TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
August 14, 2014

Release Number: **201445015**
Release Date: 11/7/2014
Uniform Issue List Numbers:
501.03-11
509.02-01
513.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

M =
N =
P =
R =
T =

Dear :

This responds to your request for rulings under I.R.C. §§ 501(c)(3), 509(a), and 511 through 514 with respect to a proposal to merge N, P, and R into M.

Facts

The Parties

Each of M, N, P, and R is exempt from federal income taxation under § 501(a) as an organization described in § 501(c)(3).

M operates a hospital and related healthcare centers. M is not a private foundation within the meaning of § 509(a) because it is described in §§ 509(a)(1) and 170(b)(1)(A)(iii).

N is the parent corporation and sole member of M, P, and R. It provides management, strategic planning, and other services to M, P, and their affiliated organizations. N is not a private foundation within the meaning of § 509(a) because it is described in §§ 509(a)(1) and 170(b)(1)(A)(vi).

P owns and operates a nursing home. It is not a private foundation within the meaning of § 509(a) because it is described in §§ 509(a)(1) and 170(b)(1)(A)(iii).

R manages, operates, and provides management counsel and advice primarily to M and P. R is not a private foundation within the meaning of § 509(a) because it is described in § 509(a)(2).

The Merger

It is proposed to merge N, P, and R into M pursuant to the terms of a statutory merger effected under an Agreement and Plan of Merger (the "Merger Agreement") and the provisions of the state's Nonprofit Corporation Act. M will be the surviving corporation, and, immediately after the merger, its name will be changed to T. The purpose of the merger is to simplify organizational and governance structures, thereby creating more effective oversight by the board of directors of the surviving corporation. After the merger, T will continue to conduct the business of M, and, in addition, will conduct the businesses currently conducted by N, P, and R.

As a statutory merger, the merger will have the following effects:

1) every other corporation party to the merger merges into the surviving corporation and the separate existence of every corporation except the surviving corporation ceases;
2) the title to all real estate and other property owned by each corporation party to the merger is vested in the surviving corporation without reversion or impairment, and such vesting shall occur without further act or deed;
3) the surviving corporation has all liabilities and obligations of each corporation party to the merger, provided that trust obligations upon property of a disappearing corporation shall be limited to the property affected thereby immediately prior to the time the merger is effective;
4) any proceeding pending against any corporation party to the merger may be continued as if the merger did not occur or the surviving corporation may be substituted in the proceeding for the corporation whose existence ceased; and
5) the articles of association and bylaws of the surviving corporation are amended to the extent provided in the plan of merger.

To effect the merger, the existing Articles of Association of M will be amended and restated, and M's By-Laws will be replaced with a new set of By-Laws. In addition to the change of name from M to T, the material changes that will be made to M's Articles of Association will be to incorporate additional corporate purposes currently found in the Articles of Association of N, P, and R. The material changes that will be made to M's By-Laws at the time of merger are: (i) the incorporation of additional corporate purposes currently in the By-Laws of N, P, and R; (ii) revision of the committee structure reflecting all committees of the merged entities in a streamlined manner; and (iii) the incorporation of the membership provisions currently in N's By-Laws.

The Merger Agreement provides that the current membership of N will be converted on the same terms and conditions regarding the rights of its members to membership in T so that the pre-merger members of N will become the post-merger members of T. The members of N are,

generally, inhabitants of the communities served by N and its subsidiaries. All persons who contribute a certain nominal amount qualify as voting members for the year.

After the merger, T's Board of Directors will consist of the current directors of each of M, N, P, and R. After the running of the terms of those directors, the number of directors will be reduced to 21 directors, each of whom will serve for a term of three years. The Board of Directors shall be constituted as follows:

a. There shall be fourteen elected directors, each of whom must be a member of T. No elected director shall serve more than three consecutive terms, but may be re-elected to the Board after an absence of one year.
b. Three directors shall be appointed by the Board of Trustees of the local college.
c. The president of the medical staff shall be a director ex-officio, with vote.
d. The vice-president of the medical staff shall be a director ex-officio, with vote.
e. The chair of the medical center auxiliary shall be a director ex-officio, with vote.
f. The president shall be a director ex-officio, without vote.

Rulings Requested

You have requested the following rulings:

1. The merger and amendments to the Articles of Association and By-Laws of M will not adversely affect the tax-exempt status of M, as the surviving corporation, under I.R.C. § 501(c)(3).

