



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street, MC 4920 DAL
Dallas, TX 75242

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: **January 31, 2019**

Number: **201925015**
Release Date: 6/21/2019

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to:
EIN:

UIL: 501.03-00

CERTIFIED MAIL – Return Receipt Requested

Dear :

This is a final revocation letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. The Internal Revenue Service's recognition of your organization as an organization described in section 501(c)(3) is hereby revoked effective May 1, 20XX.

We have made this determination for the following reason(s):

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order for an organization to be exempt under section 501(c)(3), it must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose.

Your organization's primary activity is the sale and rental of durable medical equipment to the public at competitive commercial prices. As such, you failed to meet the requirements of I.R.C. section 501(c)(3) and Treasury Regulation section 1.501(c)(3)-1(c)(1), in that you failed to establish that you are operated exclusively for an exempt purpose.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending April 30, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment. Please contact the clerk of the respective court for rules and the appropriate forms regarding filing petitions for declaratory judgment by referring to the enclosed Publication 892. Please note that the United States Tax Court is the only one of these courts where a declaratory judgment action can be pursued without the services of a lawyer. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217


US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

You may also call the Internal Revenue Service Taxpayer Advocate. The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit taxpayeradvocate.irs.gov or call 1-877-777-4778.

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

Sincerely yours,

Maria Hooke 

Maria Hooke
Director, EO Examinations



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations Examination

Date:
06/14/2018
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:

Employee ID number:
Telephone number:
Fax:
Address:

Manager's contact information:

Employee ID number:
Telephone number:
Response due date:

CERTIFIED MAIL – Return Receipt Requested

Dear ,

Why you're receiving this letter

We enclosed a copy of our audit report, Form 886-A, Explanation of Items, explaining that we propose to revoke your tax-exempt status as an organization described in Internal Revenue Code (IRC) Section 501(c)(3).

If you agree

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(3) for the periods above.

If you disagree

1. Request a meeting or telephone conference with the manager shown at the top of this letter.
2. Send any information you want us to consider.
3. File a protest with the IRS Appeals Office. If you request a meeting with the manager or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals Office after the meeting or after we consider the information.

The IRS Appeals Office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the IRS Appeals Office enough time to consider your case. For your protest to be valid, it must contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, however, generally is final and binding on Appeals.

If we don't hear from you

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final adverse determination letter.

Contacting the Taxpayer Advocate Office is a taxpayer right

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

Additional information

You can get any of the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

If you have questions, you can contact the person shown at the top of this letter.

Sincerely,

Maria Hooke
Director, Exempt Organizations Examinations

Enclosures:

Form 886-A

Form 6018

Form 4621-A

Publication 892

Publication 3498

Alternative Issue Report & Publication 594

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended 4/30/20XX & 4/30/20XX

Issue

Whether _____, an IRC § 501(c)(3) organization should be revoked of its exempt status effective May 1, 20XX, where the organization has substantial non-exempt commercial activity. The tax years involved are tax years ended April 30, 20XX and April 30, 20XX.

Facts

“ _____ ” was incorporated under the _____ of _____ on August 29, 20XX. _____ operates in _____. The organization was granted exempt status under IRC §501(c)(3) by the Internal Revenue Service on June 11, 20XX.

Per Form 1023 correspondence, “The primary focus of _____ is to serve the consumers of _____, _____, and outlying areas with medical equipment and supplies in their homes. _____ leases and/or sells medical equipment including walkers, wheelchairs, oxygen, etc. The home medical equipment is designed to assist those patients that have been discharged from hospitals and/or those who need continuous care. Amounts charged for such services are subject to the patient's ability to pay.”

The Bylaws indicate that the organization is organized to:

“To establish, own, operate, maintain and conduct the affairs of a durable medical equipment supplier in order to assist the facilities of _____ and _____ and further the provision of health care services to the patients of said hospitals and the communities they serve; to own, lease or otherwise deal with all property, real and personal, to be used in furtherance of these purposes; and to contract with other organizations, for-profit and not-for-profit, with individuals and with governmental agencies in furtherance of these purposes.

To organize and to carry on any other lawful activity which the Corporation may determine necessary or expedient for the administration of the affairs or the attainment of the foregoing purposes of the Corporation.”

"The Corporation is organized exclusively for charitable, religious, educational and scientific purposes under Section 501(c)(3) of the Internal Revenue Code of 1986 (or the corresponding section of any future United States Internal Revenue Law), including for such purposes the making of distributions to organizations that qualify as exempt organizations under said section 501(c)(3)."

The organization's Form 990 indicates that the organization's mission and most significant activities are to: “supply people of _____, _____ & _____ with medical equipment and

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supplies in their homes” and to “provide high-quality home medical equipment services and supplies to our community in a caring, efficient, and cost-effective manner.”

The organization was formed as a joint venture by two hospitals which are in , and “ ” Hospital in , . is a component of , and is an IRC §501(c)(3) hospital. Each hospital appoints one vice-president and one board of directors to the board of directors. The fifth board member is independent and is elected by the board of directors. The Articles of Incorporation provide that in the event of dissolution, the assets would be equally distributed between the two hospitals. is an independent organization.

