200041034

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

Date: JUL 17 2000

Employer Identification Number:

Contact Person:

Uniform Issue #s:
501.03-08
501.06-03
509.02-02
512.10-00
513.02-00

Contact Number:

OP:E:EO:T2

Legend:

M =
N =
O =
P =
Q =
m =
n =

Dear Applicant:

This letter is in reply to the letter from your authorized representative dated May 14, 1999, in which M, N, O, P, and Q requested rulings with respect to the tax consequences of a proposed reorganization and the related transactions described below.

M is an organization recognized by the Internal Revenue Service as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. M is a publicly supported organization described in section 509(a)(2) of the Code. M states that it is the leading association of the m profession and that it conducts an extensive program of research and education. M's activities in pursuance of its objectives include the following:

(1) development and publication of a variety of materials concerning n, including:

(a) a standard reference and diagnostic work in the field of n, which functions as a clinical, research and education tool for the profession and facilitates the collection and communication of certain public statistics;

(b) the monthly official journal, which consists primarily of scholarly papers on all aspects of n, and includes editorials, book reviews, letters to the editor, and advertising (certain classes of M's members automatically receive a subscription as part of their membership dues, while other subscribers pay a charge);

(c) a monthly peer-reviewed journal for certain m professionals, with a strong clinical focus and provision of coverage of all aspects of m care, treatment and service delivery, publication of

201

clinical and research papers, review of articles, commentary, and reporting of administrative, legal, economic and public policy matters of current interest and controversy in n (this journal is sold only by subscription and is not provided as a perquisite of membership in M;
(d) a semi-monthly newspaper, which is the principal and official means of communication within M about policies and legal issues affecting n, as well as the actions and policies of M; it also serves as a source of clinical and research news and information of interest to persons in the field of n, regularly printing letters to the editor and other columns of interest to M's members (M's members receive the newspaper as a membership benefit, and paid subscriptions are available to nonmembers); and

(e) a quarterly journal consisting of clinical and research submissions of interest to certain researchers, including articles on research, outcome studies, comparative treatments, utilization, interventions, and treatment of special populations, and reprints of classic articles with commentaries by today's experts in the field.

(2) conduct of a variety of activities directed toward the continuing professional education and development of its members in the m profession, addressing new and established knowledge emerging through research, technical advances, and clinical practice;

(3) presentation of a scientific program at M's annual meeting, consisting of an extensive number of educational and scientific activities, including industry-sponsored symposia, and multimedia and audiovisual presentations;

(4) maintenance of a member-based council on education, whose responsibilities include a spectrum of education of individuals preparing to enter the profession of n and m aspects of the education of individuals preparing to enter other specific specialties;

(5) maintenance of a library and archives which serve as an information and reference resource concerning n;

(6) make awards for the conduct of research in areas related to n;

(7) provide leadership and advocacy for the m research community and administer fellowship and research training programs;

(8) maintenance of various member-based councils on particular problems, quality improvement, policy formulation for improved access and delivery of services;

(9) development of programs to improve public understanding of n, monitor trends in public attitudes and media coverage of n, dissemination of information to members concerning issues related to n so that the information may be further distributed on a local basis, and answer public inquiries concerning m and n; and

(10) maintenance of a member-based council on n and the law, which evaluates legal developments and other government interventions affecting the practice of n;

N, O, and P are organizations recognized by the Service as exempt from federal income tax under section 501(c)(3) of the Code. All three are supporting organizations of M, are controlled by M, and are described in section 509(a)(3).

202

N is a research and education organization organized and operated exclusively for the benefit of, and to perform research and education programs for, M. N was created to establish a leadership role in contributing to the scientific basis of n and policy by:

(1) strengthening the research infrastructure,

(2) enhancing and supporting m education,

(3) training and career development, and

(4) improving the quality of care by conducting and supporting clinical and services research and training activities.

To accomplish this mission, N focuses on studies and programs of national and international significance, particularly those requiring a national organization to organize and lead efforts involving a broad consortium of academic institutions and practitioners. There will be collaboration with academic institutions, particularly departments of n, in connection with N's educational and training initiatives. N's research activities will involve multi-site studies, a consortium of minority research training sites, and a consortium of researchers conducting secondary analysis of publicly available data. It is anticipated that N will serve as the coordinating center for these efforts and expand activities in such areas as policy and educational research.

O is organized and operated exclusively to assist and support M by performing fundraising functions of M and by developing public and professional activities to advance education and research into n, m illnesses, and related subjects, and to promote the treatment of m illness. In addition to coordination of fundraising activities for M awards, O coordinates fundraising events held in conjunction with M's annual meeting, solicits contributions from M members and produces a newsletter. O provides grant funding for m research and education and programs to foster greater public awareness of the benefits of m medicine. Individual members of M, interested corporations, and foundations are the principal sources of funding and the principal sources of O's funding.

P is organized and operated to carry on publishing activities related to and supportive of the educational and scientific purposes of M. Although P prints, markets, and distributes M books and reports, P has complete control of, and responsibility for, the contents of the material.

