



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Numbers:

UIL: 501.03-11, 511.00-00, 512.00-00, 513.00-00,
514.00-00

Legend

A =

B =

C =

D =

E =

F =

X =

Dear _____ :

This is in response to a letter from your authorized representative requesting rulings on your behalf regarding a proposed statutory merger and its effect under sections 501(c)(3), 509(a), and 511 through 514 of the Internal Revenue Code.

Facts

A is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a public charity pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii). A is a holding company that owns or controls several health care related entities. A is the sole member of B, C, and D, which are its wholly controlled subsidiaries. A provides management and strategic planning services to these organizations.

The current membership of A consists of two classes: Class A and Class B. Class A Members consist of local individuals living in the area served by A. Class A Members include local community leaders, professionals, doctors, and retired professionals. A's Bylaws provide that the Class A Members' have limited voting rights. The Class B Member is E. A's Bylaws provide that the Class B Member has virtually all the voting rights, including the power to ratify the election of all of A's Trustees by the Class A Members. A's Board of Trustees is comprised of local community leaders, professionals and doctors. A majority of A's Trustees is independent of A, B, C and D.

A has adopted and carries out a charity care policy. A has also adopted a conflicts of interest policy. Both policies also apply to B, C and D.

B is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a public charity pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii). B operates a hospital and related healthcare centers. The hospital has an emergency room that is available to all patients regardless of their ability to pay.

C 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)(2). C operates a nursing home.

D 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)(2). D is a physician practice organization.

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)(3). E is the sole voting member of x nonprofit organizations exempt from federal income tax under section 501(c)(3). These organizations consist of community hospitals, home healthcare agencies and mental health centers located in F and surrounding states. E's primary purpose is to improve the health status of the communities where these organizations operate. E is governed by a Board of Trustees, which is comprised of local community leaders, professionals and doctors. A majority of E's Trustees are independent of E. E does not have members.

Proposed Merger

A, C, and D propose to merge into B in a statutory merger under the F Nonprofit Corporation Act (the "Proposed Merger"). (After the Proposed Merger, the surviving entity is referred to as "Post-Merger B.") Post-Merger B will continue its current activities and those of A, C, and D. The purposes of the Proposed Merger are to simplify B's organizational and governance structure, thereby creating more effective oversight by B's Board; and to simplify the corporate structure so that the local community will view A, B, C and D as one community healthcare organization rather than as four separate corporations.

At the time of the merger, the current membership of A will be converted on the same terms and conditions regarding the rights of its members to membership in Post-Merger B. Therefore, the members of Post-Merger B will be the same as the current members of A, which comprise two classes of members: Class A and Class B. The Class B Member will control and manage Post-Merger B, including the power to ratify the election of all of the Trustees of Post-Merger B by its Class A Members.

Post-Merger B will continue to have and carry out a charity care policy and will continue to have a conflicts of interest policy. In connection with or following the Proposed Merger, Post-Merger B will amend its Bylaws to require that a majority of its Board of Trustees consists of independent members of the community.

After the Proposed Merger, Post-Merger B will change its name to A.

Rulings Requested

1. The Proposed Merger will not adversely affect the tax-exempt status of A, B, C, D or Post-Merger B, as the surviving corporation, under Section 501(c)(3) of the Code.
2. The Proposed Merger will not adversely affect the non-private foundation status of A, B, C, D or Post-Merger B, as the surviving corporation, under Section 509(a) of the Code.
3. The transfer of assets and liabilities from A, C, and D to B pursuant to the Proposed Merger will not produce unrelated business income to A, B, C, D, or Post-Merger B, as the surviving corporation, under Sections 511 through 514 of the Code.

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 charitable, educational or scientific 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 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; IV Scott on Trusts, section 368, 372 (3rd ed. 1967); and Rev. Rul. 69-545, 1969-2 C. B. 117.

Section 509(a) of the Code provides that all organizations described in section 501(c)(3) are private foundations except 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 whose principal purpose or functions include providing medical or hospital care or medical education or medical research.

Section 511(a) of the Code imposes a tax on the unrelated business income of organizations described in section 501(c)(3).

Section 512(a)(1) of the Code defines unrelated trade or business taxable income as the gross income derived by any organization from any unrelated trade or business regularly carried on by

it, less the allowable deductions directly attributable to such business activity, with certain modifications.

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

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 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(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 productions of funds) to the organization's performance of its exempt functions.

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 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 exempt purposes.

Section 514 of the Code defines unrelated debt-financed income as income produce from debt-financed property from an unrelated business, as discussed in section 512.

Rev. Rul. 69-545, 1969-2 C.B. 117, acknowledges that the promotion of health is a charitable purpose within the meaning of section 501(c)(3) of the Code. It states that a hospital must primarily benefit the community in order to qualify for exemption under this code section. One method of establishing a community benefit is through a charity care policy. This policy provides free or subsidized care to the indigent in the community. Such a policy must be communicated to the general public. This ruling also states that when a majority of the board of directors of a hospital are independent members of the local community no inurement has occurred.

Analysis

Post-Merger B will continue to provide healthcare services to the F community. A majority of Post-Merger B's Board will be composed of a majority of independent members. Post-Merger B will continue to have and implement a charity care policy, and will continue to have a conflict of

interest policy. The hospital owned by Post-Merger B will continue to have an emergency room that will be available to all patients regardless of their ability to pay.

Therefore, since post-merger B will continue to satisfy the community benefit standard set forth in Rev. Proc. 69-545, *supra*, Post-Merger B's tax-exempt status under section 501(c)(3) of the Code and its classification as other than a private foundation, pursuant to sections 509(a)(1) and 170(b)(1)(A)(iii), will not be adversely affected by the Proposed Merger.

The purposes of the Proposed Merger are to simplify B's organizational and governance structure, thereby creating more effective oversight by B's Board; and to simplify the corporate structure so that the local community will view A, B, C and D as one community healthcare organization rather than as four separate corporations. Post-merger B will continue to carry on the activities of each of its predecessor organizations, A, C and D. Thus, the merger of A, C, and D into B furthers B's charitable purposes. Therefore, the transfer of assets and liabilities pursuant to the proposed merger will be substantially related to A, B, C, D and Post-Merger B's tax-exempt purposes within the meaning of section 1.513-1(d)(2) of the regulations.

Rulings

1. The Proposed Merger will not adversely affect the tax-exempt status of A, B, C, D or Post-Merger B, as the surviving corporation, under Section 501(c)(3) of the Code.
2. The Proposed Merger will not affect the non-private foundation status of A, B, C, D or Post-Merger B, as the surviving corporation, under Section 509(a) of the Code.
3. The transfer of assets and liabilities from A, C, and D to B pursuant to the Proposed Merger will not produce unrelated business income by A, B, C, D, or Post-Merger B, as the surviving corporation, under Sections 511 through 514 of the Code.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Please keep a copy of this ruling in your permanent records.

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 by others as precedent.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

Thank you for your cooperation.

Sincerely yours,

Debra J. Kawecki
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437