



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:
Identification Number:
Telephone Number:

Uniform Issue List:

501.03-11
509.00-00
511.00-00

Legend

R =
S =
H =
I =
C =
U =
V =
W =
X =
Y =
N =

Employer Identification Number:

Dear

This is in response to your request for a ruling dated November 13, 2008 which was submitted on behalf of R, T, U, V, W, X and Y. These organizations have requested a number of rulings regarding the income tax consequences of a proposed corporate reorganization described below. This letter will address the ruling requests of all the entities. Your ruling request was amended by your letters dated August 11, 2011 and August 17, 2011.

Facts:

R is recognized as exempt under section 501(c)(3) of the Internal Revenue Code and classified as an organization described in section 509(a)(1) and 170(b)(1)(A)(iii) of the Code. R operates a pediatric hospital and provides related health care services, including certain adult services such as maternity care, for the benefit of the public. R has an affiliation with S, a nationally ranked medical school with which R conducts medical education activities and facilitates medical research. S is recognized as exempt under section 501(c)(3) and classified as an organization described in section 509(a)(1) and 170(b)(1)(A)(ii).

I is recognized as exempt under section 501(c)(3) of the Code and is classified as an organization described in section 509(a)(3). R is the sole member of I and selects its governing board. I currently has no operations, but, pending the rulings requested herein, will operate as the parent corporation of R and its affiliated health care entities. I was established to carry out the purposes of R.

U is recognized as exempt under section 501(c)(3) of the Code and classified as an organization described in section 509(a)(3). R is the sole member of U and selects its governing board. U holds and invests funds on behalf of R and its affiliated health care entities.

V is recognized as exempt under section 501(c)(3) of the Code and classified as an organization described in section 509(a)(2). V operates a health maintenance organization.

W is recognized as exempt under section 501(c)(3) of the Code and classified as an organization described in section 509(a)(2). W employs pediatricians who provide medical care to pediatric patients in R's service area.

X is recognized as exempt under section 501(c)(3) of the Code and classified as an organization described in section 509(a)(2). X employs obstetricians, gynecologists and pediatric radiologists and provides services in support of pediatric specialists who are affiliated with R.

Y is recognized as exempt under section 501(c)(3) of the Code and classified as an organization described in section 509(a)(3). R is the sole member of Y and selects its governing board. Y supports the provision of physician services in connection with obstetrical and women's services offered by R.

Z is a for-profit company which provides primary and excess professional malpractice and general liability insurance coverage to R and its affiliated health care entities. All of the stock of Z is owned by R.

Together, R, I, U, V, W, X, Y, and Z operate as an integrated health care delivery system, providing a full range of pediatric and obstetrical services for the benefit of the public.

As the scope of services provided by R and its integrated health care delivery system has expanded, the governing board of R has spent an increasing amount of time on strategic planning and coordinating the various activities pursued under the umbrella of R's integrated

health care delivery system. After considering various organizational structures, the governing board of R has concluded that the most efficient organizational structure is to place I in the position of common parent of R, U, V, W, X, Y, and Z and pursue through I overall strategic planning and coordination. Under the proposed reorganization, I will act as the parent corporation of R, U, V, W, X, Y, and Z, providing overall strategic direction to assure that each is working towards a common goal in a manner that is cost effective and coordinated to provide the best possible medical care, medical education, and medical research for the benefit of the public. This will serve the additional purpose of separating U, V, W, X, Y, and Z assets and earnings from R's assets and earnings, promoting a more efficient economic model, as well as a more efficient governance model.

To effectuate the proposed reorganization, the Articles of Incorporation and bylaws of R, U, V, W, X, and Y will be amended so that I will be designated the sole corporate member of each. As sole corporate member, I will have the appointment and removal powers and reserved authority currently held by R. Finally, all stock of Z will be transferred to I and I will exercise all rights and powers in its status as sole shareholder. You provided copies of the proposed amended Articles and bylaws for R, I, U, V, W, X and Y.

