



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE  
TE/GE: EO Examination  
1100 Commerce Street, MS 4920 DAL  
Dallas, Texas 75242-1100

Date: March 8, 2019

Number: 201933019  
Release Date: 8/16/2019

Employer Identification Number:

Person to Contact/ID Number:

UIL: 501.03-00

Contact Numbers:

Voice:

Fax:

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:

**CERTIFIED MAIL - RETURN RECEIPT REQUESTED**

Dear :

This is a final determination regarding your foundation classification. This modifies our letter dated September 19XX, in which we determined that you were an organization described in section 509(a)(1) as described in section 170(b)(1)(A)(iii) of the Internal Revenue Code (Code). We have modified your foundation status to that of an organization described in section 509(a)(1) as described in section 170(b)(1)(A)(v) as a governmental unit of the Code as a publicly supported organization, effective for tax years beginning April 1, 20XX.

Your tax-exempt status under section 501(c)(3) of the Internal Revenue Code is not affected. Grantors and contributors may rely on this determination, unless the Internal Revenue Service publishes a notice to the contrary. Because this letter could help resolve any questions about your private foundation status, please keep it with your permanent records.

We previously provided you a report of examination explaining the proposed modification of your tax-exempt status. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On November 15, 20XX, you signed Form 6018, *Consent to Proposed Action - Section 7428*, in which you agreed to the modification of your foundation classification to 509(a)(1) as described in section 170(b)(1)(A)(v) of the Code. This is a final determination letter with regards to your Federal tax-exempt status under section 501(a) of the Code.

You are required to file Form 990, Return of Organization Exempt from Income Tax. Form 990 must be filed by the 15<sup>th</sup> day of the fifth month after the end of your annual accounting

periods. A penalty of \$20 a day is charged when a return is filed late, unless there is a reasonable cause for the delay; however, the maximum penalty charged cannot exceed \$10,000 or 5 percent of your gross receipts for the year whichever is less. In addition, organizations with gross receipts exceeding \$1,000,000 for any year will be charged a penalty of \$100 a day when a return is filed late; however, the maximum penalty charged cannot exceed \$50,000. These penalties may also be charged if a return is not complete, so be sure your return is complete before you file it.

If you are subject to the tax on unrelated business income under section 511 of the Code, you must also file an income tax return on Form 990-T, Exempt Organization Business Income Tax Return.

If you decide to contest this determination in court, you must initiate a suit for a declaratory judgment in the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date this final determination letter was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. You may write to the Tax Court at the following address:

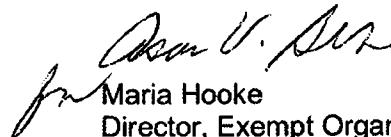
United States Tax Court,  
400 Second Street  
Washington, D.C. 20217

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your 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](mailto:taxpayeradvocate@irs.gov) or call 1-877-777-4778.

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter.

Thank you for your cooperation.

Sincerely,



Maria Hooke  
Director, Exempt Organizations Examinations



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities  
Exempt Organizations Examinations  
1100 Commerce Street  
Dallas, TX 75242

Date:  
November 6, 2018  
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact:

Employee ID:  
Telephone:  
Fax:  
Address:

Manager's Contact Information:

Employee ID:  
Telephone:  
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 modify your organization's foundation status under Internal Revenue Code (IRC) Section 509(a).

Your exempt status under IRC Section 501(c)(3) is still in effect.

**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 letter modifying your foundation status.

**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

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 letter modifying your foundation status.

**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](http://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](http://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 <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended <b>03/31/20XX</b>

**ISSUE**

Issue 1: Whether the current activities qualifies it for exemption under Section 501(c)(3)?

Issue 2: Whether the private foundation status of (" ") should be reclassified to a publicly supported organization described in Internal Revenue Code Section 509(a)(1) as described in Section 170(b)(1)(A)(v) of the Code?

**FACTS**

(" ") was granted exemption as and organization described under Section 501(c)(3) of the Code and defined in IRC Section 509(a) and 170(b)(1)(A)(ii) in September of 19XX.