In the Form 1023 application taxpayer indicated that prior to the creation of each hospital had their own wholly owned subsidiary which sold and rented durable medical equipment. The corporations were and . Neither of the corporations were exempt organizations and neither applied for tax-exemption.

has two stores located in , and . The stores are off-premises from the two hospitals. The stores are open to the public. The organization sells and rents durable medical equipment to patients for outpatient use. There are patients with written prescription(s), self-pay patients, and walk in patients. A prescription is required in order for the DME products to get billed to Medicare or private insurance. Other products are self-pay items (retail items) which are not covered by insurance. Self-pay items are not billable and not reimbursable through insurance.

Sales and rentals of the durable medical equipment are made available to the general public and are not restricted to any type of patient. Sales and rentals are made to patients referred from , “ ” , as well as patients from other hospitals and doctor’s offices located in the area. The organization sells and rents DME to both insured and non-insured patients, and they sell and rent durable medical equipment to patients qualifying for charity care and those who do not qualify for charity care.

The organization offers a certified wig and prosthesis (mastectomy) services to female patients going through chemotherapy that can be covered under the financial assistance policy if the patient qualifies. The service includes having certified wig and prosthesis fitters on staff, a private room for consultation, education and fitting.

The organization provides charity care to patients qualifying under the organization’s guidelines. The organization’s guidelines are based on Federal poverty guidelines. In the tax year ending April 30, 20XX the organization did not have their own charity care guidelines and they accepted and charity care determinations. offered 0% charity care for people

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that qualify. has a charity care scale: 0%, 0%, 0%, and 0%. The 0% charity care means that the patient would receive a 0% discount. received statements from and and used the charity care percentage that the hospitals had already approved for qualifying patients. If a patient did not come through one of the member hospitals, an application and any necessary support was maintained on file supporting the charity care decision.

In tax year ended April 30, 20XX the organization reported gross receipts of \$0 on their Form 990. The organization reported that they provided charity care at a cost of \$0. The organization indicated that the actual charity care provided was \$0 in tax year ended April 30, 20XX. In tax year ended April 30, 20XX the organization provided charity care to 0 patients. The total regular (non-charity care) patients for the year was 0 patients along with separate cash accounts with transactions for a total of 0 non-charity patients and non-charity care cash transactions.

In tax year ended April 30, 20XX the organization started their own charity care system based on the Federal poverty level. In tax year ended April 30, 20XX the organization reported gross receipts of \$0 on their Form 990. The organization reported that they provided charity care at a cost of \$0 on their Form 990. In tax year ended April 30, 20XX the organization provided information on charity care and regular care based on number of transactions. One patient may be listed more than one occasion if they had multiple sales or rentals in the year. In tax year ended April 30, 20XX the organization provided 0 charity care transactions. The total regular (non-charity care) transactions for the year was 0.

Below is a chart showing charity care provided by as a percentage to the organization's gross receipts and total expenses:

Charity Care Amounts	4/30/20XX	4/30/20XX
Total Charity Care Provided- Cost	\$0.00	\$0.00
Gross Receipts	\$0.00	\$0.00
Total Expenses	\$0.00	\$0.00
Charity Care Percentage to Gross Receipts	0.00%	0.00%
Charity Care Percentage to Total Expenses	0.00%	0.00%

Below is a chart showing charity care provided by as a percentage of charity care patients to regular patients (commercial sales):

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Charity Care Patients Served	4/30/20XX	4/30/20XX
Charity Care Patients Served (In tax year ended 4/30/20XX the number shown reflects charity care transactions)	0	0
Total Patients Served (In tax year ended 4/30/20XX the number shown reflects total patient transactions)	0	0
Charity Care Patient Percentage to Total Patients	0.00%	0.00%

The organization has a sign in front desk reception area that says, "Charity. If you are concerned that you may not be able to pay for your case, we may be able to help. (Excluding retail/ non-billable items.) Charity Care Paperwork is available upon request." The organization has a brochure which has the statement, "financial assistance available."

The organization advertises their services to the public through radio ads, newspaper ads, signs outside sporting events at local high schools, and ads in Hospital and . The organization spent \$0 and \$0 in advertising and promotion expenses in tax years ended April 30, 20XX and April 30, 20XX, respectively.

The organization's primary source of income is the sale and rental of durable medical equipment to the general public. The organization's commercial (non-charity) sales constitutes over 0% of the organization's revenue and operations. The organization was profitable in tax years ended April 30, 20XX and April 30, 20XX. The organization's sources of income are the sale and rental of durable medical equipment and investment income. The organization does not receive any grants or donations.

Below is a chart showing sources of income and expenditures for tax years ended April 30, 20XX and April 30, 20XX:

Sources of Income	4/30/20XX	4/30/20XX
Contributions and Grants	\$0.00	\$0.00
Durable Medical Equipment "DME" Sales	\$0.00	\$0.00
Durable Medical Equipment "DME" Rentals	\$0.00	\$0.00
Investment Income	\$0.00	\$0.00
Total Income	\$0.00	\$0.00

Expenses	4/30/20XX	4/30/20XX
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Grants and similar amounts paid	\$0.00	\$0.00
Salaries, compensation and employee benefits	\$0.00	\$0.00
Other Expenses	\$0.00	\$0.00
Total Expenses	\$0.00	\$0.00
Revenue Less Expenses	\$0.00	\$0.00

The amounts charged to non-charity patients for the durable medical equipment are competitive market prices to keep the organization competitive with other DME providers. There are no formal price caps on amounts charged for the durable medical equipment. The organization bills Medicare and private insurance on behalf of patients. Medicare and private insurance have fee schedules with reimbursement rates. If the organization charges amounts over the amounts set by Medicare and/or private insurance, they won't be reimbursed for amounts charged over the fee schedule. There are no price caps for retail products. The organization does not provide items at or below cost. The organization has a charity care policy which is based on Federal poverty guidelines. The charity care is available to qualifying patients.

