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511.00-00

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

200041031

Date: JUL 13 2000

Employer Identification Number

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T2

Dear Sir or Madam:

This responds to your request for ruling dated September 24, 1999 as supplemented by your letters dated February 10, 2000, April 26, 2000, and June 23, 2000 concerning the effect of the Internal Revenue Code and Income Tax Regulations resulting from proposed changes in your activities described below.

You were determined to be exempt from federal income taxes because you are described in section 501(c)(3) of the Internal Revenue Code. Your stated purpose and your principle activity is the operation of a nursing and assisted living facility in an atmosphere conducive to the customs and traditions of a particular religion. Admission to your facility is given to members of this particular religious group on a priority basis. You have been engaged in the operation of a nursing care and assisted living facility since your inception several decades ago.

Because of demographic changes in the locality where your facility is located, you have sustained substantial operating deficits. Your Board of Directors has concluded it is no longer feasible to continue to operate your present facility, and that continuation of your charitable purpose depends on your ability to relocate to a different city within the same state of your present facility. To accomplish this, you have entered into a development services agreement with a development company experienced in the development and operation of facilities similar to yours. You based your selection of the developer upon reputation and experience developing facilities of the type you have operated. You and the developer have applied to the state where you are located for a Certificate of Need, which is a condition precedent to the relocation of your facility. Your agreement with the developer makes the developer responsible for all actions needed to insure completion of the facility, while you retain approval rights over the construction budget which has a fixed, per-bed maximum. In addition, your agreement gives you the right to require the developer to provide space and equipment necessary to enable you to provide services and environment conducive to the same particular religious group you presently accommodate. If you exercise this right, you have agreed to pay the added cost of such special facilities and equipment in exchange for the guaranteed use of these special facilities until a specified date some 30 years from the date of the agreement. When construction is complete you intend to obtain conventional financing to pay construction costs.

In addition to the above terms, you agreed to lease the facility to the developer on terms that will enable you to amortize the loan you used to acquire the facilities. This lease agreement obligates the developer to operate the home in an environment enriched to serve the needs of your particular religious customs and traditions for the full 30 year term of the lease. Other terms of the lease agreement obligate

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the developer to operate the new facility in the same manner (except for operating deficits) as you previously operated your facility.

In other terms of the lease agreement, you indicate you may sell the facility in the second year of the lease to the developer at fair market value determined by an independent appraiser with certain minimum and maximum price guarantees established, and you have granted the developer an option for this purpose. Pursuant to the terms of the option agreement, the buyer is obligated to operate the home in a manner sensitive to the religious customs and traditions discussed above. In the event the developer fails to exercise its option, you may terminate the lease and offer it for sale to a third party. It is your intention to continue to provide religious accommodations whether you sell pursuant to the option agreement, or to a third-party purchaser. Sums you obtain from the lease or sale of your facility will be used to further your stated charitable purposes.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3). Section 501(c)(3) describes organizations which are organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for one or more purposes specified in section 1.501(c)(3)-1(d)(1)(i) unless it serves a public rather than private interest.

Section 1.501(c)(3)-1(d)(2) of the Regulations includes in its definition of the term "charitable" the advancement of religion.

Revenue Ruling 76-91, 1976-1 C.B. 149, provides that a purchase and sale transaction between an exempt organization and an independent third party gives rise to the presumption that the purchase price represents fair market value resulting in neither inurement to the benefit of private shareholders or individuals, nor a transaction which serves private rather than public interests.

Revenue Ruling 68-73, 1968-1 C.B. 251, holds that a nonprofit organization created to minister to the non-medical needs of patients qualifies as an organization described in Section 501(c)(3) of the Code even though the patients were in a proprietary hospital.

Section 509(a)(2) of the Code excludes from the definition of "private foundation" those organizations which normally receive more than one-third of its support from activities constituting its exempt purpose, and less than one-third from investment income and income unrelated to its exempt purpose.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(a) of the Code.

In Re:

Section 512(a)(1) of the Code defines unrelated business taxable income as the gross income derived from any unrelated trade or business as defined in section 513 that is regularly carried on, less allowable deductions computed with the modifications provided in section 512(b).

Section 512(b)(3) generally excludes rents from the computation of unrelated business income but section 512(b)(4) requires sums derived from debt-financed property as defined in section 514 shall be included.

Section 514(a)(1) provides for the computation of the percentage of income taken into account for purposes of section 512 income arising from debt-financed property.

Section 514(b)(1)(A) defines "debt-financed property" as any property held to produce income with respect to which there is acquisition indebtedness, but excepting any property substantially all the use of which is substantially related to the exercise or performance by such organization of its charitable purpose or function constituting the basis for its exemption under section 501.

From the information presented, you are undertaking a fundamental change in your activities by transferring your operation of a facility for the aged to a for-profit operator. Initially this transfer will result from a lease arrangement with the for-profit entity, and later your intention to sell to the lessee or to a third party on the same terms and conditions as agreed upon with the lessee. Following the transfer, your activities will consist of ministering to the particular needs of residents who adhere to the religious customs and practices referred to above. Based upon the above cited law, regulations, and rulings, the revised activities you describe are in furtherance of your exempt purposes.

Because rent you expect to receive will be derived from property subject to acquisition indebtedness, it would ordinarily be included in the computation of income from an unrelated trade or business. The restrictions and obligations of the lessor in the lease agreement, however, means substantially all of the property will be used to conduct activities you formally included among your charitable activities. The property is therefore excluded from the definition of debt-financed property and sums are therefor deemed derived from an activity which is in furtherance of your exempt purposes.

Based upon the above facts, law and rationale, we conclude:

1. Your status as an organization described in section 501(c)(3) of the Code will not be affected by the changes in the activities you have described. Your status as an organization described in section 509(a)(2) will also not be affected unless the transactions you describe result in changes to the sources of your support;

2. Any benefits to your lessee arising from the payment for costs of constructing facilities needed to further the religious activities of the residents in the leased premises, the lease of the facility, and the sale of the facility will be incidental to your exempt purpose and will not constitute private inurement;

3. The operation of the new facility as a trade or business will not affect your status under sections 501(c)(3) and 509(a)(2) of the Code unless, as noted above, it results in changes to the sources of your support.

4. Sums you receive as lease income, and any gain you realize on the sale of the facility will not be subject to taxes imposed by Section 511 of the Code.

In Re:

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. Any such changes should be reported to the Tax Exempt and Government Entities (TE/GE) Customer Service Office.

Except as we have specifically ruled in this letter, we express no opinion as to the consequences of these transactions under the cited provisions or under any other provision of the Code.

Because this letter could help resolve any questions about your federal income tax status, you should keep it with your permanent records. A copy of this letter is being forwarded to the TE/GE Customer Service Office.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

if you have any questions, please contact the persons whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2