The organization submitted a petition for creation of issued the 22<sup>nd</sup> day of March 19XX. The petition to the State of contained the following:

- [1] The shall upon creation, operation under Articles IX, Section 9, of the Constitution.
- [2] The name of the proposed hospital shall to be the " ".
- [3] The boundaries of the hospital shall be coextensive with the boundaries of the of
- [4] None of the territory in the proposed is included in another hospital

The following is from the

**CITATION TO LOCAL LAW**

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
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### CITATION TO LOCAL LAW

An examination of \_\_\_\_\_ was initiated by the Internal Revenue Service ("Service") on July 31, 20XX. During the audit the Service discovered \_\_\_\_\_ operations changed. \_\_\_\_\_ no longer operates a hospital facility. In 20XX \_\_\_\_\_ sold certain assets and the operations of the hospital to a \_\_\_\_\_ Limited Liability Company wholly owned by \_\_\_\_\_.

The following summary of facts was included in \_\_\_\_\_ annual audit conducted by \_\_\_\_\_

\_\_\_\_\_, (the "\_\_\_\_\_"), located in \_\_\_\_\_, is a political subdivision created and operating under the laws of the State of \_\_\_\_\_. In accordance with \_\_\_\_\_ a special election was held on March 6, 19XX in \_\_\_\_\_ approving the creation of the special "\_\_\_\_\_." The \_\_\_\_\_ is governed by a board of directors elected by the citizens of \_\_\_\_\_.

Prior to the formation of the \_\_\_\_\_ (the "Hospital"), a not-for-profit corporation, owned the hospital operations, equipment, and facilities. Effective October 1, 19XX, the \_\_\_\_\_ and the Hospital entered into a hospital sublease and transfer of operations agreement. Under this agreement, the Hospital transferred certain assets and operations and subleased the facility and equipment to the \_\_\_\_\_. The lease was a 0 year lease with a five year extension option. At the end of the original terms, the lease will automatically renew on a year-to-year basis upon the

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same terms and conditions unless a written notice of termination is given to the other party at least 0 days prior to termination.

Effective December 31, 20XX, the ( ) to ( ), a Limited Liability Company wholly owned by . The remains as a taxing with property taxes levied on real property within the . The also receives sales tax revenues.

Arrangements with - A zero year sublease agreement with became effective in December 20XX. Under the terms of the agreement, will sublease the building and land from the for \$0 per quarter. The sublease is subject to one renewal option of three years.

Effective February 1, 20XX, an amendment to the sublease agreement was entered into. Under the amendment, the rent payments were increased to \$0 per quarter. The lease term under the original sublease agreement remains the same.

Effective August 20XX, the entered into another lease agreement with for the use and operation of the for \$0 per month for 0 years. The lease is subject to zero renewal options of five years.

If the terminates this arrangement, the hospital's operations could be transferred back to the , along with the possible liability of the to reimburse for certain expenditures. As of March 31, 20XX, no such termination has been made by the .

The has committed to provide funding for certain Medicaid and non-Medicaid indigent care to support the care of qualifying patients through the . Under this program,

provide a copy of the ASSET PURCHASE AND ASSUMPTION AGREEMENT entered into with which provided the following:

THIS ASSET PURCHASE AND ASSUMPTION AGREEMENT ("Agreement") is executed as of the 28th day of September, 20XX, to be effective the 11 day of December ("Execution Date"), by and between , a limited liability company wholly owned by ("Buyer"), and , a political subdivision of the State of ("Seller").

5.7.1 Hospital Governance. Buyer shall establish a board of directors to oversee the operations of the Hospital ("Hospital Board"). Seller may appoint three members of the Hospital Board, which members shall reside within the . At Seller's discretion, the Hospital Board members may be members of Seller's board. Buyer may appoint one member of its choosing to the Hospital Board, and the chief executive officer of the Hospital shall serve as a Hospital Board member. Certain actions, as set forth below, will require the approval of at least four of the Hospital Board members:

- (i) Appointment or termination of the chief executive officer;
- (ii) Approval of the Hospital budget and strategic plan;

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- (iii) Authorization to incur indebtedness in excess of \$0; and
- (iv) Authorization to purchase or sell equipment with a value in excess of \$0.