2. The merger and amendments to the Articles of Association and By-Laws of M will not affect the non-private foundation status of M, as the surviving corporation, under I.R.C. §§ 509(a)(1) and 170(b)(1)(A)(iii).

3. The transfer of assets and liabilities from N, P, and R to M pursuant to the statutory merger will not result in gain or loss being recognized by M, as the surviving corporation, under I.R.C. §§ 511 through 514.

Law

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(3) describes organizations that are organized and operated exclusively for charitable and other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I.R.C. § 509(a)(1) provides that the term "private foundation" does not include an organization described in § 170(b)(1)(A) (other than in clauses (vii) and (viii)). I.R.C. § 170(b)(1)(A)(iii)

describes an organization the principal purpose or function of which is the providing of medical or hospital care or medical education or medical research, if the organization is not a hospital.

I.R.C. § 511(a) imposes a tax for each taxable year on the unrelated business taxable income (as defined in § 512) of every organization described in § 501(c).

I.R.C. § 512(a)(1) provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 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).

I.R.C. § 512(b)(5) excludes from unrelated business taxable income all gains and losses from the sale, exchange, or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business.

I.R.C. § 514(a) provides for the taxation under § 512 of income from debt-financed property.

I.R.C. § 514(b)(1)(A)(i) provides that the term debt-financed property does not include any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Treas. Reg. § 1.170A-9(d)(1) provides that an organization is described in § 170(b)(1)(A)(iii) if: (i) it is a hospital; and (ii) its principal purpose or function is the providing of medical or hospital care or medical education or medical research. An organization, all the accommodations of which qualify as being part of a "skilled nursing facility" within the meaning of 42 U.S.C. 1395x(j), may qualify as a "hospital" if its principal purpose or function is the providing of hospital or medical care.

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

Treas. Reg. § 1.501(c)(3)-1(a)(2) provides that the term "exempt purpose or purposes" as used in this section, means any propose or purposes specified in § 501(c)(3), as defined and elaborated in paragraph (d) of this section.

Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization: (a) limit the purposes of such organization to one or more exempt purposes; and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Treas. Reg. § 1.501(c)(3)-1(b)(4) provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1) lists "charitable" among the purposes for which an organization described in § 501(c)(3) may be organized.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense. In the general law of charity, the promotion of health is considered to be a charitable purpose. *See* Restatement (Third) of Trusts, §§ 28 (2003).

Treas. Reg. § 1.513-1(a) provides that, as used in § 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 § 512.

Treas. Reg. § 1.513-1(b) provides that, for purposes of § 513, the term "trade or business" has the same meaning it has in § 162, and generally includes any activity carried on for the production of income from the sale of goods or the performance of services.

Treas. Reg. § 1.513-1(c) provides that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on," within the meaning of § 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.

Rev. Rul. 69-545, 1969-2 C.B. 117, recognizes that a nonprofit corporation whose purpose and activity is to provide hospital care on a nonprofit basis for members of its community is organized and operated in furtherance of a purpose considered "charitable" in the generally accepted legal sense of that term. By operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, the hospital is promoting the health of a class of persons that is broad enough to benefit the community. Thus, it is held that the hospital is exempt from Federal income tax under § 501(c)(3).

Analysis

Issue 1: Whether the merger and amendments to the Articles of Association and By-Laws of M would adversely affect the tax-exempt status of M, as the surviving corporation, under I.R.C. § 501(c)(3).

To qualify as an organization described in § 501(c)(3) after the merger, M must continue to be organized and operated exclusively for one or more of the purposes specified in that section. Treas. Reg. § 1.501(c)(3)-1(a)(1). M will be deemed to be "organized exclusively" for exempt purposes after the merger if its amended Articles satisfy the organizational test under § 1.501(c)(3)-1(b). To effect the merger, the Articles of M will be amended to incorporate additional corporate purposes currently found in the Articles of N, P, and R, all of which purposes are already recognized as being in furtherance of charitable purposes within the meaning of § 501(c)(3). In addition, the amended Articles will limit M's purposes and activities to those that are appropriate and consistent with its status as an organization described in § 501(c)(3), and will contain a provision requiring that, upon M's dissolution, its assets be disposed of to one or more organizations exempt under § 501(c)(3). Thus, after the merger, M will continue to be organized exclusively for charitable purposes within the meaning of § 1.501(c)(3)-1(b).

