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

Uniform Issue List:
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513.00-00

Date: NOV 29 2000

Contact Person:

Identification Number:
T:EO:1
Telephone Number:

Employer Identification Number:

Legend:

L =
M =
N =
O =
a =
b =

Dear Sir or Madam:

We have considered your ruling request relating to the effect a proposed restructuring will have on your organization under section 501(c)(3) of the Internal Revenue Code and whether certain activities will constitute unrelated trade or business under section 513.

FACTS

L, formerly known as M, is a a nonprofit corporation that has been recognized as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) and which is not a private foundation by virtue of being described in section 509(a)(3).

L is the parent corporation of a health care system operating primarily in southern a. L was formed as a result of an affiliation between N and O, pursuant to which L was established as the sole member of each of these organizations. Each of these organizations has been recognized as exempt from federal income tax under section 501(a) of the Code as an

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as the sole member of each of these organizations. Each of these organizations has been recognized as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) which is not a private foundation because it is described in section 509(a)(3). This affiliation was the subject of private letter ruling dated b.

Effective January 1, 2000, N and O were each merged with and into L pursuant to a statutory merger under the law of the State of a (the "Mergers"). As a result of the Mergers, N and O ceased to exist as separate legal entities.

Prior to the Mergers, N was the sole member of five a nonprofit corporations which were described in section 501(c)(3) of the Code, and was the sole shareholder of a a business corporation. All of these corporations were engaged in health care activities or in related supporting activities. Recently, one of the tax-exempt corporations has been dissolved and the business corporation is in the process of being dissolved. Prior to the Mergers, O was the sole member of four a nonprofit corporations which were described in section 501(c)(3) of the Code. (Collectively, the four subordinate organizations of N and the four subordinate organizations of O, together with any other entities controlled directly or indirectly by O are referred to as the "Subsidiaries.")

Prior to the Mergers, N and O were responsible for the local network operations of their respective affiliated operating units, subject to the control of L. After the Affiliation, L, N and O determined that N and O were no longer needed to function as local area networks as originally contemplated and that their elimination would further enhance the structural and financial integration of the two health care systems served by N and O.

In contemplation of the Mergers, L, N, O, and the Subsidiaries entered into an Affiliation Agreement dated December 15, 1999 (the "Affiliation Agreement"). In accordance with the Affiliation Agreement, L continues to function as a community-based and community-governed regional integrated health care network, without the existence of N or O.

L's near-term priorities continue to include establishing strategic direction and policy, overseeing and directing the integration of the functions and the operations of the Subsidiaries and the achievement of operating efficiencies and cost reductions, through the elimination of duplicative functions, and securing managed care contracts for L and the Subsidiaries. L's long-term priorities continue to include promoting the structural and financial integration of the health care services provided by the Subsidiaries to enhance the provision of health care to communities served by L's health system.

The Certificate of Incorporation of each of the Subsidiaries has been amended and restated to reflect L as each of the Subsidiaries' sole member. The Bylaws of each of the Subsidiaries have been amended to grant L significant governance, management and financial authority with respect to each of the Subsidiaries.

Pursuant to the Affiliation Agreement, L has the right to determine the types of services each of the Subsidiaries provides, and each Subsidiary and each of its affiliated entities must comply with the directives of L's Board of Trustees. The Affiliation Agreement also provides that each Subsidiary must use its best efforts to ensure that its management maintains an effective working relationship with L's Chief Executive Officer to effectuate L's objectives. To that end,

L's Chief Executive Officer has the authority to participate in performance evaluations and goal setting of the management of each of the Subsidiaries.

Under L's Bylaws, physicians must comprise no less than 25 percent but no more than 49 percent of the voting members of L's Board of Trustees. In addition, L's Bylaws include a substantial conflicts of interest policy.

L has made the following representations:

A. At all times, at least a majority of the members of L's Board of Trustees will be comprised of independent members of the community.

B. At all times, at least a majority of a quorum of L's Board of Trustees will be comprised of independent members of the community

C. At all times, at least a majority of the members of L's Governance Committee will be comprised of independent members of the community.

D. L's conflicts of interest policy applies to all of the Subsidiaries.

E. The tax-exempt hospitals that L controls have adopted an open medical staff policy under which they accept for admission to their respective medical staffs all qualified physicians who apply.

F. The tax-exempt hospitals that L controls have adopted a charity care policy that applies to all persons without regard to age, race or socio-economic status, and that they communicate this policy to their respective employees and to the general public.

