

Internal Revenue Service

District Director

Department of the Treasury  
P.O. Box A-3290, DPN 22-3  
Chicago, Illinois 60690

Date:

Key District: [REDACTED]

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]



CERTIFIED

Dear Applicant:

This is a final adverse determination letter indicating that your organization does not meet the requirements of section 501(c)(3) of the Internal Revenue Code for tax years beginning after [REDACTED]. The adverse determination is being made according to the enclosed technical advice received from the National Office of the Internal Revenue Service sent to the Chicago Key District office on August 22, 1994.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Form 1041 for [REDACTED] years as stated in the thirty day letter mailed on January 13, 1993. You should file the return with your key District Director, EP/EO Division, within thirty days from the date of this letter unless a request for an extension of time is granted. Processing of income tax returns and assessments of any taxes due will not be delayed because you have filed a petition of declaratory judgment under section 7428 of the Code. You should file returns for later tax years with the appropriate service center shown in the instructions for those returns.

If you decide to contest this determination under the declaratory judgment provisions of section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the District Court of the United States for the District of Columbia must be filed within ninety days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment.

We will notify the appropriate State officials of this action, as required by section 6104(c) of the Code.

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

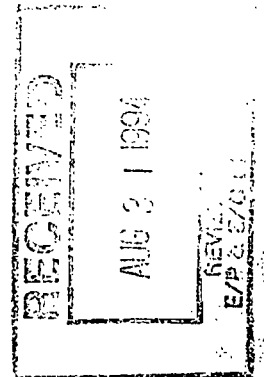
Sincerely yours,  
*Marilyn W. Day*

Marilyn W. Day  
District Director

[REDACTED]  
12-21-94

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

District Director  
Chicago District



Taxpayer's Name: [REDACTED]

Taxpayer's Address: [REDACTED]

Taxpayer's Identification Number: [REDACTED]

Years Involved: All

Date of Conference: March 4, 1994

Issue:

Whether a trust, which was created solely to provide supplemental retirement benefits to a named employee of an organization exempt under section 501(c)(3) of the Internal Revenue Code, qualifies for exemption under section 501(c)(3)?

Facts:

[REDACTED]  
[REDACTED] was formed under a Trust Agreement on [REDACTED] between [REDACTED], the Trustee, and [REDACTED] an organization which had been recognized as exempt from federal income tax under section 501(c)(3) of the Code. [REDACTED] has the right to remove the trustee and appoint a successor trustee.

Subsequent to the date of [REDACTED]'s exemption application, [REDACTED] and its primary subsidiary, [REDACTED] merged into another health care system effective [REDACTED]. The new entity resulting from the merger is [REDACTED]. The term "[REDACTED]" will be used in this memo to refer to both [REDACTED] before the merger and [REDACTED] after the merger.

[REDACTED] is exempt from federal income tax under section 501(c)(3) of the Code. It serves as the parent corporation of a multi-corporate health care system. [REDACTED] owns and operates [REDACTED] hospitals and [REDACTED] nursing homes. [REDACTED] additional hospitals have affiliation arrangements with [REDACTED]. [REDACTED] provides certain financial planning, marketing, human resources and administrative services to the affiliates. [REDACTED] and [REDACTED]

its affiliated hospitals have [REDACTED] licensed beds. [REDACTED] also owns and operates [REDACTED] separately incorporated physician clinics, and manages [REDACTED] additional clinics. [REDACTED] and its subsidiaries also own and operate over [REDACTED] diversified health care businesses. [REDACTED]'s projected operating revenue for [REDACTED] is \$[REDACTED]. Entities which now make up the [REDACTED] system had assets of approximately \$[REDACTED] for the year ending [REDACTED].