Q is a newly formed organization that has been recognized as a business league exempt from federal income tax under section 501(c)(6) of the Code. Membership in Q is and will be comprised of all the members of M.

M states that in recent years, the m profession has found that many of its needs can no longer be met by an organization exempt under section 501(c)(3) of the Code. The leadership of the m profession has determined that a more vigorous voice is needed in legislative affairs and, as the same time, members of the profession need a better understanding of the economics of medical practice in a managed care environment. M states that as a section 501(c)(3) organization, it cannot fulfill this role; additionally, it has been constrained in its ability to provide support to its related local associations because most such organizations are exempt under section 501(c)(6). As a consequence, M determined that the new organization, Q, should be created to fulfill the role of a traditional professional association. Q was created to promote the common professional interests of its members, including legislative advocacy, as well as providing greater support to local m associations than M is permitted to provide.

Local m associations, while related to M, are separately incorporated and the majority are separately recognized as exempt under section 501(c)(6).

M states that it will amend its governing documents to provide, among other matters, that Q will be the sole voting member of M and will appoint M's governing body. Q will also have the power to approve certain extraordinary actions of M, such as M's annual business plan, operating and capital budgets, and any material changes thereto; the termination or settlement of litigation where the amount in controversy exceeds a certain amount; entering into material leases of real property or acquiring real property; the sale, mortgage, or pledge of all or substantially all of M's assets, or the merger or consolidation of M; and the voluntary reorganization, dissolution, liquidation, or bankruptcy of M. Additionally, the same individuals may occupy seats on both Q's Board of Trustees and M's Board of Trustees, and the same individuals may be officers of both Q and M. Q will assume the name and certain functions of the present M, and the present M will asume the name of Q. The present members of M will automatically become members of Q, will pay dues to Q, and will elect Q's Board of Trustees.

M states that it will continue to supply the local m associations with educational materials and other support that is consistent with the exempt purposes of M set forth in section 501(c)(3) of the Code. Q, however, will form its own independent relationship with the local m associations and will support the local m associations with respect to matters involving the common professional interests of Q's members. Q expects to provide certain administrative services to the local m associations, such as joint dues collection for those local m associations that will be on Q's centralized billing file. Q will undertake, and M will cease performing, functions related to Q's membership, such as dues collection, the conduct of the annual meeting, resolution of ethics matters, matters relating to the economic aspects of the practice of n, governmental relations and certain public affairs activities, and publication of the semi-monthly newspaper. Generally, central office staff supporting the functions assumed by Q will be employed by Q, and to the extent that Q makes use of the services of central office staff continuing to be employed by M, such as staff supporting publications functions, a charge will be made to Q based on Q's actual use of those services.

M, however, states that it would continue to carry out an extensive array of charitable, educational, and scientific activities, such as publication of the monthly official journal, the monthly peer-reviewed journal, and the quarterly journal, as well as other works in the field of n, such as the standard reference and diagnostic work. The central office staff that supports activities related to these publications will continue to be employed by M, and advertising revenues derived in connection with these publications would continue to be received by M. As part of the reorganization, the governing instruments of N, O, and P will be amended to provide that, in each case, Q is the supported organization and Q has the power to elect at least a majority of the members of the boards of these organizations. M will continue to conduct other educational and research activities that have historically been conducted by it. M states that it will maintain its office of education and will develop and conduct a variety of programs and activities directed toward the professional education and development of individuals currently in and in training for careers in n. The activities of the office of education will continue to include developing and providing continuing educational programs related to n. M will continue to maintain its library as an information resource on n.

M states that its research staff office will continue to provide leadership and advocacy for the m research community, administer fellowship and research training programs, enhance system studies by expanding capacity and resources in services research, enable sophisticated analysis of relevant data, and develop and advocate for the used of evidence-based guidelines. M's staff-based office of quality improvement and m services will continue to formulate policy for improved access and delivery of m and other services to general and special populations, in general and special settings. This office will also

continue to promote m leadership in the improvement of treatment through development of practice guidelines and their derivative products, as well as scientifically and clinically informed advocacy for proposed standards and quality improvement measures intended for use by individuals, organized systems, accrediting bodies, and others.

M states that it will also continue to conduct certain public affairs activities, but no substantial part of its activities will consist of carrying on of propaganda or otherwise attempting to influence legislation. M will continue to deal with women's and minority group issues as they pertain to n and to support activities that focus on particular subspecialties in the field of n. M will continue research and educational activities pertaining to the quality and availability of m services. While the member-based councils related to these functions will become part of Q, the M staff associated with these functions will continue to work as part of M.

M states that Q may require a loan to meet temporary cash flow needs in order to begin operations, and that in the event that a loan from M is deemed advisable, such a loan would likely be of a certain amount and be outstanding for two months. M states that the terms of any such loan will be determined on an arm's-length basis. M does not expect that it will make any further loans to Q to defray the cost of Q's operations. M states that it, N, O, and P may provide services and make grants to Q in furtherance of the exempt purposes of those organizations; no portion of the resources provided to Q by M, N, O, or P will be used for any activity of an organization exempt under section 501(c)(6) of the Code that is not permitted under section 501(c)(3).

