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

200046039

Date: AUG 18 2000

Contact Person:

ID Number:

Telephone Number:

In reply refer to:
T:E:O:RA:T:1

E.I.N.

LEGEND

F=
H=
D=
N=
A=
T=

Dear Sir/Madam:

You requested a ruling that F's (formerly H) change in activities will not effect its exemption under section 501(c)(3) of the Internal Revenue Code, its non-private foundation status or result in unrelated business income tax.

FACTS

F is exempt under section 501(c)(3) of the Code and is an organization described in section 170(B)(1)(A)(iii) of the Code. F, which is a membership organization, operates a hospital.

A was formed in 1981 to act as a supporting organization for H. A is exempt under section 501(c)(3) of the Code and is classified as a supporting organization described in section 509(a)(3).

In 1965, F constructed a hospital facility to serve residents its community. F began operating the hospital in 1968. Prior to April 1, 1999, F had maintained an active medical staff consisting of one general surgeon, one pediatrician, one internist and five general practitioners.

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F's hospital operations have suffered operating losses in the past years. F's Board of Directors determined it did not have the resources to maintain its hospital without eliminating certain services it believed were essential. On March 31, 1999, in order to maintain the operation of the hospital without cutting essential services, F leased its hospital facilities, including land, building and equipment, to D. At the time of the execution of the lease, there was outstanding acquisition indebtedness (as such term is defined in section 514(c) of the Code) with respect to the leased premises totaling approximately $450,000. F paid these liabilities in full with the proceeds from the transaction.

D is a newly created Delaware for profit corporation. D is a wholly-owned subsidiary of N, a for-profit health care entity unrelated to F. When F first considered whether to lease its operations, F sent a request for proposals to a number of companies that lease or operate hospitals. Out of the few responses received by F, F states the proposal submitted by D was the most favorable to F and its community.

Simultaneously with execution of the lease, certain licenses, contracts, receivables, inventories and patient records were transferred to D by F. In addition, F contracted with D to allow it use of the H name as its fictitious name for the conduct of hospital operations. Effective March 5, 1999, H changed its name to F. No specific consideration was given by D for the right to use the name H.

Under the terms of the lease, D must operate a high quality, cost effective, acute care hospital and provide appropriate ancillary services. D is required to have an open medical staff with qualified physicians and to maintain a twenty-four hour emergency room that meets the conditions for participation as a Medicare provider. Should D fail to operate the hospital as required by the lease, F may give written notice of such failure to D. If such failure continues for thirty days after such notice, F may terminate the lease.

The payments to F under the lease are in the amount of T per month. D is responsible for all repairs, taxes and insurance in connection with the leased property. D is not allowed to assign the lease without the prior written consent of F unless D is selling all or substantially all of its assets or is engaging in a merger or consolidation in which D will not be the surviving entity. F states the terms reflected in the lease are the result of arm's-length negotiations. F's Board believes that it is receiving fair market rental under the lease.

The lease has a term of twenty years; however, at the end of the initial five-years, either party may give notice to terminate the lease. If F provides such termination notice, it must pay to D an amount equal to any enhancement in value of the leased premises accruing from the date of the lease execution.

In May of 1999, following F's lease of the hospital facility, A voted to officially disband as a separate organization. The functions and activities previously conducted by A, including its fund raising activities and volunteer services in the community, will now be conducted through a committee of F. The limited assets owned by A at the time of its dissolution have been transferred to F.

F intends to remain in existence during the term of the lease. F plans to establish a reserve with sufficient funds to enable it to fund the lease termination payment due at the end of the initial five years of the lease term, in the event the decision is made to terminate the lease. F further anticipates funding the reserve with sufficient cash to allow it to re-assume responsibility for the hospital operations should D choose not to renew the lease at the end of the initial five years or should D fail to comply with the terms of the lease.

