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

200203070

Date: OCT 2 2 2001

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T:EO:B1

Employer Identification Number: [redacted]
Area Manager:

Legend:

A = [redacted]
B =
C =
D =
E =
F =

Dear Sir or Madam:

This is in response to letters from your authorized representative requesting a series of rulings on your behalf regarding the tax consequences associated with the transactions described below.

A is the product of a merger between B and C, two hospitals which had been exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. After the merger, B became the surviving corporation and its name was changed to A, which has been operating under a favorable determination letter issued to B. Therefore, in addition to this ruling request, you are requesting the issuance of an updated determination letter, which is being issued to A of even date.

A is located in a rural area, part of which is underserved by primary care physicians and you have stated that you provide specialized medical care that does not otherwise exist in parts of your service area. You have stated that because of the difficulties in recruiting physicians to relocate to and serve in rural areas, you have established a clinic with several locations staffed by primary and specialized care physicians.

You have stated that as a service to your inpatients, you have operated a pharmacy. Recently, you also opened a "retail" pharmacy that services patients who are not inpatients. It dispenses prescriptions to your employees and patients of employed physicians, as well as patients of non-employed physicians with staff privileges who are also located in the hospital. You have stated that for various reasons you believe there will only be a small number of prescriptions filled by persons who are not otherwise on your campus to obtain healthcare services.

You have stated that the "retail" pharmacy was started as a result of requests from community

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physicians who believed that their patients did not have adequate access to prescriptions. For example, when patients were discharged before a holiday, they were oftentimes not able to get their prescriptions filled by commercial pharmacies. You have stated that prior to opening the "retail" pharmacy, you attempted to make arrangements with local pharmacies to provide 24 hour service and/or operate a retail pharmacy in the hospital to service patients being discharged, patients who had come to the emergency room after normal business hours, etc., but the local pharmacies were either unwilling or unable to provide these services. You also believe your operation of the "retail" pharmacy is an important factor in your efforts to recruit physicians to practice in the community because of the products and services it will offer.

You have initiated a nurse practitioner program through which nurse practitioners travel to rural areas on a weekly basis to see patients. Under the law of D, nurse practitioners may write prescriptions for their patients. You attempted to arrange a prescription delivery service to rural areas with local pharmacies, but the pharmacies were either unable or unwilling to provide a delivery service. Therefore, you intend to provide this service in the near future. In addition, you intend to provide pharmacy services to patients of A's home health and hospice care services.

You have stated that because the pharmacy is associated with A, it will maintain a pharmaceutical inventory that is significantly larger than many of the pharmacies in the area. In addition, it is one of only two retail pharmacies in northwest D with a "hood" which is required to mix specialized sterile compounds, such as chemotherapy medications. You have stated that the limited operating history of the pharmacy indicates that only an incidental portion of pharmacy sales have been to patients of non-employed physicians.

You have stated that A formed a wholly owned for-profit subsidiary, E, to acquire a 70% interest in F, a medical laboratory, which focuses primarily on the provision of pathology services. F provides services to A and its patients, to residents of northwest D and to persons who reside outside of the region. The remaining 30% interest in F is held by an unrelated for-profit consulting corporation which specializes in the management and operation of such laboratories. This for-profit entity manages the day-to-day activities of the laboratory, but A provides some limited services to F for fair market value.

You stated that the motivation for forming and investing in F was to obtain laboratory services on the hospital campus. Previously, A had no on-site laboratory and specimens were collected and tested off-site in a for-profit laboratory. The time delay associated with off-site testing made performing advanced surgical and other procedures impossible. Thus, in order to be able to offer more advanced healthcare services, A found it necessary to invest in F. You believe the presence of the laboratory on the campus of A is an important factor in recruiting physicians to the community. You have stated that the laboratory location in the hospital saves time in diagnosing illness. F maintains a fleet of courier vehicles to collect test specimens. All specimens are tested at A, which permits 24 hour or less turnaround time, compared to 48 hours for other laboratories in the area. This results in less specimen deterioration and more accurate results. F also offers sophisticated testing which is not available in the region without resorting to mail service. You believe this service is particularly important to small hospitals who do not have the financial resources to purchase the necessary laboratory equipment, hire competent personnel and comply with significant licensing and regulatory requirements.