The organization makes distributions to the zero related hospitals; and
. The distributions occur every two or three years and are based on the organization's resources. The organization does not have a written policy for when the distributions will occur or any formal calculation process to determine the distribution amounts. The board of directors discusses and approves the distributions during the annual meeting. The distribution amount is distributed equally to both hospitals. There are no restrictions on how the hospitals may use the funds. In tax years ended April 30, 20XX and April 30, 20XX the organization did not make any distributions to either of the hospitals. The organization did not make charitable donations to other IRC 501(c)(3) charitable organizations in tax years ended April 30, 20XX and April 30, 20XX.

The organization has a collections policy. If a balance is unpaid it goes to collections after 90 days when no payments have been made. This may include patients who qualified for charity care but did not complete or submit the required paperwork. As soon as an account is sent to collections, the expense is recorded as a bad debt expense. If collections are able to collect the amount, the organization does an offsetting entry.

Law

IRC §501(c)(3) provides exemption for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for

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public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order for an organization to be exempt under section 501(c)(3) it must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(2) defines the term "charitable" for section 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" for section 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of section 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of section 1.501(c)(3)-1(d)(1).

Treas. Reg. Section 1.501(c)(3)-1(e)(1) 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

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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. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).

In *Better Business Bureau of Washington, D.C. Inc. v. United States*, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), the Court stated that free or below cost service is only one of several factors to consider in making a determination. Others include the particular manner in which the organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. All of these must be considered, for no single factor alone is determinative. The Court concluded that the petitioner was not an organization described in section 501(c)(3) because its primary purpose was neither educational, scientific, nor charitable, but rather commercial.

In *Federation Pharmacy Services, Inc. v. Commissioner*, 72 T.C. 687 (1979) aff'd 625 F.2d 804 (8th Cir. 1980), the Tax Court stated that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for-profit. The court ruled that sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. The court said it was clear that petitioner's exclusive purpose for being was to sell drugs, an activity that is normally carried on by commercial profit making enterprises. The Tax Court said that they failed to see how the fact that it happened to deal in drugs could convert it to a section 501(c)(3) organization. If it could be so converted, then so could a store selling orthopedic shoes, crutches, health foods, or any other product beneficial to health. Virtually everything we buy has an effect, directly or indirectly, on our health. They concluded that they did not believe that the law requires that any organization whose purpose is to benefit health, however remotely, is automatically entitled, without more, to the desired exemption.

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C., 2003), the District Court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. As the court stated: "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services

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provided; pricing policies; and reasonableness of financial reserves. Additional factors include, among other things, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.”

In *Carle Foundation v. United States*, 611 F.2d 1192 (7th Cir 1979), the Seventh Circuit Court of Appeals upheld a district court decision that subjected to tax the revenues from pharmacy sales made by a nonprofit hospital to patients of a related medical group. The court rejected the argument that the sales of pharmaceuticals to clinic outpatients and to the clinic itself were primarily for the convenience of a hospital’s patients within the meaning of Section 513(a)(2). The court concluded that the pharmaceutical sales were not substantially related to the hospital’s exempt purpose. In reaching this conclusion, the court focused on the fact that the sales were substantial and not dissimilar from activities of a commercial enterprise.

In *Nonprofits' Ins. Alliance v. United States*, 32 Fed. Cl. 277 the court held that the corporation which administered a self-insurance risk and provided commercial insurance was not entitled to tax exempt status under § 501(c)(3) because it failed the operational test within § 501(c)(3). Selling insurance was inherently a commercial activity ordinarily carried on by a for-profit company, and these commercial activities outweighed any nonexempt activity it offered to the public. The existence and amount of accumulated profits and how much below cost the corporation was providing its services also factored into the court's consideration. The court cited "The presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes." *Better Business Bureau of Washington, D.C. Inc. v. United States*, 326 U.S. 279 (1945).

Taxpayer’s Position

Taxpayer believes that “ ” is operating as an IRC §501(c)(3) charitable organization and they do not agree that the organization should be revoked.

Taxpayer has made the following arguments regarding their exempt status:

considers that the sale and rental of durable medical equipment to patients furthers the organization’s exempt purpose of provision of health care services to patients. does not believe that they should be required to provide a substantial amount of charity care in order to operate as an IRC §501(c)(3) organization. Taxpayer states that they make charity care available to all patients who qualify under the Federal poverty guidelines. Taxpayer indicates that there is no requirement that exempt organizations must provide a certain amount of charity care.

Taxpayer indicates that the organization was formed to own, operate, maintain and conduct the affairs of a durable medical equipment supplier in order to assist the facilities of

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and . Additionally, the organization was formed for charitable purposes including the making of distributions to organizations that qualify as exempt. offers the sale and rental of durable medical equipment as well as a small portion of retain activity such as shower chairs, transfer benches, orthotics, gauze, ace bandages, and ice packs, etc.

Taxpayer offers charity care (financial assistance) which is advertised at/near the front desk of the locations. If a person qualifies for financial assistance they pay at a reduced rate or get the item for free. The charity care financial assistance policy is a sliding scale based on poverty guidelines.