[REDACTED] was created for the purpose of giving [REDACTED] a funding vehicle to provide supplementary retirement benefits for [REDACTED] under the [REDACTED] Arrangement. He also participates in a qualified pension plan described in section 401(a) of the Code. It is a defined benefit plan under section 401(a) and the benefit is calculated based on the employee's final pay, social security payments, and length of service. The tax rules applicable to such trusts prevent the distribution of the full formula amount to persons compensated at [REDACTED]'s level. Accordingly, [REDACTED] agreed to provide a benefit to [REDACTED] under a non-qualified retirement program, the principal purpose of which is to provide a benefit which, when added to the benefit under the 401(a) qualified plan, is equal to the full formula amount.

[REDACTED] participates in another plan called the [REDACTED] (the "Deferred Compensation Supplement Arrangement"). The Deferred Compensation Supplement Arrangement is a defined contribution type of benefits plan which requires [REDACTED] to contribute \$[REDACTED] each year until [REDACTED] ceases employment with [REDACTED]. The Deferred Compensation Supplement Arrangement and Trust (the "Deferred Compensation Supplement Trust") was created simultaneously with the Full Formula Trust for the purpose of giving [REDACTED] a funding vehicle to provide these additional retirement benefits for [REDACTED]. The Deferred Compensation Supplement Trust has also filed an application for recognition of exemption under section 501(c)(3) of the Code and has yet to receive a ruling on its application.

[REDACTED], age [REDACTED], is currently the Chief Executive Officer of [REDACTED]. Until [REDACTED], [REDACTED] was President of [REDACTED] and Chief Executive Officer of [REDACTED]. As Chief Executive Officer of [REDACTED], [REDACTED] is responsible for overseeing the operation of the [REDACTED] system and its [REDACTED] employees. [REDACTED], an experienced hospital administrator, works more than 40 hours per week for [REDACTED]. He has held offices in a number of health care professional organizations and is a member of the board of directors of a

number of organizations. He is a member of the [REDACTED] person Board of Directors of [REDACTED].

On January 13, 1993, you issued an initial adverse determination in connection with the Full Formula Trust's exemption application. In a letter dated February 12, 1993, the Full Formula Trust submitted its protest to your adverse ruling. Upon review, the St. Paul Appeals Office suggested that you withdraw your adverse ruling and forward this matter for technical advice to us since a companion application, the Deferred Compensation Supplement Trust, was under consideration by this office. Your adverse determination has not been withdrawn.

Applicable Law:

Section 501(c)(3) of the Code provides exemption to organizations organized and operated exclusively for educational, charitable, or other exempt purposes.

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 such exempt purposes specified in 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(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(d)(2) of the regulations provides the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

In Russell v. Allen, 107 U.S. 163, 167 (1982), the Supreme Court stated that charitable trusts "may, and indeed must, be for the benefit of an indefinite number of persons; for if all the beneficiaries are personally designated, the trust lacks the essential element of indefiniteness, which is one characteristic of a legal charity." See also Thomason v. Commissioner, 2 T.C. 441, (1943); Davis v. Commissioner, 55 T.C. 416, 424 (1979); Scott The Law of Trusts § 375 (4th ed. 1989).

Rev. Rul. 56-138, 1956-1 C.B. 202, held that a trust organized and operated by an employer for the primary purpose of paying pensions to its retired employees was not organized exclusively for charitable purposes to be entitled to exemption under section 501(C)(3) of the Code.

Rev. Rul. 68-422, 1968-2 C.B. 207 held that an organization created pursuant to the will of a stockholder of a company to pay pensions to all retired employees of that company did not qualify for exemption under section 501(c)(3) of the Code. The pension benefits were paid to all retired employees age 65 or over, regardless of their economic resources. Although the company did not have a pension plan, its retired employees generally received social security payments. The company did not contribute funds to the organization nor did the company have any control over its affairs. The organization in this case did not pay pensions on the basis of need. It did not show that the retired employees of the company as a class lack the necessities or comforts of life. Accordingly, the organization did not qualify for exemption from Federal income tax as a charitable organization under section 501(c)(3) of the Code.

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization formed to provide low income housing to families (but gave preference to employees of the individual who created and controlled the organization), was not described in section 501(c)(3) of the Code, because the organization served the private interests of the creator rather than the public interest.