G. The tax-exempt hospitals that L controls have adopted a policy to provide health care services to all persons without regard to their ability to pay and without regard to age, race or socio-economic status, and that they communicate this policy to their respective employees and to the general public.

H. The tax-exempt hospitals that L controls have adopted a policy to offer emergency health care services 24 hours a day to all persons without regard to their ability to pay and without regard to age, race or socio-economic status, and that they communicate this policy to their respective employees and to the general public.

I. The tax-exempt hospitals that L controls have adopted a policy relating to the performance of affordable health care education programs for the benefit of the community and that they communicate this policy to their respective employees and to the general public.

J. The tax-exempt hospitals that L controls have adopted a policy relating to the performance of medical education programs for physicians and other

health care professionals in the community.

K. The tax-exempt hospitals that L controls conduct medical research programs for the benefit of the community.

L. The tax-exempt hospitals that L controls have adopted a policy that they will use any surplus of revenues over expenses for the benefit of the community, such as to improve the quality of patient care, to expand their respective facilities or to advance their respective medical training, education or research programs.

RULINGS REQUESTED

1. After the Mergers, L will continue to qualify as exempt from federal income taxation under section 501(a) of the Code as an organization described in section 501(c)(3).

2. After the Mergers, L will continue to be a public charity under section 509(a)(3) of the Code.

3. After the Mergers, L's provision of management or other services, loans, capital contributions, and/or the transfer of assets, personnel or resources to any of the Subsidiaries will not adversely affect the tax-exempt status of L and will not constitute an unrelated trade or business to L under section 513 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.

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, with certain modifications.

Section 513(a) of the Code defines unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of the organization for funds or the use it makes of the profits derived) to the exercise of the organization's exempt purposes or functions.

Section 1.513-1(d)(2) of the 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 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.

RATIONALE

Following the Mergers, L's activities pursuant to the Affiliation Agreement will promote the charitable health care purposes of the Subsidiaries. At least a majority of the members of L's Board of Trustees and its Governance Committee will be comprised of independent members of the community, and a majority of a quorum of the Board of Trustees will be comprised of independent members of the community. L has adopted a conflicts of interests policy that also applies to the Subsidiaries. The tax-exempt-hospitals that L controls have adopted the following policies: an open medical staff policy, a charity care policy, a policy that they will provide health care services to all persons without regard to their ability to pay and without regard to their age race or socio-economic status, a policy to offer 24 hours emergency health care services to all persons without regard to their ability to pay and without regard to their age race or socio-economic status, a policy relating to the performance of affordable health care education programs for the benefit of the community, a policy relating to the performance of medical education programs for physicians, and a policy that they will use any surplus of revenue over expenses for the benefit of the community. These hospitals conduct medical research programs for the benefit of the community. Therefore, L satisfies the community benefit standard of Rev. Rul. 69-545, supra.

As a result, L will continue to be organized and operated exclusively for charitable purposes under section 501(c)(3) of the Code.

Contributions to organizations exempt from federal income tax under section 501(c)(3) of the Code or income derived from the performance of services by related section 501(c)(3) organizations do not fall within the definition of unrelated business income under section 512, nor create taxable gain or loss to the transferor or transferee.

L's entering into the Affiliation Agreement with the Subsidiaries will not adversely affect its status as an organization described in section 501(c)(3) because L will continue to be organized and operated exclusively for the promotion of health within the meaning of Rev. Rul. 69-545, supra. The provision of management or other services, loans, capital contributions, and the transfer of assets, personnel or resources between L and the Subsidiaries pursuant to the Affiliation Agreement will not adversely affect its tax-exempt status under section 501(c)(3) because these activities will facilitate its charitable purposes of promoting health for the benefit of the community within the meaning of Rev. Rul. 69-545. In addition, L will continue to qualify as a supporting organization under section 509(a)(3).

RULINGS

1. After the Mergers, L will continue to qualify as exempt from federal income taxation under section 501(a) of the Code as an organization described in section 501(c)(3).

2. After the Mergers, L will continue to be a public charity under section 509(a)(3) of the Code.

3. After the Mergers, L's provision of management or other services, loans, capital contributions, and/or the transfer of assets, personnel or resources to any of the

Subsidiaries will not constitute an unrelated trade or business to L under section 513 of the Code.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based.

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 organization that requested them 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 letter in your permanent records.

If you have any questions about these rulings, 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 representative.

Sincerely,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1

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