Taxpayer indicates that their distributions to and also further the provision of health care services to the patients of said hospitals and the communities they serve as both hospitals are exempt organization hospitals. Taxpayer indicates that the distributions are based on resources that are available for donation and the potential use of those resources for other needs at to further its mission. Taxpayer indicated that there is no agreement, written or otherwise, for the distribution process. The distributions are considered by the board of directors periodically and are made at its discretion but there is no specific mandate to do so or any formal calculation or written process. Taxpayer uses the term "distribution" consistent with their Bylaws. The term is utilized rather than "donation" due to the fact that the Bylaws of the organization state that upon dissolution the hospitals would each be entitled to 0% of the net assets of the organization.

Taxpayer indicated that while they did not make any donations or distributions in the tax years ended April 30, 20XX and April 30, 20XX; they have made donations in other tax years. Taxpayer indicated that they distributed \$0 to Hospital and \$0 to on 8/16/20XX. Taxpayer indicated that they made \$0 in charitable donations after tax year ended April 30, 20XX. Taxpayer believes that their distributions clearly rises to the level of charity necessary to support the continuation of exempt status.

Taxpayer believes that they are easily distinguishable from other durable medical equipment area suppliers:

- Taxpayer has licenses and certifications to bill Medicare or insurance companies. Taxpayer states that other providers do not have such licenses and certifications. Taxpayer indicated that this benefits the patients as their cost can be reduced or covered by Medicare or insurance.
- Taxpayer services the products that they sell. Taxpayer has trained staff that educate patients how to use the equipment free of charge. Taxpayer's staff will go to the home of the patient and repair or replace the item as needed. This applies whether the patient was

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a charity care patient or not. Taxpayer indicated that they are not designed to compete with retailers on price, but is instead designed to provide the best care to the community that it can.

- Taxpayer indicates that they are the only provider in the area that provides charity care. Taxpayer believes that if they did not provide the charity care, it could result in continued readmissions to the hospital. Taxpayer indicates that they are providing charity care at a higher level than the federal poverty level. Under current policy, a patient that has income at 0% of the federal poverty level is granted full assistance; a patient with income at 0% of the federal poverty level receives 0% assistance; a patient with income at 0% of the federal poverty level receives 0% assistance; and a patient with income at 0% of the federal poverty level receives 0% assistance.
- The organization offers a certified wig and prosthesis services to female patients going through Chemotherapy. The services can be covered under charity care if the patient qualifies. The service includes having certified wig and prosthesis fitters on staff.
- The certified fitters and the executive director participate in events that are free to the community.

Taxpayer states that these activities show that they are operating as an IRC §501(c)(3) organization.

Government's Position

should be revoked of its exempt status effective May 1, 20XX where the organization has substantial non-exempt activity and is operating in a commercial manner. The organization was granted tax exempt status on the basis that they would be operated to provide financial assistance to patients unable to pay and to make charitable donations. However, the financial assistance constitutes less than percent of the organization's activities; both in terms of revenue and based on the number of charity care patients served to total patients served.

The organization had over \$0 million in gross receipts in each of the tax years. However, charity care was only \$0 in tax year ended April 30, 20XX and \$0 in tax year ended April 30, 20XX. In tax year ended April 30, 20XX only 0 patients received charity care while the organization had 0 patients. In tax year ended April 30, 20XX the organization had 0 charity care transactions compared to 0 regular transactions. Charity care constitutes less than percent of the organization's activities. The organization's major activity is the sale and rental of durable medical equipment to the public at competitive commercial prices.

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Providing health care services by selling and renting durable medical equipment is not a charitable activity. In *Federation Pharmacy Services, Inc. v. Commissioner*, 72 T.C. 687 (1979) aff'd 625 F.2d 804 (8th Cir. 1980), the Tax Court stated that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for-profit. The court ruled that sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. Selling and renting durable medical equipment at commercial prices to the public is not an IRC §501(c)(3) charitable purpose. Charity care sales and rentals constitute less than percent of the organization's overall activities. The organization is operating in a commercial manner in competition with other DME providers.

Taxpayer cited billing Medicare and insurance on behalf of patients as an activity that furthers their exempt status. Many doctor's offices, pharmacies, clinics, hospitals and DME providers bill Medicare and private insurance. While this practice is convenient for patients, billing Medicare and private insurance is not an IRC §501(c)(3) charitable activity.

Taxpayer indicated that their employees are trained in the durable medical equipment and take the time to educate patients about durable medical equipment, and that the organization will repair or replace defective equipment. Customer support such as equipment repair or replacement and educating patients how to use the equipment is customer service and is not indicative of 501(c)(3) charitable activity.

Taxpayer also cited their distributions as being sufficient to warrant tax exemption. Taxpayer did not make any charitable donations in tax years ended April 30, 20XX and April 30, 20XX. In consideration of taxpayer's statements of donations made outside of the audit tax years; it is noted that making charitable donations does not change the fact that the organization is operating in a commercial manner. Sales to the public at prices comparable to other durable medical equipment providers is a substantial non-exempt activity. Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order for an organization to be exempt under section 501(c)(3) it must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt. Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. Selling and renting durable medical equipment on a commercial basis to the general public is a substantial non-exempt purpose.

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C., 2003), the District Court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. As the

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court stated: "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, among other things, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations."

is in competition with for-profit durable medical equipment providers that sell and rent durable medical equipment including , , and .

