DEPARTMENT OF THE TREASURY 200327065
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: APR 9 2003

Contact Person:

ID Number:

Telephone Number:

UIL: 501.03-11

T:EO: B1

Employer Identification Number:

Legend:

A =
B =
C =

Dear Sir or Madam:

This is in response to a letter from your authorized representative requesting a series of rulings on your behalf regarding the tax consequences associated with a proposed joint venture for the operation of a neonatal intensive care unit.

A is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and is classified as a nonprivate foundation under section 509(a). A operates general acute care hospitals and other health services and facilities on and off the campus of C, including a medical center based infant intensive care unit that is classified as a Level III neonatal intensive care unit. A's facilities are staffed by the faculties, residents, interns and students of C as well as community based health care providers. You have stated that in conjunction with its neonatal intensive care operations, A has developed clinical protocols and methods of training clinical personnel that enhance the level of care at this facility.

B is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a nonprivate foundation under section 509(a). It owns and operates a general acute care hospital including a Level II neonatal nursery. You have stated that neonatal nurseries are rated at Levels I, II or III depending on the intensity of care

which they are equipped and licensed to provide, with Level III providing the most intensive level of care.

You have stated that neonatal patients of B requiring a more intensive level of care than that provided at B's nursery must be transported to other facilities outside the community, including A's Level III facility. Therefore, B desires to utilize a joint enterprise with A to operate B's existing nursery while developing a new neonatal facility offering Level III intensive care services at B. A and B believe this will avoid the potential jeopardy to health and other disadvantages inherent in transferring infants needing such services to other facilities outside the community served by B.

You have stated that neonatal services are highly specialized and costly, necessitating certain minimum patient volumes to sustain the level of resources (including facilities, institutional expertise and a network of professionals with expertise in Level III care) that are required to maintain quality of care in Level III facilities. You believe participation by A and B is critical to the operation of the new facility planned for B. B's participation is essential because A alone does not have the resources (including the facilities for a Level III facility) in B's community, such as it operates in its own community. A's participation is essential because B does not have the resources (including Level III expertise, appropriate professional relationships and funding) necessary to expand its existing nursery to a Level III facility.

You have stated that the goals of the parties for the operation of the new Level III facility are: (1) to provide residents of B's community with access to high-quality children's health; (2) to achieve the patient volumes necessary to sustain the cost-effective provision of all appropriate levels of neonatal intensive care at the highest quality level; (3) to decrease the need for out of area transport of critically ill newborns and to facilitate transfers back to the community; (4) to decrease the physical and emotional stress on patients and families and to increase patient and family satisfaction with respect to the care of newborns requiring intensive care; (5) to increase the availability of trained physicians and other health care professionals in the community; (6) to improve the efficiency and effectiveness of neonatal therapies through the greater number of patients treated; (7) to enhance clinical research opportunities with respect to neonatal care and (8) to enhance educational opportunities for medical professionals with respect to neonatal care.

You have stated that A and B formed a limited liability company to operate the existing nursery at B and the new Level III facility. The limited liability company will act as the manager of the Level III facility. The operating agreement provides that A and B will contribute equally to the initial capital requirements of the facility and any revenue generated by the facility and distributed to A and B will be used in furtherance of their exempt purposes.

You have stated that the governance of the limited liability company will be implemented at the following levels: (1) through A and B as the members of the limited liability company; (2) through delegation by A and B to a governing board of certain operating decisions, subject to oversight by A and B and (3) through delegation by A and B of certain operating decisions to a manager, subject to oversight by A and B.

You have stated that the unanimous approval of A and B is required for any amendment of the operating agreement or the Articles of Organization and certain major transactions, including mergers, additional capital calls, dissolution, sale and admission of new members.

The governing board of the limited liability company will be composed of seven individuals, three appointed by A and three appointed by B and one non-voting member who will be the medical director of the facility. The governing board has responsibility for the direction of the limited liability company and its operations, including developing and approving the annual capital and operating budgets, approval of rates and charges, and establishment of performance standards.

You have stated that A will be the managing member of the facility, responsible for day-to-day operation and management, including developing clinical policies and protocols in consultation with the medical staff of B; providing consultation and support to ensure compliance with state law, managed care contracting, billing, and staffing.

You have stated that the limited liability company will be responsible for the day-to-day operations of the neonatal intensive care unit, including arranging for the provision of professional medical services provided in the facility, arranging for the services of the clinical director and nurse manager, advising and assisting B's medical staff regarding the credentialing of physicians and allied health professionals and formulating strategic plans for the facility.

You have stated that B will provide a facility setting for the neonatal intensive care unit, including space, support services, nonphysician employees, supplies, medical records, maintenance and billing and collection in exchange for reimbursement of its costs. You have stated that these services will be provided in the same manner and to the same extent as they are provided to B's other departments.

