



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR Assistant District Counsel, Delaware-Maryland

FROM: Technical Assistant (Health Care and E.O.) CC:EBEO

SUBJECT:

This Field Service Advice responds to your memorandum dated December 1, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Taxpayer =

Facility =

- ISSUES:
1. Does the operation of the Facility result in income from an unrelated trade or business?
 2. Do the cash sales from certain retail stores operated by the taxpayer result in income from an unrelated trade or business?
 3. Do certain laboratory fees result in income from an unrelated trade or business?

Issue 1:

The Taxpayer is an exempt from tax as an educational and scientific organization described in section 501(c)(3). The Facility is a component of the Taxpayer's medical center, a division of Taxpayer that carries out medical education, medical research and patient care services. The Facility runs a weight

TL-N-4104-99

management program. The Facility is located not far from the Taxpayer's campus. Participants in the program typically stay for to weeks. Its facilities are not open to the general public or to employees.

In addition to nutrition, fitness, and behavioral management classes, the participants receive a medical evaluation by a physician. Activities carried on at the Facility not only involve the direct care of program participants, but also involve continuous medical research, writing, public education, and teaching of other health professionals about obesity and nutrition. According to the information provided, data generated by the Facility has provided significant findings for research, and data has produced nutritional studies. Facility researchers have had a number of articles published in medical journals detailing the medical studies conducted on Facility participants. The Facility has published books addressing obesity and Facility medical personnel have developed guidelines and recommendations for the care of obesity. The Facility has also developed cookbooks and food diaries that are distributed without charge to promote good nutrition. A continuing study of patient outcomes began several years ago and continued through the years at issue into the present. The study measure patients over a five year period following treatment at the Facility.

Additionally, the Facility provides training and education for a variety of health care professionals. Students in Physician Assistant and Psychology programs train at the Facility and spend month or to months, respectively in training. During the years at issue, the Facility trained psychology interns per year. to graduate students in nutrition also train at the center each year and spend three to twelve weeks training. Fitness interns who are also graduate students also train at the Facility and spend to months in training. The Facility's Director and other staff also train medical residents enrolled at the Taxpayer's medical school in the treatment of obesity. Medical residents also receive training in nutrition from the Facility's nutrition staff.

The Taxpayer is exempt from federal income tax as an educational organization. The definition of "educational" includes "instruction or training of the individual for the purpose of improving or developing his capabilities" and "instruction of the public on subjects useful to the individual and beneficial to the community." See Treas. Reg. § 1.501(c)(3)-1(d)(3)(i). The conduct and publication of study and research falls within the definition of educational.

From the information provided, it appears that the activities of the Facility are educational. The Facility provides instruction to students in multiple disciplines. Also, the activities carried on at the Facility generate data that has formed the basis for published research studies. Research is scientific within the meaning of section 501(c)(3) if it carried on in furtherance of a scientific purpose and in the public interest. Treas. Reg. 1.501(c)(3)-1(d)(5). Scientific research is regarded as in the

TL-N-4104-99

public interest if the research it is directed toward benefitting the public and benefits the public where the research is carried on for the purpose of obtaining scientific information which is published in a treatise, thesis, trade publication, or in any other form available to the interested public. Treas. Reg. §1.501(c)(3)-1(d)(5)(iii)(c).

Even if the research generated from data gathered at the Facility was not related to the Taxpayer's exempt purposes, amounts derived from the research would be excluded from unrelated business taxable income if the research falls within sections 512(b)(7), 512(b)(8) or 512(b)(9). Under those subparagraphs income from (1) research performed for government entities, (2) research performed by a hospital for any person and (3) research that is fundamental with results available to the public is excluded from the computation of unrelated business taxable income.

We agree with your conclusion that the Facility carries on activities related to the Taxpayer's exempt purposes and therefore, income generated from by the Facility is not income from an unrelated trade or business.

Issue 2:

Taxpayer operates a number of retail stores (such as book and convenience stores) on its campus. of the stores have been determined to likely have sales to students, faculty and the general public. The Taxpayer breaks down its retail sales receipts into three categories: point sales (tracked on the Taxpayer credit card issued to students, faculty, and employees); internal recharges (sales to other university departments) and cash sales. Taxpayer did not further break down cash sales between sales to members of the university community and sales to the general public.

According to the information provided, it does not appear that Taxpayer advertised its retail store operations. Moreover, many of its store locations are not readily accessible to the general public as they are located within the confines of the campus. Taxpayer submitted a marketing study (prepared in March 1996) that shows that percent of the patrons of its retail stores are members of the university community, defined as students, faculty, employees, patients, volunteers, seminar attendees, prospective students and faculty, parents and service providers. The study indicated that percent of the sales were sales to the general public when visiting specific campus site or event.

According to information provided, the Taxpayer believes that any percentage of cash sales made to the general public would be excluded from the computation of unrelated business income because of the "convenience exception" of Section 513(a)(2).

