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

Date: SEP 26 2000

Contact Person:

ID Number:

Telephone Number:

T:EO:B1

Employer Identification Number:
Area Manager:

Legend:

A =
B =
x =

Dear Sir or Madam:

This is in response to letters from your authorized representative requesting a series of rulings on your behalf regarding the tax consequences associated with the transactions described below.

You are exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3), and you are other than a private foundation under section 509(a). You provide healthcare services to your community. You have stated that you purchased a sports and fitness center, which provides cardiac rehabilitation services, a fitness/wellness center, a roller skating rink and tenant services.

You have stated that as part of an overall plan to provide continuing care to your patients and increase wellness awareness in the community, you established a rehabilitation center within the fitness center for your patients who have suffered heart related illnesses. Your cardiac rehabilitation program commences when an inpatient begins the rehabilitation process at your hospital facilities. After hospital discharge, your outpatients are assisted in reaching optimal function while using heart rate monitors. You then focus on risk reduction and maintenance and assist patients who have suspected cardiovascular disease and/or other risk factors, and who make a commitment to preventative cardiology practices such as regular physical activity and proper nutrition. You then permit low risk individuals to exercise independently with the active assistance of trained medical professionals.

You have stated that the facility is a state of the art fitness center which occupies the majority of the physical facility. It contains an open fitness room with cardiovascular and strength equipment, an indoor track, exercise rooms, racquetball and tennis courts, an aquatic area with two pools, a nutrition center/juice bar, tanning beds and child care areas. You state that these services

233

and facilities are available to members only. You also provide wellness programs including weight management, nutrition counseling, smoking cessation programs, arthritis therapy, personal training, prenatal and postnatal exercise programs and stress management programs to members. In addition, you offer educational programs on disease identification and prevention, health trends and other medically newsworthy subjects. You state that the overall goals of the fitness center are to enhance cardiovascular, physical and psychosocial function, reduce morbidity and mortality, improve quality of life and promote compliance with a lifelong prevention program. You have stated that the facility is debt-financed.

You state that each member is entitled to a free fitness assessment, in which various health factors are assessed, after which your staff of exercise physiologists will design an individual exercise program and provide instruction about the equipment.

Your membership consists of three segments of the community: the general public, your employees and former rehabilitation patients. Your employees are charged a reduced initiation and monthly fee. Members who are referred at the direction of their physician, and who are patients of the cardiac rehabilitation center, are not charged an initiation fee. The general public pays an initiation fee and a monthly usage fee. The fitness center has different categories of membership with corresponding fees that vary depending on the member's age and restrictions on availability of the facilities during specific hours. Members who pay the highest fees (the A membership category) are entitled to the use of a separate locker/shower room and clean workout clothes.

You have stated that you have approximately x members. You have conducted a survey of your members, overseen by a professional consulting organization with expertise in this area, which concludes that your facilities are available to an economic cross-section of the community you serve.

Your facilities contain a roller skating rink, whose use is available to members and the general public for a nominal fee and is the site of children's and adult hockey leagues, birthday parties, school functions and other community activities.

You have stated that you rent space to a chiropractor and a physical therapist.

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. Rev. Rul. 69-545, 1969-2 C.B. 117, acknowledges that the promotion of health is a charitable purpose, and that promoting the health of the general community constitutes a sufficient basis for tax-exempt status within the meaning of section 501(c)(3).

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 income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its exempt purpose or function.

Section 513(a)(2) of the Code provides, in part, that the term "unrelated trade or business" does not include any trade or business which is carried on in the case of an organization described in section 501(c)(3) by the organization primarily for the convenience of its employees.

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)(1) of the Code includes as an item of gross income derived from a trade or business a certain percentage of the income derived from or on account of each debt-financed property.

Section 514(b)(1)(A) of the Code provides, in part, that "debt-financed" property does not include any property substantially all the use of which is substantially related to the exercise or performance by such organization of its charitable or other purpose constituting the basis for its exemption under section 501.

In Isabel Peters v. Commissioner, 21 T.C. 55 (1953), nonacq., 1955-1 C.B. 8, withdrawn and acq. substituted therefor, 1959-2 C.B. 6, the Tax Court held that an organization operating a public beach, playground and bathing facility without charge was charitable within the meaning of section 501(c)(3) of the Code. In so holding, the Court emphasized that the facilities were available to all members of the community.

