



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Uniform Form List

Date:

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Contact Person:

Identification Number:

Telephone Number:

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Employer Identification Number:

Legend:

M =

N =

O =

P =

Q =

R =

S =

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X =

Dear Sir or Madam:

We have considered the ruling request dated July 9, 2002, submitted on behalf of M, a nonprofit organization which is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and which has also been classified as other than a private foundation under section 509(a)(2). M requests rulings as to the tax consequences under sections 501(c)(3), 509(a), and 511-514 of the Code of the proposed transaction described below.

FACTS

M was formed for the purpose of owning and operating nursing homes. It currently owns one facility, N, which is a "skilled nursing facility" within the meaning of 42 U.S.C. 1395x(j), whose principal purpose is the provision of medical care to its residents. Approximately \$5,000x aggregated principal amount of FHA-insured tax exempt bonds (the "Bonds") are allocable to and secured by N.

O is a nonprofit corporation which is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a supporting organization described in section

509(a)(3) pursuant to the group ruling issued to P. O was formed in 1981 as the parent of a new health care system, to own, operate, and manage hospitals previously operated by three regional departments of P. In 1982, in recognition of America's aging population, O organized and established Q to broaden its health ministry to include care for the aging population. O is the sole corporate member of Q.

Q is a nonprofit corporation which is recognized by the Service as tax exempt under section 501(c)(3) of the Code pursuant to the group ruling issued to P. It was formed in 1982 to own, operate, and manage nursing homes and long-term care facilities for the elderly. It currently operates one nursing home and is the sole corporate member of several nonprofit, tax exempt corporations that own, lease, operate, or manage nursing homes and assisted living facilities, including M and R.

R is a nonprofit corporation that is tax exempt under section 501(c)(3) of the Code and is classified as other than a private foundation under section 509(a)(2). It was reincorporated in 1991 to own and operate nursing homes. It currently operates N pursuant to a lease of the facility from M.

S is a nonprofit corporation which is tax exempt under section 501(c)(3) of the Code, and is also classified as other than a private foundation under section 509(a)(2). S was organized and established to own, lease, manage, and operate nursing homes, retirement homes, and other enterprises related to the provision of health care. S is the sole member of several nonprofit, tax exempt subsidiaries that own, operate, or lease nursing home facilities in connection with O, Q, and Q's subsidiaries.

T is a nonprofit corporation formed in December, 2000, and which has recently received a determination letter from the Internal Revenue Service recognizing it as tax exempt under section 501(c)(3) of the Code and as other than a private foundation under section 509(a)(3). T was organized and established to foster and support S and its subsidiaries, including soliciting and raising funds and endowments. T is the sole member of S.

In 1973, P authorized the formation of five healthcare systems within the United States. These healthcare systems were established to own, operate, and manage hospitals and other health care activities previously operated by various divisions of P to carry out the health ministry of P. One such healthcare system was O.

In 1982, O recognized a growing need of an aging population and broadened the focus of its health ministry to include the ownership and operation of nursing homes and assisted living facilities. Through Q, it began to acquire a number of nursing homes and long-term care facilities. By January, 1993, Q owned, leased, or managed several long term care facilities in two regions of the United States. However, Q's need for capital soon became an obstacle to its mission of providing long term care to the elderly. The demands for capital with respect to O's operation of its hospitals were and continue to be extremely significant, given ever increasing patient volumes and overall growth.

Late in 1993, the FHA expanded its loan guarantee program for nursing homes and other long-term care facilities. This program provides FHA-insured, triple AAA rated loan guarantees for the financing or refinancing of long-term care facilities. The benefits to O of using this expanded program include low down payments to finance facilities, extremely low interest rates, and no requirement that O guarantee financing. For this reason, in 1993, the leadership of O helped to form S, which would share O's mission of promoting the health ministry of P. S was established to further this common mission by accessing the expanded FHA loan guarantee program to purchase nursing homes, which would be operated by O and its tax exempt subsidiaries. Many of the individuals who participated in the formation of S had previously participated in the governance, e.g., as board members, of healthcare facilities operated by P. As such, they were familiar with the mission of the facilities, i.e., to treat the whole person, the methods by which they would be operated (both financially and clinically), the geographic regions customarily served by P, and the patient population.

After careful consideration, the leadership of both O and S concluded that the advantages of the FHA loan guarantee program could best be availed of if S were organized as a formally independent organization. Under that approach, the debt of S would not be consolidated with the debt of O and, therefore, neither organization's ability to access financial capital would be limited by the debt of the other. Also, and of more immediate concern, the formation of S as a separate organization would allow O to exclude the debt of S from its consolidated balance sheet, which would preserve O's credit rating and ability to access financing for its hospital operations. Thus, the leadership of both organizations determined that their common mission of advancing the health ministry of P would best be served by organizing S as a separate tax exempt organization.

