



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:
Telephone Number:
Employer Identification Number:

Legend:

A =
B =
X =
Y =
Year =

Dear

This is in response to a letter from your authorized representative dated May 5, 2009, as supplemented by additional correspondence, requesting rulings on your behalf regarding the federal tax consequences associated with the transactions described below.

Facts:

You are exempt from federal income tax under section 501(a) of the Internal Revenue Code (the "Code") as an organization described in section 501(c)(3). For foundation classification purposes, you are classified as a hospital under sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code. You serve as a major center for general and specialty medical care, patient rehabilitation services, and community wellness activities. You have determined that adding a patient rehabilitation and fitness center to your A campus would be consistent with your healthcare mission and would serve the local community as a valuable resource to further promote health and prevent diseases.

In Year, you built B, an integrated medical fitness facility designed to meet the needs of users of various ages and physical abilities. B is operated as one of your divisions and is not a separate legal entity. B includes 69,000 square feet of cardiovascular and strength training areas, indoor multi-purpose gymnasium, walking track, 3 swimming pools (one used exclusively for aquatic therapy and arthritis rehabilitation), sauna, steam rooms, 4 group exercise studios, a youth fitness area, and a healing garden. B includes numerous accommodations for people with disabilities that are generally not included in commercial fitness centers. For example, B's pools

are equipped with access lanes for wheel chairs, and all of its locker rooms have been specifically built to accommodate the handicapped.

B derives revenue from the following four general categories of members:

- A. Patients receiving rehabilitation and physical therapy services;
- B. Community members receiving instruction in various subjects involving health and fitness;
- C. Your employees using the fitness center for exercise and health promotion; and
- D. Community members using the fitness center for exercise and health promotion.

A. Rehabilitation and Physical Therapy Services

B offers physical therapy, cardiac rehabilitation, pulmonary rehabilitation, and sports medicine programs. Patients enroll in the appropriate rehabilitation program pursuant to a physician's referral. Patients generally engage in rehabilitation and exercise activities at B's facility under the direction of physicians and supervision by qualified staff. B is specifically designed to accommodate patients with various physical and mental disabilities. The facility is equipped with cardiopulmonary resuscitation machines, and members of B's staff are well trained in first aid and cardiac resuscitation techniques.

B derives revenue from fees paid by patients enrolled in the rehabilitation and physical therapy programs. All patients referred to B for rehabilitation receive a discounted membership rate. Many of these patients do not have to pay out of pocket fees because the rehabilitation and therapy services are covered by their medical insurance. Additionally, B offers charity care to those who are uninsured and unable to afford the rehabilitation services.

B also offers a fitness program especially designed for children with physical and mental disabilities, and tailored to each child's age and level of physical disability. This program is open to the public at large; parents do not have to be members of B to enroll their children in program activities. Many of the children enrolled in this program receive Supplemental Security Income assistance, which also pays for rehabilitation services such as those offered by B. In addition, persons unable to pay are offered scholarship assistance.

B. Health and Wellness Education

B offers numerous educational activities related to health and wellness. Its comprehensive wellness education program includes adult and youth swimming lessons, weight management, stress reduction, nutrition classes, aquatic classes for individuals with arthritis and fibromyalgia, and children's dance classes. All of the classes held are open to the public. It is not necessary to join the facility as a member in order to participate in a class. Most classes are offered for a nominal fee and some are free of charge.

C. Use by Employees

You state that your employees exercise at B and attend many of the classes offered there. Employees are offered discounted rates to join B. Since B is located on the same campus as the main hospital facilities, B offers a convenient fitness location to your employees.

D. Use by the General Public

You state that B is operated to provide a broad range of family activities and to serve the community as a whole. For example, B offers specialty programs designed for senior citizens, mothers, and children, as well as for individuals with physical or mental disabilities. To encourage the entire family to use B facilities, you offer discounted membership rates for couples and families. In addition, B provides its facilities free of charge to a number of local charitable organizations. B's members are entitled to use all of the fitness center facilities. There are no separate classes of membership that restrict use of any B areas only to certain classes of members.

B is located in A. In 2003, the median family income in A was \$x and the median home price was \$y. You state that, despite the decrease in housing prices due to the recent recession, it is unlikely that the current median family income in A has decreased significantly since 2003. You maintain that the community's employer base remains strong, and that A continues to be a predominantly upper-middle class, professional community. You state that the fees charged by B are deliberately set at a level that is affordable to a significant portion of the local community, and at amounts that are lower than the fees charged by other comparable facilities in the area. You represent that independently obtained statistical data shows that B's membership is representative of the surrounding community, and that independent research confirms that B's membership rates are affordable to a large portion of the local community. You employed an independent consultant to conduct a telephone survey of a large number of consumers in the community surrounding B. A majority of the consumers surveyed described B's fees as affordable. Although the survey took place in Year, you state that B's membership rates have not increased significantly since then, and you have no reason to believe that median family income levels in the surrounding community have decreased since Year.

