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

Date: APR 1 2003

Contact Person:

Identification Number:

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Employer Identification Number:

Legend

A=
F=
P=

Dear Sir or Madam:

A, F and P request rulings under sections 501(c)(3), 509 and 511 through 513 of the Internal Revenue Code. In addition, A, F, and P requested three bond rulings which will be answered by Tax Exempt Bonds under separate cover.

A

A is exempt under section 501(c)(3) of the Code and is described in section 509(a)(2). A operates a skilled nursing home and a residential care facility. During the course of A's operations, it purchased real estate and developed it, added additional beds and facilities, and was involved in renovation and expansion projects to enhance its charitable mission. To pay for these projects it incurred tax exempt bond financing.

F

F is exempt under section 501(c)(3) of the Code and is described in section 509(a)(3). Its sole purpose is to conduct or support activities for the benefit of, or to carry out the purposes of A. F solicits charitable donations and grants from the public. It invests these funds and distributes them to or for the benefit of A.

P

P is exempt under section 501(c)(3) of the Code and is described in section 509(a)(3). P was incorporated for the sole purpose of supporting the charitable operations of A. The members and Board of Directors of A and the Board of Directors of P transferred title to all of A's real estate to P pursuant to an Agreement and Plan of Reorganization.

Agreement and Plan of Reorganization

On March 4, 2002, the members and Board of Directors of A decided to reorganize its exempt system's assets and operations by function. As a part of the reorganization plan, A' s members and Board of Directors also decided to amend the system's Articles of Incorporation and Code of Regulations to maximize A's control over F and P. F's members and Board of Directors decided to participate in A's plan by reorganizing its own governance structure and operations. In addition, the Board of Directors of P also decided to participate in A' s plan by agreeing to accept title to A's real estate. The reorganization maximized responsiveness to A's needs and minimized the governance differences between A and F which were causing unnecessary burdens and potential lapses in F governance. The reorganization also insulates the system's assets, operations and Directors, officers, employees and agents from potential third party liabilities.

The Agreement and Plan of Reorganization provides for the following: the transfer of A's real estate to P; the leasing of the real estate by A and F; the expansion of permitted investment vehicles for F; the leasing of A's management, administrative, and maintenance employees by F and P; the mandatory overlap in the individuals acting as Directors of A, F, and P; the indemnification of the system's Directors, officers, employees, and agents for their good faith actions taken on behalf of the system; and the sharing of the system's assets and personnel as needed to further A's charitable mission.

Under the Agreement and Plan of Reorganization, the members and Board of Directors of A and F amended their Articles of Incorporation and Codes of Regulations to resolve certain governance differences between the two entities and to address certain omissions and outdated provisions in F's governance documents. Likewise, the Directors of P decided to adopt Articles of Incorporation and a Code of Regulations conforming to the terms of the other entities' amended governance documents.

Pursuant to the Agreement and Plan of Reorganization, the governance documents of A and F were amended and the governance documents of P were amended to provide A's Directors (who are elected by A's members) automatically become the Directors of F and the Directors of P. In addition, the governance documents of F were amended and the governance documents of P were amended to eliminate the position of members. Also, F's Code of Regulations was amended and the governance documents of P were changed to allow the Directors of said entities more flexibility in the choice of investment vehicles. Finally, F's and P's Codes of Regulations were amended to provide for the indemnification of their Directors, officers, employees, or agents against potential third party claims arising from their official good faith activities.

As a result of the Agreement and Plan of Reorganization P, will lease its real estate exclusively to A to enable it to conduct its nursing home and residential care facility operations. A will sublease a portion of the premises' office space to F to enable it to conduct activities in support of A's operations. It is represented that A's and F's leases will be at rates reflecting P's cost of ownership and that neither A nor P will lease personal property to their affiliated entities.

P's planning and development activities will be conducted by P's Board of Directors and management in conjunction with A's Board of Directors and management. It is represented that all planning and development activities will have the sole purpose of supporting A' s nursing home and residential care facility operations and/or any additional section 501(c)(3) public charity activity. All or most of the revenues generated by P will consist of lease payments made by A to P in consideration of A's lease of P's real estate. Additional revenues may come from the charitable donations of F which will be utilized by P in support of A's charitable operations. Additional financial support may come from the general public.