All of the members of S's board of directors, as well as the boards of its tax exempt subsidiaries, are members of P, including several ordained ministers of P, who are committed to ensuring that S's facilities are managed and operated in a manner that reflects P's purposes and mission with respect to its health ministry. Although formally independent, O and S have a close and continuous working relationship that enables them to further their common mission. S, through its subsidiaries, furnishes O with the physical plant and equipment necessary to operate nursing homes in furtherance of their common charitable mission. In exchange, O provides nursing home management and certain other administrative services to S and its subsidiaries, including legal, tax, treasury, and certain executive management services.

M was created by S in 1998 for the purpose of owning and operating nursing homes. Until May, 1999, S was the sole corporate member of M.

N had been owned and operated by R since 1994. In 1999, O and S mutually decided that M should acquire N from R and, once acquired, to lease N back to R. Both O and S believed that M could secure advantageous financing through the FHA insured program to purchase N and that this financing would allow O to exclude the debt of N from its balance sheet. In furtherance of the acquisition, in May, 1999, Q became the sole member of M. In June, 1999, M acquired N (financing the acquisition through the issuance of the Bonds) and simultaneously leased N back to R.

Pursuant to a lease that was dated November 10, 1998, and that commenced on June 22, 1999 (the "Lease"), N (and surrounding parking areas) was, and currently is, leased by M to R. The initial term of the lease was for a one-year period that ended on June 21, 2000. However, the Lease automatically renews for consecutive one year periods unless terminated. The rent paid by R is an amount calculated to pay all mortgage payments, plus payments to reserves for taxes, replacement assets, and insurance, and necessary maintenance. The Lease requires N to be used and occupied for the sole purpose of operating a licensed nursing home facility and requires R to maintain insurance at its own cost and expense.

O and S desire to return to the original corporate structure in order to allow O to exclude the debt of N from its balance sheet, which will enhance its ability to obtain financial capital to further its charitable mission in other ways. Upon issuance of a favorable ruling by the Service in response to this request, (1) S will become the sole member of M, (2) M will amend its Articles of Incorporation to state an additional purpose of operating to further the exempt purposes of Q, and (3) M will enter into a new lease (the "Revised Lease") with R on the terms and conditions described below.

Prior to entering into the Revised Lease, M will amend its Articles of Incorporation to establish that it would be operated in connection with Q. First, M's Articles of Incorporation will be amended to require one member of Q's board of directors to be a member of M's board of directors. Second, M will amend its exempt purposes to allow it to support the exempt purposes of Q in connection with the ownership and operation of nursing homes.

The initial term of the Revised Lease will be ten (10) years; thereafter, the Revised Lease will automatically renew for consecutive five year terms. The Revised Lease will be terminable at any time by R upon 180 days notice without any penalties. Under Section 1.01 of the Revised Lease, R will not be allowed to assign the Lease without prior consent of M.

Section 2.2 of the Revised Lease provides that the rent to be paid will be in an amount sufficient to retire the Bonds, including payments to reserves for taxes, insurance, property replacement accounts, and necessary maintenance. R will be responsible for all repairs, taxes, and insurance in connection with N.

The Revised Lease expressly requires both M and R to conduct their operations and the operations of N in a manner that does not jeopardize the tax exempt status of M, R, or the interest on the Bonds. Specifically, under Section 3.3(b), R covenants and agrees that it will:

- (1) operate as a nonprofit organization for the promotion of health during the entire term of the Revised Lease;
- (2) use any and all surplus funds from the operation of N toward improving facilities, equipment, or patient care, or providing medical training, education, and research;
- (3) ensure that its earnings do not inure directly or indirectly to the benefit of any private individual, including the distribution of assets upon liquidation;

- (4) comply with applicable federal and State laws prohibiting discrimination based on race, religion, creed, color, marital status, sex, national origin, or any other protected bases; and
- (5) not use N or permit N to be used by any person in any manner that would result in either M or R not being treated as an organization described in section 501(c)(3) of the Code or the interest on the Bonds to be included in the gross income of the holders.

In addition, the Revised Lease will require R to operate N in a manner that is consistent with the requirements of section 501(c)(3) of the Code, Rev. Rul. 69-545, Rev. Rul. 72-209, Rev. Rul. 83-157, and the philosophy and mission of P. More specifically, Sec. 3.3 will require N to be operated:

- (1) solely as a charitable "skilled nursing facility" within the meaning of section 42 U.S.C. sec. 1395 whose sole function is to provide medical care to patients;
- (2) to provide medical care for the general community;
- (3) in a manner that provides medical care to patients who can pay the costs of their medical care from their own resources, through private health insurance, or with the aid of public programs such as Medicare and Medicaid; and
- (4) in accordance with the health ministry and mission of P.