The organization is profitable and their prices are competitive market prices. The organization does not receive any charitable donations or grants. The organization's financial assistance program constitutes less than percent of the organization's activities as seen in the charts below:

Charity Care Amounts	4/30/20XX	4/30/20XX
Total Charity Care Provided- Cost	\$0.00	\$0.00
Gross Receipts	\$0.00	\$0.00
Total Expenses	\$0.00	\$0.00
Charity Care Percentage to Gross Receipts	0.00%	0.00%
Charity Care Percentage to Total Expenses	0.00%	0.00%

Charity Care Patients Served	4/30/20XX	4/30/20XX
Charity Care Patients Served (In tax year ended 4/30/20XX the number shown reflects charity care transactions)	0	0
Patients Served (In tax year ended 4/30/20XX the number shown reflects total patient transactions)	0	0
Charity Care Patient Percentage to Total Patients	0.00%	0.00%

In order to qualify as an IRC §501(c)(3); an organization must be operated exclusively for exempt purposes. The sale and rental of durable medical equipment to the public at commercial prices constitutes an unrelated trade or business and a substantial non-exempt purpose. Because this constitutes over 0% of the organization's operations, cannot qualify as an IRC §501(c)(3) organization.

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The organization has failed to meet the operational test for exemption under Section 501(c)(3) because the organization is not operated exclusively for one or more of the purposes specified in Section 501(c)(3) as required by Treas. Reg. Section 1.501(c)(3)-1(a)(1). is not operated exclusively for one or more of the purposes specified in Section 501(c)(3) because they do not engage primarily in activities which accomplish such exempt purposes as required by Treas. Reg. Section 1.501(c)(3)-1(c)(1). More than an insubstantial part of the organization's activities are not in furtherance of an exempt purpose.

Specifically, the organization operates a business, which sells and rents durable medical equipment products to the general public in a manner indistinguishable from commercial DME providers. The primary source of revenue is from the sales and rentals of durable medical equipment. The organization does not receive any support from grants and contributions. The activities indicate that the organization is operated primarily for a non-exempt commercial purpose.

Similar to Airlie Foundation, is in competition with for profit commercial durable medical equipment providers and is operated in a commercial manner. The durable medical equipment stores are open to the public. The court in Airlie noted that factors courts have considered in assessing commerciality are the extent of below cost services provided and the extent to which the organization receives charitable contributions. The organization's substantial activity is selling and renting durable medical equipment to the public at commercial prices. Charity care constitutes less than percent of the organization's activities. The organization does not rely on contributions. Because of the commercial manner in which the organization, like Airlie Foundation, conducts their business, is operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose.

The court in B. S. W. Group also cited as a factor to be considered in assessing commerciality the provision of free or below cost service. Even though B.S.W. Group provided some free or below cost services, the court nevertheless determined that they were operated for commercial purposes. provides financial assistance to qualifying patients but this constitutes less than percent of the organization's operations. The organization otherwise operates in a strictly commercial manner. The court also found an indication of commerciality in the existence of annual profits. The organization is profitable.

The Court in Federation Pharmacy Services found that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for profit. Sales of prescription drugs to the elderly and the handicapped even at a discount is not, without more, in furtherance of a charitable purpose. Similarly, the sales of DME to the public at commercial prices is not in furtherance of a charitable purpose.

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The organization is operated for the primary purpose of carrying on an unrelated trade or business, and cannot be exempt under Section 501(c)(3) of the Code per Treas. Reg. Section 1.501(c)(3)-1(e)(1).

The organization fails to meet the operational test for exemption. The organization's purpose includes selling and renting durable medical equipment to the general public at a profit in a purely commercial manner. As cited in *Better Business Bureau of Washington, D.C. Inc. v. United States*, 326 U.S. 279 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. Accordingly, should be revoked effective May 1, 20XX.

Conclusion

, an IRC §501(c)(3) organization, should be revoked of its exempt status effective May 1, 20XX, where the organization has substantial non-exempt commercial activity.

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ALTERNATIVE ISSUE

An Alternative Resolution has been prepared should the IRS not uphold the Revocation Position

Alternative Position

Whether _____ is liable for filing Form 990-T and for unrelated business income tax from durable medical equipment "DME" sales and rentals to the general public at commercial prices.

Facts

_____ "_____" was incorporated under the _____ of _____ on August 29, 20XX. _____ operates in _____. The organization was granted exempt status under IRC §501(c)(3) by the Internal Revenue Service on June 11, 20XX.

Per Form 1023 correspondence, "The primary focus of _____ is to serve the consumers of _____, _____, and outlying areas with medical equipment and supplies in their homes. _____ leases and/or sells medical equipment including walkers, wheelchairs, oxygen, etc. The home medical equipment is designed to assist those patients that have been discharged from hospitals and/or those who need continuous care. Amounts charged for such services are subject to the patient's ability to pay."

The Bylaws indicate that the organization is organized to:

"To establish, own, operate, maintain and conduct the affairs of a durable medical equipment supplier in order to assist the facilities of _____ and _____ and further the provision of health care services to the patients of said hospitals and the communities they serve; to own, lease or otherwise deal with all property, real and personal, to be used in furtherance of these purposes; and to contract with other organizations, for-profit and not-for-profit, with individuals and with governmental agencies in furtherance of these purposes.

To organize and to carry on any other lawful activity which the Corporation may determine necessary or expedient for the administration of the affairs or the attainment of the foregoing purposes of the Corporation."

"The Corporation is organized exclusively for charitable, religious, educational and scientific purposes under Section 501(c)(3) of the Internal Revenue Code of 1986 (or the corresponding section of any future United States Internal Revenue Law), including for

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such purposes the making of distributions to organizations that qualify as exempt organizations under said section 501(c)(3)."