While D operates the hospital, F intends to scrutinize D's operations to ensure it abides by the lease terms and continues to provide the health care needed in the community. F will also provide continued support for the health and wellness of persons in the community through implementation of various programs. F will attempt to increase the number of health care providers in the community by offering scholarships to local students working on medically related degrees to work in the community following graduation. F will develop a wellness program for county residents to improve the overall health of the community through teaching preventive health care techniques. F will fund a compassionate care program to provide financial assistance to local residents with health care expenses who are without private insurance and who do not qualify for any public assistance programs. F will support the activities of a local health related section 501(c)(3) charitable organization.

In order to fund these programs and to retain sufficient funds to establish the reserve to enable F to fund the possible early lease termination payment, it intends to establish various fundraising programs. F will organize an annual golf tournament at a local county club. F will coordinate an annual fund raising drive that will involve solicitation of contributions from local businesses and individuals. F's Board members as well as its members will actively participate in all fund raising programs. F has submitted information indicating that a substantial amount of its time will be involved in fund raising programs. F has submitting financial information indicating that with its anticipated sources of support it could meet the support requirements of a pubic charity under sections 509(1)(1) and 170(b)(1)(A)(vi) of the Code.

In March of 1999, F amended its Articles of Organization to allow for the leasing of the hospital facilities and to provide that F will conduct charitable activities to promote the health and wellness of persons located or residing in the community. The amendment also reflected the change of name.

Ruling Requests

1. The amendment of F's Articles of Organization and the change in F's operations as described above will not adversely affect F's status as an organization exempt from federal income tax under section 501(c)(3) of the Code.

2. The rental income received under the lease will not be considered unrelated trade or business income under the exception for rental income provided in section 512(b)(3) of the Code.

3. Any income received by F under the lease that might be attributable to D's use of the name H will not be considered unrelated business taxable income as such term is described in section 512 of the Code.

4. The amendment of F's Articles of Organization and the change in its operations as described above will not adversely affect F's classification as other than a private foundation under section 509(a)(1) of the Code.

Law

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable purposes, no part of whose net earnings inures to any private individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations 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 exempt purposes specified in section 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.

Section 1.501(c)(3)-1(d)(1) of the regulations provides that an organization is not organized or operated exclusively for an exempt purpose unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of designated individuals.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts, sections 368, 372 (1959); 4A Scott and Fratcher, The Law of Trusts, sections 368, 372 (4th ed. 1989).

Section 509(a) of the Code provides that the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than (1) an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)); (2) an organization which normally receives more than one-third of its support in each taxable year from any combination of gifts, grants, contributions, or membership fees.

Section 1.170A-9(e)(ii) of the regulations provides for the definition of a section 170(b)(1)(A)(vi) organization. In general, an organization is publicly supported if it normally receives a substantial part of its support from a governmental unit referred to in section 170(c)(1) or from direct or indirect contributions from the general public.

Section 1.170A-9(e)(2) of the regulations provides an organization will be treated as a publicly supported organization if the total amount of support which the organization normally receives from governmental units referred to in section 170(c)(1), from contributions made directly or indirectly by the general public, or from a combination of these sources, equals at least 33 1/3 percent of the total support normally received by the organization.

Section 1.170A-9(e)(3) of the regulations provides even if an organization fails to meet the 33 1/3 percent-of-support test described in subparagraph (2) of this paragraph, it will be treated as a publicly supported organization if it normally receives a substantial part of its support from governmental units, from direct or indirect contributions from the general public, or from a combination of these sources, and meets the other requirements of this subparagraph. In order to satisfy this subparagraph, an organization must meet the requirements of subdivisions (i) and (ii) of this subparagraph in order to establish, under all the facts and circumstances, that it normally receives a substantial part of its support from governmental units or from direct or indirect contributions from the general public, and it must be in the nature of a publicly supported organization, taking into account the factors described in subdivisions (iii) through (vii) of this subparagraph. The requirements and factors referred to in the preceding sentence with respect to a publicly supported organization are:

(i) Ten percent-of-support limitation. The percentage of support normally received by an organization from governmental units, from contributions made directly or indirectly by the general public, or from a combination of these sources, must be substantial. For purposes of this subparagraph, an organization will not be treated as normally receiving a substantial amount of governmental or public support unless the total amount of governmental and public support normally received equals at least 10 percent of the total support normally received by such organization.