Section 16.1 of the Revised Lease provides that it will terminate in the event that any of the above covenants are breached, including the loss of federal tax exempt status by either party or the failure to operate N in accordance with the above requirements.

It is contemplated that a portion of N (the "Assisted Living Center") may be used as a home for the aged at some point in the future. This portion of N has been designed to meet the special needs of the elderly. It includes safety features such as: grab bars by bath tubs and toilets, wide entrance-exit doorways, ramps and elevators for wheelchair use, floors designed to help prevent slips and falls, conveniently located electrical outlets and cabinets, windows at eye level for residents using wheelchairs, and an emergency 24-hour alarm system.

Once the decision is made to operate a portion of N as the Assisted Living Center ("ALC" hereinafter), R and M would expand their exempt purposes to include services designed to meet the unique needs of the elderly. More specifically, the following provisions would be added to the Revised Lease:

- (1) R covenants and agrees to operate the ALC to meet the unique needs of the elderly in a manner consistent with the guidance offered in Rev. Rul. 72-124, 1972-1 C.B. 145, and Rev. Rul. 79-18, 1979-1 C.B. 194;

- (2) R covenants and agrees that it will operate the ALC:
 - (a) to meet the elderly's physical, emotional, health, recreational, social, and religious needs and their need for financial security;
 - (b) at the lowest feasible cost (consistent with debt repayment and maintaining reserves to ensure continuity of service and physical expansion of the ALC); and
 - (c) within the financial reach of a significant segment of the elderly living in the Central U area;

- (3) R covenants and agrees that it will maintain in residence any person who becomes unable to pay their regular charges provided that:
 - (a) the resident can be maintained without impairing the ability of the ALC to operate on a sound financial basis;
 - (b) the resident does not, without R's consent, impair his or her ability to meet his or her financial obligations to the ALC by transferring assets after assuming residency, other than to meet the resident's ordinary and customary living expenses; and
 - (c) the resident maintains his or her Medicaid and Medicare eligibility; and

- (4) R covenants and agrees to use any and all surplus funds from the operation of the ALC to improve the assisted living care provided, retire indebtedness, subsidize any resident unable to continue making his or her monthly payments, or expand the ALC.

Concerning the proposed ALC, R would ensure that the medical needs of elderly residents would be satisfied by providing an experienced and attentive professional staff on-site 24 hours a day, every day of the week. The professional staff would include at least one licensed nurse and at least two staff members at all times and would be able to assist residents with their personal needs. R would also make available, or arrange for, transportation to medical appointments. Every three months, residents would receive health and wellness assessments. R would also provide for medication administration, if needed. Upon request, residents could receive dietary supplements, incontinence products, and private duty nursing services.

In addition to providing for residents' medical needs, the ALC would offer a variety of services and accommodations to meet the specific physical needs of its residents. The ALC would provide housekeeping services and daily assistance with bathing, dressing, grooming, and medication management. Physical, speech, and occupational therapy also would be provided. Residents would receive three nutritionally well-balanced meals every day and snacks.

For residents' social and recreational pleasure, the ALC would be renovated to include an exercise room, library, and many places to relax, socialize, and enjoy the company of other residents. In addition, the ALC would offer a comprehensive daily activities program, which would include social events, arts and crafts, and regularly scheduled community outings. R would provide transportation for shipping and appointments.

Finally, to meet the religious needs of residents, the ALC would coordinate with a local P Church or other religious organizations to make religious services available to residents, either on-site or through transportation to such services. Through these activities, R believes that the ALC would meet the medical, physical, recreational, and ecclesiastical needs of the elderly.

RULINGS REQUESTED

1. M's activity of leasing N to R pursuant to the Revised Lease is substantially related to M's exempt purpose and accordingly does not adversely affect M's tax exempt status under section 501(c)(3) of the Code.
2. Amounts received by M under the Revised Lease will not be taxable as unrelated business income.
3. After commencement of the Revised Lease, M will qualify as other than a private foundation as a supporting organization described in section 509(a)(3) of the Code.

LAW

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations that are organized and operated "exclusively" for charitable, religious, educational, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. In the law of charity, the promotion of public health has long been considered a foremost charitable objective. See Restatement (Second) Trusts, sections 368 and 372. The Service has published many revenue rulings recognizing exemption under section 501(c)(3) for organizations that are promoting community health in one way or another, including the rulings discussed below.

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 exempt purposes under section 501(c)(3). 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 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of Code section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or non-existence of such primary purpose, all the circumstances

must be considered, including the size and extent of the activities which are in furtherance of one or more exempt purposes.