As the vehicle for strategic planning and coordination, I will facilitate overall executive management, finance, legal, compliance, human resources, internal audit and other system-wide functions. The community-based governing board of R will become the governing board of I and continue to exercise overall control over R, U, V, W, X, Y, and Z. In the new organizational structure the governing board of I can concentrate on strategic planning and overall coordination of activities without the burden of operational oversight functions required to be undertaken by the governing board of an operating hospital.

With the migration of the community-based governing board of R into the role of governing board of I, the governing board of R will be restructured and reduced in size to reflect its narrower role as the governing body of an operating hospital. As reorganized, the governing board of R will operate in a manner similar to the governing boards of U, V, W, X, Y, and Z, focusing primarily on the operational issues affecting R as it pursues the delivery of quality health services, medical education and medical research. R and its affiliates believe that the proposed reorganization will allow each member of R's integrated health care delivery system to pursue its mission in the most efficient manner, while enhancing strategic planning and coordination.

After the proposed reorganization, two of the voting members of the board of directors of R will also be members of the board of directors of I. In addition, each of the four key senior executive management officers of R will serve as the four key senior executive management officers of I. These common executive management officers include each organization's chief executive officer and each organization's executive-vice presidents. I's Articles of Incorporation will be amended to state that I was formed to benefit R and its affiliated organizations that are described in section 501(c)(3) of the Code and classified as organizations described in section 509(a)(1) or (2) of the Code.

After the proposed reorganization, one of the voting members of the board of directors of R will serve on the board of directors of U. R's president and chief executive officer will serve as the president and chief executive officer of U. In addition, R's chief financial officer will serve as the

chief financial officer of U. U's Articles of Incorporation will be amended to state that U was formed to benefit R and its affiliated organizations that are described in section 501(c)(3) of the Code and classified as organizations described in section 509(a)(1) or (2) of the Code.

Rulings requested:

1. The proposed reorganization and resulting corporate structure will not result in the revocation of, or otherwise adversely affect, the continued status of R, T, U, V, W, X or Y as organizations described in section 501(c)(3) of the Code.
2. Any transfers of funds, assets, services and/or personnel in connection with the proposed reorganization will not jeopardize the continued status as an organization described in section 501(c)(3) of the Code of the organization providing such funds, assets, services and/or personnel.
3. Any transfers of funds, assets, services and/or personnel in connection with the proposed reorganization will not adversely affect the continued nonprivate foundation status of R, T, U, V, W or X under sections 509(a)(1), 509(a)(2) or 509(a)(3) of the Code, as applicable.
4. Any payments or transfers of funds, assets, services and/or personnel in connection with the proposed reorganization will not generate unrelated business taxable income under sections 511 through 514 of the Code.
5. Under the proposed reorganization, T and U will qualify as Type II supporting organizations under section 509(a)(3)(B)(ii) of the Code.

Law:

Section 501(c)(3) of the Code provides that organizations that are organized and operated exclusively for religious, charitable, scientific or educational purposes are exempt from federal income tax, so long as no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(1) of the Income Tax Regulations provides, in pertinent part, 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 charitable purposes.

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.

In the general law of charity, the promotion of health is considered to be a charitable purpose. *Restatement (Second), Trusts*, sec. 368 and sec. 372; *IV Scott on Trusts* (3rd ed. 1967), section 368 and sec. 372. A nonprofit organization whose purpose and activity are providing health care is promoting health and may, therefore, qualify as organized and operated in furtherance of a charitable purpose. If it meets the other requirement of section 501(c)(3) of the Code, it will qualify for exemption from Federal income tax under section 501(a).

Section 509(a) of the Code provides that the term "private foundation" means an organization described in section 501(c)(3) other than certain organizations described in section 509(a)(1), (2), (3) or (4).

Section 170(b)(1)(A)(iii) of the Code describes an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research.

