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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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No Third Party Contact

Contact Person:

Telephone Number:

In Reference to:

Date: JUL 05 1999

Employer Identification Number:
Key District:

Legend

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Dear Sir or Madam:

This is in reference to your ruling request concerning a proposed consolidation of A's corporate network and its implications under sections 501(c)(3), 509(a), and 511 through 514 of the Internal Revenue Code.

Your current corporate structure consists of five (5) corporations exempt from federal income tax under section 501(c)(3) of the Code. The five corporations are B, C, D, E, and F.

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C is a z non-profit corporation exempt from federal income tax under section 501(c)(3) of the Code and is classified as a public charity pursuant to section 509(a)(2) of the Code. C was established in 1899 as a home for the aged. Over time, C expanded to include operation of a 71-bed residential health care facility and ownership and management of four apartment buildings, each containing 16 units. Effective March 1996, C transferred its residential health care facility and two of its four apartment buildings (which were immediately demolished) to B. C is currently constructing and intends to operate a 259 unit senior living community.

B is a z non-profit corporation established in 1994. B is exempt from federal income tax under section 501(c)(3) of the Code and is classified as not a private foundation pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii). B is in the process of significantly renovating and expanding the residential health care facilities transferred to it in March 1996 by C and A Nursing Home, Inc. (a formerly affiliated corporation that was dissolved). B currently operates a 475 bed residential health care facility in the city of x.

C and B are membership corporations. The members of C are the incumbent pastors, assistant pastors and associate pastors of certain churches and 2 lay persons designated by each of the churches. C is the sole member of B. The members of the Boards of Directors of C and B are identical. Currently, D, E and F are non-membership corporations and their Boards of Directors are not required to have any members in common with the Boards of Directors of any other corporation.

D is a z non-profit corporation established in 1992. D is exempt from federal income tax under section 501(c)(3) of the Code and is classified as not a private foundation pursuant to section 509(a)(1) and 170(b)(1)(A)(vi). D is operated for the purposes of soliciting, receiving, and maintaining real and personal property for the benefit of C, B, F, and E and engaging in other programs serving the health-related or other needs of the elderly, disabled or chronically ill persons in the area.

E is a z non-profit corporation incorporated in 1997. E is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a public charity pursuant to section 509(a)(1) and 170(b)(1)(A)(vi). The purposes of E are to provide non-medical services directly to elderly and chronically ill persons and to provide professional support, consulting and advisory services to providers of services to the elderly and chronically ill persons.

F is a z non-profit corporation incorporated in 1997. F is exempt from federal income tax under section 501(c)(3) and is classified as a supporting organization pursuant to section

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509(a)(3). Its purposes are to provide general support and assistance to C, B, D, and E, including administrative support.

The proposed corporate structure

The proposed consolidated network of corporations would be implemented by establishing the representatives of the churches, currently the members of C, as the members of F and establishing F as the sole member of each of C, B, and E. In its capacity as the sole member, F will be entitled to elect the directors of each of C, B and E and to approve any amendments to the organizational documents of those corporations. D would continue to operate as a non-membership corporation with a self-perpetuating Board of Directors.

In addition to the changes in the membership structure, certain corporate governance linkages would be created between F and each of C, B, E and D. First, all directors of F, C, B and E and one director of D will be nominated by a Network Nominating Committee, which will be constituted as a committee of F. The Network Nominating Committee will be composed of five (5) members, including one member of the Boards of Directors of each of F, C, B and E and one representative of the churches. Second, the Boards of Directors of C, B, E and D, which will consist of 9, 13, 7, and 13 members, respectively, will each include the President of F, who will serve as an ex-officio director with voting rights. In addition, the Boards of Directors of C, B and E will each include three other members of the Boards of Directors of F. The Board of Directors of D will include one other member of the Board of Directors of F.

These changes in membership structure and corporate governance will be implemented by having each of the corporations involved amend its organizational documents as necessary.

It is possible that funds, assets, services and/or personnel may be transferred by and among the various component entities of the consolidated system (B, C, D, E, and F) by means of gratuitous transfers between tax-exempt entities, loans, sales and/or leases.

It is anticipated that the proposed consolidation will benefit the corporations involved in several ways. F will: (1) provide a unified vision for the growth of the affiliate corporations and the network, (2) will coordinate strategic planning for the network, and (3) review and monitor the operations of the affiliates to ensure that their operations are consistent with their corporate purposes and the mission of the network. It is anticipated that the oversight and guidance of F will reduce the functional overlap among the affiliates and maximize the utilization of resources available to the network. F will also undertake the administrative activities currently

engaged in by each of the affiliated corporations individually, thereby creating economies of scale for the network, eliminating administrative redundancy, increasing overall efficiency of the network and permitting each of the affiliates to dedicate its efforts to its charitable mission. Finally, F will promote innovation and diversification in response to changing needs within the community by facilitating the ability of the network and the affiliates to enter into collaborative enterprises with outside entities by negotiating and/or contracting with such entities on behalf of the affiliates. The ultimate objectives of the proposed consolidation are to improve the quality and expand the scope of the care and services provided to the elderly and chronically ill through member corporations of the network while reducing the cost of such care and services.

