SIN 501.03-00
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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: AUG 2 0 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T2

Dear Sir or Madame:

This responds to your request for ruling dated March 2, 1999, as supplemented by information submitted in your letter of May 28, 1999. You ask us to consider whether the operation of an assisted living facility under the circumstances described below will affect your exempt status or result in the imposition of the taxes on income derived from unrelated business activities.

You were incorporated in 1955 and from the date of incorporation until 1985, you operated as part of a group exemption issued to your parent. In 1985, you applied and were recognized independently as an organization described in Section 501(c)(3) of the Internal Revenue Code. You are also classified as an organization described in Section 509(a)(2) of the Code. Your purpose as stated in your articles of incorporation is to operate a home for the aged, sick and destitute, to assist in improving moral and social conditions of its beneficiaries and to provide relief of distressed beneficiaries, visitation of sick and burial of the dead, and such other benevolent and worthy purposes as may be necessary in connection with this purpose. Presently your only activity consists of the operation of a licensed seventy-five bed intermediate care nursing facility. This facility has been a certified Medicaid participant and has been operating at, or near capacity for the last five years.

You now propose to expand your activities to provide services to the aged. You intend to operate an assisted living facility able to accommodate sixty one residents. The facility will be comprised of 38 one-bedroom apartments and 4 two-bedroom apartments. In addition, you will provide 15 units specially designed to house up to fifteen tenants afflicted with Alzheimer's disease. There will be space for adult day care for up to thirty participants and a chapel which will be accessible by both the assisted living facility and your nursing facility residents. Your operations will conform to rules promulgated by your state's Department of Health. These rules define the aged as persons over 62 years and define the physical conditions that must be met by prospective residents seeking admission to your facility. Your facility will be built and operated so as to address the special needs of persons meeting the state guidelines. The rates you will charge will vary according to the type of service or accommodation provided, but will be affordable to a significant segment of the elderly population of the area where you are located. You indicate residents will be expected to demonstrate their ability to pay your customary charges, but it is your policy not to evict a resident who subsequently becomes unable to pay your charges.

The facility will be built adjacent to the facility you presently operate on property you own. The Health, Education and Housing Facility Board of the County where you are located will construct the facility using \$6.7 million of the proceeds of bonds it will issue. You will provide an additional \$1.8 million of funding to cover the total \$8.5 million cost of the facility. The county agency will retain ownership of the facility and will lease it to you under terms that will enable the amortization of the indebtedness. Your agreement with the issuer provides you the opportunity to purchase the facility for a nominal sum as soon as the indebtedness is retired.

Section 501(a) of the Internal Revenue Code provides for the exemption from income tax for organizations described in 501(c)(3).

Section 501(c)(3) of the Code describes, in pertinent part, organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in Section 501(c)(3) in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged.

Revenue Ruling 72-124, 1972-1 C.B 145, recognizes the elderly as a charitable class and an organization which meets the needs of the elderly for housing, health care and financial security is engaged in charitable activities.

Revenue Ruling 79-18, 1979-1 C.B. 194 concluded that an organization formed to meet the housing needs of the elderly by building and operating an apartment rental complex qualified for exemption as a charitable organization. The organization provided a facility specially designed to meet the various special needs of the elderly and 24-hour staffing and assistance.

Section 509(a)(2) of the Code excepts from the definition of Private Foundation an organization which normally receives more than one-third of its annual support from any combination of gifts, grants, contributions or membership fees, and gross receipts from the conduct of activities not unrelated to its exempt purposes from persons who are not disqualified persons.

Section 512(a)(1) of the Code provides the term "unrelated business taxable income" means the gross income derived by an organization from any unrelated trade or business as defined in Section 513 of the Code, less the deductions allowed for expenses directly connected with such trade or business.

Section 513(a) defines "unrelated trade or business" as any trade of business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable or other purpose constituting its basis for exemption under 501(c)(3).

Section 514(a) of the Code provides for the inclusion in the computation of unrelated business taxable income, income derived from property subject to acquisition indebtedness. Section 514(c)(4), however, provides that acquisition indebtedness does not include indebtedness the incurrence of which is inherent in the performance or exercise of the purpose or function constituting the basis of an organization's exemption.

Section 1.514(b)-1(b)(i) of the Regulations provides that to the extent the use of any property is substantially related to the exercise or performance by an organization of its charitable purpose, such property shall not be treated as "debt-financed property."

The above cited revenue rulings make it clear that the elderly constitute a charitable class of persons because of the nature of afflictions commonly found in that group, such as mobility problems, health problems and financial insecurity. An organization which is operated to alleviate those afflictions is therefore deemed charitable and may be recognized exempt if it otherwise operates in conformity with Section 501(c)(3) of the Code. Your facility will be specially constructed to accommodate those with special physical needs, and will be staffed continuously. You will offer a variety of services to residents according to their special needs, and the presence of your skilled nursing facility will serve to alleviate the medical needs of residents in such need. Your fees are fixed so as to be accessible to a significant

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segment of the population in your area and your commitment to continue to care for those who become unable to pay will provide financial security. You expect the fees you charge to equal or exceed the expenses of operating the facility and will be your principle means of support. Although you will derive income from property subject to indebtedness, it is clear the type of services you will render through this property furthers you stated purpose to provide relief to the distressed. This brings you within the exception contemplated in the above cited regulation, and means your proposed property is deemed not to be debt-financed for purposes of computing unrelated business taxable income.

Based on the above we hold:

1. Your tax exempt status will not be adversely affected by the operation of the assisted living facility described;

2. The fees you receive from the operation of the assisted living facility will be derived from activity related to the accomplishment of your charitable objectives and are not included in the computation of unrelated business taxable income, and will not affect your qualification as an organization described in Section 509(a)(2) of the Code; and

3. Bond proceeds expended for the construction of your assisted living facility are inherent to the fulfillment of your exempt purposes and are not considered acquisition indebtedness, and will not cause fees you obtain from operation of this facility to be included in computation of unrelated business taxable income.

Because this letter could help resolve any questions about your tax status, you should keep it with your permanent records.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to your key District Director.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2