5.7.3 Buyer shall provide hospital services to Medicaid patients and shall provide "Services" to "Non-Medicaid Indigent" patients at all times it operates the Hospital, where: "Services" shall include the following basic health care services: primary and preventative services designed to meet the needs of the community, including: (A) immunizations; (B) medical screening services; and (C) annual physical examinations; inpatient and outpatient hospital services; rural health clinics; laboratory and X-ray services; family planning services; physician services; payment for not more than three prescription drugs a skilled nursing facility services, regardless of the patient's age and (b) "Non-Medicaid Indigent" patients shall mean patients who are residents of \_\_\_\_\_ with resources not exceeding \$0 (or \$0 if an aged or disabled person is in the household), whose countable monthly income does not exceed 0% of the Federal Poverty Index Guidelines as now existing or amended in the future, and who are not eligible for healthcare services from private health insurance or federal or state assistance programs.

5.7.4 Buyer shall make available to Seller upon its request records documenting the amount of care and other community benefits Buyer provides to residents of the \_\_\_\_\_ community.

5.7.5 Buyer hereby grants Seller a right of first refusal to repurchase the Hospital and Buyer's leasehold interest in the Lease Property at fair market value in the event Buyer determines it will sell, assign, lease or transfer its leasehold interest in the Hospital; provided, however, this right of first refusal shall not apply in the event of any change in the ownership of Buyer's parent  
Upon receipt of a bona fide offer from a third party to acquire ownership or operation of the Hospital from Buyer ("Offer"), Buyer shall notify Seller of the Offer, and Seller shall have thirty days after its receipt of such notice to notify Buyer in writing as to whether it desires to exercise its rights under this Section. If Seller elects to acquire the Hospital pursuant to this Section, it shall do so on terms no less favorable to Buyer than those set forth on the Offer, and the parties shall negotiate in good faith any terms not set forth in the Offer. In the event Buyer does not receive notice from Seller within thirty days after Seller's receipt of the Offer, or in the event Seller notifies Buyer that Seller does not desire to acquire the Hospital under this Section, then Buyer may accept the Offer and sell the Hospital to the third party. Nothing in this Section shall waive any requirement in the Operating Lease for the consent of Seller to such a transaction.

## LAW

### Issue 1

Section 1.501 (c)(3)-I (a)(I) of the regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization 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 test or the operational test, it is not exempt.

Section 1.501 (c)(3)-I (c)(I) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.



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Section 1.501 (c)(3)-I (d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501 (c)(3)-I (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 and includes the relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501 (c)(3)-I (e)(1) of the regulations 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 purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In *Better Business Bureau Washington D. C, Inc. v. United States*, 326 U.S. 279 (1945), the Supreme Court held that 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. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university. An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single noncharitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. See *Stevens Bros. Foundation, Inc., v. Commissioner*, 324 F.2d 633 (8th Cir. 1963), *affd.* 39 TC 93 (1962), *cert. denied*, 376 US 969 (1964). Operating for the benefit of private parties who are not members of a charitable class constitutes such a substantial nonexempt purpose.

Rev. Rul. 76-152, 1976-1 CB 151. If the private benefit is only incidental to the exempt purposes served, and not substantial, it will not result in a loss of exempt status. See *St. Louis Union Trust Co. v. United States*, 374 F.2d 427 (8th Cir. 1967). If an activity serves both exempt and nonexempt purposes, the organization will be exempt only if the predominant motivation underlying the activity is an exempt purpose. A private benefit is considered incidental only if it is incidental in both a qualitative and a quantitative sense. In order to be incidental in a qualitative sense, the benefit must of necessity coexist with the activity which benefits the public at large.

Rev. Rul. 80-309, 1980-2 CB 183, January 1, 1980, a nonprofit organization was created to construct, maintain, and operate or lease a public hospital and related facilities for the benefit of a city and surrounding communities is operated exclusively for charitable purposes and qualifies for exemption under IRC section 501(c)(3). After construction of these facilities, the organization's only activity was to lease facilities to an association exempt under IRC 501(c)(3). The lessee operates the facilities and pays as consideration an amount sufficient only to retire the organization's indebtedness incurred to finance the hospital and meet the organization's administrative expenses. The organization's income is derived from lease payments and disbursements are made for administrative expenses and retirement of indebtedness.