You have stated that as part of its mission to promote rural healthcare, A provides varying types and levels of services and assistance to small rural hospitals. Some of the assistance is provided as part of state and federal government programs, which are mandated by legislation and/or regulation and include: information and technology services and assistance, medical consultative services, personnel training and support services, remote emergency room, and cardiac monitoring. You state that you also provide similar

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services to small hospitals outside of these government programs (approximately 28% of services) and that you provide services in addition to the ones mandated under the government programs. You believe that your services permit the small hospitals to deliver higher quality healthcare and in some cases permit them to continue to operate.

You have stated that you recently completed a "state of the art" addition which includes medical office space which is provided to physicians who are employees of A and is leased to staff physicians who are not employed by A. Non-employed physicians presently lease approximately 5% of the office space in A. The lease provides that non-employed physicians must maintain staff privileges at A or they cannot continue to occupy the space. You have stated that since the community A serves is a geographically large and sparsely populated area, significant problems exist in recruiting and retaining physicians to serve the community. You believe the medical office space contributes importantly to A's mission of providing healthcare to this community by attracting physicians to the community that would not otherwise locate their practices in this geographic area. In addition, because of its physical proximity to the hospital, the medical office space enables physicians to better serve the needs of patients seeking medical services, especially in cases when these individuals require admission to the hospital.

You have stated that you have a physician recruitment department due to the unavailability of sufficient medical services. You have cited numerous sources to support this conclusion. A will attempt to recruit a physician directly for either a position as an employed physician or for the physician to establish his or her independent practice or join an established physician or group practice. A has also coordinated with a physician group to assist them in recruiting a new physician who will become an employee of the group. A has approved and funded financial incentives for physician recruitment which include: income guarantees (not in excess of three years); student loan assistance; relocation assistance and other incentives which A believes to be reasonable under the circumstances, provided that the terms of each physician recruitment package are reasonable in their entirety. You have stated that incentives must be provided pursuant to a written agreement and are offered only to physicians who will satisfy a community need.

You have stated that under any income guarantee, A will advance funds to the recruited physician with respect to each month during the guarantee period in which the recruited physician's net income (monthly gross receipts for professional services minus actual and reasonable direct and indirect costs) falls below the guarantee amount. The guaranteed amount is based upon an annual base salary and, in some cases, an incentive bonus. This amount will be reasonable, falling within the range reflected in regional or national surveys regarding income earned by physicians in the same specialty. Amounts advanced under the physician recruitment agreements will be treated as loans, will be represented by a written promissory note and will bear interest at a reasonable fixed rate. The borrower will be required to repay the balance due at the end of the guarantee period; however, the obligation to repay the note may be satisfied by the recruited physician's continued maintenance of a full-time medical practice. For each month beyond the guarantee period during which the recruited physician maintains a full-time medical practice, the balance due under the note will be reduced by a proportionate amount. You have stated that A does not require that the recruited physician continue to practice with a specified organization in order to receive the forgiveness of the recruitment incentives.

You have stated that you are constructing a center for health improvement on the campus of A, which will be operated as a division of A and will contain therapeutic, rehabilitation and fitness facilities as well as office space for non-employed physicians. In addition, a firm which makes and fits prosthetic and orthotic devices for the patients of A will occupy space in the building. You believe the location of the physicians is important because of their proximity to the therapeutic and rehabilitation facilities.

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You have stated that approximately one-third of the center will be used as the clinical and rehabilitation component, which will house A's sleep laboratory, behavioral based pain management clinic, cardiopulmonary rehabilitation, sports medicine, physical, occupational speech and hand therapy as well as its occupational and out-patient mental health programs. You state that patients in the clinical and rehabilitation programs described above will also use the fitness component of the facility, which will include warm water pool, track, whirlpool, and cardiovascular and strength equipment.