Section 509(a)(2) of the Code describes, in pertinent part, organizations which normally receive more than one-third of their support in gross receipts from the performance of services or furnishing of facilities.

Section 509(a)(3) of the Code provides that the term "private foundation" does not include an organization that:

(A) is organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more organizations described in section 509(a)(1) or (2);

(B) is operated, supervised or controlled by, or in connection with, one or more organizations described in section 509(a)(1) or (2);

(C) is not controlled, directly or indirectly, by one or more persons who would be disqualified persons as defined in section 4946 if the organization were a private foundation, other than foundation managers as defined in section 4946(a)(1)(B) and organizations described in section 509(a)(1) and (2).

Section 509(a)(3)(B) of the Code describes three relationships, one of which must be established in order to satisfy the requirements of supporting organization status. One of those relationships, referred to as the Type II relationship is described in section 509(a)(3)(B)(ii). Section 509(a)(3)(B)(ii) requires the supporting organization to be "supervised or controlled in connection with" the supported organization.

Section 1.509(a)-4(h)(1) of the regulations provides that to qualify as a Type II supporting organization, "the control or management of the supporting organization must be vested in the same persons that control or manage the publicly supported organizations." Such persons need not necessarily be board members, but can hold other types of leadership roles. See Example (3) of section 1.509(a)-4(h)(3).

Section 1.509(a)-4(d)(2) of the regulations provides, in pertinent part, that an organization that is "supervised or controlled in connection with" a supported organization may designate the publicly supported organizations it was formed to support by class or purpose.

Section 1.509(a)-4(e) of the regulations sets forth the operational test of section 509(a)(3)(A) of the Code. There are two parts to this test, the permissible beneficiaries requirement and the permissible activities requirement. The permissible beneficiaries requirement described at section 1.509(a)-4(e)(1) provides that a supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations only if it engages solely in activities which support or benefit the specified publicly supported organizations. An organization will be regarded as "operated

exclusively" to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations. The permissible activities requirement of section 1.509(a)-4(e)(2) provides that an organization will not be regarded as operated exclusively to support or benefit one or more specified publicly supported organizations if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations. All such support must be limited to the permissible beneficiaries in accordance with section 1.509(a)-4(e)(1).

Section 1.509(a)-4(j) of the regulations provides that under the provisions of section 509(a)(3)(C) of the Code a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations.

Section 511(a) of the Code imposes a tax on the unrelated business 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 allowable deductions that are directly connected with the carrying on of the trade or business, with certain modifications. Section 1.513-1(b) of the regulations provides that the phrase "trade or business" includes activities carried on for the production of income and that possess the characteristics of a trade or business within the meaning of section 162 of the Code. Finally, section 1.501-1(c) of the regulations explains that "regularly carried on" refers to the frequency and continuity of the conduct of an activity and the manner in which the activity is pursued.

Section 513(a) of the Code defines an "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 funds or the use it makes of the profits derived) to the exercise of the organization's exempt purposes or functions.

Section 1.513-1(d)(2) of the regulations provides, in part, that a trade or business is related to exempt purposes only where the conduct of the business activities has a causal 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 a 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 goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes.

Rev. Rul. 60-143, 1960-1 C.B. 192 held that an alumni association whose major activities are participating in a university's fund raising campaigns and performing necessary services for the university qualifies for exemption under section 501(c)(3) of the Code where the association is controlled by or operated as an integral part of an educational institution or otherwise shows a substantial integration with such an institution.

Rev. Rul. 69-545, 1969-1 C.B. 117 describes the standards under which a nonprofit hospital may qualify for recognition of exemption under section 501(c)(3) of the Code. The revenue ruling considered two separate hospitals, only one of which was determined to qualify for exempt status under section 501(c)(3). By weighing all the relevant facts and circumstances, the revenue ruling analyzed whether both the control and use of the hospitals were for the benefit of the public or the benefit of private interests.