Rev. Rul. 73-313 provides that an organization formed and supported by residents of an isolated rural community to provide medical building and facilities at reasonable rent to attract a doctor who would provide medical services to the entire community is exempt under section 501(c)(3). The circumstances in this case reveal the following facts particularly relevant to the determination of whether the devotion of

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resources to the provision of a physical facility for medical practice in the manner described qualifies as a charitable use: The community was totally lacking in local medical service, and the isolation of the community was such that the lack of such services posed a real and substantial threat to the health and safety of the community. The lack of adequate facilities for the conduct of a medical practice in the community was shown to be a significant factor in the inability of civic leaders of the community to induce a doctor to locate in the community. Providing the physical facility in the manner described bears a clear relationship to lessening of the health hazards resulting from the absence of a local practitioner in the community. The terms of the arrangement entered to induce the doctor to locate his practice in the locality bear a reasonable relationship to promotion and protection of the health of the community. The arrangements in question were completely at arm's length, with no relationship between any person connected with the organization and operation of the organization and the medical practitioner induced to locate in the community.

Rev. Rul. 69-545 compares two hospitals. Hospital 1 is controlled by a board of trustees composed of independent civic leaders; maintains an open medical staff; operates a full-time emergency room open to all regardless of ability to pay; otherwise admits all patients able to pay; and uses surplus funds to improve the quality of patient care, expand facilities, and advance its medical training, education and research programs. Hospital 2 is controlled by physicians who have a substantial economic interest in the hospital, restricts the number of physicians admitted to the medical staff, enters into favorable rental agreements with individuals who control the hospital, and limits emergency room and hospital admission substantially to the patients of the physicians who control the hospital.

Rev. Rul. 69-545 concludes that Hospital 1 is exempt, while the Hospital 2 is not, and notes that the fact that Hospital 1 operates at an annual surplus of receipts over disbursements does not preclude its exemption. By using its surplus funds to improve the quality of patient care, expand its facilities, and advance its medical training, education, and research programs, the hospital is operating in furtherance of its exempt purposes. Furthermore, Hospital 1 is operated to serve a public rather than a private interest. Control of the hospital rests with its board of trustees which is composed of independent civic leaders.

Rev. Rul. 98-15 provides examples illustrating whether nonprofit hospitals that participate in joint ventures with for-profit entities continue to qualify for exemption as organizations described in IRC 501(c)(3).

In Situation 1, A is an IRC 501 (c)(3) corporation that owns and operates an acute care hospital and B is a for-profit corporation that owns and operates a number of hospitals. A concludes that it could better serve its community if it obtained additional funding. B is interested in providing financing for A's hospital, provided it earns a reasonable rate of return. A and B form a limited liability company, C. A contributes all of its operating assets, including its hospital to C. B also contributes assets to C. In return, A and B receive ownership interests in C proportional and equal in value to their respective contributions. C's Articles of Organization and Operating Agreement ("governing documents") provide that C is to be managed by a governing board consisting of three individuals chosen by A and two individuals chosen by B. The governing documents further provide that they may only be amended with the approval of both owners and that a majority of three board members must approve certain major decisions relating to C's operation, including, decisions relating to any of the following topics: A. C's annual capital and operating budgets; 8. Distributions of C's earnings;

Rev. Rul. 98-15 cites a number of court cases in analyzing the Situations 1 and 2. In *Broadway Theatre League of Lynchburg, Virginia, Inc. v. U.S.* 293 F. Supp. 3, f. § (W.D.Va.1968) ("Broadway Theatre League"), the court held that an organization that promoted an interest in theatrical arts did not jeopardize

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its exempt status when it hired a booking organization to arrange for a series of theatrical performances, promote the series and sell season tickets to the series because the contract was for a reasonable term and provided for reasonable compensation and the organization retain ultimate authority over the activities being managed.

In *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F.2d 170 (9th Cir. 12/11/80) ("est of Hawaii"), several for-profit organizations (Note: "est" stands for Erhard Seminars Training) exerted significant indirect control over est of Hawaii, a non-profit entity, through contractual arrangements. The Tax Court concluded that the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, est of Hawaii did not qualify as an organization described in IRC 501(c)(3).