Rev. Rul. 73-126, 1973-1 C.B. 220, held that an exempt organization's payment of reasonable pensions to retired employees at the discretion of its Board of Directors does not adversely affect its exempt status. The organization carried out its charitable program through a staff of salaried employees. It had no established retirement plan for these employees but has followed a general practice of paying pensions to retired employees at the discretion of its Board of Directors. The recipients had no enforceable rights to payment. The pensions are not gratuities but represent extra compensation for past services, are reasonable in amount as compensation for such services, and would be deductible for Federal income tax purposes if incurred in the conduct of trade or business. The payment of pensions to retired employees is an accepted method of employee compensation used by many public and private organizations. Since the payments for the pensions in this case were reasonable compensation in the light of the surrounding circumstances, they are a proper expense in the operation of the organization's charitable program and did not constitute the improper use of the

organization's charitable resources, nor do they constitute inurement of the organization's net earnings to private individuals within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 78-41, 1978-1 C.B. 148, held that a trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital, and from which the hospital directs the bank-trustee to make payments to claimants, was operated exclusively for charitable purposes and is exempt from tax under section 501(c)(3) of the Code. By serving as a repository for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust was operating as an integral part of the hospital. Of equal importance is the fact that the trust was performing a function that the hospital could do directly.

Rationale:

The Full Formula Trust's primary objective is to provide [REDACTED] with a supplemental retirement benefit in accordance with his employment agreement with [REDACTED]. The Full Formula Trust's primary activity is to hold and invest funds to provide deferred compensation benefits to a single person who is not a member of a charitable class.

While a charitable organization may pay reasonable retirement benefits to its retired employees (Rev. Rul. 73-126), and a tax-exempt hospital may create a subsidiary exempt trust to satisfy its liability insurance claims (Rev. Rul. 78-41), these rulings do not suggest, nor does any other legal authority indicate, that a trust created by a charitable organization to benefit a single employee may be exempt as a charitable trust under section 501(c)(3) of the Code. By engaging primarily in activities not in furtherance of an exempt purpose, the Full Formula Trust is not operated exclusively for one or more exempt purposes pursuant to section 1.501(c)(3)-1(c)(1) of the regulations.

Further, because the Full Formula Trust serves the benefit of a designated private individual, it fails the public interest requirement of section 1.501(c)(3)-1(d)(1)(ii) of the regulations. In this regard, the sole purpose of this trust is to provide one individual with a supplemental retirement benefit. Any benefit to the public is minor or incidental. The trust is organized for the benefit of a single beneficiary and not for a charitable class. The trust's representatives assert that the provision of retirement benefits to the chief executive officer

[REDACTED]

of its controlling hospital furthers the exempt purposes of the hospital. In our view, the relationship between the compensation of one individual and the furtherance of a hospital's exempt purposes is not a compelling one and does not overcome the fact that the primary purpose of the trust is to provide substantial retirement benefits to a private individual.

We conclude that the Full Formula Trust is operated for the substantial benefit of one individual contrary to the requirements for exemption under section 501(c)(3) of the Code. Compare Rev. Ruls. 56-138 and 68-422. Rev. Rul. 73-126 is not relevant to the disposition of this matter since the applicant trust under review has been established for one individual.

We also find that the Full Formula Trust is distinguishable from the trust described in Rev. Rul. 78-41. Whereas that trust was formed by a hospital to be operated to defray claims against the hospital or its doctors, and thus benefitting the hospital, the applicant Trust was operated to defray a specific expense for the benefit of a single person.

Conclusion:

Based on the foregoing, the Full Formula Trust which was created to provide supplemental retirement benefits to a single employee of an organization described under section 501(c)(3) of the Code does not qualify for exemption under section 501(c)(3). We concur with your adverse ruling.

Internal Revenue Service

Department of the Treasury

District  
Director

230 South Dearborn Street  
Chicago, Illinois 60604

[REDACTED] Employer Identification Number:

[REDACTED] Person to Contact:

[REDACTED] Telephone Number:

[REDACTED] Refer Reply to:

Internal Revenue Service  
[REDACTED]

**CERTIFIED**  
[REDACTED]

Date: JAN 13 1993

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986.