Rev. Rul. 77-72, 1977-1 C.B. 157 held that if participating exempt organizations are in an affiliated system or are organizations subject to common control, then corporate services provided between them necessary to their being able to accomplish their exempt purposes are treated as other than an unrelated trade or business and the financial arrangements between them are viewed as merely a matter of accounting.

Analysis:

The proposed reorganization will enable R and its affiliated organizations to broaden and diversify their services and achieve administrative efficiencies while furthering R's primary goal and mission to support pediatric and adult patient care, medical education and medical research with a commitment to quality service, and cost-effective care to enhance the health and well-being of children locally, nationally and internationally. R anticipates that the reorganization will enhance its ability to more efficiently structure its varied operations and strategically plan for the future of its integrated health care delivery system. Ultimately, the reorganization will allow R and its affiliates to provide a broader range of services to the general public while continually improving the overall quality of health care provided.

In conjunction with the proposed reorganization, the Articles of Incorporation and bylaws of R, T, U, V, W, X and Y will be amended. The language in the proposed amendments satisfies the organizational test with respect to section 501(c)(3) of the Code.

After the proposed reorganization, R, V, W, and X will continue to provide health care services to the community in the manner described in Rev. Rul. 69-545, *supra*. See also *Restatement (Second), Trusts*, sec. 368 and sec. 372; *IV Scott on Trusts* (3rd ed. 1967), section 368 and sec. 372. T, U and Y will engage primarily in activities which support R's charitable purpose. See Rev. Rul. 60-143, *supra*. The only significant structural changes resulting from the reorganization will be T's replacement of R as the sole corporate member of U, V, W, X, and Y, the addition of T as the sole corporate member of R, and T's replacement of R as the sole shareholder of Z. With R's community based governing board becoming the governing board of T, overall control of the integrated health care delivery system will rest in the same persons who currently exercise such control, assuring uninterrupted pursuit of charitable goals by R and its affiliates.

R has been recognized as an organization described in section 509(a)(1) and 170(b)(1)(A)(iii) of the Code. After the proposed reorganization, R will continue to operate as a hospital described in section 170(b)(1)(A)(iii).

V, W and X have been recognized as organizations described in section 509(a)(2) of the Code. Section 509(a)(2) of the Code describes organizations supported by fees from the provision of

services and facilities. After the proposed reorganization, V, W and X will continue to provide health care services and will be supported by related fees.

I has been recognized as an organization described in section 509(a)(3) of the Code. After the proposed reorganization, I will continue to meet the organizational test set forth in section 1.509(a)-4(c) of the regulations because its proposed amended Articles of Incorporation limit its purposes to one or more of the purposes set forth in section 509(a)(3)(A) of the Code; do not expressly empower I to engage in activities that do not further such purposes; specify R and its affiliated organizations that are described in section 501(c)(3) of the Code and classified as organizations described in section 509(a)(1) or (2) of the Code as I's supported organizations; and do not expressly empower I to operate to support or benefit any organization other than the specified publicly supported organizations.

To meet the operational test described at section 1.509(a)-4(e) of the regulations, I must engage solely in activities which support or benefit the publicly supported organizations specified in its proposed amended Articles of Incorporation. However, I may support or benefit organizations other than those specified in its Articles if such organizations are permissible beneficiaries. See section 1.509(a)-4(e)(1).

After the proposed reorganization, I will meet the operational test since it will engage in activities that support or benefit R, V, W, and X. See section 1.509(a)-4(e)(2) of the regulations. R, V, W, and X are identified by name or class as supported organizations in I's proposed amended Articles of Incorporation. In addition, I may engage in activities that support or benefit U, an organization described in section 509(a)(3) of the Code. Since U is "supervised or controlled in connection with" R, U is a permissible beneficiary as defined at section 1.509(a)-4(e)(1).

After the proposed reorganization, two of the voting members of the board of directors of R will also be members of the board of directors of I. In addition, each of the four key senior executive management officers of R will serve as the four key senior executive management officers of I. These common executive management officers include each organization's chief executive officer and each organization's executive-vice presidents. Thus, I will be "supervised or controlled in connection with" R, within the meaning of section 1.509(a)-4(h) of the regulations.

