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

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Date: NOV 15 2000

Contact Person:

Identification Number:

Telephone Number:

T:EO:1

No third party contact
SIN: 501.03-11 514.00-00
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Employer Identification Number:

Legend:

T-
X--
Y-

Dear Sir or Madam:

This is in reference to your ruling request concerning a proposed restructuring and its effect on your tax exempt status under section 501(c)(3) of the Internal Revenue Code and your unrelated business income tax liability under sections 511 through 514 as described below.

T is an organization described in section 501(c)(3) of the Code and is not a private foundation as described in section 509(a). T currently provides services through two divisions, the family social service/counseling services division and the home health services division.

X is an organization described in section 501(c)(3) and is an organization described in sections 509(a)(1) and 170(b)(1)(A)(vi). Y is an organization described in section 501(c)(3) and is an organization described in section 509(a)(2). T created X and Y pursuant to a plan of reorganization.

T plans on reorganizing its structure in order to separate the family/social service counseling services and home health agency services; lessen exposure of endowment funds, pledge receivables and real property to third party liability; provide more efficient centralized planning and program development, administration and fund raising that are subject to coordination through X as the parent entity; and improve the quality of programming, attract high quality personnel, and increase the ability of the organizations to attract the attention of national funding sources that may have an interest in one or more of the family social service counseling services or home health agency services.

Pursuant to the proposed plan of restructuring, T will continue to operate the family/social service counseling services division and will transfer and convey to Y the assets related to the operation of the home health agency services, subject to existing mortgages, liens and encumbrances; provided that Y has obtained all licenses and permits for the operation of the

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home health agency services. Y will assume the lease and continue to occupy space that is currently leased by T from an unrelated third party.

T will transfer to X any outstanding contribution pledge receivables, parcels of real property, and all assets and personnel related to the operation of administration, program development, and fund raising activities, subject to the existing mortgages, liens and encumbrances. X will be the sole member of Y and T, creating a parent-subsidiary relationship between the entities.

Under the terms of the restructuring, any existing and future endowment funds and contribution pledge receivables could be held be either X, Y or T. Although X will coordinate fundraising activities of all of the taxpayers, Y and T may also do separate fundraising. X will provide services related to the development and enhancement of programs, which will then be implemented by Y and T. X will occupy a portion of its existing building and will lease a portion of its building to T after the restructuring. In the future, X may construct additional buildings and lease all or a portion of the buildings to Y. All leases will be at rental rates designed to reimburse X for the cost of the building.

All records, files, lists of contributors and other items related to fund raising of T, X and Y will be transferred from T to X.

It is expected that Y and T will raise funds from contributions that each entity receives. In some cases an organization may make distributions of funds and/or assets or provide services to either X or T. In addition it is expected that X will also engage in fundraising and may distribute portions of the contributions it receives to T and Y, based upon directions given by the donors or the needs of the particular entity as determined by X. X may also provide assets and services to Y and T, including program enhancements, fundraising coordination, and assistance with staff recruiting.

You are requesting the following rulings:

1. The restructuring of T and transfer of some of its home health division assets, liabilities and activities to Y and the transfer of its endowment assets and administrative activities to X will not adversely affect the determination of tax-exempt status of X, Y, or T, nor will restructuring of Y result in the classification of X, Y or T as a private foundation under section 509(a) of the Code.

2. The restructuring and transfer of assets pursuant thereto will not give rise to unrelated business taxable income pursuant to sections 511 through 514 of the Code to X, Y or T.

3. The sharing of assets and services and transfer of funds among X, Y, and T after the reorganization will not give rise to unrelated business taxable income under sections 511 through 514 for either X, Y, or T.

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Law

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

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts, sections 368, 372; IV Scott on Trusts, sections 368, 372 (3rd ed. 1967); and Revenue Ruling 69-545, 1969-2 C.B. 117.

Section 509(a)(1) of the Code provides that the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)).

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 the term "unrelated business taxable income" as gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions directly attributable to such business activity.

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 the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purpose or function constituting the basis for its exemption.

