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

Date: JUN 30 2000

Contact Person:

ID Number:

Telephone Number:

UIL: 511.00-00
OP: E: ED: T4

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LEGEND:

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Dear Taxpayer:

This is in response to a ruling request dated July 16, 1999, as amended by letters dated February 28, 2000, and May 19, 2000, concerning the application of section 513 of the Internal Revenue Code to proposed retail sales of durable medical equipment.

B is a public charity exempt from federal income tax under section 501(a) as an organization described in section 501(c)(3) of the Code. B's purpose is to provide family support and other programs to the disabled that fall under the umbrella of supported living. More specifically, B's purposes include:

- 1) The establishment of a coordinated program through interagency cooperation and coordination of the local agencies that offer services for the mentally retarded and for seriously handicapped persons; to promote through such community program the greatest and most efficient use of the facilities and services available in the area to be served by the corporation; to encourage the development of needed preventative, habilitative, and treatment services in such area through development, improvement, and expansion of local agencies offering or to offer the same.
- 2) Alleviation of the need for constant expansion of State institutions for the mentally retarded and for the seriously handicapped and for long term custodial care of patients in such institutions.
- 3) Provide a coordinated program of State and local services for the mentally retarded and for the seriously handicapped and to eliminate the duplication and overlap of such services.
- 4) Solicit and receive funds and property for the above purposes from any source by gift, appropriation, or otherwise, and to define and redefine its specific objectives and programs to conform to the requirements and carry out the objectives of local, State, or Federally financed programs extending aid or services for the mentally retarded and for the seriously handicapped persons within the area served by said corporation.

To qualify for B's services, a person must meet a statutory definition of developmental disabilities (which, among other criteria, includes a physician's attestation of eligible diagnosis) and attain priority on the waiting list for services based on eligibility date. Once eligibility for services is established, an annual plan for services is established by an Interdisciplinary Team, which includes the individual, his or her family members as appropriate, physicians/psychiatrists, legal guardian, and others. The end result of this annual meeting is an Individualized Plan for services, or IP. For the subsequent year, services are provided within the parameters of this plan, which may include the acquisition and training on a certain identified piece of equipment or other item of home medical equipment (HME).

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As a natural extension of these services, B's Board of Directors decided that the interests of B's clients, their families, and the community at large would be served best through the development of its own retail showroom and service facilities for products for persons with disabilities.

B intends to provide individuals with disabilities and their families with a respectful and appropriate shopping opportunity, including the acceptance of Medicaid. B intends to properly fit individuals into appropriate devices, such as wheelchairs, and properly match an individual's unique needs with the most appropriate product available. B also intends to provide timely, efficient, and cost appropriate repairs for all equipment, regardless of where purchased, recognizing the need for quality and efficiency of all such repairs.

The products and services that B intends to provide to its clients, other individuals with physical and developmental disabilities and to the public will be conducted through the construction of a 20,000 square foot retail facility in C. This building will be immediately adjacent to the main headquarters building of B, where substantial program operations occur. In addition, most of the planning for services, done annually in the form of IP occurs at this location. The retail facility will provide products and services required under the IP to B's disabled clients that are specifically fitted to their individual needs.

The new facility will include 12,000 square feet provided for store use, including approximately 5,000 square feet of showroom. Another 7,000 or so square feet will be dedicated to inventory, service and installation of wheelchair equipment, wheelchair lifts, auto and van conversions for handicapped accessibility, etc. This portion of the facility will include drive-in bay doors and other customer conveniences for persons with disabilities. The remaining 8,000 square footage of retail space will initially be leased to other businesses in the community. The two primary reasons for building the space larger than initial needs are to accommodate future growth potential and provide additional sources of revenue to compensate for the low margins required by the provision of Medicaid billing.

The ancillary space will be marketed to unrelated business concerns with compatible products or services. For example, approximately 1,500 square feet have been set aside for a bagel or sandwich shop. B anticipates that many individuals who shop at the Store will have arrived via public transportation, and as such will make a long excursion out of the experience. Accordingly, available light food service, on site, will accommodate their need for a meal during the shopping and/or repair process. The remaining leased space is planned to be occupied by a compatible business, such as a rehabilitation center, which would provide natural synergy with the "one stop" HME facility next door.

Based upon the facts set forth above, and the assumption that the transaction will be carried out as previously described, B requests the following ruling:

The sale of durable medical equipment and other home medical equipment (HME), and related installation and repair services, to individuals and families who are served by B, and the sale of which is in compliance with and contemplated within the annual Individualized Plan (IP) for services for the individual do not generate unrelated business taxable income.

LAW

Section 501(c)(3) of the Code provides for the exemption of organizations organized and operated exclusively for charitable 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) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. The term "charitable" also includes relief of the poor and distressed or the underprivileged, advancement of education, lessening of the burdens of government and the elimination of prejudice and discrimination.

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Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of 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 nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

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

Section 512 of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions which are directly connected with carrying on the trade or business, with certain modifications.

Section 513 of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt functions.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "substantially related" only if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption was granted.

Rev. Rul. 78-435, 1978-2 C.B. 181, holds that the sale of hearing aids to its patients by an exempt hospital whose primary activity is rehabilitating the handicapped, including those with hearing deficiencies, does not constitute unrelated trade or business under section 513 of the Code.

ANALYSIS

B intends to operate a retail showroom and service facility to provide durable medical equipment and other home medical equipment (HME), and related installation and repair services, to individuals and families who are served by B, and who use such equipment in conjunction with and contemplated within the annual Individualized Plan (IP). The availability of these sales and services contributes importantly to the organization's purpose of promoting family support and other programs that fall under the umbrella of supported living. This activity is similar to the sale of hearing aids discussed in Rev. Rul. 78-435. As such, sales and services to individuals and families who are served by B are substantially related to B's exempt purpose.

As a related activity, income generated from sales and services is not subject to the unrelated business income tax imposed by section 511 of the Code.

Based upon the information you have submitted, under the facts described above we rule as follows:

The sale of durable medical equipment and other home medical equipment (HME), and related installation and repair services, to individuals and families who are served by B, and the sale of which is in compliance with and contemplated within the annual Individualized Plan (IP) for services for the individual do not generate unrelated business taxable income.

We have not been asked and we express no opinion on whether income derived from any sales made by B's retail facility other than the sales to B's clients specifically described above constitute unrelated business taxable income under section 512(a)(1) of the Code.

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Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transaction described above under any other provision of the Code.

Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

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

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

Sincerely,

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

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