

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B05
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Date:
December 14, 2017

Legend

The Issuer =

The University =

The Buyer =

Date 1 =

The Prior Bonds =

Dear _____ :

This letter is in response to your request for a ruling that the Proposed Bonds, as defined below, will not be a refunding issue that fails to be tax-exempt pursuant to § 149(d)(3)(A)(i) of the Internal Revenue Code (the Code).

Facts and Representations

The Issuer makes the following representations. The University and the Buyer are both organizations exempt from income tax under § 501(c)(3) of the Code. The Buyer's charter provides that the Buyer is organized in part for the purpose of operating an academic medical center as part of a health system affiliated with the University.

Prior to Date 1, the University operated an academic medical center as an operating unit within the University (the Medical Center). The Medical Center housed certain charitable, academic, and health care activities and assets of the University. The Medical Center has been nationally recognized for its excellence and is a primary provider of care to the communities in the region. On Date 1, the Buyer acquired the Medical Center from the University.

In the years prior to Date 1, the University used the proceeds of tax-exempt bonds, including the Prior Bonds, to finance and refinance both assets of the Medical Center and assets of the University unrelated to the Medical Center. The Prior Bonds are tax-exempt qualified 501(c)(3) bonds that advance refunded tax-exempt bonds.

To finance a portion of its acquisition of the Medical Center from the University, the Buyer borrowed and used proceeds of taxable debt issued by the Issuer (the Taxable Debt). The University, in turn, used a portion of the proceeds of the Taxable Debt received from the Buyer to defease the Prior Bonds. As the Prior Bonds remain outstanding, the Taxable Debt was issued more than 90 days before the redemption of the Prior Bonds. The Issuer proposes to issue qualified 501(c)(3) bonds (the Proposed Bonds) and loan the proceeds to the Buyer to refund the portion of the Taxable Debt used to defease the Prior Bonds. The Proposed Bonds and the Prior Bonds will be outstanding concurrently for more than 90 days.

Since before Date 1, the Buyer has been governed by an 11-member board of directors. Pursuant to the Buyer's bylaws, the board must have no fewer than 11 and no more than 17 members, of which the University has the right to appoint 30%. The University's Chancellor serves ex officio as one of the directors appointed by the University, and the individual who is Buyer's President and CEO also serves ex officio on the board. Directors not appointed by the University or serving ex officio are elected by a majority vote of the Buyer's board. Directors not serving ex officio may serve a term of no more than three years and are limited to three successive terms. A director appointed by the University may be removed without cause by the University. Any director not appointed by the University may be removed for cause by a majority vote of the board and without cause by a two-thirds vote of the board. Following the term of the Buyer's initial board, no employee of the University other than the Chancellor may serve as a director.

Without oversight or approval from the University, the Buyer determines its operating and capital budgets, issues debt, and expends funds. The University has no power to compel the Buyer to use its funds or assets for any purpose of the University. The University has no power to hire or to fire the Buyer's employees or to determine the salaries of the Buyer's employees. The Buyer has sole control over collection of its accounts receivable and is solely responsible for satisfaction of its liabilities.

The University has the right to approve certain actions of the Buyer, and those actions are not effective without such approval. The actions requiring the University's approval

are: (1) any major corporate transaction not within the ordinary course of the Buyer's business; (2) any action that would result in a change in the Buyer's exempt status under §§ 501(c)(3) and 509(a) of the Code; (3) any academic affiliation of the Buyer with any educational institution other than the University; (4) any material change to the Buyer's purposes; (5) any change in the fundamental, nonprofit, charitable, tax-exempt mission of the Buyer; (6) any action that would grant any entity or organization the right to appoint directors of the Buyer; (7) a joint operating agreement or similar arrangement under which the Buyer's governance is substantially subject to a board or similar body that the Buyer does not control; and (8) the sale or transfer of all or substantially all of the assets of the Buyer to a third party.

Law

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any State or local bond. Section 103(b) provides in part that § 103(a) shall not apply to any bond unless such bond meets the applicable requirements of § 149.

Section 149(d)(1) provides that nothing in § 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in § 149(d)(2), (3), or (4). Section 149(d)(3)(A)(i) generally provides that an issue is described in § 149(d)(3) if any bond (issued as part of such issue) is issued to advance refund a bond, unless the refunding bond is only the first advance refunding of the original bond if the original bond is issued after 1985. Section 149(d)(5) provides that a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond. Section 1.149(d)-1(e)(1) of the Income Tax Regulations provides in part that, except as provided in § 1.149(d)-1(e)(2), for purposes of § 149(d)(3)(A)(i), an advance refunding issue the interest on which is not excludable from gross income under § 103(a) (that is, a taxable advance refunding issue) is not taken into account. Section 1.149(d)-1(e)(2) provides that a taxable issue is taken into account under § 149(d)(3)(A)(i) if it is issued to avoid the limitations of that section. For example, in the case of a refunding of a tax-exempt issue with a taxable advance refunding issue that is, in turn, currently refunded with a tax-exempt issue, the taxable advance refunding issue is taken into account under § 149(d)(3)(A)(i) if the two tax-exempt issues are outstanding concurrently for more than 90 days.