You have stated that the center will also provide preventative healthcare, physical education programs and medical based fitness programs for the patients of A, A's employees and members of the general public. The fitness component of the center is intended as a discharge destination for many of A's patients. The center will have an indoor pool which will be made available to public school students for educational purposes and the school district has agreed to make a nominal payment to you for this use to help offset some of the additional costs you will incur for operating this program. You state that there are presently 3 private operations in your community which offer fitness programs, but they do not offer education, health assessments, a pool, etc. You have stated that the fees you intend to charge the general public for the use of the fitness facility will be nominally higher than that charged at the three for-profit facilities. However, you believe your facility will offer a significantly higher level of service. You have submitted information concerning the median income of members of your community as well as average costs for fitness centers nationwide. You believe your fees will be approximately 70% of the average cost of fitness centers nationwide and will be affordable to a major portion of the community. You intend to implement a charity scholarship program for those individuals who qualify based on their income level. You have also stated that a fitness trail, a senior activities area and public park facilities will be available for use by the general public with no charge. You have also stated that the fitness center will contain a pro shop and juice bar selling these services to members and employees.

You have requested the following rulings in connection with these transactions:

1. The operation of the pharmacy contributes importantly to the accomplishments of A's exempt purposes and pharmacy sales will not constitute unrelated business taxable income.

2. To the extent that the outreach services provided by A to small rural hospitals are within the scope of section 513(e) of the Code, amounts received by A for such services will not constitute unrelated business taxable income. To the extent that outreach services provided by A to small rural hospitals are outside the scope of section 513(e), the provision of such services contributes importantly to the accomplishment of A's exempt purposes, and amounts received by A from the sale of such services will not constitute unrelated business taxable income.

3. The extension of income guarantees and other recruitment incentives to recruit physicians contributes importantly to the achievement of A's exempt purposes and will not adversely affect A's continuing status as a section 501(c)(3) organization.

4. The separate corporate identities of A, E and F will be respected and neither the activities of E nor F will be attributed to A.

5. Rental income generated from the lease of office space in the hospital to nonemployed physicians and F contributes importantly to the accomplishment of A's exempt purposes and such income will not constitute unrelated business taxable income.

6. The operation of the fitness center satisfies one or more exempt purposes under section 501(c)(3) and

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contributes importantly to the accomplishment of A's exempt purposes.

a. Rental income generated from the lease of the medical office space component of the fitness center to nonemployed physicians and an orthotics provider contributes importantly to the accomplishment of A's exempt purposes and such income will not constitute unrelated business taxable income.

b. The operation of the clinical component of the fitness center contributes importantly to the accomplishment of A's exempt purposes, and the income generated from such operations will not constitute unrelated business taxable income.

c. The operation of the fitness component of the fitness center contributes importantly to the accomplishment of A's exempt purposes, and the income generated from such operations will not constitute unrelated business taxable income.

7. A's indirect investment in F contributes importantly to its exempt purposes, and with respect to the income received by A for providing services to F, only the percentage of such income which is equal to the percentage of income generated by testing performed for hospitals which are not small rural hospitals or for residents of counties which are not served by small rural hospitals will constitute unrelated business taxable income.

8. If A directly holds the 70% interest in F, which interest it presently holds indirectly through E, the activities of F would contribute importantly to the accomplishments of A's exempt purposes, and only the income generated by testing performed for hospitals which are not small rural hospitals or for residents of counties which are not served by small rural hospitals will constitute unrelated business taxable income.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for charitable, educational or scientific purposes.

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. Rev. Rul. 69-545, 1969-2 C.B. 117, acknowledges that the promotion of health is a charitable purpose, and that promoting the health of the general community constitutes a sufficient basis for tax-exempt status within the meaning of section 501(c)(3).

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 income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its exempt purpose or function.

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Section 513(a)(2) of the Code provides, in part, that the term "unrelated trade or business" does not include any trade or business which is carried on in the case of an organization described in section 501(c)(3) by the organization primarily for the convenience of its employees.

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 the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes.

Section 514(a)(1) of the Code includes as an item of gross income derived from a trade or business a certain percentage of the income derived from or on account of each debt-financed property.

Section 514(b)(1)(A) of the Code provides, in part, that "debt-financed" property does not include any property substantially all the use of which is substantially related to the exercise or performance by such organization of its charitable or other purpose constituting the basis for its exemption under section 501.

Section 1.514(b)-1(c)(1) of the Income Tax Regulations provides by example that where a tax exempt hospital leases real property owned by it to an association of doctors for use as a clinic, the rents derived under such lease would not be included unrelated business taxable income if the clinic is substantially related to the carrying on of hospital functions.

Revenue Ruling 69-463, 1969-2 C.B.131, provides that the leasing of its office building and the furnishing of certain services by an exempt hospital to a hospital based medical group is not unrelated trade or business under section 513 of the Code.

In Isabel Peters v. Commissioner, 21 T.C. 55 (1953), nonacq., 1955-1 C.B. 8, withdrawn and acq. substituted therefor, 1959-2 C.B. 6, the Tax Court held that an organization operating a public beach, playground and bathing facility without charge was charitable within the meaning of section 501(c)(3) of the Code. In so holding, the Court emphasized that the facilities were available to all members of the community.

Rev. Rul. 59-310, 1959-2 C.B. 146, holds that an organization formed to establish, maintain and operate a public swimming pool, playground and other recreation facilities for the children and other residents of a particular community is described in section 501(c)(3) of the Code since the property and its uses are dedicated to members of the general public of the community and are charitable in that they serve a generally recognized public purpose which tends to lessen the burdens of government. Thus, the facts in the ruling were virtually identical to the Isabel Peters case except that a minor amount of the income was derived from charges for admission to the swimming pool.

Rev. Rul. 67-325, 1967-2 C.B. 113, holds that the provision of a community recreational facility open to the community as a whole by an organization is, under certain circumstances, within the general category of activities recognized as charitable under section 501(c)(3) of the Code because they tend to lessen the burdens of government. In Rev. Rul. 67-325, an organization provided recreational facilities without charge to the residents of a township. However, the organization was not organized and operated exclusively for charitable purposes because the use of the facilities was restricted to less than the entire community on the basis of race.

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Rev. Rul. 79-360, 1979-2 C.B. 236, distinguishes the operation of a health club from the operation of a recreational and fitness center on the basis of fees charged to members of the two facilities. An organization described in section 501(c)(3) of the Code, whose purpose was to provide for the welfare of young people, operated a recreational and fitness facility and a separate health club under a two-tiered membership structure that made recreational facilities available to the general public at one rate, and health club facilities available at a higher rate. The Rev. Rul. concluded that the operation of the health club facilities generated unrelated business taxable income under section 513 because its operation did not contribute importantly to the organization's exempt purpose. The operation of the health club was seen to be separate from the organization's general fitness program inasmuch as the commercially comparable annual dues or daily fees were sufficiently high to restrict participation in the health club to a limited segment of the community.

The activities of a fitness center owned by a hospital may promote health under section 501(c)(3) of the Code in certain instances. The clinical and rehabilitative treatment of hospital inpatients or outpatients in accordance with treatment plans prescribed by physicians or appropriate hospital personnel furthers the hospital's exempt purpose of serving the healthcare needs of the community. Accordingly, your clinical and rehabilitation program promotes the health of the community within the meaning of Rev. Rul. 69-545, supra, and is substantially related to the furtherance of your exempt purposes under section 501(c)(3). Also, use of the fitness center by your employees would fall under the "convenience" exception of section 513(a)(2), including sales by the pro shop and juice bar.

As for use of the facility by the general public, a fitness center can further a charitable purpose if it is available to a significant segment of the community. The operation of such a fitness center is related to the charitable purpose of providing community recreational facilities only if the fees charged are affordable to the community served. In this regard, you have stated that the fitness center will have a scholarship program to help low income participants obtain free or low cost memberships even though you project that the fitness center will generate substantial losses based on the cost to operate the facility with the fee structure you have proposed. In addition, you state that your indoor pool will be made available to students for physical education and sports activities. (You note that there are no other public indoor swimming facilities in your geographic area). You also intend to stress programs for senior citizens and offer low or no cost health screenings for the community. You intend to provide community education seminars on health and other topics and you intend to monitor the composition of the membership by performing demographic surveys. The information you submitted shows that the fitness center will be available to, and the fees charged will be affordable by, an economic cross-section of the community. Therefore, for purposes of section 513(a) of the Code, amounts derived from the general public for fitness activities constitute income from an activity that is substantially related to your exempt purpose. You intend to implement a charity scholarship program for those individuals who qualify based on their income level. You have also stated that a fitness trail, a senior activities area and public park facilities will be available for use by the general public with no charge.

