Internal Revenue Service

Department of the Treasury

S.I.N. 0511.00-00
S.I.N. 0512.00-00
S.I.N. 0513.00-00
NO THIRD PARTY CONTACT
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Washington, DC 20224

199914051

Contact Person: XXXXXXXXXXXXXXXXX

Telephone Number: XXXXXXXXXXXXXXXXX

In Reference to: OP:E:EO:T:3

Date: JAN 13 1999

EIN: XXXXXXXXXXX

Legend:

P= XXXXXXXXXXXXXXXXXXXXX
S= XXXXXXXXXXXX
T= XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
X= XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
O= XXXX
A= XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
B= XXXXXXXXXXXXXXXXXXXXXXX
L= XXXXXXXXXXXXXXXXXXXXXXXXX
R= XXXXXXXXXXXXXXXXXXXXXXXXXXX
d= XXXX
e= XX
f= XX
g= XX
h= XXX
i= XX
j= XXX
M1= XXXXXXXXXXXXXXXXXXXXXXXXXX
M2= XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

Gentlemen:

This is in response to your ruling request dated October 16, 1998, as updated, modified, revised, and supplemented by subsequent correspondence dated October 28, 1998, and November 3, 1998, in which you request certain rulings with respect to a proposed transaction.

Background:

P was incorporated under the laws of the State of O as a not-for-profit corporation in d. P has a Board of Trustees which consists of fifteen members. The members are appointed on a 3-year rotating basis. P was initially incorporated to provide and maintain a home for the care of aged, infirm and distressed members of R, a fraternal organization, their wives, widows, orphans, and children.

P operates homes for the aged, either directly, or through wholly owned subsidiaries. P provides support services to two

operating subsidiaries, M1 and M2. M1 operates both a licensed nursing facility consisting of h beds and a licensed residential care facility consisting of e beds. M2 operates a residential care facility consisting of f beds and independent housing for the elderly consisting of g units. Admissions to M1 is open to any individual who may require nursing care. The facilities of M2 are available to members of the R fraternity and their respective families.

P is currently recognized as exempt under section 501(c)(3) of the Internal Revenue Code of 1986 (hereafter Code). P has been held to be a publicly supported charity within the meaning of section 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

S is a not-for-profit corporation organized under the laws of the State of O as a wholly owned subsidiary of P. P is S's sole member. All of the members S's Board of Trustees are elected by P's Board of Trustees.

S is recognized as exempt under section 501(c)(3) of the Code, and has been held that it can reasonably be expected to be a publicly supported organization described in section 509(a)(2) of the Code.

T was established pursuant to the last Will and Testament of B and is administered subject to the jurisdiction of the Probate Court of L. T was established to build and operate an old age home open to elderly members of R and their spouses, as well as certain aged clergy. T operates a congregate residential facility of i units for the benefit of elderly Rs and their wives and widows, and superannuated clergy.

By letter dated November 20, 1979, the Service held that for taxable years beginning with September 1, 1979, T was a private operating foundation within the meaning of section 4942(j)(3) of the Code, and otherwise qualified for recognition of exemption under section 501(c)(3) of the Code.

By letter dated June 12, 1996, the Service determined that T had terminated its status as a private foundation under the provisions of section 507(b)(1)(B) of the Code, and that effective January 1, 1991, it was classified as a section 509(a)(2) public charity. In 1990, the Probate Court of L recognized P as the contingent beneficiary of T.

X is a not for profit corporation organized under the laws of the State of O. X operates independent living housing for the elderly. By letter dated August 12, 1998, X was recognized as exempt under section 501(c)(3) of the Code, and has been held that it can reasonably be expected to be a publicly supported

organization described in section 509(a)(2) of the Code.

The Proposed Transaction:

On October 1, 1998, the X and S Boards of Trustees determined that it was in their best interest to merge and X and S entered into a merger and consolidation agreement.

An action was initiated in the Probate Court of L to facilitate the consolidation of T into S. The Attorney General of O has agreed to the consolidation. The Probate Court of L approved the consolidation subject to the issuance of a favorable private letter ruling. Upon the issuance of a favorable private letter ruling, the Court will permit the termination of T and the transfer of its assets and operations to S, subject to S continuing to fulfil the charitable purposes of the grantor of T.

The information furnished shows that S currently has a Board of Trustees which consists of three members. After the consolidation and merger, S's Board of Trustees will have seven (7) members. After the consolidation and merger S will change its name to A. P will remain the sole member of S.

In conjunction with the consolidation, the assets and charitable activities of T will be consolidated into S and will be carried on by S. Thereafter, T's Trustees will be discharged of all further responsibility.