The proposed consolidation has been approved by the Board of Directors of each of C, B, E and F, and by the members of C and B. Their approval was given subject to and conditioned upon obtaining favorable rulings on the rulings requested from the Internal Revenue Service.

You state that subsequent to the proposed consolidation the exempt purposes and activities of C, B, E D and F will remain unchanged.

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

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that for an organization to be exempt as one described in section 501(c)(3) of the Code, it must be both organized and operated exclusively for one or more exempt purposes. Under section 1.501(c)(3)-1(d)(1)(i)(b) of the regulations, an exempt purpose includes a charitable purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code 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 (1959); 4A Scott and Fratcher, The Law of Trusts, sections 368, 372 (4th ed. 1989); Rev. Rul. 69-545, 1969-2 C.B. 117.

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Rev. Rul. 69-545, 1969-2 C.B. 117, established a community benefit standard as the basis for the federal income tax exemption of a hospital. This revenue ruling held that a hospital satisfies the community benefit standard if it promotes the health of a class of persons broad enough to benefit the community as a whole and it does not unduly benefit private individuals in achieving that objective.

Section 1.501(c)(3)-1(c)(1) of the 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 exempt 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 509(a) of the Code provides that all organizations described in section 501(c)(3) are private foundations except for those described in sections 509(a)(1), (2), (3) or (4).

Section 509(a)(1) of the Code excludes from the term "private foundation" an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii).

Section 170(b)(1)(A)(iii) of the Code describes an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research.

Section 170(b)(1)(A)(vi) of the Code describes, in part, an organization created in the United States, organized and operated exclusively for religious, charitable, scientific, or educational purposes and which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c)(1) or from direct or indirect contributions from the general public.

Section 509(a)(2) of the Code excludes from the definition of "private foundation" 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), and (B) normally receives not more than one-third of its support in each taxable year from the sum of (i) gross investment income and (ii) the excess (if any) of the amount of unrelated business taxable income over the amount of the tax imposed by section 511.

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Section 509(a)(3) of the Code excludes from the definition of "private foundation" an organization which (A) 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 section 509(a)(1) or 509(a)(2), (B) is operated, supervised or controlled by or in connection with one or more organizations described in paragraph (1) or (2), and (C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2).

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations described in 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 512(b)(5) of the Code excludes from unrelated business taxable income all gains and losses from the sale, exchange, or other disposition of property other than (1) stock in trade or other property which would be property includable in inventory if on hand at the end of the year, and (2) property held primarily for sale to customers in the ordinary course of the organization's trade or business.

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 such organization of the purpose or function constituting the basis for its exemption.

Section 513(a)(2) of the Code provides 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), such as a hospital, by the organization primarily for the convenience of its patients.

Section 1.513-1(a) of the regulations defines unrelated business taxable income to include the gross income of an exempt organization if, and to the extent that: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

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Section 1.513-1(d)(2) of the regulations states 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 an 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 income from debt-financed property. Section 514(b)(1)(A)(i), 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.

Your proposed changes are primarily in membership structure and corporate governance. The exempt purposes and activities of B, C, D, E, and F will remain the same.

Your proposed change of having the representatives of churches as members of F rather than as members of C; having F as the sole member of C, B and E; having a Network Nominating Committee, as described; and F's new role and responsibilities within the reorganization; plus the continuation of each of the organizations' activities in furtherance of their charitable purposes will not adversely affect their tax exempt status under section 501(c)(3) of the Code and their classification as not private foundations under sections 509(a)(1) and 170(b)(1)(A)(iii) and 170(b)(1)(A)(vi), 509(a)(2) and 509(a)(3), as applicable.

Any proposed transfers of funds and/or assets will be one time transfers and, therefore, will not possess the characteristics of a trade or business "regularly carried on." The sharing of services, facilities and/or personnel, whether or not a fee is charged, will be substantially related to the exercise or performance of the exempt purposes of B, C, D, E and F and will, therefore, not constitute unrelated trade or business activities subject to tax. 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) of the Code.

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

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1. The creation of the proposed consolidated system will not result in the revocation or otherwise adversely affect the continuing tax-exempt status of C, B, D, E or F under section 501(c)(3) of the Code.

2. The proposed consolidated system will not adversely affect the continued non-private foundation status of C, B, D, E or F under section 509(a) of the Code.

3. Any transfers or sharing of funds, assets, services and/or personnel by and among C, B, D, E and F will not jeopardize the continued tax-exempt status under section 501(c)(3) of the Code of the organization providing such funds, assets, services and/or personnel.

4. Any payments for or in connection with such transfers or sharing of funds, assets, services and/or personnel by and among C, B, D, E and F will not generate unrelated business taxable income under sections 511 through 514 of the Code.

These rulings are based on the understanding that there will be no material changes to the facts upon which they are based.

The rulings in this letter only apply the specifically indicated sections of the Code and regulations to the facts that you have represented. In this letter we do not rule on the applicability of any other sections of the Code and regulations to your case.

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

We are informing your key District Director of this action. Because this letter could help resolve any future questions about your income tax responsibility, please keep a copy of this ruling in your permanent records.

Sincerely,

Marvin Friedlander

Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1