In *Harding Hospital, Inc. v. United States*, 505 F.2d 1068 (6th Cir 1974) ("Harding"), a non-profit hospital with an independent board of directors executed a contract with a medical partnership composed of seven physicians. The contract gave the physicians control over care of the hospital's patients and the stream of income generated by the patients while also guaranteeing the physicians thousands of dollars in payment for various supervisory activities. The court held that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

Rev. Rul. 98-15 provides that an IRC 501 (c)(3) organization may enter into a management contract with a private party giving that party authority to conduct activities on behalf of the organization and direct the use of the organization's assets provided that the organization retains ultimate authority over the assets and activities being managed (emphasis added) and the terms and conditions of the contract are reasonable, including reasonable compensation and a reasonable term. See *Broadway Theatre League*. However, if the private party is allowed to control or use the nonprofit organization's activities and assets for the benefit of the private party, and the benefit is not incidental to the accomplishment of exempt purposes, the organization will fail to be organized and operated exclusively for exempt purposes. See *est of Hawaii: Harding*; section 1.501 (c)(3)-1(c)(1); and section 1.501(c)(3)-J(d)(1)(H).

In its analysis of Situation 1, Rev. Rul. 98-15 states that the governing documents of C commits C to providing health care services for the benefit of the community as a whole and to give charitable purposes priority over maximizing profits for C's owners. Furthermore, through A's appointment of members of the community familiar with the hospital to C's board, the board's structure, which gives A's appointees voting control, and the specifically enunciated powers of the board over changes in activities, disposition of assets, and renewal of the management agreement, A can ensure that the assets it owns through C and the activities it conducts through C are used primarily to further exempt purposes.

With respect to Situation 2, Rev. Rul. 98-15 concludes that in absence of a binding obligation in F's governing documents for F to serve charitable purposes or otherwise provide its services to the community as a whole, F will be able to deny care to segments of the community, such as indigent. Because D will share control of F with E, D will not be able to initiate programs within to serve new health needs within the community without the agreement of at least one governing board member appointed by E. As a business enterprise, E will not necessarily give priority to the health needs of the community over the consequences for F's profits. The primary source of information for board members appointed by D will be its chief executives, who have a prior relationship with E and the management company, which is a subsidiary of E. The management company itself will have broad discretion over F's activities and assets that may not

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always be under the board's supervision. For example, the management company is permitted to enter into all but "unusually large" contracts without board approval. Thus, D will fail the operational test when it forms F, contributes its operating assets to F, and then serves as an owner to F.

Rev. Rul. 98-15 holds that A will continue to qualify as an organization described in IRC section 501(c)(3) because it has established that it will be operating exclusively for charitable purpose and only incidentally for the purpose of benefiting the private interests of B. Conversely, D will violate the requirements to be an organization described in IRC section 501(c)(3) when it forms F and contributes all of its operating assets to F because D has failed to establish that it will be operated exclusively for exempt purposes.

## Issue 2

Section 170(a), subject to certain limitations, allows as a deduction any charitable contribution (as defined in Section 170(c)) payment of which is made within the taxable year.

Section 170(c)(1) of the Code states that the term "charitable contribution" includes a contribution or gift to or for the use of a State, a possession of the United States, any political subdivision of a State or a possession of the United States, the United States, or the District of Columbia, but only if the contribution is made for exclusively public purposes.

For example, Rev. Rul. 79-323, 1979-2 C.B. 106, holds that gifts to an industrial commission established by a state legislature for exclusively public purposes are deductible under § 170(c)(1). Rev. Rul. 69-90, 1969-1 C.B. 63, holds that voluntary payments by merchants and property owners to a city to be used to provide unrestricted public parking facilities in the general area of the business and properties of the contributors are charitable contributions as defined in § 170(c)(1).

Section 103(a) provides, in part, that except as provided in subsection (b), gross income does not include interest on any state or local bond. Section 103(c)(1) provides that the term "state or local bond" means an obligation of a state or political subdivision thereof.

Section 1.103-1(b) of the Income Tax Regulations provides that the term "political subdivision" denotes any division of any state or local governmental unit that is a municipal corporation or that has been delegated the right to exercise part of the sovereign power of the unit. As thus defined, a political subdivision of any state or local governmental unit may or may not, for purposes of this section, include special assessment so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar and divisions of these units.

Rev. Rul. 78-276, 1978-2 C.B. 256, states that the term "political subdivision" has been defined consistently for all federal tax purposes as denoting either (1) a division of a state or local government that is a municipal corporation, or (2) a division of such state or local government that has been delegated the right to exercise sovereign power. The three generally acknowledged sovereign powers are the power to tax, the power of eminent domain, and the police power.