Section 1.170A-9(c)(1) of the regulations provides that an organization, all of the accommodations of which qualify as being part of a "skilled nursing facility" within the meaning of 42 U.S.C. sec. 1395x(j), may qualify as a "hospital" if its principal purpose is the provision of hospital or medical care.

Rev. Rul. 69-545, 1969-2 C.B. 117, sets forth two examples to illustrate whether a nonprofit hospital claiming exemption under section 501(c)(3) of the Code is operated to serve a public rather than a private interest.

Concerning the hospital in *Situation 1*, Rev Rul. 69-545 states that inasmuch as it provides hospital care on a nonprofit basis for members of its community, it is organized and operated in furtherance of a purpose considered "charitable" in the generally accepted legal sense of that term. The revenue ruling goes on to state that, "The promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, such as indigent members, provided that the class is not so small that its relief is not of benefit to the community. *Restatement (Second), Trusts*, sec. 368, comment (b) and sec. 372, comments (b) and (c); *IV Scott on Trusts* (3rd ed. 1967), sec. 368 and 372. By operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, Hospital A is promoting the health of a class of persons that is broad enough to benefit the community."

Further, the hospital is operated to serve a public rather than a private interest. Control of the hospital rests with its board of trustees, which is composed of independent civic leaders. The hospital maintains an open medical staff, with privileges available to all qualified physicians, including the leasing of space in its medical building.

All of the above factors indicate that the hospital in *Situation 1* is operated to benefit the public and that no part of its income inures to the benefit of any private individual nor is any private interest being served. Accordingly, this hospital qualifies for exemption under section 501(c)(3) of the Code.

In contrast, the hospital described in *Situation 2* "has continued to operate for the benefit of its original owners who exercise control ... through the board of trustees and the medical committee. They have used their control to restrict the number of doctors admitted to the medical staff, to enter into favorable rental agreements with the hospital, and to limit emergency room care and hospital admission substantially to their own patients. These facts indicate that the hospital is operated for the benefit of its original owners, rather than for the exclusive benefit of the public." Accordingly, this hospital does not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 72-209, 1972-1 C.B. 148, holds that a nonprofit organization formed to provide low cost home health care to residents of a community served many of the same health needs as a hospital, and, therefore, it was promoting health within the meaning of the general law of charity. The organization provides nursing and other therapeutic services to patients (primarily the elderly) in their home. The patients receive the organization's services based upon a course of treatment prescribed in writing by their physicians. The organization is a "qualified home health agency" within the meaning of 42 U.S.C. sec. 1395x(o). The organization uses any excess income to cover the costs of those patients who cannot afford to pay for the organization's services and to expand its services. Held, this organization qualifies for tax exemption under section 501(c)(3) of the Code.

In Rev. Rul. 72-124, 1972-1 C.B. 145, the Service sets forth its criteria for qualification of an "old age home" under section 501(c)(3) of the Code. A home for the aged (otherwise qualified for charitable status) will qualify for exemption under section 501(c)(3) if it operates in a manner designed to satisfy the three primary needs of aged persons: the need for housing, the need for health care, and the need for financial security.

The need for housing will generally be satisfied if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons.

The need for health care will generally be satisfied if the organization either directly provides some form of health care, or in the alternative, maintains some continuing arrangement with other organizations, facilities, or health personnel, designed to maintain the physical, and, if necessary, the mental well being of its residents.

The need for financial security, i.e., the aged person's need for protection against the financial risks associated with the later years of life, will generally be satisfied if two conditions exist. First, the organization must be committed to an established policy of maintaining in residence any persons who become unable to pay their regular charges. This may be done through its own reserves, governmental assistance, support from members, outside support, or some combination thereof. Second, the organization must operate so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to ensure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization. The fact that an organization makes some part of its facilities available at rates below its customary charges for such facilities to persons of more limited means than its regular residents will constitute additional evidence that the organization is attempting to satisfy the need for financial security.

Rev. Rul. 72-124 concludes that the organization depicted relieves the distress of aged persons by providing for their primary needs of housing, health care, and financial security in conformity with the criteria specified above. Accordingly, it qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 79-18, 1979-1 C.B. 194, holds that an organization that operates an elderly housing complex qualifies for exemption under section 501(c)(3) of the Code where the organization: provides specially designed housing units within the financial reach of a significant segment of the community's elderly persons; commits itself to operating such housing at the lowest feasible cost; and maintains in residence those elderly persons who become unable to pay their monthly fees. Units in the complex were constructed with fire resistant materials and are equipped with safety features such as grab bars by bathtubs and toilets, wide entrance-exit doorways, ramps and elevators for wheelchair use, floors designed to help prevent slips and falls, and an emergency 24-hour alarm system. The complex has an employee on duty 24 hours a day to give temporary aid in emergencies, and it provides transportation for medical examinations and follow-up treatments for residents. The complex contains indoor and outdoor recreation areas. Rental charges for apartment units are set at a level that is within the financial reach of a significant segment of the community's elderly. The ruling concludes that this organization is operated exclusively for charitable purposes.

