Uniform Issue List
501.03-10
512.01-00
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509.02-01

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

200027057

APR - 7 2000

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Legend:

M =
N =
O =
P=
Q=
R=
S=
T=
U=
V=
x=

Dear Applicant:

This is in response to the ruling requests submitted to this office on January 13, 2000, on behalf of the three entities described below. The ruling requests concern the effect of a merger, involving two of the entities, upon the tax exempt status of all three entities as well as any unrelated business taxable income which may result therefrom.

M, which you refer to as the "Parent", was incorporated on a nonprofit basis under the laws of the State of N in the latter part of the nininteenth century. Since then, it has operated, either directly or through wholly owned subsidiaries, homes for the aged in two identified localities in N. In 1941, the Service recognized M as tax exempt under section 101(6) of the Internal Revenue Code of 1939, which corresponds to section 501(c)(3) of the present Code. M is also a public charity within the meaning of sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

M has a Board of Trustees consisting of (15) fifteen members. The members are divided into three (3) equal classes which are appointed to three year terms, on a rotating basis. The Trustees of M are appointed by the respective heads of the O, which is the N branch of a

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fraternal order. The Trustees neither are employed by M nor have a proprietary interest in M or any of its vendors.

P, which you refer to as the "Subsidiary" was incorporated under the laws of N in 1999 as a wholly owned subsidiary of M. P has been recognized by the Service as a tax exempt organization under section 501(c)(3) of the Code. The purpose of P is to provide for the care of aged, infirm and distressed individuals who are members of specified fraternal organizations.

P currently has a Board of Trustees which consists of three (3) members. After the merger, the Board of Trustees will have seven (7) members. All of the members will be elected by the Board of Trustees of M. The Trustees neither are employed by M nor have a proprietary interest in P or any of its vendors.

After the Merger is consummated, the name of P will change to Q and its principal offices will be moved to another city in N.

M is the sole member of P. Shares of stock of P have neither been authorized or issued by P.

R, which you refer to as the "Target", is a nonprofit corporation formed under the laws of N in the earlier part of the twentieth century. R was recognized by the Service as an exempt organization in 1937. In 1987, the Service confirmed the tax exempt status of R under section 501(c)(3) of the Code as well as its status as a public charity.

In conjunction with the Merger, as described below, the assets and charitable activities of R will be merged into, and carried on by P.

You have provided the following background information concerning M, P, and R:

M was initially incorporated to provide and maintain a home for the care of the aged, infirm, and distressed members of a particular fraternal order, their wives, widows, orphans, and children. Its corporate purposes were subsequently broadened to enable it to provide care and support to the elderly members of the general population.

M provides support services to three operating subsidiaries, namely S, T, and U. S operates both a licensed nursing facility consisting of 298 beds and a licensed residential facility consisting of 48 beds and independent housing for the elderly consisting of 89 units. U operates an elderly housing facility in a town of N, and it is in the process of developing a residential care facility for the elderly. Admissions to S and U are open to any individual who may require nursing care.

The facilities of T are available to members of the particular fraternal order and affiliated organizations and their respective families. The membership of this order in N is approximately 140x individuals. Membership is available to any man who believes in a monotheistic Being and without regard to his race, color, familial status, national origin, and/or disability.

R operates in an identified city of N a nursing home and assisted living facility for the elderly. The facilities of R are located on approximately 2 1/2 acres of land.

After the merger, the operations of R will be continued by P. Admissions to the facility will be broadened to include any elderly members of the public, regardless of an individual's affiliation with the V sorority and the fraternal order in question. P may also increase the scope of its services for the elderly.

In the fall of 1999, the respective Boards of Trustees of R, and P, determined that it was in the best interest of each corporation that they be merged pursuant to an identified section of the N Revised Code, and the Directors of R and Board of Trustees of P determined that it was in the best interest of each organization that their operations be consolidated. Accordingly, the parties entered an Agreement for Merger, which you have submitted .

On or about March 1, 2000, subject to regulatory review and approval, R will be merged into P, and P will be the surviving corporation. P will assume all the liabilities of R, including the commitment to provide support to R's current residents. P will apply to continue the provider agreements of R under the Medicare and Medicaid programs and it will assume the provider history of R.