Rev. Rul. 59-310, 1959-2 C.B. 146, holds that an organization formed to establish, maintain and operate a public swimming pool, playground and other recreation facilities for the children and other residents of a particular community is described in section 501(c)(3) of the Code since the property and its uses are dedicated to members of the general public of the community and are charitable in that they serve a generally recognized public purpose which tends to lessen the burdens of government. Thus, the facts in the ruling were virtually identical to the Isabel Peters case except that a minor amount of the income was derived from charges for admission to the swimming pool.

Rev. Rul. 67-325, 1967-2 C.B. 113, holds that the provision of a community recreational facility open to the community as a whole by an organization is, under certain circumstances, within the general category of activities recognized as charitable under section 501(c)(3) of the Code because they tend to lessen the burdens of government. In Rev. Rul. 67-325, an organization provided recreational facilities without charge to the residents of a township. However, the

235

organization was not organized and operated exclusively for charitable purposes because the use of the facilities was restricted to less than the entire community on the basis of race.

Rev. Rul. 79-360, 1979-2 C.B. 236, distinguishes the operation of a health club from the operation of a recreational and fitness center on the basis of fees charged to members of the two facilities. An organization described in section 501(c)(3) of the Code, whose purpose was to provide for the welfare of young people, operated a recreational and fitness facility and a separate health club under a two-tiered membership structure that made recreational facilities available to the general public at one rate, and health club facilities available at a higher rate. The Rev. Rul. concluded that the operation of the health club facilities generated unrelated business taxable income under section 513, because its operation did not contribute importantly to the organization's exempt purpose. The operation of the health club was seen to be separate from the organization's general fitness program inasmuch as the commercially comparable annual dues or daily fees were sufficiently high to restrict participation in the health club to a limited segment of the community.

The activities of a fitness center owned by a hospital may promote health under section 501(c)(3) of the Code in certain instances. The rehabilitation of hospital inpatients or outpatients in accordance with treatment plans prescribed by physicians or appropriate hospital personnel furthers the hospital's exempt purpose of serving the healthcare needs of the community. Accordingly, your cardiac rehabilitation program promotes the health of the community within the meaning of Rev. Rul. 69-545, supra, and is substantially related to the furtherance of your exempt purposes under section 501(c)(3). Also, use of the fitness center by your employees would fall under the "convenience" exception of section 513(a)(2).

As for use of the facility by the general public, a fitness center can further a charitable purpose if it is available to a significant segment of the community. The operation of such a fitness center is related to the charitable purpose of providing community recreational facilities only if the fees charged are affordable to the community served. In this regard, with the assistance of a professional consultant you have surveyed your membership to determine your members' income levels and compared the results of this survey to income data for the general community. The survey data you submitted shows that the fitness center is available to, and the fees charged are affordable by, an economic cross-section of the community. Therefore, for purposes of section 513(a) of the Code, amounts derived from your regular membership category constitute income from an activity that is substantially related to your exempt purpose.

The information submitted concerning the operation of the roller rink clearly indicates that the fee structure makes this facility affordable for the community, and, therefore, for purposes of section 513(a) of the Code its operation is substantially related to your exempt purpose.

Since the facility is "debt-financed" within the meaning of section 514 of the Code, the leasing of space in the facility must be substantially related to your exempt purpose for the fees generated to be excluded from the unrelated business income tax. The facts you submitted indicate that the leasing of space to a chiropractor and physical therapist is substantially related to your exempt purpose, and the fees generated are therefore not subject to the unrelated business income tax.

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

1. The operation of the cardiac rehabilitation program within your fitness center is not an unrelated trade or business under section 513 of the Code.

2. The operation of the fitness/wellness component of your fitness center is not an unrelated trade or business under section 513 of the Code.

3. The operation of your roller skating rink is not an unrelated trade or business under section 513 of the Code.

4. The operation of rental spaces at your fitness center to a chiropractor and physical therapist will not jeopardize your exempt status under section 501(c)(3) of the Code, and is not an unrelated trade or business under section 513.

We have not been asked and express no opinion on whether amounts derived by you from the A category of membership constitute unrelated business taxable income under section 512(a)(1) of the Code. Furthermore, we have not been asked and we express no opinion on whether amounts you receive from B, including income attributable to leased employees, constitute unrelated business taxable income under section 512(a)(1).

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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

We are informing your Area Manager of this action. Please keep a copy of this letter in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter

Sincerely,

Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1