In order to make the use of B available to members who are experiencing temporary financial distress, you instituted a financial freeze policy, which allows members who are temporarily unemployed or experiencing other financial difficulties to continue using B without having to pay monthly fees due. You also offer sliding scale membership rates and scholarship assistance to community members who may not be able to afford the full membership rate.

Rulings Requested:

You have requested the following rulings:

1. The operation of the B medical rehabilitation and fitness center in the manner described above is substantially related to your exempt purpose.
2. The operation of the B medical rehabilitation and fitness center in the manner described above is not an unrelated trade or business under section 513 of the Code.
3. The income derived from the operation of the B medical rehabilitation and fitness center in the manner described above is not subject to unrelated business income tax imposed by section 511 of the Code.

Law:

Section 501(a) of the Code provides for the exemption from federal income tax of organizations described in section 501(c). Section 501(c)(3) describes organizations that are organized and operated exclusively for charitable, educational, or other specified exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c) of the income tax regulations (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 that accomplish one or more of the 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)(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.

Rev. Rul. 69-545, 1969-2 C.B. 117, acknowledges that the promotion of health is a charitable purpose under the general law of charity, and that promotion of the health of the general community constitutes a sufficient basis for tax-exempt status within the meaning of section 501(c)(3).

Section 1.501(c)(3)-1(d)(3) of the regulations provides that, for purposes of section 501(c)(3) of the Code, the term "educational" relates to the instruction or training of an individual for the purposes of improving or developing that individual's capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. Organizations whose activities consist of presenting seminars, lectures, or other similar programs may be educational.

Rev. Rul. 77-365, 1977-2 C.B. 192, concerns an organization that is organized and operated to instruct and educate individuals of all ages and skill levels in a particular sport. It conducts clinics, workshops, lessons, and seminars at municipal parks and recreation areas. The organization's instruction program is open to anyone in the community for a nominal fee. The ruling concludes that, by instructing individuals of all ages in a given sport in the manner described, the organization is instructing or training individuals for the purpose of improving or

developing their capacities within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

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

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions allowed by Chapter 1 which are directly connected with the carrying on of the trade or business, with certain modifications.

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

Section 513(a)(2) of the Code provides, in pertinent part, that the term "unrelated trade or business" does not include any trade or business which is carried on in the case of an organization described in section 501(c)(3) by the organization primarily for the convenience of its employees.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from "unrelated trade or business," within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question – the activities, that is, of producing or distributing the goods or performing the services involved – and the accomplishment of the organization's exempt purposes.

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 casual relationship to the achievement of exempt purposes; and it is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business.

In Isabel Peters v. Comm'r, 21 T.C. 55 (1953), nonacq., 1955-1 C.B. 8, withdrawn and acq. substituted therefore, 1959-2 C.B. 6, the Tax Court held that an organization operating a public beach, playground and bathing facility without charge was charitable within the meaning of section 501(c)(3) of the Code. In so holding, the court emphasized that the facilities were

available to all members of the community.

Rev. Rul. 67-325, 1967-2 C.B. 113, concerns an organization that provides community recreational facilities without charge to the residents of the community. The ruling states that community recreational facilities may be classified as charitable if they are provided for the use of the general public of the community. In this case, however, the organization did not qualify for exemption under section 501(c)(3) because admission to its facilities was restricted on the basis of race.

Rev. Rul. 79-360, 1979-2 C.B. 236, concerns an organization exempt as a charitable organization under section 501(c)(3) of the Code. The organization operates a recreational and fitness facility and a separate health club under a two-tiered membership structure that makes recreational facilities available to the general public at one rate and health club facilities available at a higher rate. The ruling concludes that the operation of the health club facilities does not contribute importantly to the accomplishment of the organization's exempt purposes because the annual dues charged to health club members are comparable to fees charged by similar local commercial health clubs, and are sufficiently high to restrict the health club's use to a limited number of the members of the community.