The information submitted discloses that you were formed under a Trust Agreement on [REDACTED].

The purposes as shown in your Trust Agreement are to establish supplemental retirement benefits for [REDACTED] and to create a funding vehicle for said benefits.

According to your application and supporting documentation the activities of your organization are to serve as the depository for funds administered as part of the supplemental retirement benefits provided to [REDACTED] an employee of [REDACTED].

The trust is funded by contributions made by [REDACTED] an exempt organization described in Section 501(c)(3) of the Internal Revenue Code.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of corporations organized and operated exclusively for religious, charitable, literary, scientific, and educational purposes; no part of the net earnings of which inures to any private shareholder or individual.

Section 1.501(c)(3)-1 of the Income Tax Regulations relates to the definition of the organization and operation of organizations described in Section 501(c)(3). It is quoted, in part, as follows:

"(a) Organizational and operational tests. (1) In order to be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt. (2) The term "exempt purpose or purposes", as used in this section, means any purpose or purposes specified in Section 501(c)(3)...."



"(c) Operational test. (1) Primary activities. 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). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. (2) Distribution of earnings. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals..."

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized and operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization seeking exemption under Section 501(c)(3) to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Revenue Ruling 56-138, 1956-1 C.B. 202 states a trust organized and operated for the primary purpose of paying pensions to retired employees is not organized exclusively for charitable purposes within the intendment of Section 501(c)(3) of the Internal Revenue Code of 1936, and therefore, is not entitled to exemption from Federal income tax.

Revenue Ruling 68-422, 1968-2, C.B. 207 states an organization created pursuant to the will of a stockholder of a company to pay pensions to all retired employees of that company does not qualify for exemption under Section 501(c)(3) of the Code.

According to Revenue Ruling 56-138, and 68-422 a nonprofit organization set up to provide retirement benefits to one person ( ) does not qualify for exemption under Section 501(c)(3) or any other section of the Internal Revenue Code.

Your organization is an ordinary pension trust and not created for exclusively charitable purposes. Your organization does not meet the operational test under Section 501(c)(3) of the Code because you are not conducting an activity that furthers an exempt purpose.

Accordingly, we have concluded that you are not entitled to recognition of exemption from Federal Income Tax under Section 501(c)(3) of the Code, since you are not organized and operated exclusively for charitable, religious, or other exempt purposes within the meaning of Section 501(c)(3).

You are required to file Federal Income Tax Returns.

Contributions made to you are not deductible by the donors as charitable contributions as defined in Section 170(c) of the Code.

If you do not agree with these conclusions, you may within 30 days from the date of this letter, file a brief of the facts, law and arguments (in duplicate) which clearly sets forth your position. In the event you desire an oral discussion of the issues, you should so indicate in your submission. A conference will be arranged in the Regional Office after we have had an

opportunity to consider the brief and it appears that the conclusions reached are still unfavorable to you. Any submission must be signed by one of your principal officers. If the matter is to be handled by a representative, the Conference and Practice Requirements regarding the filing of a power of attorney and evidence of enrollment to practice must be met. We have enclosed Publication 892, Exempt Organization Appeal Procedures for Adverse Determinations, which explains in detail your rights and procedures.

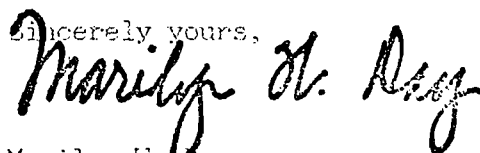
If you do not protest this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service".

Please keep this determination letter in your permanent records.

If you agree with this determination, please sign and return the enclosed Form 6018.

If we do not hear from you within 30 days from the date of this letter, this determination will become final. In accordance with Code Section 6104(c), we will notify the appropriate State officials of this action.

Sincerely yours,



Marilyn W. Day  
District Director

Enclosures:  
Publication 892  
Form 6018