The information furnished shows that T operates a congregate residential facility of i units and that X operates independent living housing for the elderly. It is represented that T's and X's facilities are located on j acres of land in L. It is represented that after the consolidation and merger, T's and X's operations will be continued by S. Admissions to the facility will be broadened to include any elderly member of the public regardless of affiliation with the R fraternity. Also, it is represented that S may increase the scope of its services by providing a residential care facility for the elderly.

P represents that it proposes to engage in the merger and consolidation for the following "business reasons":

A. To promote flexible and efficient management by concentrating long range planning and policy decisions in P and allowing the subsidiaries to focus their efforts on certain specific operations.

B. To facilitate long-range planning on a state-wide basis.

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C. To integrate the functions of T and X into a system which will include P and its operating subsidiaries.

D. To expand access to, and convenience of, nursing care and other elderly support services which will be provided by P and its operating subsidiaries;

E. To promote efficient use of financial, human and facility resources among T, X, P; and

F. To enhance fraternal philanthropy efforts in order to more ably serve the neediest constituents of the elderly community.

The information furnished shows that immediately following the issuance of a favorable private letter ruling, X will be merged into S and S will be the surviving corporation. Further, the information furnished shows that immediately following the issuance of a favorable private letter ruling, T will be consolidated into S, and T's charitable activities will be carried on by S.

Further, the information furnished shows that S will assume all of the liabilities of T and X including the commitment of T and X to provide support to their respective residents. Moreover, it is represented that S will provide care and housing to aged individuals who would otherwise be unable to provide for themselves.

Further, and more specifically, the information furnished shows that immediately after the consolidation and merger:

A. P and S will continue to be operated in charitable manner which is consistent with the requirements of Section 501(c)(3) of the Code;

B. The facilities of S will be financially available to a substantial number of elderly individuals who require care and support within the surrounding and R communities;

C. S will have a policy to ensure that all residents will be retained should they become unable to meet their financial obligations needs for reasons other than transfers of their property for less than fair market value;

D. S will offer admissions to indigent persons, to the extent space for the type of care and support required by the individual is available and the corporation has

the necessary financial resources;

E. The services that will be rendered by S will be available to all or a reasonable proportion of its residents at substantially below the actual cost thereof, to the extent of the corporation's financial ability;

F. The services that will be rendered by S are of the type which minister to the needs and the relief of hardship or distress of aged individuals;

G. P will provide management services to S;

H. The various assets that will be transferred by T and X as part of the merger and consolidation, respectively, will be a one time occurrence;

I. The activities of P will substantially assist S in accomplishing its charitable purposes;

J. S is committed to operating its facilities at the lowest feasible cost;

K. S will succeed in the interest of both T and X in a relationship with a neighboring health care facility to provide nursing care to its residents.

L. The amount of any payments made between P and S will be equal to the actual costs of services provided by one another and such amounts will be equal to or less than fair market value;

M. No part of the net earnings of P, S, T and X will inure directly, or indirectly, to the benefit of any private shareholder or individual. No employer or any of the aforementioned organizations will receive more than reasonable compensation for the services that they may render and;

N. The total amount of financial grants which P will provide to S will be greater than the aggregate amount of rental and other payments which may be paid by S to P.

Law:

Section 501(c)(3) of the Code provides, in part, for the recognition of exemption from federal income tax of organizations that are organized and operated exclusively for

charitable or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder of individual.

The term charitable is defined by section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations (hereafter Regulations) to include "relief of the poor and distressed or of the underprivileged..."

Section 509(a) of the Code states in pertinent part, that the term "private foundation" means a domestic or foreign organization described in section 501(c)(3), other than an organization described in sections 509(a)(1), 509(a)(2) and 509(a)(3) of the Code. In general, organizations described in sections 509(a)(1) and 509(a)(2) are publicly supported organizations.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under 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.

Section 512(b)(5) of the Code provides that there shall be excluded from unrelated business taxable income all gains from the sale, exchange, or other disposition of property, other than property which would properly be includable in inventory if on had at the close of a taxable year, or property held primarily for sale to customers in the ordinary course of trade or business.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the purpose or function constituting the basis for income derived for debt-financed property that is not used substantially for tax exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "substantially related" to an organization's exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes for which such organization was formed.

Rev. Rul. 57-467 holds that a home for aged people that does

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not accept charity guests and that requires the discharge of guests who fail to make certain required monthly payments is not organized and operated exclusively for charitable purposes and is, therefore, not entitled to exemption from Federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 61-72, 1961-1 C.B. 188, holds that, if otherwise qualified, a home for the aged is exempt under section 501(c)(3) of the Code if "(1) the organization is dedicated to providing, and in fact furnishes, care and housing to aged individuals who would otherwise be unable to provide for themselves without hardship, (2) such services are rendered to all or a reasonable proportion of its residents at substantially below the actual costs thereof, to the extent of the organization's financial ability, and (3) the services are of the type which minister to the needs and the relief of hardship or distress of aged individuals."

