Restatement (2nd), Trusts, Sections 368 and 372; IV Scott on Trusts (3rd ed. 1967), Sections 368 and 372.

Rev. Rul. 67-149, 1967-1 C.B. 133, holds that an organization formed for the purpose of providing financial assistance to several different section 501(c)(3) exempt organizations is exempt from federal income tax if such organization carries on no other activity other than: 1) receiving contributions and incidental investment income; 2) making distributions of such income to such exempt organizations at periodic intervals and 3) the organization does not accumulate its investment income.

Rev. Rul. 69-545, 1969-2 C.B. 117, establishes that a nonprofit organization whose purpose and activity include providing hospital care is promoting health and may, therefore, qualify as organized and operated in furtherance of a charitable purpose, provided other requirements of section 501(c)(3) are satisfied.

Rev. Rul. 74-132, 1974-1 C.B. 152, confirms that an exempt foundation that fosters and supports the activities and purposes of an exempt hospital corporation and advances the hospital's objectives, including, the sponsorship of specific projects and programs to improve the hospital's services to its patients and to support and promote the

hospital's education, training and research programs is exempt within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 78-41, 1978-1 C.B. 148, holds that a trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital and from which the hospital directs the bank trustee to make payments to claimants qualifies for exemption under section 501(c)(3) of the Code. By serving as a repository for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust is performing a function that the hospital could do directly.

For federal income tax purposes, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is incorporated are the equivalent of business activities or the subsidiary subsequently carries on business activities (see Britt v. United States, 431 F.2d 227, 233 (5th Cir. 1970)) and the corporation was not created to contravene directly or indirectly the policies of the Internal Revenue Code. See Gregory v. Helvering, 293 U.S. 465, (1935). See also National Carbide Corp. v Commissioner, 336 U.S. 422 (1949). That is, where a corporation is organized with the bona fide intention that it will have some real and substantial business function, its existence may not generally be disregarded for tax purposes. See Britt, supra at 234. However, where the parent corporation so controls the affairs of the subsidiary that it is merely an instrumentality of the parent, the corporate entity of the subsidiary may be disregarded. See Krivo Industrial Supply Co. v. National Distillers and Chemical Corp., 483 F.2d 1098, 1111 (5th Cir. 1973).

Section 501(c)(3) organizations do not jeopardize their tax-exempt status by transferring their assets to other organizations exempt under section 501(c)(3) where the assets transferred are used to further exempt charitable purposes.

Hospital Entities, Licensed Entities and Merger Entities have all been recognized as organizations exempt from tax pursuant to sections 501(c)(2), 501(c)(3), and 501(c)(4) of the Code. Hence, after the Hospital Merger, the Licensed Merger, and the Certified Home Health Agency Merger, the pertinent issues are:

1) Whether the tax-exempt status of D and Member Entities is affected by the Hospital Merger;

2) Whether the tax-exempt status of D and E is affected by the Licensed Merger;

3) Whether the tax-exempt status of D and J is affected by the Certified Home Health Agency Merger;

4) Whether the public foundation status of D and Member Entities is affected by the Hospital Merger;

5) Whether the public foundation status of E is affected by the Licensed Merger;

6) Whether the public foundation status of J is affected by the Certified Home Health Agency Merger;

7) Whether the transfer of funds, assets, services and/or personnel resulting from the Hospital Merger, Licensed Merger and/or Certified Home Health Agency Merger will affect the tax-exempt status of D and its tax-exempt affiliates;

8) Whether the incidental furnishing of assets, services and/or personnel by D or its affiliated tax exempt entities to D taxable subsidiaries will affect the tax-exempt status of D or any of its affiliated tax-exempt entities;

9) Whether D's tax-exempt status is affected by its 100% stock ownership of taxable subsidiaries;

10) Whether the taxable income and activities of D's taxable subsidiaries will be attributed to D; and

11) Whether dividends received by D from a taxable subsidiary are subject to the unrelated business income tax under section 511 of the Code?

**Tax Exempt Status:**

D's purpose is to create an integrated delivery system. The integrated delivery system is designed to: (1) broaden the health care services available in the community; (2) enhance administrative efficiencies within the health care system; and (3) promote efficiency and economy in the delivery of health care services. Because the attainment of these objectives can reasonably be expected to improve health care services in the community, the Hospital Merger, the Certified Home Health Agency Merger and the Licensed Merger will not adversely affect the tax exempt status of D, E J or the Member Entities.

Furthermore, transferring assets, services or personnel among the exempt organizations in the system will not jeopardize the tax exempt status of the sections 501(c)(2), 501(c)(3), 501(c)(4) organizations because such transferred assets will continue to be used to further exempt purposes.

**Foundation Status:**

D, E, J and Member Entities have all been recognized as not being private foundations within the meaning of sections 509(a)(3), 509(a)(2) or 509(a)(1) and

170(b)(1)(A)(iii) of the Code. After the Hospital Merger, D and Member Entities will continue to provide medical or hospital care and medical education or medical research. Moreover, D will continue to serve as a supporting organization in order to achieve its section 501(c)(3) charitable purposes. Hence, the Hospital Merger will not adversely affect the public foundation status of D and Member Entities.

After the Licensed and Certified Home Health Agency Mergers, E and J will continue to satisfy the requirements of section 509(a)(2) of the Code. Hence, the Certified Home Health Agency and Licensed Mergers will not adversely affect the public foundation status of E or J.

**Unrelated Business Income Tax**

Section 512(b)(1) provides that dividends are excluded from unrelated business income tax. Hence, D is not subject to unrelated business income tax on dividends received from its taxable subsidiaries.

**D's Taxable Subsidiaries**

D and its taxable subsidiaries are separate taxable entities. The taxable subsidiaries were organized with a bona fide business intention and are not merely instrumentalities of D. Therefore, D's taxable subsidiaries' activities cannot be imputed to D and will not affect its tax-exempt status under section 501(c)(3) of the Code. See Britt and National Carbide, supra.

Sales of goods, services, or facilities to the taxable subsidiaries which are an insubstantial portion of the activities of D or Member Entities will not adversely affect their exempt status because the selling organizations will continue to be primarily engaged in activities in furtherance of their exempt purposes.

Accordingly, based on the facts and circumstances presented herein, we rule that:

1) The tax-exempt status of D, E, J and Member Entities is not adversely affected by the Hospital Merger, the Licensed Merger or the Certified Home Health Agency Merger.

2) The public foundation status of D E, J and Member Entities is not adversely affected by the Hospital Merger, the Licensed Merger, or the Certified Home Health Agency Merger.

3) The transfer of funds, assets, services and/or personnel resulting from the Hospital Merger, Licensed Merger and/or Certified Home Health Agency Merger will not affect the tax-exempt status of D or Member Entities.

4) The incidental furnishing of assets, services and/or personnel by D or Member Entities to D's taxable subsidiaries will not adversely affect the tax-exempt status of D or Member Entities.

5) D's tax-exempt status is not adversely affected by wholly owning taxable subsidiaries.

6) The taxable income and activities of D's taxable subsidiaries are not attributed to D.

7) Dividends received by D from its taxable subsidiaries are not subject to the unrelated business income tax under section 511 of the Code.

These rulings are directed only to the organizations that requested them. Section 6110(j)(3) of the code provides tat they may not be used or cited 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,

Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1