See *Commissioner v. Estate of Shamburg*, 3 T.C. 131 (1944), acq., 1945 C.B. 6, aff'd 144 F.2d 998 (2d Cir. 1944), cert denied, 323 U.S. 792 (1945). It is not necessary that all three sovereign powers enumerated in *Shamburg* be delegated. See Rev. Rul. 77-164, 1977-1 C.B. 20. However, possession of only an insubstantial amount of any or all sovereign powers is not sufficient. In determining whether an entity is a division of a state or local governmental unit, important considerations are the extent that the entity is (1)

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controlled by the state or local government unit, and (2) motivated by a wholly public purpose. Rev. Rul. 83-131, 1983-2 C.B. 184.

### TAXPAYER'S POSITION

The taxpayer's position is being solicited at this time.

### GOVERNMENT'S POSITION

#### Issue 1

, (the " "), located in , is a political subdivision created and operating under the laws of the State of . In accordance with a special election was held on March 6, 19XX in approving the creation of the special " ." The is governed by a board of directors elected by the citizens of

Prior to the formation of the , (the "Hospital"), a not-for-profit corporation, owned the hospital operations, equipment, and facilities. Effective October 1, 19XX, the and the Hospital entered into a hospital sublease and transfer of operations agreement. Under this agreement, the Hospital transferred certain assets and operations and subleased the facility and equipment to the . The lease was a 0 year lease with a five year extension option. At the end of the original terms, the lease will automatically renew on a year-to-year basis upon the same terms and conditions unless a written notice of termination is given to the other party at least 0 days prior to termination.

During the audit conducted in 20XX the Service discovered a change in activities occurred in 20XX. On December 31, 20XX, the sold certain assets and the operations of ( ) to ( ), a Limited Liability Company wholly owned by . The remains as a taxing with property taxes levied on real property within the . The also receives sales tax revenues.

Under the original agreement subleased the building and land from the for \$0 per quarter. The sublease is subject to one renewal option of three years. On February 1, 20XX, an amendment to the sublease agreement was entered into with the rent payments increased to \$0 per quarter. The lease term under the original sublease agreement remains the same.

Effective August 20XX, the entered into another lease agreement with for the use and operation of the for \$0 per month for 0 years. The lease is subject to three renewal options of five years. If the terminates this arrangement, the hospital's operations could be transferred back to the , along with the possible liability of the to reimburse for certain expenditures. As of March 31, 20XX, no such termination has been made by the .

The has committed to provide funding for certain Medicaid and non-Medicaid indigent care to support the care of qualifying patients through the . Under this program,

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 03/31/20XX

The contract between \_\_\_\_\_ and \_\_\_\_\_ can serve exempt purposes by maintaining land, building and equipment of a hospital to ensure it would continue to be available to the public in a rural community. Maintaining and leasing medical facilities via a lease to an individual or entity to provide medical care in a rural community under certain circumstances can be considered to constitute exempt purposes.

The asset purchase and assumption agreement states \_\_\_\_\_ shall establish a board of \_\_\_\_\_ directors to oversee the operations of the Hospital ("Hospital Board"). Seller may appoint three members of the Hospital Board, which members shall reside within the \_\_\_\_\_. At Seller's discretion, the Hospital Board members may be members of Seller's board. Buyer may appoint one member of its choosing to the Hospital Board, and the chief executive officer of the Hospital shall serve as a Hospital Board member. Certain actions, as set forth below, will require the approval of at least four of the Hospital Board members: (i) Appointment or termination of the chief executive officer; (ii) Approval of the Hospital budget and strategic plan; (iii) Authorization to incur indebtedness in excess of \$0; and (iv) Authorization to purchase or sell equipment with a value in excess of \$0.

