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

TAX EXEMAT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200702035**
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Contact Person:

Identification Number:

Telephone Number:

UIL: 513.00-00

Employer Identification Number:

Legend:
A =
B =
C =
D =
E =
x =

Dear :

This is in reply to the ruling request submitted by your authorized representative concerning the proposed reorganization between A, B and C.

Facts

A was incorporated in x as a non-member nonprofit corporation under the laws of the State of E. A has been recognized as an organization described in section 501(c)(3) of the Internal Revenue Code and as a supporting organization classified under section 509(a)(3). A provides management, consolidated administration, data processing services, budgeting, accounting, and administrative services to B and C. A also provides marketing services for all of A's related entities. A charges administrative fees for those services at cost, which will not exceed the market rate for such services. A is managed by its Board of Directors ("Board"). A will only manage related organizations that it will fully control through its Board.

B was incorporated as a member nonprofit corporation under the laws of the State of E. B has been recognized as an organization described in section 501(c)(3) of the Code and as a hospital classified under sections 509(a)(1) and 170(b)(1)(A)(iii). B provides specialized healthcare in the areas of rehabilitation, arthritis treatment, and specialized psychiatric care both for geriatric patients and for children and adolescents. B also provides hospice and home health care services for patients in the community. B is managed by its Board of Trustees ("Board"). A's membership is composed of its Board.

C was incorporated as a non-member nonprofit corporation under the laws of the State of E. B has been recognized as an organization described in section 501(c)(3) of the Code and as a supporting organization under section 509(a)(3). C raises funds for B and is controlled by B. C is managed by its Board of Directors ("Board").

Over the past year, A, B, and C have reviewed their structures and interactions. Recent events in the exempt organization sector prompted an examination of the way that governance of these organizations should be conducted. The examination particularly focused on the inefficient current organizational structure and methods for B to enable it to better fulfill its charitable (i.e., health care) purpose. Therefore, the organizations propose to reorganize as described below ("Reorganization"):

A will function as the sole member of B, and will control B and C, as well as any additional entities that may be added to this group of related organizations in the future. A will elect the members of the Boards of B and C, and A will always have the right to appoint a majority of the members of the Board of all of A's subsidiaries. B's articles of incorporation ("Articles") will be restated to change its name to D, and to provide:

1. A will be the sole member of B;
2. A will elect all the Board members of B;
3. B's Board will always be composed of a majority of members from A; and
4. A must approve any amendments to B's Articles and bylaws before they can become effective.

C's Articles and bylaws will be restated in the same manner to provide for the same control relationship by A.

B will provide the initial operating capital to A. The costs incurred by A in providing services to B and C will be allocated to B and C based upon each entity's relative budgets, in order to provide a proper matching of revenue and expenses. There will be no profit involved in the allocation of those costs; which will primarily consist of wages and benefits. After the reorganization, B and C will continue to have the same purposes and conduct the same activities as before the reorganization.

The organizations anticipate several benefits from the Reorganization. These include ease of managing the existing members of the group of related organizations, and cost savings via a more efficient system, which will also slow the increase in community healthcare costs. The Reorganization will also facilitate the expansion of programs and services through additional entities which may be added in the future. The long range plan of B is to add lines of services that will expand the types of care it can offer to its patients and to the community.

Ruling Requested

The Reorganization will not result in unrelated business taxable income to A under section 511 through section 514 of the Code.

Law

Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations described in section 501(c).

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means the gross income derived from any unrelated trade or business which it carries on regularly.

Section 512(b)(3) of the Code excludes from unrelated business taxable income rents from real property. Section 513 of the Code defines the term "unrelated trade or business" as one that is not substantially related to the exercise or performance by an organization of its charitable purpose or function constituting the basis for its exemption.

Section 512(b)(5) of the Code excludes from unrelated business taxable income all gains or losses from the sale, exchange, or other disposition of property other than (A) inventory, or (B) property held primarily for sale to customers in the ordinary course of a trade business. Section 514(a)(1) of the Code requires that with respect to each debt-financed property, a proportion of the income derived from an unrelated trade or business be included in gross income.

Section 514(b)(1)(A)(i) of the Code excludes from the term "debt-financed property," the income from which must otherwise be included in gross income, property that is substantially related to the exercise or performance of the organization's charitable function.

Section 1.513-1(d)(2) of the regulations state that a trade or business is related to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of exempt purposes, and it is substantially related for the purpose 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.

Analysis

A will not receive any consideration in connection with the reorganization involving B and C. In addition, following the reorganization, A will provide essential services to B and C, services that are necessary to the effective operations of B as a provider of hospital services and of C as a fundraiser. Since these services have a substantial causal relationship to the achievement of A's exempt purpose, within the meaning of section 1.513-1(d)(2) of the regulations, A's provision of these services do not constitute an unrelated trade or business.

Ruling

The Reorganization will not result in unrelated business taxable income to A under section 511 through section 514 of the Code.

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

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.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides 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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven B. Grodnitzky
Manager
Exempt Organizations
Technical Group 1

Enclosure
Notice 437