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

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Date: November 8, 2000

Contact Person:

ID Number:

Telephone Number:

T:EO:B1

Employer Identification Number:

Legend:

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Dear Sir/Madam:

This letter is in response to your request for a ruling under section 501(c)(3) of the Internal Revenue Code.

FACTS

L is the parent corporation of a multi-entity health care system located in the a area. L was created in 1988 as a result of a restructuring of M into a multi-corporation health care system (the "System").

The System is composed of the following organizations:

1. L is the parent of the System and has been recognized as tax-exempt under section 501(c)(3) of the Code. L promotes health education and related activities, and promotes the charitable work of some of its tax-exempt subordinate organizations, including the provision of strategic planning, finance, marketing, and overall direction to the organizations within the System. (Unless otherwise indicated below, each of the following organizations are subordinates of L.)

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2. M owns and operates a b bed acute care inpatient hospital in a, and has been recognized as tax-exempt under section 501(c)(3) of the Code. M is the sole stockholder of U.

3. N is organized to provide non-acute health care services, including home health services, walk-in clinics, health care professional services, community health education, day care services and nursing care facilities for the elderly. N has been recognized as tax-exempt under section 501(c)(3) of the Code. N is the sole member of R, which also has been recognized as tax-exempt under section 501(c)(3).

4. O was created to engage in fundraising activities for the benefit of the tax-exempt organizations in the System. O has been recognized as tax-exempt under section 501(c)(3) of the Code.

5. P is a nonprofit, non-exempt corporation that provides support staff to an ambulatory surgery center operated as a division of M.

6. R provides hospice care to the a community. Its sole member is N. R has been recognized as tax-exempt under section 501(c)(3) of the Code.

7. S is a health maintenance organization that has applied for recognition of exemption under section 501(c)(4) of the Code.

8. T is a for-profit corporation that owns and leases real property and engages in management services, real estate development and joint ventures.

9. U is a foreign insurance company owned by M. It provides professional and general liability insurance coverage for the System entities and physicians on the M medical staff who meet the qualifications for insurability.

L and M have determined that their missions of delivering high quality health care to the community may be better achieved by restructuring their respective boards of directors and committee governance configuration to change the mix of physician, community and management involvement. As a result, L and M have proposed amending their respective bylaws, forming various committees and issuing Committee Protocols in the manner described below.

L's and M's boards of directors will be identical. Each board will have 15 voting members and one nonvoting member. One nonvoting seat on each board will be held by the Vice Chief of Medical Staff of M. The voting members will be comprised of:

Nine persons who must live in or work in L's service area, but who must not be members of M's medical staff or employed by L or by any of its subsidiaries ("Community Directors");

Four persons who are active members of the professional staff of M or an organization controlled by M ("Provider Directors"); and

The President of M and L and the Chief of Staff of M ("Official Directors").

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A quorum consists of a simple majority of the voting members of the board. However, at least four members of the majority must be Community Directors and at least three members of the majority must be Provider Directors.

All of L's and M's board committees and officer positions will be identical. The standing board committees will be:

Hospital Oversight Committee
Executive Committee
Clinical Quality and Service Committee
Managed Care and Reimbursement Committee
Finance Committee
Governance Committee
Joint Conference Committee

Except as described below with respect to the Executive Committee, none of these committees will have any power over the day-to-day operations of either L, M or other entities in the System. Instead, they will report to the respective boards of directors of L and M and will perform duties delegated by the respective boards. Certain committees will have decisive powers, granted through express board sanction or under the limited and narrow authorization provided in the Committee Protocols issued by the board. In general, the full board retains authority to modify or reject any decisions made by a committee.

All the tax-exempt subsidiaries in the System will amend their respective articles of incorporation and bylaws so that they will be identical to each other, except for their respective charitable purposes, corporate member, and size and composition of their respective boards. The operations of these organizations will not change.

L and M, as well as all the other entities in the System, have adopted a substantial conflicts of interest policy.

