Internal Revenue Service

Department of the Treasury

200032049

Washington, DC 20224

Uniform Issue List: 414.07-00

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Contact Person: **********

Telephone Number: **********
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In Reference to: **********T:EP:RA:T4

Date:

Attention: **********

Legend:

Employer = **********
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Medical School = **********
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University = **********

State A = *********

State A Board = **********

Head of State A Board = **********
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Plan X = **********
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Ladies and Gentlemen:

This is in response to a request submitted on your behalf by your authorized representative in a letter dated May 23, 1997, as supplemented by a letter dated June 8, 1999, for a letter ruling concerning whether Plan X is a governmental plan as defined in section 414(d) of the Internal Revenue Code ("Code") and whether Plan X meets the requirements of section 403(b) of the Code.

The following facts and representations have been made in support of the governmental plan ruling request.

The Employer is a medical faculty practice incorporated as a professional service corporation under the laws of State A and is associated with the University through the Medical School. The Employer received a letter dated August 25, 1986, from the Internal Revenue Service recognizing it as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). The letter also stated that the Employer is not a private foundation under section 509(a) of the Code. The Employer established Plan X as a tax-deferred annuity plan pursuant to section 403(b) of the Code, effective January 1, 1996. Plan X has been amended and restated, incorporating Amendments One and Two, to meet the requirements of section 403(b).

The Employer was chartered to advance the purposes of the medical educational program and related activities of the Medical School at the University, which is a state university chartered as part of the State A university system. As stated in the Employer's Charter, the Employer's purpose is primarily to conduct medical education, medical research, medical care, and the practice of medicine in order to improve the Medical School and its affiliated teaching hospitals, their teaching and research resources, their facilities and their service opportunities. The Employer fulfills its duties by providing physicians to render patient care in hospitals operated in connection with the University, furnishing assistance in the training and education of students of the Medical School and assisting in certain research activities of the Medical School.

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The Employer provides facilities for students and resident physicians to see patients and to observe the members in the practice of medicine. The activities are required as part of the students' curriculum at the Medical School. The Employer will not provide care to any patients who are uncomfortable being seen by students and resident physicians. The medical services are carried out in a building owned by State A. It is represented that the Employer performs a legitimate government function by educating students of the Medical School through clinical instruction and research activities.

Under the By Laws of the Employer, a physician member of the Employer must be a faculty member of the Medical School, and, if any physician member leaves the faculty of the Medical School, membership in the Employer terminates automatically. Under the Private Practice Regulations of the Employer, the appropriate department chairperson with the approval of the Dean of the Medical School shall specify the maximum portion of time to be devoted to medical/health services of the Employer by physician members. The Medical School has the authority to restrict the physician members from participating in the medical/health practice carried on by the Employer if such services interfere with the proper performance of academic duties of the Medical School.

The Medical School, the University, and State A retain control over the administration and operation of the Employer. Under the By Laws of the Employer, the Board of Directors is composed of the Dean of the Medical School, the chairperson of each clinical department of the Medical School, the President of the University, the Head of State A Board or their designees, and three elected Directors at large. The Directors at large must be members of the Employer, all of whom are faculty members of the Medical School. As set forth in the Employer's By Laws, the Head of State A Board was required to approve the Charter of the Employer, its By Laws, the Agreement between the University and the Employer, and its Private Practice Regulations. The Employer's By Laws may not be altered or amended without approval of the Dean of the Medical School, the President of the University, and the Head of State A Board.

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Although the Employer was not created under any specific statute of State A, implied statutory authority was necessary for the creation and use of the Employer. The Employer was created by the State A Board. The State A Board was established pursuant to State A statute. The State A Board has the authority to do all things necessary for the creation, proper maintenance, and successful and continuous operation of the State A university system. The Employer was created to benefit the Medical School, which is a part of the State A university system.

Under the Employer's Charter, no part of its net earnings shall inure to the benefit of its members, trustees, officers or other private persons, except that the Employer shall be authorized to pay reasonable compensation to its employees for services rendered, including physician members' supplemental salaries, and to make payments and distributions in furtherance of its purposes.

The Agreement between the University and the Employer provides that the Employer may create, implement, and operate a medical services plan. The Agreement approves of the By Laws of the Employer. It also prohibits any amendments to the Employer's Charter or By Laws without the written approval of the University and the State A Board. Under the Agreement, the Employer, in the conduct of its independent activities, may provide medical and health care services and charge fees for such services. All income and funds received for patient care activities belong to the Employer. All gifts to, contributions, bequests, devises, or grants negotiated with or by the Employer shall be subject to the prior approval of the President of the University, and, if so approved, shall belong to the Employer. All real property acquired by gifts or bequests or purchased with the Employer's funds shall be subject to the approval of the President of the University, and, if so approved, shall become the property of the Employer. In general, Article V of the Agreement provides that total collections of the Employer shall be applied in the following priorities: First, [funds will be used] for payment of all expenses of the Employer, excluding salary supplements of the members. Second, a percentage of all