After the proposed reorganization, I will not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations. See section 1.509(a)-4(j) of the regulations.

U has been recognized as an organization described in section 509(a)(3) of the Code. After the proposed reorganization, U will continue to meet the "organizational test" set forth in section 1.509(a)-4(c) of the regulations because its proposed amended Articles of Incorporation limit its purposes to one or more of the purposes set forth in section 509(a)(3)(A) of the Code; do not expressly empower U to engage in activities that do not further such purposes; specify R and its affiliated organizations that are described in section 501(c)(3) of the Code and classified as organizations described in section 509(a)(1) or (2) of the Code as U's supported organizations; and do not expressly empower U to operate to support or benefit any organization other than the specified publicly supported organizations.

To meet the operational test described at section 1.509(a)-4(e) of the regulations, U must engage solely in activities which support or benefit the publicly supported organizations specified in its proposed amended Articles of Incorporation. However, U may support or benefit organizations other than those specified in its Articles if such organizations are permissible beneficiaries. See section 1.509(a)-4(e)(1).

After the proposed reorganization, U will meet the operational test since it will engage in activities that support or benefit R, V, W, and X. See section 1.509(a)-4(e)(2) of the regulations. R, V, W, and X are identified by name or class as supported organizations in U's proposed amended Articles of Incorporation. In addition, U may engage in activities that support or benefit I, an organization described in section 509(a)(3) of the Code. Since I is "supervised or controlled in connection with" R, I is a permissible beneficiary as defined at section 1.509(a)-4(e)(1).

After the proposed reorganization, one of the voting members of the board of directors of R will serve on the board of directors of U. R's president and chief executive officer will serve as the president and chief executive officer of U. In addition, R's chief financial officer will serve as the chief financial officer of U. Thus, U will be "supervised or controlled in connection with" R, within the meaning of section 1.509(a)-4(h) of the regulations.

After the proposed reorganization, U will not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations. See section 1.509(a)-4(j) of the regulations.

Rev. Rul. 77-72, *supra.*, held that if participating exempt organizations are in an affiliated system or are organizations subject to common control, then corporate services provided between them necessary to their being able to accomplish their exempt purposes are treated as other than an unrelated trade or business and the financial arrangements between them are viewed as merely a matter of accounting. Like the organizations described in Rev. Rul. 77-72, R, I, U, V, W, X and Y are part of an affiliated system subject to common control. The transfer of assets, funds, services and/or personnel which will occur as a result of the proposed reorganization are necessary to their being able to accomplish their exempt purposes under section 501(c)(3) of the Code.

Based on the information furnished, we rule that:

1. The proposed reorganization and resulting corporate structure will not result in the revocation of, or otherwise adversely affect, the continued status of R, I, U, V, W, X or Y as organizations described in section 501(c)(3) of the Code.
2. Any transfers of funds, assets, services and/or personnel in connection with the proposed reorganization will not jeopardize the continued status as an organization described in section 501(c)(3) of the organization providing such funds, assets, services and/or personnel.

3. Any transfers of funds, assets, services and/or personnel in connection with the proposed reorganization will not adversely affect the continued nonprivate foundation status of R, T, U, V, W or X under sections 509(a)(1), 509(a)(2) or 509(a)(3) of the Code, as applicable.
4. Any payments or transfers of funds, assets, services and/or personnel in connection with the proposed reorganization will not generate unrelated business taxable income under sections 511 through 514 of the Code.
5. Under the proposed reorganization, T and U will qualify as Type II supporting organizations under section 509(a)(3)(B)(ii) of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

We express no opinion as to the tax consequences of the proposed transaction under any other section of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. A copy of this letter should be kept in its 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 by others as precedent.

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

Sincerely,

Theodore R. Lieber
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437