



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

Identification Number:

UIL Index:
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Telephone Number:

Employer Identification Number:

Legend:
Hospital =
X =
Y =
a =
z =

Dear _____ :

We have considered your ruling request regarding the consequences under section 501(c)(3) of the Internal Revenue Code ("Code") of the proposed reorganization involving you, Hospital, X, and Y.

FACTS

You are a nonprofit membership corporation that is exempt from federal income tax under section 501(c)(3) of the Code and classified as a supporting organization under section 509(a)(3). Your members broadly represent the interests of the communities you serve. Your members elect your Board of Directors, a majority of whom represent a broad spectrum of the interests of the community. You are the sole member of Hospital and of X, and you are the sole shareholder of Y.

Hospital is a nonprofit membership corporation that operates a community hospital and has been certified as a critical access hospital. It is exempt from federal income tax under section 501(c)(3) of the Code and classified as a hospital under sections 509(a)(1) and 170(b)(1)(A)(iii). You elect Hospital's Board of Directors. Hospital's activities include, among others, operating a number of primary care medical practices in a and the surrounding communities.

X is a nonprofit membership corporation that holds title to some of the property you use and collects income from the property. X is exempt from federal income tax under section 501(c)(2) of the Code. You elect X's Board of Directors.

Y is a for-profit corporation. You elect Y's Board of Directors. Y engages primarily in providing support services to Hospital and to independent physician practices in the service area. Y has a contract with Hospital to provide billing services, and has contracts with three unrelated healthcare providers to provide billing and collections services. Y also employs and manages some nurses and nurse practitioners who support Hospital. Y provides its services on an arm's-length basis, and its charges to all its clients, including Hospital, are at market value.

For the purpose of simplifying your organizational and governance structure, and to enable you to be eligible to become a Federally Qualified Health Center ("FQHC"), as defined by the Medicare and Medicaid statutes, you, Hospital, X and Y propose to undergo a reorganization by taking the following steps (collectively, the "Proposed Reorganization"):

- (1) Hospital will transfer nine of its primary care medical practices to you. After the Proposed Reorganization, you will operate the medical practices as an FQHC in a and the surrounding communities, serving almost z patients.
- (2) X will merge into you in a statutory merger, as a result of which you will succeed to all the rights, privileges, immunities and powers of X.
- (3) Y will be liquidated and dissolved, and you will absorb all of its assets and liabilities, including its three service contracts to the extent that they are not terminated prior to the dissolution. The revenue from the three contracts will represent a de minimus portion of your total patient service revenue.

Therefore, after the Proposed Reorganization, Hospital will be your only subsidiary organization.

After the Proposed Reorganization, you will adopt a charity care policy under which your medical practices will provide healthcare services to all regardless of their ability to pay, and you will notify the community about the availability of this policy.

In conjunction with the Proposed Reorganization, you will amend and restate your Articles of Association and Bylaws to reflect your additional activities and purposes and to provide that you will no longer have any members. In addition, you will amend your Bylaws to provide that: (i) your Board of Directors will consist of persons who are residents of your service area or maintain places of business there; (ii) a majority of your Directors will be individuals who are active users of your healthcare services and who, as a group, represent the individuals being served in terms of demographic factors, race, ethnicity, and sex; (iii) no more than half of the remaining Directors may be individuals who derive more than 10 percent of their income from

the healthcare industry; and (iv) except for ex-officio members, no employee of yours will serve as a Director. Your Bylaws will include a conflicts of interest policy.

RULING REQUESTED

The Proposed Reorganization and the proposed amendments to your Articles of Association and Bylaws will not adversely affect your tax-exempt status under section 501(c)(3) of the Code.

STATEMENT OF LAW

Section 501(a) of the Code exempts from taxation organizations described in section 501(c)(3), which describes organizations organized and operated exclusively for charitable and educational purposes.

Section 501(c)(3) of the Code describes organizations organized and operated exclusively for various exempt purposes, including charitable, scientific, or educational 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(a)(1) of the Income Tax Regulations ("regulations") states that to be described in section 501(c)(3) of the Code an organization must be both organized and operated exclusively for purposes specified in the regulations. If an organization fails to meet either test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities that are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations states that an organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code. 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)(i) of the regulations states that an organization may be exempt as an organization described in section 501(c)(3) of the Code if it is organized and operated exclusively for one or more of exempt purposes, which include charitable and scientific.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" as used in section 501(c)(3) of the Code includes its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts §§ 368, 372 (1969); 4A Austin W. Scott and William F. Fratcher, The Law of Trusts §§ 368, 372 (4th ed. 1989).

Rev. Rul. 69-545, 1969-2 C.B. 117, holds that a non-profit hospital that benefits a broad cross section of its community by having an open medical staff and a board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare) may qualify as an organization described in section 501(c)(3) of the Code.

ANALYSIS

After the Proposed Reorganization, you will operate the nine primary care medical practices, which Hospital transferred to you, as an FQHC in a and the surrounding communities, serving almost z patients. You will also perform the title-holding activities previously performed by X, and you will carry on the billing and collection activities previously carried on by Y. The revenue from the billing and collection activities will represent a de minimus portion of your total patient service revenue. You will amend your Articles of Association so that at all times your Board of Directors will be community controlled. In addition, you have adopted a charity care policy about which you will notify the community.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See *Restatement (Second) of Trusts*, §§ 368, 372 (1959); 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* §§ 368, 372 (4th ed. 1989).

An organization that provides medical services to individuals, such as a hospital providing inpatient, outpatient and/or emergency medical services may qualify for recognition as an organization described in section 501(c)(3) of the Code, on the basis that it promotes health in a manner that is charitable within the meaning of section 501(c)(3). See Rev. Rul. 69-545, *supra*. Therefore, after the Proposed Reorganization, considering all the facts and circumstances, your activities will promote health in a manner that is charitable within the meaning of section 501(c)(3).

RULING

The Proposed Reorganization and the proposed amendments to your Articles of Association and Bylaws will not adversely affect your tax-exempt status under section 501(c)(3) of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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 by others as precedent.

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

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

Sincerely,

Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437