As demonstrated by its Resident Handbook, P will provide care and housing to aged individuals who would otherwise be unable to provide for themselves.

You have set forth the following business reasons for the Merger:

A. To promote flexible and efficient management by concentrating long range planning and policy decisions in M and allowing the subsidiaries of M to focus their efforts on certain specific operations;

B. To facilitate long-range planning on a statewide basis;

C. To integrate the functions of the R into a system which will include M and its other operating subsidiaries;

D. To expand access to, and convenience of, nursing care and other elderly support services which will be provided by M and its operating subsidiaries;

E. To promote efficient use of financial, human and facility resources between R and M; and,

F. To enhance fraternal philanthropy efforts in order to more ably serve the neediest elderly constituents of R.

With respect to this ruling request, M, P, and R, make the following representations:

A. Immediately after the Merger, M and P will continue to be operated in a charitable manner which is consistent with the requirements of section 501(c)(3) of the Code;

B. The facilities of P will be financially available to a substantial number of elderly individuals who require care and support within the neighboring communities;

C. P will have a policy to ensure that all residents will be retained should they become unable to meet their financial obligations for reasons other than transfers of their property for less than fair market value;

D. P will offer admissions to indigent persons, to the extent space for the type of care or support required by the individual is available and the corporation has the necessary financial resources;

E. The services that will be rendered by P will be available to all or a reasonable proportion of its residents at substantially below the actual cost thereof, to the extent of the corporation's financial ability;

F. The services that will be rendered by P are the type which minister to the needs and the relief of hardship or distress of aged individuals;

G. M will provide management services to P;

H. The various assets which will be transferred by R as part of the Merger will be a one time occurrence;

I. The activities of M will substantially assist P in accomplishing its charitable purposes;

J. P is committed to operating its facilities at the lowest feasible cost;

K. P will succeed in the interest of R in a relationship with a neighboring health care facility to provide health and nursing care to its residents;

L. The amount of any payments made between M and P will be equal to the actual costs of services provided by one another and such amounts will be equal to or less than fair market value;

M. No part of the net earnings of M, P, and R will inure, directly or indirectly, to the benefit of any private shareholder or individual. No employee or any of the aforementioned organizations will receive more than reasonable compensation for the services that they may render; and

N. The total amount of financial grants which M will provide to P will be greater than the aggregate amount of rental and other payments which may be paid by P to M.

Your first ruling request is as follows: After the proposed Merger, M and P will remain tax exempt organizations within the meaning of section 501(c)(3) of the Code; M will remain a

publicly supported charity within the meaning of sections 509(a)(1) and 170(b)(1)(A)(vi), and P will remain a publicly supported charity within the meaning of section 509(a)(2).

The consummation of the Merger will cause P to receive assets from R, and to continue the tax exempt operations of both organizations. M will support the operations of P by providing general administrative support and financial assistance, to the extent required by P and to the extent of the resources which may be available to M.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated "exclusively" for religious, charitable, educational, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and which does not engage in proscribed legislative and political activities.

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 and includes providing relief to the poor and distressed, lessening the burdens of government, and promoting social welfare in a number of specified ways.

Rev. Rul. 72-124, 1972-1-C.B. 145 sets forth requirements that "homes for the aged" must meet to qualify for exemption under section 501(c)(3) of the Code. The organization described therein was formed under the sponsorship of leaders of a church congregation in a particular community. Other civic leaders are on the Board of Trustees. The organization provides housing, limited nursing care, and other services and facilities needed to enable its elderly residents to live safe, useful, and independent lives. The organization is self-supporting in that its operating funds are derived principally from fees charged for residing in the home. An entrance fee is charged upon admission with monthly fees charged thereafter for the life of each resident.

Because of the necessity of retiring its indebtness, the organization ordinarily admits only those who are able to pay its established rates. However, once persons are admitted to the home, the organization is committed by established policy to maintaining them as residents, even if they subsequently become unable to pay its monthly charges. It does this through various means, including going into its own reserves and by soliciting members of the church congregation which sponsored its formation.