Since the facility is "debt-financed" within the meaning of section 514 of the Code, the leasing of space in the facility must be substantially related to your exempt purpose for the fees generated to be excluded from the unrelated business income tax. The facts you submitted indicate that the leasing of space to nonemployed physicians and an orthotics provider is substantially related to your exempt purpose, and the fees generated are therefore not subject to the unrelated business income tax.

Revenue Ruling 68-376, 1968-2 C.B. 246, provides situations in which persons who purchase pharmaceutical supplies from an exempt hospital are considered "patients" of the hospital for purposes of determining whether the hospital is engaged in unrelated trade or business.

Revenue Ruling 68-374, 1968-2 C.B. 242 provides, in part, that "casual sales" of products to nonpatients are not regularly carried on under the rationale of section 1.513-1(c)(2)(ii) of the Income Tax Regulations and would be excluded from the computation of unrelated business taxable income. The hospital did not promote the sales, the sales did not occur with frequency and the sales represented only a small percentage of the pharmacy's total sales.

Hi Plains Hospital v. United States, 670 F.2d 528 (5th Cir. 1982), holds, in part, that an exempt hospital's pharmacy sales to private patients and the general public did not generate unrelated business taxable income where the pharmacy sales were made to individuals who had limited access to a pharmacy because of their residence in a rural area.

The hospital's sale of pharmaceuticals to nonpatients in this case, based on the facts of the situation, either contribute importantly to its exempt purposes or are "casual sales" within the meaning of Revenue Ruling 68-374.

Section 513(e) of the Code provides that certain services described in section 501(e)(1)(A) which are furnished by a tax exempt hospital to other tax exempt hospitals will not constitute an unrelated trade or business where: (a) the recipient hospital has facilities that serve not more than 100 patients; (b) the services, if performed by the recipient hospital on its own behalf, would constitute activities consistent with its exempt purposes and (c) the services are provided at a fee which does not exceed cost.

You have stated that services are provided by A that meet the requirements of section 513(e). However, A also provides certain services to small rural hospitals that are not enumerated in section 501(e)(1)(A). Since your provision of this latter class of services furthers your exempt purposes and are needed by the recipients to maintain quality healthcare for their patients, amounts received by A from the provision of these services will not constitute unrelated business taxable income, provided that the recipient hospital has facilities that serve not more than 100 patients. This same rationale will apply to a direct or indirect investment by A in F. Only the percentage of income earned by A from F's provision of testing services for hospitals which are not small rural hospitals or for residents of counties which are not served by small rural hospitals will constitute unrelated business taxable income.

Section 1.501(c)(3)-1(c)(2) of the regulations states that an organization is not operated exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) of the regulations defines the term "private shareholder or individual" as referring to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized and operated for any of the purposes specified in section 501(c)(3) unless it serves a public rather than a private interest. Thus, an organization exempt under section 501(c)(3) must not be organized or operated for the benefit of private interests.

Revenue Ruling 69-545, 1969-2 C.B. 117, holds that a non-profit hospital that benefits a broad cross section of the community by having an open medical staff and a board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare) may qualify as an organization described in section 501(c)(3).

Revenue Ruling 72-559, 1972-2 C.B. 247, holds that an organization that provides subsidies to recent law school graduates during the first three years of their practice to enable them to establish legal practices in economically depressed communities that have a shortage of available legal services and to provide free legal service to needy members of the community may qualify as an organization described in section 501(c)(3).

Revenue Ruling 73-313, 1973-2 C.B. 247, holds that providing office facilities to attract a physician to a community that had no available medical services furthered the charitable purposes of promoting the health of the community. The ruling states that certain facts are particularly relevant: (1) the demonstrated need for a physician to avert a real and substantial threat to the community; (2) evidence that the lack of a suitable office had impeded efforts to attract a physician; (3) the arrangements were at completely arm's length; and (4) there was no relationship between any person connected with the organization and the recruited physician. The ruling states that, under all the circumstances, the arrangement used to induce the doctor to locate a practice in the area bears a reasonable relationship to promotion and protection of the health of the community and any private benefit to the physician is incidental to the public purpose achieved.