The organization's Form 990 indicates that the organization's mission and most significant activities are to: "supply people of , & with medical equipment and supplies in their homes" and to "provide high-quality home medical equipment services and supplies to our community in a caring, efficient, and cost-effective manner."

The organization was formed as a joint venture by two hospitals which are in , and " " in , . is a component of , and is an IRC §501(c)(3) hospital. Each hospital appoints one vice-president and one board of directors to the board of directors. The fifth board member is independent and is elected by the board of directors. The Articles of Incorporation provide that in the event of dissolution, the assets would be equally distributed between the two hospitals. is an independent organization.

In the Form 1023 application taxpayer indicated that prior to the creation of each hospital had their own wholly owned subsidiary which sold and rented durable medical equipment. The corporations were and . Neither of the corporations were exempt organizations and neither applied for tax-exemption.

has two stores located in , and . The stores are off-premises from the two hospitals. The stores are open to the public. The organization sells and rents durable medical equipment to patients for outpatient use. There are patients with written prescription(s), self-pay patients, and walk in patients. A prescription is required in order for the DME products to get billed to Medicare or private insurance. Other products are self-pay items (retail items) which are not covered by insurance. Self-pay items are not billable and not reimbursable through insurance.

Sales and rentals of the durable medical equipment are made available to the general public and are not restricted to any type of patient. Sales and rentals are made to patients referred from , " " , as well as patients from other hospitals and doctor's offices located in the area. The organization sells and rents DME to both insured and non-insured patients, and they sell and rent durable medical equipment to patients qualifying for charity care and those who do not qualify for charity care.

The organization offers a certified wig and prosthesis (mastectomy) services to female patients going through chemotherapy that can be covered under the financial assistance policy if the patient qualifies. The service includes having two certified wig and prosthesis fitters on staff, a private room for consultation, education and fitting.

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The organization provides charity care to patients qualifying under the organization's guidelines. The organization's guidelines are based on Federal poverty guidelines. In the tax year ending April 30, 20XX the organization did not have their own charity care guidelines and they accepted and charity care determinations. Hospital offered 0% charity care for people that qualify. has a charity care scale: 0%, 0%, 0%, and 0%. The 0% charity care means that the patient would receive a 0% discount. received statements from and and used the charity care percentage that the hospitals had already approved for qualifying patients. If a patient did not come through one of the member hospitals, an application and any necessary support was maintained on file supporting the charity care decision.

In tax year ended April 30, 20XX the organization reported gross receipts of \$0 on their Form 990. The organization reported that they provided charity care at a cost of \$0. The organization indicated that the actual charity care provided was \$0 in tax year ended April 30, 20XX. In tax year ended April 30, 20XX the organization provided charity care to 0 patients. The total regular (non-charity care) patients for the year was 0 patients along with two separate cash accounts with 0 transactions for a total of 0 non-charity patients and non-charity care cash transactions.

In tax year ended April 30, 20XX the organization started their own charity care system based on the Federal poverty level. In tax year ended April 30, 20XX the organization reported gross receipts of \$0 on their Form 990. The organization reported that they provided charity care at a cost of \$0 on their Form 990. In tax year ended April 30, 20XX the organization provided information on charity care and regular care based on number of transactions. One patient may be listed more than one occasion if they had multiple sales or rentals in the year. In tax year ended April 30, 20XX the organization provided 0 charity care transactions. The total regular (non-charity care) transactions for the year was 0.

Below is a chart showing charity care provided by as a percentage to the organization's gross receipts and total expenses:

Charity Care Amounts	4/30/20XX	4/30/20XX
Total Charity Care Provided- Cost	\$0.00	\$0.00
Gross Receipts	\$0.00	\$0.00
Total Expenses	\$0.00	\$0.00
Charity Care Percentage to Gross Receipts	0.00%	0.00%
Charity Care Percentage to Total Expenses	0.00%	0.00%

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Below is a chart showing charity care provided by
as a percentage of charity care patients to regular patients (commercial sales):

Charity Care Patients Served	4/30/20XX	4/30/20XX
Charity Care Patients Served (In tax year ended 4/30/20XX the number shown reflects charity care transactions)	0	0
Total Patients Served (In tax year ended 4/30/20XX the number shown reflects total patient transactions)	0	0
Charity Care Patient Percentage to Total Patients	0.00%	0.00%

The organization has a sign in front desk reception area that says, "Charity. If you are concerned that you may not be able to pay for your case, we may be able to help. (Excluding retail/ non-billable items.) Charity Care Paperwork is available upon request." The organization has a brochure which has the statement, "financial assistance available."

The organization advertises their services to the public through radio ads, newspaper ads, signs outside sporting events at local high schools, and ads in _____ and _____. The organization spent \$0 and \$0 in advertising and promotion expenses in tax years ended April 30, 20XX and April 30, 20XX, respectively.

The organization's primary source of income is the sale and rental of durable medical equipment to the general public. The organization's commercial (non-charity) sales constitutes over 0% of the organization's revenue and operations. The organization was profitable in tax years ended April 30, 20XX and April 30, 20XX. The organization's sources of income are the sale and rental of durable medical equipment and investment income. The organization does not receive any grants or donations.