Section 1.150-1(d)(1) provides that a refunding issue is an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (a prior issue, as more particularly defined in § 1.150-1(d)(5)), including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue. Section 1.150-1(d)(2)(ii)(A) provides that an issue is not a refunding issue to the extent that the obligor (as defined in § 1.150-1(d)(2)(ii)(B)) of one issue is neither the obligor of the other issue nor a related party with respect to the obligor of the other issue.

Under § 1.150-1(d)(2)(ii)(B), the obligor of an issue is the actual issuer of the issue, except that the obligor of the portion of an issue properly allocable to an investment in a purpose investment means the conduit borrower under that purpose investment.

Under § 1.150-1(b), related party means, in reference to a governmental unit or a § 501(c)(3) organization, any member of the same controlled group. Under § 1.150-1(e), a controlled group is a group of entities controlled directly or indirectly by the same entity or group of entities. Section 1.150-1(e)(1) provides that the determination of direct control is made on the basis of all the relevant facts and circumstances.

Section 1.150-1(e)(1) further provides that one entity or group of entities (the controlling entity) generally controls another entity or group of entities (the controlled entity) for purposes of § 1.150-1(e) if the controlling entity possesses either of the following rights or powers and the rights or powers are discretionary and non-ministerial: (1) the right or power both to approve and to remove without cause a controlling portion of the governing body of the controlled entity; or (2) the right or power to require the use of funds or assets of the controlled entity for any purpose of the controlling entity.

Analysis

At issue in this ruling is whether the Proposed Bonds will be a refunding issue that is not tax-exempt pursuant to § 149(d)(3)(A)(i). If the Taxable Debt, which is to be refunded by the Proposed Bonds, is a refunding of the Prior Bonds, which advance refunded tax-exempt bonds and would be outstanding concurrently with the Proposed Bonds for more than 90 days, then § 149(d)(3)(A)(i) and § 1.149(d)-1(e)(2) would prohibit the Proposed Bonds from being tax-exempt. The Taxable Debt is not a refunding issue if the Buyer, as obligor of the Taxable Debt, and the University, as obligor of the Prior Bonds, are not related parties.

As organizations exempt from tax under § 501(c)(3), the Buyer and the University are related parties if they are members of the same controlled group. Under § 1.150-1(e), the Buyer and the University are members of the same controlled group if one directly or indirectly controls the other or if they are both controlled directly or indirectly by another entity. Here, the only inquiry is whether the University directly controls the Buyer.

Under § 1.150-1(e)(1), the determination of whether the University directly controls the Buyer is made on the basis of all of the relevant facts and circumstances. The University holds the power to approve and remove without cause four of the Buyer's 11 directors, which proportion is not a controlling share of the board. With the exception of the University's chancellor, no employee of the University may serve as a director of the Buyer. The University holds no right or power to require the use of the Buyer's funds or assets for the University's purposes. Rather the Buyer determines its budget, issues debt, and expends funds without oversight from the University. The Buyer has sole control over collection of its receivables and sole responsibility for satisfaction of its liabilities. The University does not control hiring, firing, or salaries of the Buyer's

employees. These facts evidence the Buyer's operational independence from the University and support a conclusion that the University does not directly control the Buyer.

On the other hand, the University has the right to prohibit the Buyer from taking certain actions. Although this right certainly represents a form of control over the Buyer, such control is qualitatively different from the operational control described in the preceding paragraph. Here, the University's right is not a power to cause the Buyer to act, but a power to bar the Buyer from taking certain actions. The right merely limits the Buyer's capacity to deviate from the charitable mission it shares with the University and diminishes the chance that the Buyer will stray from the quality standards and community focus established when the Medical Center was an operating unit of the University.

Considering the context and content of the University's specific rights and powers with respect to the Buyer in this case, we conclude that the University does not directly control the Buyer. Therefore, the University and the Buyer are not part of the same controlled group and, consequently, are not related parties. Accordingly, the Taxable Debt is not a refunding of the Prior Bonds. Therefore, the Proposed Bonds will not fail to be tax-exempt pursuant to § 149(d)(3)(A)(i).

Conclusion

On these facts, we conclude that the Proposed Bonds will not be a refunding issue that fails to be tax-exempt under § 149(d)(3)(A)(i).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express no opinion on whether any of the bonds described herein are qualified private activity bonds under § 141 or tax-exempt under § 103.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

/S/

Vicky Tsilas
Chief, Branch 5
(Financial Institutions & Products)

cc: