

Internal Revenue Service

Department of the Treasury

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Contact Person:

Telephone Number:

In Reference to:

Date:

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OP: E: EO: 1

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Employer Identification Number:

Dear Sir or Madam:

We are responding to your request for a ruling concerning whether certain activities will adversely affect your status as an organization described in sections 501(c)(3) and 509(a)(2) of the Internal Revenue Code and whether those activities will generate unrelated business taxable income.

You have been recognized as an organization described in section 501(c)(3) of the Code and classified as an organization described in section 509(a)(2). You were formed to provide skilled nursing services in the county in which you are located (the "County"). Your governing board is comprised of community leaders who are residents of the County.

Prior to mid-1997 you leased and operated a 44-bed skilled nursing facility (the "Existing Facility") which is owned by the County. In 1996, the County constructed and equipped a new 123-bed skilled nursing facility (the "Replacement Facility"). In 1996, you entered into an agreement with the County in which the Replacement Facility and the Existing Facility were leased to you (the "Lease Agreement"). You currently operate the Replacement Facility as a skilled nursing facility.

The County is in the process of converting the Existing Facility into a 44-unit senior housing facility. The Lease Agreement was amended in mid-1997 to reflect the change in use of the Existing Facility.

When the conversion is complete, you will operate the Existing Facility as a home for the elderly. The home will include independent and assisted living units (the "Assisted Living Facility"). Each unit will be designed to accommodate the special needs of the elderly. For example, each unit will be handicapped accessible, will contain a barrier-free bathroom and will be equipped with an emergency call system. You have made

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arrangements with organizations such as the county hospital to provide home health and related services to the residents. Residents will be granted priority status in obtaining a bed in your skilled nursing facility if the resident's medical condition requires this type of care. The Assisted Living Facility will provide 24-hour security and staff availability.

You will provide a variety of services to the residents including meals served in the main dining room or in the resident's unit during temporary illnesses, housekeeping, laundry, parking, mail, barber/beauty and flat linen services. When possible, you will provide special guest accommodations and catering for special events for the convenience of the residents.

You will provide and/or arrange recreational, social and religious activities for the residents. You will make available to the residents transportation to shopping, entertainment and medical locations.

You represent that units in the Assisted Living Facility will rent for a monthly fee that is affordable to a significant segment of the elderly residing in your service area. Although prospective residents and their families will be required to demonstrate that they are able and will continue to be able to pay your fees and charges, no resident will be forced to move from the facility if at some point the resident and his/her family become unable to pay the fees and charges. You plan to fund a reserve out of the Assisted Living Facility's operating revenues to fund deficits which may arise as a result of non-paying residents. If needed, you will seek grants from other exempt organizations.

You request the following rulings:

1. The operation of the Assisted Living Facility will not adversely affect your status as an organization described in section 501(c)(3) of the Code.
2. The operation of the Assisted Living Facility will not jeopardize your status as an organization described in section 509(a)(2) of the Code.
3. Income from the operation of the Assisted Living Facility will not constitute unrelated trade or business income under sections 511 through 514 of the Code.

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Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for charitable, educational or scientific purposes.

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. The promotion of health and care of the elderly have long been recognized as charitable purposes.

Section 1.501(c)(3)-1(b)(1) of the regulations provides, in part, that an organization is organized exclusively for one or more exempt purposes only if its articles of incorporation (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.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose.

Section 1.501(c)(3)-1(c)(1) of the regulations 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 section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

Rev. Rul. 69-545, 1969-2 C.B. 117, provides that a nonprofit organization whose purpose and activity are providing hospital care for members of its community is promoting health and qualifies as being organized and operated in furtherance of a charitable purpose.

Rev. Rul. 72-209, 1972-1 C.B. 148, provides that an organization formed to provide low cost home health care on a nonprofit basis to the people of the community serves many of the same health needs of the community that hospitals have traditionally served and, therefore, is promoting health within the meaning of the general law of charity.

The elderly, apart from considerations of financial distress, are as a class, highly susceptible to other forms of distress in the sense that they have special needs because of their advanced

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years. See Rev. Rul. 72-124, 1972-1 C.B. 145, which provides that an organization operating a home for the elderly qualifies for charitable status if it operates in a manner designed to satisfy the three primary needs of the elderly, the need for housing, health care and financial security.