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Below is a chart showing sources of income and expenditures for tax years ended April 30, 20XX and April 30, 20XX:

Sources of Income	4/30/20XX	4/30/20XX
Contributions and Grants	\$0.00	\$0.00
Durable Medical Equipment "DME" Sales	\$0.00	\$0.00
Durable Medical Equipment "DME" Rentals	\$0.00	\$0.00
Investment Income	\$0.00	\$0.00
Total Income	\$0.00	\$0.00

Expenses	4/30/20XX	4/30/20XX
Grants and similar amounts paid	\$0.00	\$0.00
Salaries, compensation and employee benefits	\$0.00	\$0.00
Other Expenses	\$0.00	\$0.00
Total Expenses	\$0.00	\$0.00
Revenue Less Expenses	\$0.00	\$0.00

The amounts charged to non-charity patients for the durable medical equipment are competitive market prices to keep the organization competitive with other DME providers. There are no formal price caps on amounts charged for the durable medical equipment. The organization bills Medicare and private insurance on behalf of patients. Medicare and private insurance have fee schedules with reimbursement rates. If the organization charges amounts over the amounts set by Medicare and/or private insurance, they won't be reimbursed for amounts charged over the fee schedule. There are no price caps for retail products. The organization does not provide items at or below cost. The organization has a charity care policy which is based on Federal poverty guidelines. The charity care is available to qualifying patients.

The organization makes distributions to the two related hospitals; and
. The distributions occur every or years and are based on the organization's resources. The organization does not have a written policy for when the distributions will occur or any formal calculation process to determine the distribution amounts. The board of directors discusses and approves the distributions during the annual meeting. The distribution amount is distributed equally to both hospitals. There are no restrictions on how the hospitals may use the funds. In tax years ended April 30, 20XX and April 30, 20XX the organization did not make any distributions to either of the hospitals. The organization did not make charitable donations to other IRC 501(c)(3) charitable organizations in tax years ended April 30, 20XX and April 30, 20XX.

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The organization has a collections policy. If a balance is unpaid it goes to collections after 90 days when no payments have been made. This may include patients who qualified for charity care but did not complete or submit the required paperwork. As soon as an account is sent to collections, the expense is recorded as a bad debt expense. If collections are able to collect the amount, the organization does an offsetting entry.

Law

IRC §511(a)(1) provide for the imposition of unrelated business income tax —There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a tax computed as provided in section 11. In making such computation for purposes of this section, the term “taxable income” as used in section 11 shall be read as “unrelated business taxable income”.

IRC §512(a)(1) defines unrelated business income as follows —Except as otherwise provided in this subsection, the term “unrelated business taxable income” means 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 allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

IRC §513(a) GENERAL RULE. —The term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)), except that such term does not include any trade or business —

513(a)(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

513(a)(2) which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 501(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

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513(a)(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Federal Tax Regulation §1.512(a)-1(a) defines unrelated business taxable income-
Definition. —(a) *In general.* —Except as otherwise provided in §1.512(a)-3, §1.512(a)-4, or paragraph (f) of this section, section 512(a)(1) defines “unrelated business taxable income” as the gross income derived from any unrelated trade or business regularly carried on, less those deductions allowed by chapter 1 of the Code which are directly connected with the carrying on of such trade or business, subject to certain modifications referred to in §1.512(b)-1. To be deductible in computing unrelated business taxable income, therefore, expenses, depreciation, and similar items not only must qualify as deductions allowed by chapter 1 of the Code, but also must be directly connected with the carrying on of unrelated trade or business. Except as provided in paragraph (d)(2) of this section, to be “directly connected with” the conduct of unrelated business for purposes of section 512, an item of deduction must have proximate and primary relationship to the carrying on of that business. In the case of an organization which derives gross income from the regular conduct of two or more unrelated business activities, unrelated business taxable income is the aggregate of gross income from all such unrelated business activities less the aggregate of the deductions allowed with respect to all such unrelated business activities.

Federal Tax Regulation §1.512(a)-1(b) *Expenses attributable solely to unrelated business activities.* —Expenses, depreciation and similar items attributable solely to the conduct of unrelated business activities are proximately and primarily related to that business activity, and therefore qualify for deduction to the extent that they meet the requirements of section 162, section 167 or other relevant provisions of the Code. Thus, for example, salaries of personnel employed full-time in carrying on unrelated business activities are directly connected with the conduct of that activity and are deductible in computing unrelated business taxable income if they otherwise qualify for deduction under the requirements of section 162. Similarly, depreciation of a building used entirely in the conduct of unrelated business activities would be an allowable deduction to the extent otherwise permitted by section 167.

Federal Tax Regulation §1.512(a)-1(c) *Dual use of facilities or personnel.* —Where facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses, depreciation and similar items attributable to such facilities (as, for example, items of overhead) shall be allocated between the two uses on a reasonable basis. Similarly, where personnel are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses and similar items attributable to such personnel (as, for example, items of salary) shall be allocated between the two uses on a reasonable basis. The portion of any such item so allocated to the unrelated trade or business activity is proximately and primarily related to that business activity, and shall be allowable as a deduction in computing unrelated business taxable income in the manner and to the extent permitted by section 162, section 167 or other

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relevant provisions of the Code. Thus, for example, assume that X, an exempt organization subject to the provisions of section 511, pays its president a salary of \$20,000 a year. X derives gross income from the conduct of unrelated trade or business activities. The president devotes approximately 10 percent of his time during the year to the unrelated business activity. For purposes of computing X's unrelated business taxable income, a deduction of \$2,000 (10 percent of \$20,000) would be allowable for the salary paid to its president.