You have stated that B will pay to the limited liability company all of the revenues it receives with respect to the operations of the facility, out of which the limited liability company will pay all expenses related to the operation of the facility. As part of such expenses, in exchange for acting as the limited liability company's managing member, A is entitled to reasonable compensation as determined by the parties, which will be

limited to A's actual costs related to its provision of services as managing member. The net profits will then be distributed to A and B as members of the limited liability company. If expenses exceed revenues, the limited liability company and its members will bear such losses.

You have stated that the limited liability company can be dissolved for the following reasons: expiration of the term of the operating agreement, approval of the members, disposition of the assets, failure of the members to successfully renegotiate the agreement if plans to increase the quality and level of services are not implemented, if mutually agreed upon performance standards are not achieved and modifications are not agreed upon or there is a change in law that adversely affects a member with respect to its participation as such.

You have requested the following rulings in connection with the reorganization described above:

1. Participation in the limited liability company will not adversely affect the status of A or B as organizations described in section 501(c)(3) of the Code, nor affect their public charity status under section 509(a)(1).

2. All payments received by A and B from the limited liability company for goods, property, services or personnel provided in connection with the operation of the neonatal intensive care unit, and A's and B's distributive shares of the income or loss of the limited liability company in connection with its operation of the neonatal intensive care unit, will constitute income from a trade or business that is substantially related to the tax-exempt purposes of A and B within the meaning of section 513 and, therefore, will not be subject to the tax on unrelated business income under section 511.

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.

Section 1.501(c)(3)-1(e)(1) of the regulations states that an organization exempt under section 501(c)(3) of the Code may operate a trade or business as a substantial part of its activities if the operation of the trade or business is in furtherance of the organization's exempt purposes.

Revenue Ruling 69-545, 1969-2 C.B. 117, acknowledges that the promotion of health is a charitable purpose within the meaning of section 501(c)(3) of the Code.

Revenue Ruling 98-15, 1998-1 C.B. 718, in Situation 1, approved the formation of a limited liability company by an exempt hospital, even where the other member was not an exempt organization. In that case the hospital's principal activity continued to be the provision of health care, the hospital controlled the limited liability company and the limited liability company was used to further the exempt charitable purposes of the hospital and the hospital .

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 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) requires unrelated business income attributable to debt-financed property to be included within the calculation of an organization's unrelated business taxable income.

The exempt purposes of both A and B will be furthered by establishing the Level III neonatal intensive care unit at B. B's participation will permit it to improve and expand the level of hospital care offered to its infant patients. A's participation will permit it to use the sophisticated skills of its neonatal specialists to reach more patients, improve neonatal techniques and therapies, provide additional clinical research opportunities,

and create an additional venue for clinical education programs. Accordingly, because the joint venture enables the parties to continue to promote health in a charitable manner and contributes importantly to the accomplishment of each organization's exempt purposes, any income received by A or B as members of the limited liability company that operates the neonatal intensive care unit will not constitute income from an unrelated trade or business within the meaning of section 513.

All patients in the neonatal intensive care unit will be patients of B. B provides equipment, space, support services, the services of non-physician employees, supplies, medical records, maintenance, billing and collection in relation to the neonatal intensive care unit patients in the same manner and to the same extent as for its other patients. None of these services constitutes the provision of administrative services to the limited liability company. For example, the billing and collection activity relates solely to billing the neonatal intensive care unit's patients, not to the provision of financial or accounting services to the limited liability company. Similarly, any payment to B for the services of its specialized medical and nursing personnel to effectuate the clinical operations of the neonatal intensive care unit will not be income from the conduct of an unrelated trade or business because such income will be derived from activities that constitute the provision of patient care rather than ordinary administrative services.

The participation in the limited liability company described herein will not adversely affect the tax exempt status of A or B under section 501(c)(3) of the Code as they will continue to conduct the activities that form the basis for their exemption from federal income tax. In addition, A and B will not adversely affect their nonprivate foundation status as the basis for their classification as nonprivate foundations under section 509(a) will not change. Their participation in the limited liability company to operate the neonatal intensive care facility will not result in the receipt by the above entities of unrelated business income under sections 511 through 514 of the Code because these activities will be substantially related to the accomplishment of their exempt purposes.

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

1. Participation in the limited liability company will not adversely affect the status of A or B as organizations described in section 501(c)(3) of the Code, nor affect their public charity status under section 509(a)(1).

2. All payments received by A and B from the limited liability company for goods, property, services or personnel provided in connection with the operation of the neonatal intensive care unit, and A's and B's distributive shares of the income or loss of the limited liability company in connection with its operation of the neonatal intensive care unit, will constitute income from a trade or business that is substantially related to the tax-exempt purposes of A and B within the meaning of

section 513 and, therefore, will not be subject to the tax on unrelated business income under section 511.

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

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

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.

Please keep a copy of these rulings in your permanent records.

Sincerely,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1