Revenue Ruling 97-21, 1997-1 C.B. 121, provides examples illustrating whether nonprofit hospitals that provide incentives to physicians to join their medical staffs or to provide medical services in the community violate the requirements for exemption as organizations described in section 501(c)(3) of the Code.

In order to meet the requirements of section 501(c)(3), a hospital that provides recruitment incentives to physicians must provide those incentives in a manner that does not violate the operational test of section 1.501(c)(3)-1. Whether the recruitment incentives violate the operational test is determined based on all the relevant facts and circumstances.

A has provided objective evidence demonstrating the need for additional physicians in its service area and has engaged in a physician recruitment activity bearing a reasonable relationship to promoting and protecting the health of the community. The facts indicate that arrangements are at arm's length and there will be no relationship between A and the recruited physicians. The provision of the incentives under the circumstances described furthers the charitable purposes served by A and is consistent with the requirements for exemption under section 501(c)(3). Any private benefit to the physicians is incidental to the public purpose achieved.

Generally, for federal income tax purposes, a parent and its subsidiary corporations are separate taxable entities so long as the purposes for which the subsidiary is formed are the equivalent of business activities or the subsidiary subsequently carries on business activities. Moline Properties Inc., v. Commissioner, 319 U.S. 436 (1943). Generally, where a corporation is organized with a bona fide intention that it will have real and substantial business activities, its existence will not be disregarded for tax purposes.

A, E and F are separate corporate entities, each carrying on bona fide business activities. Thus, the separate corporate identities of these entities will be respected and neither the activities of E or F will be attributed to A.

Rental income generated from the lease of office space to nonemployed physicians and F contributes importantly to the accomplishment of A's exempt purposes of providing health care to the community and income derived from this activity will not constitute unrelated business taxable income.

Accordingly, based on all the facts and circumstances described above, we rule:

1. The operation of the pharmacy contributes importantly to the accomplishments of A's exempt purposes and pharmacy sales will not constitute unrelated business taxable income.

2. To the extent that the outreach services provided by A to small rural hospitals are within the scope of section 513(e) of the Code, amounts received by A for such services will not constitute unrelated business taxable income. To the extent that outreach services provided by A to small rural hospitals are outside the scope of section 513(e), the provision of such services contributes importantly to the accomplishment of A's exempt purposes, and amounts received by A from the sale of such services will not constitute unrelated business taxable income.

3. The extension of income guarantees and other recruitment incentives to recruit physicians contributes importantly to the achievement of A's exempt purposes and will not adversely affect A's continuing status as a section 501(c)(3) organization.

4. The separate corporate identities of A, E and F will be respected and neither the activities of E nor F will be attributed to A.

5. Rental income generated from the lease of office space in the hospital to nonemployed physicians and F contributes importantly to the accomplishment of A's exempt purposes, and such income will not constitute unrelated business taxable income.

6. The operation of the fitness center satisfies one or more exempt purposes under section 501(c)(3) and contributes importantly to the accomplishment of A's exempt purposes.

a. Rental income generated from the lease of the medical office space component of the fitness center to nonemployed physicians and an orthotics provider contributes importantly to the accomplishment of A's exempt purposes and such income will not constitute unrelated business taxable income.

b. The operation of the clinical component of the fitness center contributes importantly to the accomplishment of A's exempt purposes and the income generated from such operations will not constitute unrelated business taxable income.

c. The operation of the fitness component of the fitness center contributes importantly to the accomplishment of A's exempt purposes and the income generated from such operations will not constitute unrelated business taxable income.

7. A's indirect investment in F contributes importantly to its exempt purposes, and with respect to the income received by A for providing services to F, only the percentage of such income which is equal to the percentage of income generated by testing performed for hospitals which are not small rural hospitals or for residents of counties which are not served by small rural hospitals will constitute unrelated business taxable income.

8. If A directly holds the 70% interest in F, which interest it presently holds indirectly through E, the activities of F would contribute importantly to the accomplishments of A's exempt purposes, and only the income generated by testing performed for hospitals which are not small rural hospitals or for residents of counties which are not served by small rural hospitals will constitute unrelated business taxable income.

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

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.

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 this ruling, please contact the person whose name and telephone number are shown in the heading of this letter

Sincerely,

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1