Section 501(c)(3) of the Code provides for exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific, or educational purposes provided no part of the net earnings of which 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. In the law of charity, the promotion of health is considered to be a charitable purpose.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Section 509(a)(3) of the Code excludes from the definition of the term "private foundation" an organization which is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in sections 509(a)(1) or (2), and is operated, supervised, or controlled by or in connection with one or more organizations described in sections 509(a)(1) or (2). The Code continues that for purposes of this paragraph, an organization described in section 509(a)(2) shall be deemed to include an organization described in section 501(c)(4), (5), or (6) which would be described in section 509(a)(2) if it were an organization described in section 501(c)(3).

205

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

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions and modifications.

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 such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the function constituting the basis of its exemption.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes; and it is "substantially related" only if the causal relationship is a substantial one. The regulation continues that for the conduct of 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 the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 514(a)(1) of the Code provides that a portion of the income derived from, or on account of, each debt-financed property shall be included as an item of gross income derived from unrelated trade or business.

Section 514(b) of the Code defines "debt-financed property" to mean, with certain exceptions, any property which is held to produce income and with respect to which there is an "acquisition indebtedness" at any time during the taxable year.

Section 514(c) of the Code defines "acquisition indebtedness" as the unpaid amount of indebtedness incurred in acquiring or improving the property.

Subsequent to the proposed reorganization, M, N, O, and P will operate exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. The transfer of activities and actions described above will have no adverse effect on a determination of exempt status or exception from private foundation status. Subsequent to the proposed reorganization, Q will operate as a business league within the meaning of section 501(c)(6). The transfer of activities and actions described above will have no adverse effect on a determination of exempt status under section 501(c)(6). Further, the creation of Q and the proposed transfers of activities and actions as described above do not involve the regular carrying on of unrelated trade or business within the meaning of section 513. Also, a single short term loan from a section 501(c)(3) organization to a related section 501(c)(6) organization, made on an arm's-length basis, does not involve the regular carrying on of unrelated trade or business nor will it have an adverse effect on a determination of exempt status. Nor does the loan, in this case, represent "acquisition indebtedness" incurred by Q.

An organization exempt under section 501(c)(3) of the Code may create an organization exempt under section 501(c)(6) to act as its parent without jeopardizing its exempt status. However, the section 501(c)(3) organization must not give up control of its purposes or activities to the section 501(c)(6) parent. In this case, control could mean the day-to-day management of the section 501(c)(3) organization, or the adoption or performance of activities by the section 501(c)(3) organization that are described in section

1.501(c)(6)-1 of the regulations and which would normally be carried on by a section 501(c)(6) organization. Also, in this case, as allowed under section 509(a)(3), M would not be defined as a private foundation because Q's support would be counted as proper support under section 509(a)(2) if Q had been a section 501(c)(3) organization.

Accordingly, based on the facts and circumstances concerning the reorganization and related transactions as stated above, we rule as follows:

(1) The reorganization and the continuing relationships described will not affect the tax-exempt status of Q under section 501(c)(6) of the Code, or M, N, O, and P under section 501(c)(3).

(2) The following specific transactions as part of the reorganization will not result in unrelated business taxable income for M, N, O, P, or Q under sections 511 through 514: (a) the transactions described as being part of the reorganization, (b) the provision without cost of the monthly official journal, the monthly peer-reviewed journal, and the quarterly journal by M to the members of Q (this relates only to the provision of these publications to members and not to further operations with respect to the publications, such as advertising), (c) the continuing collaboration in research and educational activities of member-based councils of Q with M's staff, (d) the "start-up" loan from M to Q, (e) the provision of management, administrative, support, and governance services among M, N, O, P, and Q and local m associations at cost, (f) the leasing of office space by M to Q, at cost, and (g) a "start-up" lease of office equipment by M to Q at cost and/or a one-time sale of such equipment by M to Q.

(3) Following the reorganization, and amendment of Articles to provide specific language, M, N, O, and P will be excepted from the definition of private foundation pursuant to section 509(a)(3) of the Code.

(4) M may make grants to Q for specific projects that are in furtherance of M's educational and scientific purposes.

(5) M, N, O, and P may provide, without charge, scholarly journals and other educational materials to members of Q and to the local m associations without affecting the tax exempt status of M under section 501(c)(3).

These rulings are based on evidence that the funds of M, N, O, and P are dedicated to the purposes listed in section 501(c)(3) of the Code. To assure their continued exemption, they should maintain records to show that funds are expended only for those purposes. If they distribute funds to other organizations, their records should show whether those organizations are exempt under section 501(c)(3). In cases where the recipient organization is not exempt under section 501(c)(3), there should be evidence that the funds will remain dedicated to the required purposes and that they will be used for those purposes by the recipient. These rulings are also based on the understanding that there will be no material changes in the facts upon which they are based. Any such change should be reported to the Tax Exempt and Government Entities (TE/GE) Customer Service office. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to the TE/GE Customer Service office.

Except as we have specifically ruled herein, we express no opinion as to the consequences of these transactions under the cited provisions or under any other provisions of the Code. This ruling is limited to the facts contained herein. 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.

207

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Group 2

208