An entity which provides facilities specifically designed to meet some combination of the physical, emotional, recreational, social, religious and similar needs of the elderly will satisfy the need for housing. The need for health care will be met if the organization directly provides some form of health care or maintains a continuing arrangement with other organizations, facilities or health personnel to provide such care. The need for financial security will be satisfied if the organization's fees are affordable to a significant segment of the community and the organization commits to maintaining in residence individuals who become unable to pay their regular charges.

Rev. Rul. 79-18, 1979-1 C.B. 194, holds that a nonprofit organization providing specially designed housing to elderly persons at the lowest feasible cost that maintains in residence those tenants who subsequently become unable to pay its monthly fees is an organization operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code.

Section 509(a)(2) of the Code provides, in pertinent part, that the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than an organization which:

(A) normally receives more than one-third of its support in each taxable year from any combination of

(i) gifts, grants, contributions, or membership fees; and

(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of \$5,000

or 1 percent of the organization's support in such taxable year, from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii); and

(B) normally receives not more than one-third of its support in each taxable year from gross investment income. Section 1.509(a)-3(b)(1) of the regulations provides that in computing the amount of support received from gross receipts under section 509(a)(2)(A)(ii) of the Code for purposes of the one-third support test of section 509(a)(2)(A), gross receipts from related activities received from any person, or from any bureau or similar agency of a governmental unit, are includible in any taxable year only to the extent that such receipts do not exceed the greater of \$5,000 or 1 percent of the organization's support in such taxable year.

Section 511(a) of the Code imposes a tax on the unrelated business income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines unrelated business taxable income as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of the trade or business, with certain modifications.

Section 513(a) of the Code defines unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of the organization for funds or the use it makes of the profits derived) to the exercise of the organization's exempt purposes or functions.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is related to exempt purposes only where the conduct of the business activities has a substantial causal relationship to the achievement of exempt purposes. To be substantially related to purposes for which exemption is granted, the production or distribution of goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes.

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Section 513(a)(2) of the Code provides that the term unrelated trade or business does not include any trade or business which is carried on, in the case of an organization described in section 501(c)(3), such as a hospital, by the organization primarily for the convenience of its patients.

Your continued operation of a skilled nursing facility in a charitable manner promotes health within the meaning of section 501(c)(3) of the Code. See Rev. Ruls. 69-545 and 72-209, supra.

Once the conversion of the Existing Facility is complete, you will operate a home for the elderly. The facility's operations, as described above, indicate that it will satisfy the elderly's need for housing, health care and financial security and that each unit will be designed to accommodate the special needs of the elderly. See Rev. Ruls. 72-124, and 79-18, supra.

In addition to promoting health care by the operation of your skilled nursing facility, you will provide care for the elderly, a charitable class. The operation of the Assisted Living Facility in the manner described above is a charitable activity. Thus, it does not constitute an unrelated trade or business as described in section 513(a) of the Code.

You will receive income from the provision of special guest accommodations and catering for special events provided for the convenience of your residents (e.g., a resident's birthday celebration attended by friends and relatives). Section 513(a)(2) of the Code provides that such income is not considered to be from an unrelated trade or business because it is derived from activities conducted for the convenience of your residents.

Fees related to the operation of your skilled nursing facility are your primary source of income. The Assisted Living Facility will generate income by engaging in the activities that are related to your exempt function. Thus, income from the Assisted Living Facility will be exempt function income described at section 509(a)(2)(ii) of the Code.

Based upon the representations contained in your request for a ruling, we rule as follows:

1. The operation of the Assisted Living Facility will not adversely affect your status as an organization described in section 501(c)(3) of the Code.

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2. The operation of the Assisted Living Facility will not jeopardize your status as an organization described in section 509(a)(2) of the Code so long as you continue to meet the requirements of section 509(a)(2)(A) and (B) of the Code.

3. The operation of the Assisted Living Facility will not be considered an unrelated trade or business under section 513(a) of the Code and will not generate unrelated business taxable income.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. 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.

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

We are informing your key District Director of this action. Please keep a copy of this ruling in your permanent records.

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

Sincerely,

Marvin Friedlander

Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1