The asset purchase and assumption agreement states \_\_\_\_\_ shall provide hospital services to Medicaid patients and shall provide "Services" to "Non-Medicaid Indigent" patients at all times it operates the Hospital, where: "Services" shall include the following basic health care services: primary and preventative services designed to meet the needs of the community, including: (A) immunizations; (B) medical screening services; and (C) annual physical examinations; inpatient and outpatient hospital services; rural health clinics; laboratory and X-ray services; family planning services; physician services; payment for not more than three prescription drugs a skilled nursing facility services, regardless of the patient's age and (b) "Non-Medicaid Indigent" patients shall mean patients who are residents of \_\_\_\_\_ with resources not exceeding \$0 (or \$0 if an aged or disabled person is in the household), whose countable monthly income does not exceed 0% of the Federal Poverty Index Guidelines as now existing or amended in the future, and who are not eligible for healthcare services from private health insurance or federal or state assistance programs. In addition, \_\_\_\_\_ shall make available to Seller upon its request records documenting the amount of care and other community benefits Buyer provides to residents of the community.

The facts are similar to the revenue rulings and court decisions cited above for determining whether a hospital functions in an exempt manner is control over the operation for exempt purposes. \_\_\_\_\_ has demonstrated control over the operations of the hospital assets and within its lease arrangement with \_\_\_\_\_. The agreement between \_\_\_\_\_ and \_\_\_\_\_ states the hospital shall provide services to Medicaid patients and shall provide "Services" to "Non-Medicaid Indigent" patients at all times it operates the Hospital.

\_\_\_\_\_ has operated similar to like the hospital situation in Revenue Ruling 80-309, where the organization leased the facilities to a for-profit corporation rather than to another non-profit corporation.

## Issue 2

The petition creating \_\_\_\_\_ states boundaries shall be coextensive with the boundaries of the \_\_\_\_\_ of \_\_\_\_\_, \_\_\_\_\_ was organized under the law of the State of \_\_\_\_\_ Articles IX, Section 9 of the State Constitution. Upon its creation, \_\_\_\_\_ assumed full responsibility for the furnishing of medical and hospital care of the indigent and needy persons residing in the Hospital \_\_\_\_\_.

**EXPLANATIONS OF ITEMS**

Name of taxpayer

Tax Identification Number

Year/Period ended  
**03/31/20XX**

Under the enabling legislation \_\_\_\_\_ may exercise the power of eminent domain to acquire a fee simple or other interest in property located in \_\_\_\_\_ territory if the interest is necessary for the \_\_\_\_\_ to exercise a right or authority conferred by this chapter. The \_\_\_\_\_ must exercise the power of eminent domain in the manner provided by \_\_\_\_\_, except the \_\_\_\_\_ is not required to deposit in the trial court money or a bond as provided by \_\_\_\_\_. In a condemnation proceeding brought by the \_\_\_\_\_, the \_\_\_\_\_ is not required to pay in advance or provide a bond or other security for costs in the trial court.

The enabling legislation \_\_\_\_\_ may impose a tax on all property in the \_\_\_\_\_ subject to \_\_\_\_\_ taxation. The tax may be used to pay indebtedness issued or assumed by the \_\_\_\_\_ and the maintenance and operating expenses of the \_\_\_\_\_. \_\_\_\_\_ shall be governed by a permanent board on nine directors to be elected from the \_\_\_\_\_ at large.

The term "political subdivision" is not defined by the Internal Revenue Code. However, the term is defined by section 1.103-1(b) of the Income Tax Regulations to include any division of a state or local governmental unit that is a municipal corporation or has been delegated the right to exercise part of the sovereign power of the unit.

In *Commissioner v. Estate of Shamberg*, 3 T.C. 131 (1944), acq., 1945 C.B. 6, aff'd 144 F.2d 998 (2nd Cir.1944), cert. denied, 323 U.S. 792 (1944), the United States Tax Court said that three generally acknowledged sovereign powers of states are the power to tax, the power of eminent domain, and the police power. In Rev. Rul. 77-164, 1977-1 C.B. 20, the Internal Revenue Service concluded it is not necessary that all the powers enumerated in *Shamberg* be delegated. However, possession of merely an insubstantial amount of any or all of those powers is not sufficient for political subdivision status. All of the facts and circumstances must be taken into consideration, including the public purposes of the entity and its control by a government.

\_\_\_\_\_ was created to perform a significant public purpose. \_\_\_\_\_ has eminent domain power and has powers to cause tax to be levied and bonds to be issued in its name. \_\_\_\_\_ is a political subdivision for purposes of the federal income tax.

**CONCLUSION**

\_\_\_\_\_ continues to qualify for exemption under 501(c)(3) and should be reclassified as a public charity as defined by IRC Section 509(a)(1) and 170(b)(1)(A)(v).