The purpose of L's and M's respective Executive Committees are to provide a means of interim action for board-level decision-making between board meetings and to perform other responsibilities as delegated by the board or as established in the Committee Protocols (described below). L's and M's Executive Committees are authorized to meet and act on behalf of L's and M's boards of directors, respectively, on an emergency basis, when a meeting of the full board of each organization is not feasible. In such cases, each Executive Committee can act with full power of the respective board. In other situations, if the board has expressly delegated decision-making powers to the Executive Committee by specific board policy or directive, the Executive Committee can meet and act on behalf of the board between board meetings on such delegated matters.

Each Executive Committee will be comprised of five voting members, consisting of the Chairperson, the Vice Chairperson, the President, the Secretary-Treasurer, and one at large member selected by the board of directors. At least one member of the Executive Committee will be a member of the medical staff. The Chief of Staff will serve as a non-voting member of this committee. A quorum of four of the five voting members is necessary to act on matters in lieu of action by the board. If the Executive Committee is merely advising the board, a quorum is only three voting members. At any time the Executive Committee intends to act on behalf of the board, community members of the Executive

Committee (non-employee, non-medical staff) must constitute a majority of the voting members of the Executive Committee.

Decisions of the Executive Committee can be modified or reversed by the board, to the extent that action in reliance on such decisions has not occurred.

The composition of the membership of the other standing committees is as follows:

The Hospital Oversight Committee is comprised of 11 voting members from the following categories of persons:

Two Community Trustee/Directors:

> Each community Trustee/Director must be representatives of the community in System's service area, and not be a member of the medical staff nor an employee of any System entity. Thus, the community Trustee/Directors must be independent of the System and be reflective of the community.

Five Medical Staff Members:

> The Medical Staff Members must be active members of the professional staff of M or any entity in the System; and two of those Medical Staff Members must be board members, nominated by the Governance Committee, recommended by the Medical Executive Committee and elected by the board.

Four Administrative Representatives:

> The Chief Operating Officer, Chief Medical Administrative Officer, Vice President responsible for Nursing and the Vice President for Quality comprise the representatives from Administration in an ex officio voting capacity.

The Chairperson of the board, the Chief of Staff, and the Chief Executive Officer serve in ex officio non-voting capacities.

The Clinical Quality and Service Committee is comprised of seven voting members from the following categories:

Four Community Trustee/Directors:

> Each Community Trustee/Director must be representative of members of the community in the System's service area, and not be a member of the medical staff nor an employee of any entity in the System. Thus, each community Trustee/Director must be independent of the System and be reflective of the community. One of the four members must be a board member and at least one member of this committee must be a member of the Hospital Oversight Committee, nominated by the Governance Committee and elected by the board.

Three Medical Staff Members:

The Medical Staff Members must be active members of the professional staff of the System. At least one member of this committee must be a board member, and at least one must be a member of the Hospital Oversight Committee, nominated by the Governance Committee and elected by the board.

Non-Voting Members:

The Vice President for Quality will serve in an ex officio non-voting capacity. The Chairperson of the board of Trustees, the Chief Executive Officer, the Chief of Staff and the Vice Chief of Staff will also serve in ex officio nonvoting capacities.

The Managed Care and Reimbursement Committee is comprised of seven voting members from the following categories:

Four Community Trustee/Directors:

Each Community Trustee/Director must be representative of members of the community in the System's service area, and not be a member of the medical staff nor an employee of any entity in the System. Thus, the Community Trustee/Director must be independent of the System and be reflective of the community. At least one of these members must be a board member and be nominated by the board.

Three Medical Staff Members:

The Medical Staff Members must be active members of the professional staff of any entity in the System; and one of these members will be a board member and be nominated by the board.

Non-Voting Representatives:

The Chairperson of the board of Trustees, the Chief of Staff, and the Chief Executive Officer will serve in ex officio non-voting capacities. The Chief Managed Care Officer and the Chief Financial Officer will serve as staff to this committee.

The Finance Committee is comprised of seven voting members from the following categories:

Five community Trustee/Directors:

Each community Trustee/Director must be representative of members of the community in the System's service area and not be a member of the medical staff nor an employee of any entity in the System. Thus, the Community Trustee/Director must be independent of the System and be reflective of the community. At least three of these members must be members of the board, be nominated by the Governance Committee and elected by the board.