Most of the existing management and staff of the nursing home and residential facility will remain employed by A after the reorganization, thereby maximizing operational and administrative efficiencies. It is anticipated that after the reorganization, P and F will regularly procure the services of certain A managerial, administrative and maintenance staff to perform the supporting organizations' management, administrative and maintenance functions. The supporting organizations' procurement of services from A will be evidenced by Services Agreements which will incorporate rates reflecting A' s cost of providing these services.

Rulings Requested

1. The reorganization of the assets, governance and operations of A, F and P will not adversely affect the tax exempt status of A under section 501(c)(3) of the Code, nor A's status as other than a private foundation under section 509(a)(2).

2. The reorganization of the assets, governance and operations of A, F and P will not adversely affect the tax exempt status of F and P under section 501(c)(3) of the Code, nor said entities' status as other than private foundations under section 509(a)(3).

3. The transfer of real estate by A to P will not constitute an unrelated trade or business under section 513 of the Code and will not subject A or P to the payment of unrelated business income tax under section 511(a).

4. The transfer of real estate by A to P will not create taxable gain or loss to A or to P.

5. The leasing of real estate by P to A will be substantially related to P's exempt purposes. Likewise, the subleasing of office space by A to F will be substantially related to A's exempt purposes.

6. The rents that will be received by P in consideration of its lease of its real estate to A and the rents that will be received by A in consideration of its sublease of office space to F will not constitute unrelated business taxable income under section 512 of the Code so long as the rents do not reduce any net unrelated income or increase any net unrelated loss of the tenant and subtenant.

7. A' s provision of managerial, administrative and maintenance services to F and P will be substantially related to A' s exempt purposes.

8. The payments that will be received by A for its provision of management, administrative and maintenance services to F and P will not constitute unrelated business taxable income under section 512 of the Code.

9. The ongoing transfer or sharing of assets, personnel, or resources by and among A, F and P without remuneration and in furtherance of A's charitable purposes will not cause any of the entities to be engaged in an unrelated trade or business within the meaning of section 513 of the Code.

Law

Section 501(a) of the Code provides for the exemption from federal income tax of organizations described in section 501(c)(3), including organizations 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.

Revenue Ruling 69-545, 1969-2 C.B. 117, recognizes the promotion of health is a charitable purpose within the meaning of section 501(c)(3) of the Code.

Revenue Ruling 78-41, 1978-1 C.B. 148, concludes that a trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital is operated exclusively for charitable purposes and is exempt under section 501(c)(3) of the Code.

Section 509(a) of the Code provides the term private foundation means an organization described in section 501(c)(3) other than one described in section 509(a)(1), (2), (3), or (4).

Section 509(a)(2) of the Code provides the term private foundation means a domestic or foreign organization described in section 501(c)(3) other than an organization which--(A) normally receives more than one-third of its support in each taxable year from any combination of--(i) gifts, grants, contributions, or membership fees, and (ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of $5,000

or 1 percent of the organization's support in such taxable year, from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and (B) normally receives not more than one-third of its support in each taxable year from the sum of-- (i) gross investment income (as defined in subsection (e)) and (ii) the excess (if any) of the amount of the unrelated business taxable income (as defined in section 512) over the amount of the tax imposed by section 511.

Section 509(a)(3) of the Code excludes from the definition of a private foundation an organization which is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or 509(a)(2).

Section 509(a)(3) of the Code describes an organization which is organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in sections 509(a)(1) or 509(a)(2). The supporting organization must also be operated, supervised or controlled by the supported organization; supervised or controlled in connection with the supported organization; or operated in connection with the supported organization in order to be classified as a public charity under section 509(a)(3).

Section 1.509(a)-4(a) of the regulations describes in general terms the various tests that a supporting organization must meet in order to be classified as an organization described in section 509(a)(3) of the Code.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 50l(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions, computed with the modifications listed in section 512(b).

Section 512(b)(3) of the Code provides generally that rents from real property (and its incidental related personal property) are not unrelated business income unless the property is debt-financed under section 514 of the Code. Debt-financed property does not include any property substantially related to the exercise or performance by such organization of its charitable functions.

Section 512(b)(4) of the Code requires that notwithstanding paragraphs (1), (2), (3) or (5), the net income realized with respect to debt-financed property must be included in unrelated business taxable income.

Section 512(b)(5) of the Code exempts from the definition of unrelated business taxable income all gains and losses from the sale, exchange or other disposition of non-inventory items and items not held for sale in the ordinary course of business.