In Rev. Rul. 69-464, 1969-2 C.B. 132, a section 501(c)(3) community hospital built an adjacent office building for doctors in order to encourage members of its medical staff to maintain their private medical practices near the hospital. The building is subject to a mortgage incurred at the time of its construction. The hospital leases office space in the building to doctors to carry on their private medical practices. Only members of the hospital's active or courtesy medical staff may lease space, with active staff members given preference.

The hospital established that as a result of the above arrangement, (1) greater use is made of the hospital's diagnostic facilities and patient admissions are easier, and (2) the physical presence of the members of the medical staff on the hospital's grounds makes the services of their doctors more readily available for outpatient and inpatient emergencies, facilitates carrying out their everyday medical duties in the hospital, makes their attendance at staff meetings easier, and serves to increase their participation in the hospital's medical education and research programs.

Based on the benefits derived by the hospital and its patients from the above leases, the ruling concluded that these leases "come within the provisions of section 514(b)(3)(A)(i) of the Code and are not business leases."

In Rev. Rul. 69-463, 1969-2 C.B. 131, the facts are similar to those in Rev. Rul. 69-464, except that the exempt hospital made its lease with a hospital-based medical group, and also agreed to furnish the group with the nursing, secretarial, billing, collection, and record keeping services needed to carrying on its medical practice. In turn, the various specialists in the group are responsible for providing all diagnostic and therapeutic procedures, such as anesthesiology and radiology, to all hospital patients. The contract also requires that the group operate the hospital's emergency room on a 24-hour basis. The medical group also functions as the outpatient department of the hospital.

The hospital has established that the presence of the group practice at the hospital has had the effect of (1) reducing hospital admissions, days of stay, and surgical rates; (2) permitting more efficient use of existing facilities; (3) making more effective use of scarce

health manpower; (4) fulfilling the hospital's role as the health center of the community; (5) fixing administrative responsibility in a single group; and (6) making more effective use of hospital facilities for training purposes.

The ruling concluded that the group practice contributes importantly to the hospital's operations and is therefore substantially related to the carrying on of hospital functions. Accordingly, the leasing activity described above is not unrelated trade or business under section 513 of the Code.

Rev. Rul. 73-313, 1973-2 C.B. 174, holds that an organization formed and supported by residents of an isolated rural community to provide a medical building and facilities at reasonable rent to attract a doctor who would provide medical services to the entire community qualifies for exemption under section 501(c)(3) of the Code. For a number of years there had been no medical practitioners located in the area, and the nearest regular practicing doctors were located a considerable distance away. This situation not only created a serious health hazard in the case of emergency illnesses and accidents, but also tended to discourage adequate routine medical attention for many members of the community.

From time to time, efforts had been made to induce a doctor to establish a practice in the area, but to no avail. One of the principal reasons given by doctors for declining to set up practice in the community was the lack of an adequate building or office space for carrying on a modern medical practice. In response thereto, the organization erected a medical building suitable for use as a doctor's office. The building was funded by contributions from members of the community. The building contained office space, treatment rooms, and the basic equipment generally necessary for housing a modern medical practice. The organization then entered into an arrangement with a doctor to locate in the community. The rental agreed to was less than what would be necessary to provide a normal return on the investment in the building and other facilities, but it nevertheless was negotiated in good faith.

The understanding was that the doctor would be professionally independent and would charge for his services, but that insofar as possible he would conduct his practice so as to make his services available to the entire community. Thus, the doctor agreed to treat patients requiring emergency care and, within reasonable limits on his time, to provide services for those unable to pay.

Under the terms of the arrangement, the building will remain under the control of the organization, and the rental arrangement is subject to termination by the organization on reasonable notice. The organization is committed to review the arrangement periodically in the light of community needs and to determine, on the basis of all surrounding circumstances, whether the arrangement should be continued or modified in the light of the community needs involved. At any point at which the organization determines that adequate medical services are available to the community without the continuation of the arrangement, it is committed to the termination of the arrangement and the devotion of the property to other charitable uses in furtherance of the community's health.

Rev. Rul. 73-313 cites section 1.501(c)(3)-1(d)(2) of the regulations, which provides that an organization is not organized or operated exclusively for any exempt purpose unless it serves a public rather than a private interest.

The revenue ruling then cites Rev. Rul 69-545 to the effect that in the general law of charity, the promotion of health is a charitable purpose. "Assisting an isolated community lacking medical care to secure such care by reasonable means is a method of promoting health ... and, therefore, a charitable purpose. See *In re: Carlson's Estate*, 187 Kan. 543, 358 P. 2d 669 (1961)."