Two Medical Staff Members:

The Medical Staff Members must be active members of the professional staff of the System; and at least one of these members must be a board member, nominated by the Governance committee and elected by the board.

Non-Voting Members:

The Chairperson of the Board of Trustees, the Chief of Staff, and the Chief Executive Officer will serve in an ex officio non-voting capacity.

The Governance Committee is comprised of five voting members from the following categories:

Two Community Trustee/Directors:

Each community representative must be a representative member of the community in the System's service area and cannot be a member of the medical staff nor an employee of any System entity. Both of these committee members must be members of and elected by the board. Thus, these committee members must be independent from the System and be reflective of the community.

Two Medical Staff Members:

The Medical Staff Members must be active members of the professional staff of the System. Both of these committee members must be members of and elected by the board.

Chief Executive Officer:

The Chief Executive Officer of the System will serve as a voting member.

In addition, the Chief of Staff of M will serve as an ex officio non-voting member of the committee.

The Joint Conference Committee consists of L Chief of Medical Staff and Chief of Staff-Elect; all elected Officers of the board of directors; one Physician board member; the President of M; M's executive in charge of operations; and M's executive in charge of medical affairs.

RULING REQUESTED

The revised composition and duties of M's boards of directors and of its committees will not adversely affect M's status as an organization described in sections 501(c)(3) and 509(a) of the Code.

APPLICABLE LAW

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3).

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that for an organization to be exempt as one described in section 501(c)(3) of the Code, it must be both organized and operated exclusively for one or more exempt purposes. Under section 1.501(c)(3)-1(d)(1)(i)(b) of the regulations, an exempt purpose includes a charitable purpose.

Section 1.501(c)(3)-1(b)(1) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

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

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court stated that "the presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [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. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second), Trusts, sections 368, 372; 4A Scott & Fratcher, The Law of Trusts, sections 368, 372 (4th ed. 1989).

Rev. Rul. 69-545, 1969-2 C.B. 117, states that a properly organized nonprofit hospital meets the community benefit standard, and thus qualifies for exemption as a charitable organization under section 501(c)(3) of the Code, where its board of trustees is controlled by independent civic leaders; it has a medical staff open to all qualified physicians in the area, consistent with the size and nature of its facilities; it operates a full-time emergency room open to all persons, without regard to the ability to pay; and it provides hospital care for everyone in the community able to pay the cost thereof, either themselves, through private health insurance, or with the aid of public programs. The application of the community benefit standard to exempt hospitals and other exempt health care organizations was sustained in Eastern Kentucky Welfare Rights Org. v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), vacated on other grounds, 426 U.S. 26 (1975); and in Sound Health Association v. Commissioner, 71 T.C. 158 (1978), acq., 1981-2 C.B. 2.

RATIONALE

One of the components of the community benefit standard with respect to a hospital is that the hospital's governing body must be controlled by independent members of the community. L and M have each proposed restructuring their respective boards of directors and committee governance configuration to change the mix of physician, community and management involvement. As a result, L and M have

proposed amending their respective bylaws, forming various committees and issuing Committee Protocols in the manner described above.

Following the proposed restructuring, the proposed amendments to L's and M's bylaws, the formation of various committees and the issuance of Committee Protocols, the respective board of directors and Executive Committees will be controlled by independent members of the community. In addition, the quorum requirements in L's and M's bylaws and the adoption of a substantial conflicts of interest policy ensure this result.

Therefore, you will satisfy the community control component of the community benefit standard of Rev. Rul. 69-545, supra. As a result, you will continue to be organized and operated exclusively for charitable purposes under section 501(c)(3) of the Code.

RULING

The revised composition and duties of your board of directors and of its committees will not adversely affect your status as an organization described in sections 501(c)(3) and 509(a) of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

This ruling is directed only to the organization that requested it and may not be used or cited by others as precedent.

We are informing your Exempt Organizations Area Manager of this action. Please keep a copy of this ruling in 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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representatives.

Sincerely,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1

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