Section 1.513-1(a) of the regulations defines "unrelated business taxable income" to mean gross income from any unrelated trade or business regularly carried on. Section 1.513-1(b) states that the phrase "trade or business" includes activities carried on for the production of income and which possess the characteristics of a trade or business within the meaning of section 162 of the Code. Finally, section 1.513-1(c) explains that "regularly carried on" has reference to the frequency and continuity of the conduct of an activity and the manner in which the activity is pursued.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activity has a causal relationship to the achievement of any exempt purpose, and is "substantially related" for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of a 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 those purposes.

Section 514 of the Code provides for the taxation under section 512 of the Code of income from debt-financed property. Section 514(b)(1)(A)(i) of the Code, however, provides that the definition of 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 purposes constituting the basis for its exemption under section 501.

Rev. Rul. 69-545, 1969-2 C.B. 117, sets forth standards under which a nonprofit hospital may qualify for recognition of exemption under section 501(c)(3) of the Code. This revenue ruling gave consideration to two separate hospitals, only one of which was determined to qualify for exempt status under section 501(c)(3). By weighing all the relevant facts and circumstances, the revenue ruling analyzed whether both the control and use of the hospitals were for the benefit of the public or for the benefit of private interests. The hospital that qualified for exemption was found to be organized and operated to further the charitable purpose of promoting health by satisfying a community benefit standard that included, among other factors, a board of directors that broadly represented the interests of the community. The hospital that did not qualify for recognition of exemption was found to be operating for the private benefit of those who controlled it rather than for the benefit of the public.

Rev. Rul. 72-209, 1972-1 C.B. 148, provides that a nonprofit organization formed to provide low cost home health care for people of a community may qualify for exemption under section 501(c)(3) of the Code as a charitable organization. The revenue ruling concludes that by providing home nursing and therapeutic care in the manner described, the organization serves many of the same health care needs of the community that hospitals traditionally serve, and therefore is promoting health within the meaning of the general law of charity.

Rev. Rul. 78-41, 1978-1 C.B. 148, concludes that a trust created by a hospital to accumulate and hold funds to pay malpractice claims against the hospital qualified for exemption under section 501(c)(3) of the Code as an integral part of the hospital. The hospital provided the funds for the trust, and the banker-trustee was required to make payments to claimants at the direction of the hospital. The organization conducted an activity that the hospital could perform itself.

Since T will continue to operate the family/social service counseling division, its current tax-exempt status under section 501(c)(3) of the Code and classification as not a private foundation will not be affected by the reorganization.

The restructuring of T and transfer of assets to X and Y will not adversely affect their exempt status. X and Y will perform the same functions that T formerly performed or could have performed consistent with its exempt purposes.

Any transfer of assets and/or funds will be one time transfers and therefore, will not possess the characteristics of a trade or business "regularly carried on." Following the proposed reorganization, the sharing of services and facilities, whether or not a fee is charged, and transfers of cash and assets among the exempt organizations will be substantially related to the exercise or performance of the exempt purposes of the involved corporations and will, therefore, not constitute unrelated trade or business activities subject to tax. Therefore, each corporation will be merely supplying a related charitable organization with a service or facility

necessary for, and in the furtherance of, the performance of exempt functions under section 501(c)(3).

Based on all the facts and circumstances described above, we rule as follows:

1. The restructuring of T and transfer of some its home health division assets, liabilities and activities to Y, and the transfer of its endowment assets and administrative activities to X, will not adversely affect the tax -exempt status of X, Y or T under section 501(c)(3), nor affect the status of X, Y or T as not a private foundation under section 509(a).

2. The restructuring and transfer of assets pursuant thereto will not give rise to unrelated business taxable income pursuant to sections 511 through 514 of the Code for either X, Y, or T.

3. The sharing of assets and services and transfer of funds among X, Y and T after the restructuring will not give rise to unrelated business taxable income under sections 511 through 514 for either X, Y, or T.

We have not been asked and we express no opinion on whether payments of rent by Y and T to X, which would otherwise be excluded from the computation of unrelated business taxable income pursuant to sections 512(b)(3) of the Code would be subject to tax by reason of section 512(b)(13).

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

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.

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,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, EO Technical
Group 1

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