Section 512(b)(13) of the Code limits the exclusion of interest, annuities, royalties, and rents provided by section 512(b)(1), (2), and (3) where such amounts are derived from a controlled organization.

Section 1.512(b)-1(1) of the regulations provides that if an exempt organization has control of another organization, the controlling organization shall include as an item of gross income in computing its unrelated business taxable income the amount of interest, annuities, royalties, and rents derived from the controlled organization, determined in accordance with the formula described in section 512(b)(13) of the Code and section 1.512(b)-1(1)(3) of the regulations.

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 of the organization's exempt purposes or functions.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is related to exempt purposes, in the relevant sense, only where the conduct of business activities has a causal relationship to the achievement of exempt purposes; and it is substantially related only if the causal relationship is a substantial one. The regulation states that 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 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 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 the charitable purposes constituting the basis for its exemption under section 501.

Analysis

The purposes of A, F and P will not change as a result of the proposed reorganization and the corresponding amendments to their respective Articles of Incorporation and Codes of Regulations. Each of these organizations will continue to operate to accomplish its respective exempt purpose under section 501(c)(3) of the Code. Therefore, neither the act of reorganization nor the resulting organizational structures will adversely affect A's, F's and P's continued exemption under section of 501(c)(3) of the Code.

Because A, F, and P will continue to receive their support from the same sources after the reorganization, the reorganization will not adversely affect their respective classification as non-private foundations.

As a parent, A will provide guidance and direction to F and P. F and P will be considered an integral part of A's system within the meaning of Rev. Rul. 78-41, supra. The reorganization and related transactions by A, F, and P will not adversely affect their exempt status because the transferred assets will be put to the same charitable uses. The tax on unrelated business income imposed by section 511 of the Code will not be applicable with respect to the transactions among and between A, F, and P because section 513(a) of the Code excludes

from the definition of unrelated trade or business any trade or business which contributes importantly to the accomplishment of an organization's exempt purpose. The proposed real estate asset transfers, the leasing of real estate, and the provision of managerial, administrative and maintenance services among the affiliated tax exempt entities will contribute to the accomplishment of their charitable mission. The proposed rents received from the leasing and subleasing of real estate are also derived from activities substantially related to A's and P's exempt purpose. The payments received for the provision of management, administrative and maintenance services are also derived from activities substantially related to A's exempt purposes. Lastly, the transfer of real estate by A to P will not be a taxable gain or loss to A or to P because the transfer will be between affiliated exempt entities within the same commonly controlled system. Therefore, the reorganization and transactions described above will not result in unrelated business income under sections 511 through 513 of the Code for A, F and P.

Conclusion

We rule as follows:

1. The reorganization of the assets, governance and operations of A, F and P will not adversely affect the tax exempt status of A under section 501(c)(3) of the Code, nor A's status as other than a private foundation under section 509(a)(2).

2. The reorganization of the assets, governance and operations of A, F and P will not adversely affect the tax exempt status of F and P under section 501(c)(3) of the Code, nor said entities' status as other than private foundations under section 509(a)(3).

3. The transfer of real estate by A to P will not constitute an unrelated trade or business under section 513 of the Code and will not subject A or P to the payment of unrelated business income tax under section 511(a).

4. The transfer of real estate by A to P will not create taxable gain or loss to A or to P.

5. The leasing of real estate by P to A will be substantially related to P's exempt purposes. Likewise, the subleasing of office space by A to F will be substantially related to A's exempt purposes.

6. The rents that will be received by P in consideration of its lease of its real estate to A and the rents that will be received by A in consideration of its sublease of office space to F will not constitute unrelated business taxable income under section 512 of the Code so long as the rents do not reduce any net unrelated income or increase any net unrelated loss of the tenant and subtenant.

7. A' s provision of managerial, administrative and maintenance services to F and P will be substantially related to A' s exempt purposes.

8. The payments that will be received by A for its provision of management, administrative and maintenance services to F and P will not constitute unrelated business taxable income under section 512 of the Code.

9. The ongoing transfer or sharing of assets, personnel, or resources by and among A, F and P without remuneration and in furtherance of A's charitable purposes will not cause any of the entities to be engaged in an unrelated trade or business within the meaning of section 513 of the Code.

These ruling are based on the understanding there will be no material changes in the facts upon which they are based. These rulings are directed only to the organization that requested them. Section 6110(k)(3) of the Code provides they may not be used or cited by others as precedent.

Please keep a copy of this ruling 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,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1