Analysis:

B offers physical therapy, cardiac rehabilitation, pulmonary rehabilitation, and sports medicine programs to patients of your hospital on referral by a physician. These programs are conducted under the direction of physicians and the supervision of qualified staff. Such activities, and the fitness program for disabled children, serve to alleviate the distress of the sick and incapacitated and, therefore further charitable purposes through the promotion of health. See, Rev. Rul. 69-545, above. Since such activities accomplish one or more of your exempt purposes within the meaning of section 1.501(c)(3)-1(c) of the regulations and contribute importantly to the accomplishment of those purposes within the meaning of section 1.513-1(d)(2), engaging in such activities through B is consistent with your status as an organization described in section 501(c)(3), and income derived from such activities would not be considered income derived from an unrelated trade or business for purposes of section 512(a)(1) of the Code.

B offers a variety of health and wellness educational programs (such as swimming lessons, weight management, stress reduction and nutrition classes, and aquatics classes for individuals suffering from arthritis and fibromyalgia) to the public for a nominal fee or free of charge. In so doing, B is operated to provide instruction or training to individuals for the purpose of improving or developing their capacities in a manner similar to that of the organization described in Rev. Rul. 77-365, above. Since B's health and wellness educational programs meet the definition of "educational" under section 1.501(c)(3)-1(d)(3) of the regulations, they accomplish one or more of your exempt purposes within the meaning of section 1.501(c)(3)-1(c) of the regulations and contribute importantly to the accomplishment of those purposes within the meaning of section 1.513-1(d)(2). Consequently, engaging in such programs and activities through B is consistent with your status as an organization described in section 501(c)(3), and income derived from such activities would not be considered income derived from an unrelated trade or business for

purposes of section 512(a)(1) of the Code.

B makes its facilities available for the convenience of your employees. Employees receive a discounted membership rate and B derives a modest amount of revenue from employee membership to cover costs. Allowing employees access to B is consistent with your hospital's commitment to promote health and wellness of its employees and meets the convenience exception to "unrelated trade or business" within the meaning of section 513(a)(2) of the Code.

B provides a broad range of activities for the community as a whole. Many programs are open to the public and do not require membership, though membership is required for use of the fitness center facilities. Unlike the organization described in Rev. Rul. 79-360, above, B has no separate classes of membership that restrict use of any facilities only to certain classes of members. All members are entitled to use all of the fitness center facilities.

The operation of community recreational facilities may be considered "charitable" within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations provided the facilities are available to the general community. See Isabel Peters v. Comm'r, 21 T.C. 55 (1953); Rev. Rul. 67-325, above. But where fees are sufficiently high to restrict use of the facilities to a limited number of the members of the community, the operation of such facilities does not contribute importantly to the accomplishment of exempt purposes within the meaning of section 1.513-1(d)(2) of the regulations. See Rev. Rul. 79-360, above.

You have obtained independent statistical data showing that B's membership is representative of the surrounding community, and that membership fees are affordable to a large portion of the local community. You have also employed an independent consultant to conduct a survey of a large number of consumers in the community surrounding B. The majority of those surveyed considered B's fees to be affordable. B offers sliding scale membership rates and scholarship assistance to community members who cannot afford the full membership rate. Rehabilitation patients and families are offered discounted membership rates. Since B is located on the same campus as your main hospital facilities, you allow your employees to exercise and attend classes at B, and offer them memberships in B at discounted rates. In addition, you have instituted a "financial freeze" policy that allows members who are temporarily unemployed or experiencing financial difficulties to continue using B's facilities without having to pay monthly dues.

These facts tend to establish that B's programs and facilities are available to, and affordable by, a significant segment of the general population. As such, the operation of B as a community recreational facility meets the definition of "charitable" under section 1.501(c)(3)-1(d)(2) of the regulations. Providing community recreational facilities to the general public in the manner described accomplishes one or more of your exempt purposes within the meaning of section 1.501(c)(3)-1(c) of the regulations and contributes importantly to those purposes within the meaning of section 1.513-1(d)(2). Consequently, engaging in such activities through B is consistent with your status as an organization described in section 501(c)(3), and income derived from such activities would not be considered income derived from an unrelated trade or business for purposes of section 512(a)(1) of the Code.

Conclusion:

Accordingly, based on the facts and circumstances described above, we rule as follows:

1. The operation of the B medical rehabilitation and fitness center in the manner described above is substantially related to your exempt purpose within the meaning of section 1.513-1(d) of the regulations.
2. The operation of the B medical rehabilitation and fitness center in the manner described above is not an unrelated trade or business within the meaning of section 513(a) of the Code.
3. Income derived from the operation of the B medical rehabilitation and fitness center in the manner described above is not unrelated business taxable income within the meaning of section 512(a)(1) 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.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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,

Theodore R. Lieber
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437