The analysis section of Rev. Rul. 72-124 cites three earlier revenue rulings dealing with old aged homes: Rev. Rul. 57-467, 1957-2 C.B. 313; Rev. Rul. 61-72, 1961-1 C.B. 188; and Rev. Rul. 64-231, 1964-2 C.B. 138. Under these revenue rulings, exemption under section 501(c)(3) "is conditioned, in effect, upon whether an organization relieves the financial distress of aged persons by providing care and housing for them on a gratuitous, or below cost, basis."

"However, it is now generally recognized that the aged, apart from considerations of financial distress alone, are also, as a class, highly susceptible to other forms of distress in the sense that they have special needs because of their advanced years. For example, it is recognized in the Congressional declaration of objectives, Older Americans Act of 1965, Public Law 89-73, 89th Congress, 42 U.S.C. 3001, that such needs include suitable housing, physical

and mental care, civic, cultural, and recreational activities, and an overall environment conducive to dignity and independence, all specially designed to meet the needs of the aged. Satisfaction of these special needs contributes to the prevention and elimination of the causes of the unique forms of 'distress' to which the aged, as a class, are highly susceptible and may in the proper context constitute charitable purposes or functions even though direct financial assistance in the sense of relief of poverty may not be involved."

A home for the aged (otherwise qualified for charitable status) will qualify for charitable status under federal tax law if it operates in a manner designed to satisfy the three primary needs of aged persons: the need for housing, the need for health care, and the need for financial security.

The need for housing will be generally be satisfied if the organzation provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons.

The need for health care will generally be satisfied if the organization either directly provides some form of health care, or in the alternative, maintains some continuing arrangement with other organizations, facilities, or health personnel, designed to maintain the physical, and if necessary, mental well-being of its residents.

The need for financial security, i.e., the aged person's need for protection against the financial risk associated with the later years of life, will generally be satisfied if two conditions exist. First, the organization must be committed to an established policy, whether written or in actual practice, of maintaing in residence any persons who becme unable to pay their regular charges. This may be done by utilizing the organization's own reserves, seeking funds from local and federal welfare units, soliciting funds from its sponsoring organization, its members, or the general public, or by some combination thereof.

As to the second condition, respecting the provision of financial security, the organization must operate so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization. The fact that an organization makes some part of its facilities available at rates below its customary charges for such facilities to persons of more limited means than its regular residents will constitute additional evidence that the organization is attempting to satisfy the need for financial security.

Rev. Rul. 72-124 concludes that the organization depicted relieves the distress of aged persons by providing for their primary needs of housing, health care, and financial security in conformity with the criteria specified above. Accordingly, it qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 79-18, 1979-1 C.B. holds that a nonprofit organization which provides specially designed housing to physically handicapped persons at the lowest feasible cost and maintains in residence those tenants who subsequently become unable to pay its monthly fees is operated

exclusively for charitable purposes and qualifies for tax exemption under section 501(c)(3) of the Code.

With respect to the proposed Merger, the information submitted indicates that P, the surviving entity, will clearly meet all requirements of a home for the aged as set forth in Rev. Rul. 72-124. P will provide residential facilities that are designed to meet the physical, emotional, recreational, social, religious, and other similar needs of aged persons. P will provide nursing care pursuant to the nursing home and residential care facility licenses which it intends to receive by assignment from R. The residents will be assured of financial security through P's policy of maintaining them in residence if they become unable to pay their regular charges, provided that they do not waste or give away their personal resources without receiving adequate consideration. In addition, P will enhance the financial security of its residents by operating in a manner which provides its services at the lowest feasible cost.

Section 170(b)(1)(A)(vi) of the Code describes a tax exempt organization which normally receives a substantial part of its support from direct or indirect contributions from the public. The underlying regulations provide that an organization which receives one-third of its support from such sources will be considered "publicly supported." An organization which is described in section 170(b)(1)(A)(vi) of the Code is considered other than a private foundation by virtue of section 509(a)(1).