(ii) Attraction of public support. An organization must be so organized and operated as to attract new and additional public or governmental support on a continuous basis. An organization will be considered to meet this requirement

if it maintains a continuous and bona fide program for solicitation of funds from the general public, community, or membership group involved, or if it carries on activities designed to attract support from governmental units or other organizations described in section 170 (b)(1)(A)(i) through (vi). In determining whether an organization maintains a continuous and bona fide program for solicitation of funds from the general public or community, consideration will be given to whether the scope of its fundraising activities is reasonable in light of its charitable activities. Consideration will also be given to the fact that an organization may, in its early years of existence, limit the scope of its solicitation to persons deemed most likely to provide seed money in an amount sufficient to enable it to commence its charitable activities and expand its solicitation program.

In addition to the requirements set forth in subdivisions (i) and (ii) of this subparagraph which must be satisfied, all pertinent facts and circumstances, including the following factors, will be taken into consideration in determining whether an organization is publicly supported.

(iii) Percentage of financial support. The percentage of support received by an organization from public or governmental sources will be taken into consideration in determining whether an organization is publicly supported. The higher the percentage of support above the 10 percent requirement of subdivision (i) of this subparagraph from public or governmental sources, the less will be the burden of establishing the publicly supported nature of the organization through other factors described in this subparagraph, while the lower the percentage, the greater will be the burden. If the percentage of the organization's support from public or governmental sources is low because it receives a high percentage of its total support from investment income on its endowment funds, such fact will be treated as evidence of compliance with this subdivision if such endowment funds were originally contributed by a governmental unit or by the general public. However, if such endowment funds were originally contributed by a few individuals or members of their families, such fact will increase the burden on the organization of establishing compliance with the other factors described in this subparagraph.

(iv) Sources of support. The fact that an organization meets the requirement of subdivision (i) of this subparagraph through support from governmental units or directly or indirectly from a representative number of persons, rather than receiving almost all of its support from the members of a single family, will be taken into consideration in determining whether an organization is publicly supported. In determining what is a representative number of persons, consideration will be given to the type of organization involved, the length of time it has been in existence, and whether it limits its activities to a particular

community or region or to a special field which can be expected to appeal to a limited number of persons.

(v) Representative governing body. The fact that an organization has a governing body which represents the broad interests of the public, rather than the personal or private interests of a limited number of donors (or persons standing in a relationship to such donors which is described in section 4946(a)(1)(C) through (G)) will be taken into account in determining whether an organization is publicly supported. An organization will be treated as meeting this requirement if it has a governing body which is comprised of public officials acting in their capacities as such; of individuals selected by public officials acting in their capacities as such; of persons having special knowledge or expertise in the particular field or discipline in which the organization is operating; of community leaders, such as elected or appointed officials, clergymen, educators, civic leaders, or other such persons representing a broad cross-section of the views and interests of the community; or, in the case of a membership organization, of individuals elected pursuant to the organization's governing instrument or bylaws by a broadly based membership.

(vi) Availability of public facilities or services; public participation in programs or policies. (a) The fact that an organization is of the type which generally provides facilities or services directly for the benefit of the general public on a continuing basis will be considered evidence that such organization is publicly supported. (b) The fact that an organization is an educational or research institution which regularly publishes scholarly studies that are widely used by colleges and universities or by members of the general public will also be considered evidence that such organization is publicly supported. (c) Similarly, the following factors will also be considered evidence that an organization is publicly supported:

(1) The participation in, or sponsorship of, the programs of the organization by members of the public having special knowledge or expertise, public officials, or civic or community leaders;

(2) The maintenance of a definitive program by an organization to accomplish its charitable work in the community, such as slum clearance or developing employment opportunities; and

(3) The receipt of a significant part of its funds from a public charity or governmental agency to which it is in some way held accountable as a condition of the grant, contract, or contribution.

