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Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply to:
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Date: APR 7 1999

LEGEND:

Issuer =

R =

S =

T =

U =

V =

W =

X Bonds =

Y Bonds =

Z =

247

Dear

This letter is in reply to a request by Issuer and in further reply to requests for rulings on behalf of R, S, T, U, V, and W (collectively, the "Entities") regarding the effect of proposed affiliation and economic integration agreements on outstanding X Bonds and Y Bonds (collectively, the "Bonds") issued by Issuer. Specifically, a ruling is requested that the proposed Corporate Affiliation Agreement (the "Affiliation Agreement") and Economic Agreement (the "Economic Agreement") will not cause there to be private use, within the meaning of §§ 141(b) and 145(a) of the Internal Revenue Code, of any facilities that are owned by any of the Entities participating in the Affiliation and Economic Agreements and that were financed with the proceeds of the Bonds (the "Bond-financed facilities").

Earlier rulings ("Prior Ruling Letters") relating to the tax-exempt status of the Entities upon their participation in the proposed Affiliation and Economic Agreements were contained in letters dated August 26, 1998, sent to R, S, T, U, V, and W from the Chief, Exempt Organizations, Technical Branch 1 (CP:E:EO:T:1). The Prior Ruling Letters state that the Economic Agreement and the Affiliation Agreement will not result in an activity that is an unrelated trade or business. The following facts and representations have been made in connection with the Prior Ruling Letters and this ruling request.

PARTIES TO THE TRANSACTION

R is the parent of a community based healthcare system and is the sole corporate member of several other nonprofit corporations including hospitals S, T, and U, and nursing home Z. R, S, T, U, and Z are exempt from federal income tax under § 501(c)(3). R's affiliates provide hospital, physician, home health, hospice, nursing home, and other health care services in its service area. R also has additional affiliates and subsidiaries, other than those named above, including § 501(c)(3) organizations and for-profit corporations.

V, which is unrelated to R, is the parent of a community based health care system that includes W, a hospital. Both V and W are exempt from federal income tax under § 501(c)(3). V also has additional affiliates and subsidiaries, including a for-profit corporation.

R and V propose to enter into the (1) Affiliation Agreement and (2) Economic Agreement.

THE ISSUER AND THE BONDS

Issuer is a statewide authority, which was created, in part, for the purpose of assisting healthcare facilities with the acquisition, construction, reconstruction and equipping of healthcare facilities and the refinancing of existing indebtedness. In furtherance of the these purposes, Issuer has issued the Bonds to refund existing debt and to pay for capital expenditures. The prior debt had, in part, been loaned to R for construction, acquisition, or renovation of healthcare related facilities of S, T, U, and Z. It is represented that the Bonds and all the bonds that have been refunded by the Bonds have met the requirements of § 103 and §§ 141-150 for exclusion of interest from gross income from the time of issuance. Neither V nor any of its subsidiaries or affiliates has outstanding tax-exempt bonds.

THE TRANSACTION

R and V will enter into the Affiliation and Economic Agreements for the operation of their health care facilities as a single regional integrated health care delivery network. Under the Affiliation Agreement, V will become a subsidiary of R (R will become the sole corporate member of V). Under the Economic Agreement, the Entities will make available their net revenues to a strategic pool for the benefit of the Entities, coordinate the provision of services, and jointly contract with payors of healthcare services on an integrated regional basis. The Economic Agreement will not include any subsidiary of R or V not described in § 501(c)(3) as either a party or as a participant in the strategic pool and no fund distribution from the strategic pool will be made to any taxable subsidiary.

The Economic Agreement provides that all of the assets of the parties shall remain the property of the respective party. Further it is represented that after executing the proposed Affiliation and Economic Agreements, each of the Bond financed facilities will continue to be owned by a § 501(c)(3) organization.

Issuer represents that the Affiliation and Economic Agreements will not result in any direct or indirect use of any Bond-financed facility by an organization not described in § 501(c)(3) that will, when aggregated with any other private business use (within the meaning of §§ 145(a) and 141(b)) of any Bond-financed facility, equal 5% or more of the proceeds of the Bonds.

APPLICABLE LAW

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond.

Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond within the meaning of § 141.

Section 141(a) provides that the term "private activity bond" includes any bond issued as part of an issue that meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or meets the private loan financing test of § 141(c).

Section 141(b)(1) provides that, except as otherwise provided in the subsection, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use.

Section 141(b)(6)(A) provides that for purposes of section 141(b), the term "private business use" means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Section 141(b)(6)(B) provides that any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(e)(1)(G) provides that a "qualified bond" includes a qualified 501(c)(3) bond.

Under section 145(a), a qualified 501(c)(3) bond means any private activity bond issued as part of an issue if (1) all property which is to be provided by the net proceeds of the issue is to be owned by a § 501(c)(3) organization or a governmental unit, and (2) such bond would not be a private activity bond if (A) § 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying § 513(a), and (B) paragraphs (1) and (2) of § 141(b) were applied by substituting "5 percent" for "10 percent" each time it appears and by substituting "net proceeds" for "proceeds" each place it appears.

Section 1.141-3 of the income tax regulations concerns the definition of private business use and provides, in part, that the use of financed property is treated as the direct use of proceeds. Further, in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of proceeds. Direct use could include ownership or lease by a nongovernmental person of financed property. Section 1.141-3(b)(7) further provides that any other arrangement that conveys special legal entitlements for

beneficial use of bond proceeds or of financed property (comparable to special legal entitlements described in other subparagraphs) results in private business use.

ANALYSIS

The provisions of § 145(a) are applied to determine whether a particular transaction or course of action causes a qualified 501(c)(3) bond to no longer be qualified.

First it is represented in this case that all property financed by the Bonds has been owned by § 501(c)(3) organizations, and that the proposed transaction, as embodied in the Affiliation and Economic Agreements, will not result in a transfer of ownership to any entity not described in § 501(c)(3).

Second, the Prior Ruling Letters have concluded that the Economic and Affiliation Agreements will not result in the Bond-financed facilities being used in an unrelated trade or business activity. In addition, it is represented that the Economic and Affiliation Agreements will not result in private business use that equals or exceeds 5% of the proceeds of the Bonds.

Finally, there are no facts to indicate that the Economic and Affiliation Agreements will result in use of the Bond-financed facilities by an organization not described in § 501(c)(3).

CONCLUSION

Based solely on the information presented, the representations made, and applying the foregoing analysis, we conclude that the proposed arrangement will not by itself cause the facilities financed by any of the Bonds to be treated as used for any private business use within the meaning of §§ 141(b) and 145(a).

This ruling letter is directed solely to the effect of the transaction described on the X Bonds and the Y Bonds. Thus, no opinion is expressed regarding the consequences of the transaction described herein under any section of the Code, the Income Tax Regulations, or the temporary Income Tax Regulations, except as specifically stated in this ruling. In particular, no opinion is expressed whether interest on any of the Bonds is or was excludable from the gross income of the respective holders thereof under § 103 of the Code, prior to the transaction described.

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

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions & Products)

By: _____
Rebecca L. Harrigal
Chief, Branch 5

Enclosures:
Copy for § 6110 purposes