199947039

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN: 414.07-00

Person to Contact:

Telephone Number:

Refer Reply to: CP:E:EP:T:3

Date: SEP 1 1999

Legend:

State A =

County C =

Employer E =

University U =

Medical School M =

Board B =

Plan X =

Plan Y =

This letter is in response to a ruling request dated December 21, 1998, as supplemented by letters dated February 25,1999, March 19, 1999 and April 22, 1999, concerning whether Plans X, and Y qualify as governmental plans under section 414(d) of the Internal Revenue.

244

Your authorized representative has submitted the following facts and representations.

Employer E operates as a tertiary care, academic medical center, providing medical services to the citizens of a 29 county region in state A. Employer E was incorporated under the laws of State A on February 6, 1953. Employer E is organized as a nonprofit, tax exempt, charitable organization under section 501(c)(3) of the Internal Revenue Code and is in receipt of a determination letter issued by the Internal Revenue Service recognizing its status under section 501(c)(3) of the Code. In 1953, the State A legislature enacted 1953 Session Law, c. 399, which authorized and empowered County C (a political subdivision of State A) to appoint trustees to operate Employer E. Under this legislation, County C leased to Employer E the County C property and facilities where the hospital operates. Prior to the conveyance described herein, Employer E was controlled by a 20 member board of trustees appointed by County C. Eight members of the board of trustees were nominated by Board B which is the board of governors of University U and the entire State A university system. The State A university system, including University U, is an instrumentality of State A.

In 1975, Employer E entered into an affiliation agreement with Medical School M, also a part of the State A University system, through which Employer E and Medical School M agreed to utilize their combined resources to provide quality medical services to the citizens of State A. Employer E and Medical School M intended that the affiliation agreement render unnecessary the construction and operation of a separate teaching hospital owned by state A. Medical School M is adjacent to Employer E and pursuant to the affiliation agreement furnishes Employer E with physicians from its faculty. Faculty members chair most of Employer E's clinical departments and supervise the respective hospital department's operations. Medical School M reimburses Employer E for certain normal costs associated with utilities, insurance and security. Joint undertakings of Employer E and Medical School M are paid for on a pro rata basis, and Medical School M reimburses Employer E for medical resident costs unrelated to the direct care of patients. Employer E annually reimburses Medical School M for services provided by the medical directors and chiefs of service. Patients are the major source of Employer E's operating funds.

On June 1, 1998, County C contractually agreed to convey the hospital facilities to Employer E and the parties consummated the conveyance on September 17, 1998. In order to legally complete the conveyance, County C and Employer E had to comply with the State A General Statute, section 131E-8.

Section 131E-8 authorizes a municipality to sell or convey to a nonprofit corporation organized, under Chapter 55A of the State A General Statutes, any rights it has in a hospital facility, as long as, the nonprofit corporation is legally bound to operate the hospital as a community general hospital open to the general public. Under section 131E-8, a nonprofit corporation and the municipality must agree with respect to the services to be provided to indigent patients. Employer E's board adopted amended and restated articles of incorporation on September 15, 1998, in order to meet the requirements of Chapter 55A. Employer E is now organized under Chapter 55A. Section 131E-8 requires the municipality and the corporation to agree that should the corporation fail to comply with certain terms and conditions, the hospital property shall revert to the municipality. Under the conveyance agreement of June 1, 1998, (the Agreement) County C and Board B appoint all of Employer E's board members. It is represented that Employer E's board is charged with all authority and responsibility for overseeing and managing Employer E's affairs and is involved in Employer E's finances and expenses through approval of Employer E's budget. Employer E's every day operations are carried out by its staff and managers under the supervision of the president who is appointed by and evaluated by Employer E's board and acts as a duly authorized representative of Employer E's board.

The Agreement contains the terms, conditions and restrictions summarized, in part, below:

(1) A 20 member Board will govern Employer E's affairs. County C will appoint 55 percent of the board and Board B will appoint the remaining 45 percent. County C and Board B may remove their appointed trustees for cause. The trustees will serve for 5 years, not to exceed 2 consecutive terms and their terms will be staggered. Employer E must obtain written County C consent prior to any future amendment to employer E's articles of incorporation or bylaws relating to board appointment. Violation of any of these governance provisions will result in County C's discretionary right to cause a reversion of ownership rights in the hospital.

(2) After the reorganization is completed, Employer E will own, maintain and operate the hospital as a community general hospital, open to the general public without regard to ability to pay and free of discrimination based upon race, creed, color, sex or national origin.

(3) Employer E will continue to provide indigent care services without regard to ability to pay for those services, consistent with Employer E's historical practice and

expenditures. Employer E's historical and current practice is to provide care regardless of race, color, creed, social status, national origin or ability to pay.

(4) Employer E must obtain the written approval of County C prior to subjecting the hospital real property to any mortgage, deed of trust or similar encumbrance, Employer E's breach of this covenant will result in County C's discretionary right to cause a reversion of ownership rights in the hospital.

(5) Employer E must obtain the written consent of County C prior to any sale, lease or other disposition of hospital real property. Employer C's breach of this covenant will result in County C's discretionary right to cause a reversion of ownership rights in the hospital.

(6) Employer E may not sell or merge the hospital without the prior written consent of County C. If such consent is given, all net proceeds from any sale or merger will accrue to County C. Employer E's breach of this covenant will result in County C's discretionary right to cause a reversion of ownership rights in the hospital.