Federal Tax Regulation §1.513-1(a) provides the definition of unrelated trade or business. — *In general* — As used in section 512 the term “unrelated business taxable income” means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the modifications provided in section 512. Section 513 specifies with certain exceptions that the phrase “unrelated trade or business” means, in the case of an organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)). (For certain exceptions from this definition, see paragraph (e) of this section. For a special definition of “unrelated trade or business” applicable to certain trusts, see section 513(b).) Therefore, unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if (1) it is income from trade or business, (2) such trade or business is regularly carried on by the organization, and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Federal Tax Regulation 1.513-1(b) *Trade or business*. — The primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete. On the other hand, where an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization sends out low cost articles incidental to the solicitation of charitable contribution, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations. However, in general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute “trade or business” within the meaning of section 162 — and which, in addition, is not substantially related to the performance of exempt functions — presents sufficient likelihood of unfair competition to be within the policy of the tax.

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Accordingly, for purposes of section 513 the term “trade or business” has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services. Thus, the term “trade or business” in section 513 is not limited to integrated aggregates of assets, activities and good will which comprise businesses for the purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose identity as trade or business merely because the pharmacy also furnishes supplies to the hospital and patients of the hospital in accordance with its exempt purposes or in compliance with the terms of section 513(a)(2). Similarly, activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to the exempt purposes of the organization. However, where an activity carried on for the production of income constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

Federal Tax Regulation §1.513-1(c) defines Regularly carried on

(1) *General principles.* —In determining whether trade or business from which a particular amount of gross income derives is “regularly carried on,” within the meaning of section 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. Hence, for example, specific business activities of an exempt organization will ordinarily be deemed to be “regularly carried on” if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Federal Tax Regulation §1.513-1(d) defines Substantially related

(1) *In general.* —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 organizations exempt purposes.

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(2) *Type of relationship required.* —Trade or business is “related” to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is “substantially related,” for purposes of section 513, 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 those 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. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

(3) *Size and extent of activities.* —In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

Federal tax Regulation §1.513-1(e) provide for Exceptions from unrelated business income — Section 513(a) specifically states that the term “unrelated trade or business” does not include —

(1) Any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) Any trade or business carried on by an organization described in section 501(c)(3) or by a governmental college or university described in section 511(a)(2)(B), primarily for the convenience of its members, students, patients, officers, or employees; or, any trade or business carried on by a local association of employees described in section 501(c)(4) organized before May 27, 1969, which consists of the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

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(3) Any trade or business which consists of selling merchandise, substantially all of which has been received by the organization as gifts or contributions.

Revenue Ruling 68-490 provides that hospital pharmaceutical sales to the general public constitute unrelated business income under IRC §512. The revenue ruling provided that there is no substantial causal relationship between the achievement of the hospital's exempt purpose and the sale of pharmaceutical supplies to members of the general public who do not otherwise avail themselves of the hospital's medical or diagnostic facilities. The ruling provided that pharmaceutical sales to the general public by an IRC §501(c)(3) hospital constitute unrelated business income.

IRC§ 6651(a)(1) Failure to file tax return- Addition to the tax. In case of failure--(1) to file any return required under authority of subchapter A of chapter 61 (other than part III thereof [IRC Sections 6031 et seq.]), subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

IRC §6651(a)(2) Failure to pay the amount shown as tax on any return specified in paragraph (1) on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount shown as tax on such return 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

Taxpayer's Position

Taxpayer states that the sale and rental of durable medical equipment to all patients furthers their exempt purpose and is not subject to unrelated business income. Taxpayer refers to the bylaws of stating that is formed "to assist the facilities of and and further the provision of health care services to the patients of said hospitals and the communities they serve". and communities are , , and the outlying areas. does not refuse medically necessary services to anyone based on ability to pay.

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Taxpayer indicates that the sale and rental of durable medical equipment furthers an exempt purpose of the provision of health care. They believe that all sales and rentals of DME constitute exempt income and are excluded from unrelated business income for that reason.

Government's Position

Taxpayer's sales and rentals of durable medical equipment to the general public in a commercial manner constitutes unrelated business income as defined under IRC §513(a). The sales and rentals of durable medical equipment constitute an unrelated trade or business regularly carried on. The organization is operating two stores located in , and .

Selling and renting durable medical equipment at commercial prices is not a charitable activity under IRC §501(c)(3) and does not further an exempt purpose. Further, taxpayer's sale and rental of durable medical equipment to the public are in direct competition with other for profit durable medical equipment providers including , , and .

IRC §513(a) provides that the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption. The sale and rental of durable medical equipment at commercial market prices to the public is in direct competition with other for profit durable medical equipment providers. The sale of rental of durable medical equipment to the public at market prices constitutes unrelated business income under IRC §513(a). Taxpayer is liable for filing Forms 990-T *Exempt Organization Business Income Tax Return*, unrelated business income tax, and penalties under IRC §6651(a)(1) and IRC §6651(a)(2) for failure to file and failure to pay.

Conclusion

Taxpayer's sales and rentals of durable medical equipment to the public at commercial prices constitutes unrelated business income as defined under IRC §513(a). Taxpayer is liable for filing Forms 990-T *Exempt Organization Business Income Tax Return*, unrelated business income tax, and penalties under IRC §6651(a)(1) and IRC §6651(a)(2) for failure to file and failure to pay.