Rev. Rul. 73-313 then summarizes the fact situation set forth above and comments as follows: "Providing the physical facility in the manner described bears a close relationship to lessening of the health hazards resulting from the absence of a local practitioner in the community. The terms of the arrangement entered into to induce the doctor to locate his practice in the locality bear a reasonable relationship to promotion and protection of the health of the community. The arrangements in question were completely at arm's length, with no relationship between any person connected with the organization and operation of the organization and the medical practitioner induced to locate in the community."

Further: "In these circumstances, any personal benefit derived by the doctor (the use of the building in which to practice his profession) does not detract from the public purpose flowing from its activities and is not considered to be the type of private interest prohibited by the regulations."

Rev. Rul. 69-572, 1969-2 C.B. 119, holds that a nonprofit organization, created to construct and maintain a building for the exclusive purpose of housing and serving exempt member agencies of a community chest, qualifies for exemption under section 501(c)(3) of the Code. All the occupant agencies are tax exempt under section 501(c)(3). The organization's building was erected on city land that is the subject of a long term lease under which the organization pays only a nominal rental and is committed to use the premises for the exclusive purpose of housing and otherwise serving the community chest agencies. The rental charged member agencies is such that the organization's rental income is approximately equal to its total annual operating costs without any allowance for depreciation. This means that the rental rate is substantially less than commercial rates for comparable facilities.

In concluding that the above organization qualifies for exemption under section 501(c)(3) of the Code, Rev. Rul. 69-572 reasons as follows:

The performance of a particular activity that is not inherently charitable may nonetheless further a charitable purpose. The overall result in any given case is dependent on why and how that activity is actually being conducted. See Rev. Rul. 67-4, C.B. 1967-1, 121. Because of the close connection between this organization and the charitable functions of the tenant-organizations, the rental of the organization's facilities at rates substantially below their fair rental value, and the operation by

the organization with the intention of realizing an amount sufficient only to meet annual operating costs, the organization is committed to carrying out the charitable endeavors of the community chest and its member agencies. ...

This Revenue Ruling is distinguishable from Revenue Ruling 58-547, C.B. 1958-2, 275, which holds that a lease, the parties to which are both exempt under section 501(c)(3) of the Code, and which otherwise constitutes a business lease within the meaning of section 514 of the Code, will not be considered as substantially related to the charitable purpose of the lessor solely because the lessee is likewise an exempt organization. By contrast, the instant organization leases space in a non-commercial manner at substantially below the "going rate", and there is a close relationship between its purposes and functions and those of the tenant organizations.

Concerning the unrelated business income tax issue presented:

Section 511 of the Code imposes a normal tax and surtax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c) of the Code.

Section 512 provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 513(a) provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

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 activities has causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513, only if the causal relationship is a substantial one. For this relationship to exist, the production or the performance of the service from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Whether the activities productive of gross income contribute importantly to such purposes depends in each case upon the facts and circumstances involved.

Section 514(a) of the Code defines the term "unrelated business taxable income" to include a percentage of the net income derived from "debt-financed property." This percentage, in general, has as its numerator and denominator the average "acquisition indebtedness" and the average adjusted basis, respectively, for the year with respect to the debt-financed property.

Section 514(b)(1)(A) of the Code defines the term "debt-financed property" to mean property that is held to produce income and with respect to which there is an "acquisition indebtedness", except that such term does not include any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other exempt purposes.

Section 514(b)(2) of the Code provides that, for the purposes of applying section 514(b)(1)(A), the use of any property by an exempt organization which is related to an organization shall be treated as use by such organization.

Section 514(c)(1)(A) of the Code defines the term "acquisition indebtedness" to mean, with respect to any debt-financed property, the unpaid amount of the indebtedness incurred by the organization in acquiring or improving such property.

Section 1.514(b)-1(b)(1)(ii) of the regulations provides that property is substantially related to the exercise or performance of an organization's charitable, educational, or other exempt purposes if 85 percent or more of such property is devoted to the organization's exempt purposes.

Concerning the foundation classification issue presented:

An organization is other than a private foundation under section 509(a)(1) of the Code if it comes within the definition of one of the organizations described in sections 170(b)(1)(A)(i) through (vi). Section 170(b)(1)(A)(iii) identifies hospitals. Section 1.170A-9(c)(1) of the regulations states that an organization, all the accommodations of which qualify as being a "skilled nursing facility" within the meaning of 42 U.S.C. 1395x(j), may qualify as a "hospital" if its principal purpose is the provision of medical care.