TL-N-4104-99

Section 513(a)(2) excludes from the meaning of “unrelated trade or business” any trade or business which is carried on, in the case of an organization described in section 501(c)(3), or in the case of a college or university describe in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees.

Section 513(c) provides that an activity does not lose its identity as a trade or business merely because it is carried on within a larger complex of other endeavors which may or may not be related to the exempt purposes of the organization.

The Taxpayer’s position is that because the retail stores are operated primarily for the convenience of the Taxpayer’s students, faculty and staff none of the income from the stores is unrelated business taxable income. See Rev. Rul. 55-676, 1955-2 C.B. 266.

The Taxpayer’s reliance on Rev. Rul. 55-676 is misplaced. The Service position on the application of section 513(a)(2) to sales to the general public is stated in Rev. Rul. 68-374, 1968-2 C.B. 242. In Situation 1 of Rev. Rul. 68-374, a hospital exempt from tax maintains a facility on its premises for the sale of pharmaceutical supplies. In addition to prescription drugs, the pharmacy also sells nonprescription drugs and a few personal articles. The primary source of the pharmacy’s income is sales to patients of the hospital. The pharmacy is open to the general public and a small percentage of its income is from sales to persons who are not patients of the hospital.

The ruling concludes that the buyer-seller relationship between members of the general public and the pharmacy does not create a hospital-patient relationship. Therefore, sales to those persons cannot be considered primarily for the convenience to the patients of the hospital within the meaning of section 513(a)(2).

The same analysis applies in the case of the Taxpayer’s retail sales to members of the general public. The buyer-seller relationship between the Taxpayer and the general public does not create one of the relationships specified in section 513(a)(2). Accordingly, section 513(a)(2) does not operate to except the Taxpayer’s sales to the general public from the definition of unrelated trade or business.

We agree with your conclusion that revenues from retail sales to the general public are included in the calculation of unrelated business taxable income. We also agree with your conclusion that not all cash sales can be assumed to have been to the general public. In this case, it appears that the Taxpayer has admitted, through the data in the marketing survey, that a portion of the retail stores’ cash sales were made to members of the general public.

Issue 3:

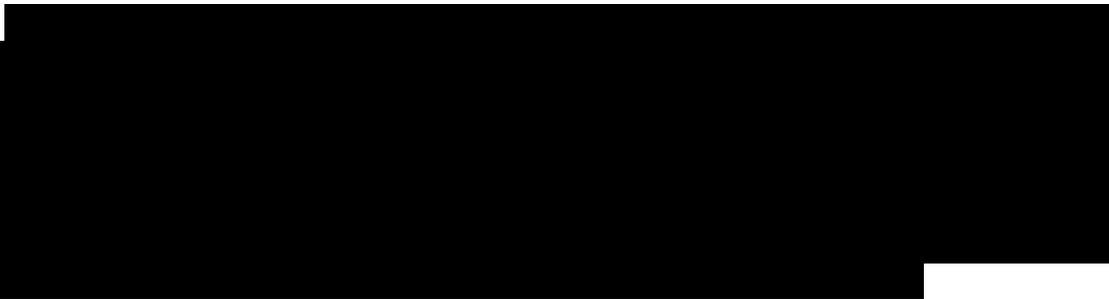
The Taxpayer's Medical Center operates laboratories throughout its hospital complex. The examining agent determined that some of the laboratory fees that the Taxpayer received were from outside entities requesting lab services.

The Taxpayer argues that the laboratory fees at issue are related because the diagnostic services performed to which the fees relate are unique or rare and are not otherwise available to individuals in the community or region. Taxpayer asserts that in at least _____ instance, the laboratory procedures in question are performed _____ at its medical center. The other argument made by the Taxpayer is that the laboratory testing was for research and educational purposes. There was no information in the underlying file that described the particular lab tests for purposes of assessing uniqueness or unavailability of the tests within the community or region.

Diagnostic laboratory testing, otherwise available in the community, performed on nonpatient specimens is an unrelated trade or business within the meaning of section 513. See Rev. Rul. 85-110, 1985-2 C.B. 166. However, unique circumstances may exist where such services may further exempt purposes, such as emergency testing for drug overdoses or poisoning cases. Also, if other laboratories are not available within a reasonable distance from the are served by the hospital or are clearly unable or inadequate to conduct tests needed by nonpatients, a hospital's testing services may further its exempt function promoting community health. Id.

A teaching hospital that conducts nonpatient laboratory testing on specimens needed for the conduct of its teaching activity is not engaged in an unrelated trade or business where the outside testing contributes importantly and substantially to the hospital's teaching program. See Rev. Rul. 85-109, 1985-2 C.B.165, See also St. Luke's Hospital of Kansas City v. United States, 494 F.Supp. 85 (W.D. Mo. 1980).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Issue 3: 

TL-N-4104-99



Please call (202) 622-6080 if you have any further questions.

By: _____
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EO)