(vii) Additional factors pertinent to membership organizations. The following are additional factors to be considered in determining whether a membership organization is publicly supported:

(a) Whether the solicitation for dues-paying members is designed to enroll a substantial number of persons in the community or area, or in a particular profession or field of special interest (taking into account the size of the area and the nature of the organization's activities);

(b) Whether membership dues for individual (rather than institutional) members have been fixed at rates designed to make membership available to a broad cross section of the interested public, rather than to restrict membership to a limited number of persons; and

(c) Whether the activities of the organization will be likely to appeal to persons having some broad common interest or purpose, such as educational activities in the case of alumni associations, musical activities in the case of symphony societies, or civic affairs in the case of parent-teacher associations.

Section 512(a)(l) 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, computed with the modifications listed in section 512(b).

Section 512(b)(2) of the Code provides there shall be excluded from unrelated business taxable income all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

Section 512(b)(3) of the Code provides generally that rents from real property (and its incidental related personal property) are not unrelated business income unless the property is debt-financed under section 514 of the Code. Debt-financed property does not include any property substantially related to the exercise or performance by such organization of its charitable functions.

Section 512(b)(4) of the Code requires that notwithstanding paragraphs (1), (2), (3) or (5), the net income realized with respect to debt-financed property must be included in unrelated business taxable income.

Rationale

The information submitted states F amended its Articles of Organization to change its activities from the operator of a hospital to a supporter of community health and wellness. F's new programs include: offering scholarships to local students working on medically-related degrees; developing a wellness program for county residents; the funding of a compassionate care program; and the support of a local section 501(c)(3) health related charitable organization. Accordingly, the change in F's activities will not adversely affect F's section 501(c)(3) of the Code exempt status.

In order to fund these charitable community programs and retain sufficient funds to establish the reserve, F established various fund raising programs. F submitted information stating a substantial amount of its time will involve fund raising programs. F's financial information indicates that with F's anticipated sources of support it should meet the support requirements of a pubic charity under sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code. In particular F should meet the requirements of the 10 percent facts and circumstances test of section 1.170A-9(e)(3) of the regulations because it has a continuing program of attracting public support, has a representative governing body, and has a definitive program to accomplish charitable work in the community.

F's rental income received under the lease will not be considered unrelated trade or business income under the exception for rental income provided in section 512(b)(3) of the Code because section 512(b)(3) of the Code provides that rents from real property are not unrelated business income unless the property is debt-financed under section 514 of the Code. F's property is not debt-financed.

Lastly, any income received by F under the lease that might be attributable to D's use of the name H will not be considered unrelated business taxable income because it is a royalty and section 512(b)(2) of the Code provides an exclusion from unrelated business taxable income for royalties.

Conclusion

1. The amendment of F's Articles of Organization and the change in F's operations as described above will not adversely affect F's status as an organization exempt from federal income tax under section 501(c)(3) of the Code.

2. The rental income received under the lease will not be considered unrelated trade or business income under the exception for rental income provided in section 512(b)(3) of the Code.

3. Any income received by F under the lease that might be attributable to D's use of the name H will not be considered unrelated business taxable income as such term is described in section 512 of the Code.

4. The amendment of F's Articles of Organization and the change in its operations as described above will not adversely affect F's classification as other than a private foundation under section 509(a)(1) of the Code.

These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

These rulings are directed only to the organizations that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited as precedent.

These rulings are based on the understanding that there will be no material change in the facts upon which they are based. Any changes that may have a bearing on your tax status should be reported to the Service. We are informing your key District Director of these rulings. Please keep this ruling letter in your permanent records.

Sincerely yours,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, EO Technical
Group 1