Section 509(a)(2) of the Code describes a section 501(c)(3) organization which normally receives more than one-third of its support from any combination of (i) gifts, grants, contributions, or membership fees, and (ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in any activity which is not an unrelated trade or business within the meaning of section 513. In addition, such an organization will receive not more than one-third of its support from (i) gross investment income, and (ii) the excess (if any) of the amount of the unrelated business taxable income (as defined in section 512) over the amount of the tax imposed by section 511.

Inasmuch as the Merger will change neither the corporate purposes, the corporate operations, nor the sources of financial support for both M and P, we are able to rule that M and P will retain their tax exempt status under section 501(c)(3) of the Code; that M will remain a publicly supported charity within the meaning of sections 509(a)(1) and 170(b)(1)(A)(vi); and that P will remain a publicly supported charity within the meaning of section 509(a)(2).

Your second ruling request is as follows: The participation of R in the Merger will not adversely affect its present status as a tax exempt organization under section 501(c)(3) of the Code and as a public charity under section 509(a)(2).

R shares similar charitable purposes with P. Each has been recognized as tax exempt under section 501(c)(3) of the Code in its own right. R, like P, fully satisfies the criteria for an old age home as set forth in Rev. Rul. 72-124 in that its program and facility meets the needs of the aged for housing, health care, and financial security. At this time, R lacks sufficient financial resources to sustain its operations. The Merger will enable R to fulfill its charitable purposes through the continued operation of P with the financial support of M. Inasmuch as the Merger will perpetuate the charitable purposes of R, its participation in the Merger will not adversely

affect its tax exempt status under section 501(c)(3) of the Code and its status as other than a private foundation, i.e., a public charity, under section 509(a)(2).

Your third ruling request is as follows: Any transfer of funds, assets, services, and/or personnel by or among M, P, and R in conjunction with the Merger will not generate unrelated business taxable income pursuant to sections 511 through 514, inclusive, of the Code.

Section 511 of the Code imposes a tax on the unrelated business income of organizations described in section 501(c). Section 512 defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed which are directly connected with the carrying on of such trade or business, with certain modifications.

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

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 activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513 of the Code, only if the causal relationship is a substantial one. For this relationship to exist, 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 exempt purposes. Whether the activities productive of gross income contribute importantly to such purposes depends, in each case, upon the facts and circumstances involved.

Section 512(b) (5) of the Code provides for the exclusion from unrelated business taxable income of gains or losses from the sale, exchange, or other disposition of property other than (a) stock in trade or other property of the kind which would properly be included in inventory if on hand at the close of the taxable year or (b) property held primarily for sale to customers in the ordinary course of the trade or business.

M, P, and R are all involved in providing relief to the aged through the provision of affordable housing and through a program which also attempts to meet the needs of the aged for health care, social and recreational outlets, and financial security. As such, this program meets the criteria for homes for the aged as set forth in Rev. Rul. 72-124, discussed above, and is the basis for all three entities to be considered charitable organizations under section 501(c)(3) of the Code. The transfer of funds, assets, and/or personnel involving M, P, and R with the objective of providing satisfactory housing for the aged is in furtherance of their exempt purposes and thus is considered "related" within the meaning of section 1.513-1(d)(2) of the regulations. Accordingly, such activities will not be subject to the unrelated business income tax imposed by Code section 511.

In conjunction with the transfer, R intends to transfer all of its assets to P. These assets do not constitute stock in trade. Accordingly, they come within the exception to unrelated business taxable income set forth in section 512(b)(5) of the Code, cited supra. Thus, for this additional reason, the transfer in question is not subject to tax under section 511.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. Any changes that may have a bearing upon your tax status should be reported to the Tax Exempt and Government Entities (TE/GE) Customer Service Office. You should notify that office of any change in your name, address, sources of support, purposes, or method of operation. If you amend your organizational document or bylaws, please send a copy of the amendment to that office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, . Its telephone number is (a toll free number).

We are sending a copy of this ruling letter to the TE/GE Customer Service office. Because this letter could help resolve any questions about your tax status, you should keep it with 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.

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 as precedent.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4