An organization is other than a private foundation pursuant to section 509(a)(2) of the Code if it "normally" receives at least one-third of its support from a combination of gifts, grants, contributions from the general public, and gross receipts from the performance of activities in furtherance of its exempt purposes, and "normally" receives no more than one-third of its support from gross investment income and unrelated business taxable income.

Section 1.509(a)-3(b) of the regulations provides that, in computing the amount of support which an organization receives from gross receipts for purposes of the one-third support test, gross receipts from related activities received from any person, or from any bureau or similar agency of a governmental unit, are includible in any taxable year only to the extent that such receipts do not exceed the greater of \$5,000 or one percent of the organization's support in such taxable year.

Section 1.509(a)-3(m) of the regulations provides that, for purposes of Code section 509(a)(2), where a section 501(c)(3) organization accomplishes its charitable purposes through the furnishing of facilities for a rental fee or loans to a particular class of persons, such as aged, sick, or needy persons, then the support received from such persons will be considered gross receipts from an activity that is not an unrelated trade or business rather than gross investment income.

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

Section 1.509(a)-4(c)(1) of the regulations provides that an organization is organized exclusively for one or more of the purposes specified in Code section 509(a)(3)(A) only if its articles of organization: (i) limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A); (ii) do not expressly empower the organization to engage in activities that are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph; (iii) state the specified publicly supported organizations on whose behalf such organization is to be operated; and (iv) do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii).

Section 1.509(a)-4(i)(1)(i) of the regulations provides that a supporting organization will be considered as being operated in connection with one or more publicly supported organizations only if it meets a responsiveness test and an integral part test.

Section 1.509(a)-4(i)(2) of the regulations provides that a supporting organization will be considered to meet the responsiveness test if (1) the officers, directors, or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors, or trustees of the publicly supported organizations; and (2) the officers, directors, or trustees of the publicly supported organizations have a significant voice in directing the use of the income or assets of such supporting organization.

Section 1.509(a)-4(i)(3) of the regulations provides that a supporting organization will be considered to meet the integral part test if the activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

ANALYSIS

Concerning the continued exempt status of M (Ruling Request #1):

After becoming a member of the S system, M will continue to be described in section 501(c)(3) of the Code because it will continue to be organized and operated for the promotion of health. In addition, like S, M will operate as an auxiliary corporation in close consultation and cooperation with O, Q, and R.

S, through its subsidiaries, furnishes O with the physical plant and equipment necessary to operate nursing homes in furtherance of their common charitable mission. In exchange, O provides nursing home management and certain other administrative services to S and its subsidiaries, including legal, tax, treasury, and certain executive management services. M's activities are an integral part of the nursing home and long term care activities of O, Q, and R. M provides Q with the necessary nursing home facility to expand its nursing home operations. Without M, the ability of Q to so expand may be limited because O is highly leveraged in order to meet the capital needs of its hospitals. Accordingly, after it becomes a tax exempt subsidiary of S, M will continue to be described in Code section 501(c)(3).

If, as contemplated, R uses a portion of N as an Assisted Living Center, then M will expand its exempt purposes to include services designed to meet the unique needs of the elderly. Thus, at such time, M will continue to be exempt under Code section 501(c)(3) as an organization operated exclusively for the promotion of health and care for the elderly.

The promotion of health is a broad charitable purpose that may be furthered by various activities, including the leasing of specialized health care facilities. We look to the following factors, based on the rulings cited above: (1) the relationship between the exempt purposes and activities of M and R; (2) the non-commercial aspects of the lease; and (3) a charitable, as opposed to a profit motive, for the lease.

The facts outlined above demonstrate a close relationship between the exempt purposes of M and R. Each is organized for the charitable purpose of promoting health, and each has the specific purpose of owning and operating nursing homes. Further, the ultimate parent of both entities, O, and the proposed parent of M, S, share a close and continuous relationship designed to accomplish the objective of ensuring that their facilities are operated in a manner consistent with the health ministry and mission of the P church.

The above relationship arises in part from the fact that many of the individuals who participated in the formation of S had previously participated in the governance (as Board members) of healthcare facilities operated by P. Further, the leadership of O organized S to assist O in expanding the health care ministry of P by obtaining favorable financing to acquire nursing homes and other long-term care facilities. This close relationship between the exempt purposes of M and R, and O and S, satisfies a key factor in cases that have held that leasing is a charitable activity.

M maintains that its leasing activity is conducted in a noncommercial manner, another key factor in the rulings dealing with lease situations. The leasing activity is not carried on primarily for the production of income. Instead, the permitted use of M's facility (N) by R is limited to a use that will further the charitable purposes of M. Section 3.3 of the Revised Lease will require R to operate N "as a charitable facility open to the general public in a manner consistent with the guidance offered in Revenue Ruling 69-545... Revenue Ruling 72-209... and Revenue Ruling 83-157...". In addition, R will agree in the Revised Lease to operate N in accordance with the health ministry and mission of P.