(7) In order to maintain operational flexibility, Employer E may dispose of certain hospital assets in a manner consistent with standard hospital financing practices ... However, the Agreement prohibits the disposition of assets if the disposition would impair the functional utility of the hospital or materially reduce the scope of medical services provided within County C. Employer E must obtain written approval from County C for any disposition of assets if the value of the assets exceeds 10 percent of Employer E's unrestricted fund balance as shown on Employer E's audited financial statements for its most recent fiscal year. Employer E's breach of this covenant will result in County C's discretionary right to cause a reversion of ownership rights in the hospital.

(8) Employer E must maintain its status as a Code-section 501(c)(3) charitable organization. Employer E's breach of this covenant will result in County C's discretionary right to cause a reversion of ownership rights in the hospital.

(9) Employer E must strive to maintain the financial integrity of the hospital. Should Employer E fail to maintain minimum long-term debt and cash cushion ratios, Employer E must notify County C and engage a consultant to determine the steps necessary to correct the failure. At County C's discretion, ownership rights in the hospital will revert to County C if Employer E fails to follow the consultant's recommendations.

247

(10) All ownership rights in the hospital and hospital-related property will automatically revert to County C if any of the following occurs:

(a) Employer E fails to maintain the level of indigent care consistent with its historical practice;

(b) Employer E fails to maintain the hospital as a community general hospital open to the general public;

(c) Employer E fails to maintain the hospital's accreditation or to have its accreditation reinstated within a period specified by the Joint Commission on Accreditation of Health Care Organizations, or an equivalent accrediting organization or agency; or

(d) Employer E dissolves without a successor nonprofit corporation approved by County C to carry out the terms and conditions of the Agreement.

(11) Employer E must continue to maintain its affiliation with Medical School M, according to the affiliation agreement between Medical School M, County C and Employer E. The hospital will continue to serve as the primary academic teaching hospital of Medical School M.

(12) Employer E must provide County C with an annual audit confirming its compliance with the terms of the Agreement.

(13) Employer E's board meetings must remain open to the general public, other than as permitted under the State A Open Meetings Law

(14) Employer E must provide notice to the County C Board of Commissioners of all meetings of Employer E's board. Upon the County C Board members' execution of confidentiality agreements, Employer E must provide the County C Board-members with access to all closed sessions of Employer E's board.

Employer E continues to operate the hospital as it did prior to the conveyance. Employer E retained the same employees it had prior to the conveyance.

Employer E established and maintains the following employee retirement plans for the purpose of providing retirement and other benefits for its employees: Plan X, a qualified defined benefit pension plan, and Plan Y, a profit sharing plan meeting the requirements of section 401(k) of the Code, adopted before May 7, 1986 and maintained in accordance with section 1.401(k)-1(e)(4) of the Income Tax Regulations.

Based on the above facts and representations you have requested a ruling that Plans X and Y are governmental plans within the meaning of section 414(d) of the Code.

Section 414(d) of the Code provides that a governmental plan means a plan established and maintained for its employees by the government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Revenue Ruling 89-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. It holds that one of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision thereof is the degree of control that the state or federal government has over the organization's everyday operations. Other factors listed in Revenue Ruling 89-49 include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization's trustees or operating board are selected; and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above factors are considered in determining whether an organization is an agency of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.

Employer E was established by state statute. Its everyday operations are carried out by its staff and managers under the supervision of Employer E's president. However, the governmental entities, County C and Board B, have control over such operations. County C and Board B appoint all directors and may remove their appointed trustees for cause. The board members are appointed for staggered five-year terms. Employer E's articles of incorporation and bylaws provisions regarding board appointment may not be amended without prior written consent of County C. As a result, governmental entities control Employer E's board composition on a continuing basis. Board meetings must remain open to the general public and even closed meetings are open to County C upon execution of confidentiality agreements.

Employer E's board is charged with all authority and responsibility for overseeing and managing Employer E's affairs. Employer E's president is appointed by and evaluated by Employer E's board and acts as a duly authorized representative of that board. Through its affiliation agreement

with Employer E, Medical School M, governed by Board B, provides the hospital with most of its clinical department chairpersons who supervise the respective hospital department's operations.

Employer E's board is involved with Employer E's finances and expenses through its approval of Employer E's budgets. As expressed in the Agreement's provisions, County C has required Employer E to maintain financial health. Employer E must hire a financial consultant if it does not maintain minimum debt service coverage and cash cushion ratios set forth in the Agreement. The consultant will recommend the steps necessary to improve Employer E's financial condition. If Employer E fails to follow the consultant's recommendations, the Agreement grants a discretionary right of reversion of hospital property to County C. Employer E may not encumber, sell, lease or otherwise dispose of hospital real property without prior written approval of County C. If a sale of the hospital is approved, County C receives any net proceeds. Further, Employer E must provide an annual audit report to County C confirming compliance with all of the Agreement's terms and conditions.

Thus County C and Board B retain considerable control over Employer E's daily operations through their power to appoint and remove Employer E's board of trustees and County C's authority to monitor Employer E's financial affairs. In addition, Medical School M, through its faculty members, directly supervises the operation of the Employer E clinical departments that are chaired by such faculty members.

Accordingly, based on the above facts and representations, we conclude that Plans X and Y are governmental plans within the meaning of section 414(d) of the code.

Under sections 13.01 and 13.02 of Revenue Procedure 99-4 I.R.B. 115, this ruling may only be relied upon by Employer E. Other taxpayers, including subsidiaries and affiliates of Employer E, may not rely on this ruling.

In accordance with a power of attorney on file in this office, the original of this letter is being sent to the authorized representative you have designated, with a copy to you and another copy to the second authorized representative designated by you.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:
Deleted copy of letter
Notice 437