Rev. Rul. 64-231, 1964-2 C.B. 139, holds that an entrance fee paid in addition to a required lump sum life-care payment as a prerequisite to obtaining direct personal services and residence in a home for the aged must be included along with the required lump-sum life-care payments to the home in determining whether the home meets the "below cost" requirement of Revenue Ruling 61-72.

Rev. Rul. 72-124, 1972-1 C.B. 145, holds that homes for the aged that meet the special needs of the elderly, such as the need for health care, financial security, and residential facilities designed to meet the specific physical, social, and recreational requirements of the elderly, qualify for recognition of exemption under section 501(c)(3) of the Code.

Rev. Rul. 79-18, 1979-1 C.B. 194, holds that a nonprofit organization that provides specially designed housing to elderly persons at the lowest feasible cost and maintains in residence those tenants who subsequently become unable to pay its monthly fees is an organization operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code.

Analysis:

The purposes and activities of P will not be changed as a result of the reorganization. P will continue to provide and maintain a home for the care of aged, infirm and distressed members of R, their wives, widows, orphans, and children as it has in the past. Further Ps operating subsidiaries, M1 and M2 will continue to operate an h bed licensed nursing facility, an e bed licensed residential care facility, an f bed residential care facility and a g unit independent housing facility for the

elderly. Thus, P's exempt status will not be affected by the reorganization or related transactions. Accordingly, P will continue to be exempt under section 501(c)(3) and will continue to be a publicly supported charity within the meaning of section 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

S is a wholly owned subsidiary of P and is recognized as exempt under section 501(c)(3) of the Code. S has been held to be a publicly supported organization described in section 509(a)(2) of the Code. The information furnished reflects that the various assets and facilities that will be transferred by T and X to S, as part of the merger and consolidation, will be used directly and indirectly by S in carrying out its exempt activities. After the merger and consolidation T and X will cease to exist.

After the merger and consolidation, S will operate the i unit congregate residential facility, that was originally operated by T, and will operate the independent living housing for the elderly, that was originally operated by X. Because the information furnished establishes that, both before and after the merger and consolidation, the i unit congregate residential facility, and the independent living housing for the elderly have always been and will continue to be operated as homes for the aged that meet the special needs of the elderly, the requirements imposed under Rev. Ruls. 72-124 and 79-18, supra, are satisfied.

Because after the merger and consolidation, S will operate the i unit congregate residential facility, and the independent living housing for the elderly, as T and X had operated them in the past, we also conclude that these facilities will be substantially related to S's exempt purposes within the meaning of section 1.513-1(d)(2) of the regulations. Thus, the income generated by these facilities will not be treated as unrelated business taxable income.

The information furnished indicates that P will provide management services to S and that P's activities will substantially assist S in accomplishing its charitable purposes. Further, it is represented that the amount of any payments made between P and S will be equal to the actual costs of services provided and that such amounts will be equal to or less than fair market value. Moreover, it is represented that neither P nor S will receive more than reasonable compensation for any services they may render. Finally, it is represented that the total amount of financial grants which P will provide to S will be greater than the aggregate amount of rental and other payments which may be paid by S to P.

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Rulings:

Accordingly based on the information furnished we rule as follows:

1. After the proposed merger and consolidation, the Parent, P and the Subsidiary, S will remain tax-exempt organizations within the meaning of section 501(c)(3) of the Code; P will remain a publicly supported charity within the meaning of sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code, and S will remain a publicly supported charity within the meaning of section 509(a)(2) of the Code.

2. The participation of the Trust, T and the X exempt organization in the consolidation and merger, respectively, will not adversely affect their current status as exempt organizations within the meaning of section 501(c)(3) of the Code or their respective status as publicly supported charities within the meaning of section 509(a)(2) of the Code.

3. Any transfer of funds, assets, services, and/or personnel by or among the P, S, T and X in conjunction with the consolidation and merger will not generate unrelated business taxable income pursuant to sections 511 through 514, inclusive, of the Code.

We are informing the key District Director for the subject organization of this action. Please keep a copy of this ruling in the permanent records of P, S, T, and X.

This ruling is directed only to the taxpayers who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Kenneth J. Earnest

Kenneth J. Earnest
Acting Chief,
Exempt Organizations
Technical Branch 3

30