The noncommercial nature of M's leasing activity will also be demonstrated when R expands the operation of N to include an Assisted Living Facility. In such instance, additional provisions will be added to the Revised Lease that will require R to "operate the Assisted Living Center to meet the unique needs of the elderly in a manner consistent with the guidance offered in Revenue Ruling 72-124...and Revenue Ruling 79-18...". Further, R will be required to operate the ALC: (1) to meet the elderly's physical, emotional, recreational, social, and religious needs and their need for financial security; (2) at the lowest feasible cost (consistent with debt repayment and maintaining reserves to ensure continuity of service and physical expansion of the ALC); and (3) within the financial reach of a significant segment of the elderly living in the central U community. R will also be required to adopt a policy to maintain in residence any person who becomes unable to pay their regular charges.

The amount of the rental payments also demonstrates the noncommercial nature of the Revised Lease. The rental payments which M will receive will not be set to produce a market rate of rent or a profit. Instead, they will be set at an amount sufficient for M to retire the Bonds, including payments to reserves for taxes, insurance, and property replacement accounts, and to take care of necessary maintenance. R will be responsible for all repairs, taxes, and insurance in connection with N.

The noncommercial manner of the leasing activity, as indicated above, also points to a charitable, rather than a profit, motive. M will enter into the Revised Lease in order to ensure that N continues to be operated in a manner consistent with the health ministry of P. R will be required to operate the leased facilities in accordance with Rev. Ruls. 69-545 and 72-209, and, at a later date, Rev. Ruls. 72-124 and 79-18. Any other use would be a breach of the Revised Lease, and allow M to terminate the lease.

Concerning the unrelated trade or business issue presented (Ruling Request #2):

As indicated above, M's activity of leasing N to R is substantially related to its charitable purpose of promoting health in its community. Therefore, the income generated by such activity is not subject to unrelated business income tax under section 511 of the Code.

Similarly, when M expands its exempt purposes to include meeting the unique needs of the elderly, income generated by the ALC will be substantially related to its exempt purposes. Accordingly, such income will not be subject to the tax imposed under Code section 511.

Concerning the foundation classification issue presented (Ruling Request #3):

Once the Revised Lease is in effect, M will be operated in connection with Q, which is classified by the Service as a public charity under section 509(a)(2) of the Code. Prior to the commencement of the Revised Lease, M will amend its Articles of Incorporation to expand its stated purposes to include operating to further the exempt purposes of Q. Therefore, upon commencement of the Revised Lease, M will satisfy the organizational requirements of section 509(a)(3).

Section 5.1 of the Revised Lease will require one member of Q's Board of Directors to be a member of M's Board. As is already the case, the officers and directors of M will maintain a close and continuing working relationship with the officers and directors of Q. This is similar to the close and continuous working relationship maintained by O and S. These relationships, along with the other terms of the Revised Lease, ensure that the officers and directors of Q will have a significant voice in directing the use of N, which represents substantially all of the assets of M. Thus, M will satisfy the responsiveness test of section 1.509(a)-4(i)(1)(i) of the regulations.

By leasing N to R, M is engaged in an activity that carries out the purposes of Q and R, and, but for the involvement of M, would normally be engaged in by Q and R themselves. Thus, M satisfies the integral part test of section 1.509(a)-4(i)(3) of the regulations.

M 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 sections 509(a)(1) or (2) of the Code.

The foregoing discussion clearly indicates that M will meet the organizational and operational tests for qualification as a supporting organization described in section 509(a)(3) of the Code.

RULINGS

Based on M's representations, and the applicable law, we are able to rule as follows:

1. M's proposed activity of leasing N to R pursuant to the Revised Lease will be substantially related to M's exempt purpose and, accordingly, will not adversely affect M's tax exempt status under section 501(c)(3) of the Code.
2. Amounts received by M under the Revised Lease will not be treated as unrelated business taxable income under section 512 of the Code and, accordingly, will not be subject to the tax imposed under section 511.
3. Once the Revised Lease is in effect, M will qualify as other than a private foundation as a supporting organization described in section 509(a)(3) of the Code.

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Any changes that may have a bearing upon M's exempt status should be reported to the Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, the telephone number there

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to your authorized representative.

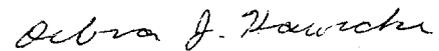
We are also sending a copy of this ruling to the . Because this letter could help resolve any questions about M's exempt status, it should be kept with M's permanent records.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

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

Thank you for your cooperation.

Sincerely,



Debra J. Kawecki
Acting Manager, Exempt
Organizations Technical Group 4