M will be deemed to be "operated exclusively" for exempt purposes after the merger if it continues to engage primarily in activities which accomplish exempt purposes. After the merger, M will continue to perform the same activities in furtherance of charitable purposes for

which it has already been recognized exempt under § 501(c)(3), i.e., the operation of a hospital and related healthcare centers for the benefit of the community. Thus M will continue to operate for the promotion of health and thereby further charitable purposes within the meaning of § 1.501(c)(3)-1(d)(2). *See* Rev. Rul. 69-545. In addition, after the merger M will carry on the activities formerly performed by N, P, and R – i.e., the operation of a skilled nursing facility and the provision of various healthcare management, planning, and support services essential to the operation of the hospital and its related healthcare facilities – activities that are in furtherance of the promotion of health, and for which N, P, and R were recognized exempt under § 501(c)(3). Thus, after the merger, M will continue to be operated exclusively for exempt purposes within the meaning of § 1.501(c)(3)-1(c).

Since M will be organized and operated exclusively for exempt charitable purposes after the merger, the merger and amendments to the Articles and By-Laws of M will not adversely affect the tax-exempt status of M as an organization described in § 501(c)(3).

Issue 2: Whether the merger and amendments to the Articles of Association and By-Laws of M would affect the non-private foundation status of M, as the surviving corporation, under I.R.C. §§ 509(a)(1) and 170(b)(1)(A)(iii).

To qualify as an organization described in § 170(b)(1)(A)(iii) after the merger, M must be a hospital and have as its principal purpose or function the providing of medical or hospital care. The term "hospital" includes facilities like skilled nursing facilities whose principal purpose or function is the providing of hospital or medical care. Treas. Reg. § 1.170A-9(d)(1).

Currently, M operates a hospital and is classified as an organization described in § 170(b)(1)(A)(iii). The merger will result in M acquiring the assets, and carrying on the activities, of P, N, and R. P operates a skilled nursing facility and is classified as an organization described in § 170(b)(1)(A)(iii). N and R are organizations whose purpose is to provide management and planning support for the operations of M and P. Thus, after the merger, M will still operate a hospital and, in addition, will itself conduct all essential support services necessary to its operation. Its principal purpose or function will continue to be the providing of medical or hospital care. Consequently, after the merger, M will still be an organization described in § 170(b)(1)(A)(iii).

Issue 3: Whether the transfer of assets and liabilities from N, P, and R to M pursuant to the statutory merger would result in gain or loss being recognized by M, as the surviving corporation, under I.R.C. §§ 511 through 514.

In order for any gain or loss to be taxable under § 511, it must meet the definition of "unrelated business taxable income" under § 512. I.R.C. § 512(a)(1) defines "unrelated business taxable income" as gross income derived from any unrelated trade or business that is regularly carried on. I.R.C. § 512(b)(5) excludes from unrelated business taxable income all gains or losses from

the sale, exchange, or other disposition of property, except that § 512(b)(4) operates to include such gains or losses with respect to debt-financed property. Nevertheless, § 514(b)(1)(A)(i) excludes from debt-financed property any property substantially all the use of which is substantially related to the exercise or performance of the organization's exempt purpose or function. Finally, § 1.513-1(b) clarifies that "trade or business" to which the unrelated business income tax applies has the same meaning it has in § 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

The transfer of assets and liabilities pursuant to the Merger Agreement will be a one-time transaction. Consequently, the transfer is not considered to be "regularly carried on" within the meaning of § 1.513-1(c), and does not have the characteristics of a trade or business under § 162 or, consequently, § 1.513-1(b). Therefore, the unrelated business income tax imposed under § 511 would not apply to the transfer. Moreover, to the extent the transfer involves capital assets, the gain would have been excluded from unrelated business taxable income by § 512(b)(5). And because the use of such assets after the merger will be substantially related to the exercise and performance by M of its exempt charitable purposes, § 514 would not apply to such assets.

Conclusion

In light of the foregoing, we rule as follows:

1. The merger and amendments to the Articles of Association and By-Laws of M will not adversely affect the tax-exempt status of M, as the surviving corporation, under I.R.C. § 501(c)(3).

2. The merger and amendments to the Articles of Association and By-Laws of M will not affect the non-private foundation status of M, as the surviving corporation, under I.R.C. §§ 509(a)(1) and 170(b)(1)(A)(iii).

3. The transfer of assets and liabilities from N, P, and R to M pursuant to the statutory merger will not result in gain or loss being recognized by M, as the surviving corporation, under I.R.C. §§ 511 through 514.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, EO Technical

Enclosure
Notice 437