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cash receipts will be contributed to a specific fund for the Medical School ("Fund"). Such percentage shall not exceed 3% without approval of the Employer's membership. Expenses may be paid from the Fund subject to the annual Employer's operating budget. Any monies remaining in the Fund at year end will be contributed to the University for the exclusive use of the Medical School. Third, [funds will be used for] the salary supplements of individual members as stipulated in their professional services agreements, pro rata based on individual total collections. Fourth, [funds will be used] to establish a corporate reserve. Fifth, a department's residual income at year end (i.e., that of a clinical department of the Medical School) will be used for educational, research and service purposes. A portion of residual departmental revenues at the end of the fiscal year, such portion determined by the departmental chair, may be redistributed to individual faculty in that department based upon their percentage of contribution to the total cash collected for that year. The Dean of the Medical School must approve such distribution.

The Employer shall keep financial records in accordance with generally accepted accounting principles and the accounting system of the Employer shall be subject to the approval of the University, the State A Board and the Comptroller of the Treasury of State A. Financial records shall be audited annually by a certified public accountant recommended by the Employer and approved by the University. The University, the State A Board, and the Comptroller of the Treasury of State A shall have access to financial or other records of the Employer at any time.

Copies of the Employer's audited financial statements for the 1995 and 1996 years were submitted with the ruling request. The statements show that the Employer is funded primarily from patient service revenue, and most of the expenses are wages, salaries and benefits.

Under the Employer's By Laws, the Employer may be dissolved by the Head of the State A Board subject to the approval of the State A Board. The Charter of the Employer provides that upon dissolution the Board of Directors shall, after paying or making provision for payment of all

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liabilities, distribute the remaining assets of the Employer to the University for the benefit of the Medical School. In the event that the University ceases to be an exempt organization as an agency of State A, then all remaining assets shall be distributed to the State A Board. In the event the State A Board ceases to be an exempt organization as an agency of State A, then all remaining assets shall be distributed to State A.

Separate payrolls are maintained by the Employer and the University. The physicians employed by the Employer receive Income Tax Form W-2s from the Employer as well as from the University. It has been represented that the physicians are considered to be employees of both the Employer and the University. It has also been represented that the Employer has always paid FICA tax with respect to its employees.

Based on the foregoing, your authorized representative has requested the following ruling:

That the Employer, through its affiliation with the University and direct oversight by State A, is an instrumentality of State A under section 414(d) of the Code and, consequently, that Plan X, which is sponsored by the Employer, is a governmental plan as that term is defined by section 414(d) of the Code.

Section 414(d) of the Code provides, in part, that for purposes of Chapter 1D, Part I, the term "governmental plan" means a plan established and maintained for its employees by the Government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Rev. Rul. 89-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. One of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision is the degree of control that a governmental entity (or

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entities) exercises over the organization's everyday operations. Other factors include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization's trustees or operating board are selected; and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit.

The Employer performs a governmental function by educating students through clinical instruction and research activities and through observation of the physician faculty members of the Medical School in the practice of medicine. These educational services are performed on behalf of the Medical School, which is part of the University, and which, in turn, the University is chartered as part of the State A university system.

The Employer is governed by its Board of Directors. State A, through its representation on the Board of Directors, substantially controls the Employer. The Employer's Board of Directors is composed of the Dean of the Medical School, the chairperson of each clinical department of the Medical School, the President of the University, the Head of State A Board or their designees, and three elected Directors at large. As previously indicated, the at large Directors must also be full-time employees of the Medical School. Consequently, they must act in a manner which will not jeopardize their employment with the Medical School and the University in order to remain on the Board. As a result, State A, through the State A Board, the University, and the Medical School, exercises substantial control over the Employer. The Head of the State A Board must approve the Charter, the By Laws, the Agreement between the University and the Employer, and the Employer's Private Practice Regulations. Under these circumstances, the Employer is controlled and supervised by a public authority.

Implied statutory authority was necessary for the creation and use of the Employer. The Employer was created by the State A statute granting the State A Board such powers, not otherwise prescribed by law, as are necessary to carry out the Board's responsibility for the efficient

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administration and operation of the university system. The Employer was created to benefit the Medical School, which is part of the State A university system.

The Employer is funded primarily by income generated from a medical services plan. The University monitors the Employer's finances and its expenditures. The Employer's accounting is audited annually and is subject to approval of the University and the Comptroller of the Treasury of State A. The Employer may be dissolved by the State A Board. In the event that the Employer is dissolved, all remaining assets of the Employer shall be distributed to the University for the benefit of the Medical School, or to the State A Board, or to State A.

The provisions of Plan X show that the plan was established by the Employer and will be maintained for its employees.

Based on the information submitted, we conclude that the Employer, through its affiliation with the University and oversight by State A, is an instrumentality of State A under section 414(d) of the Code and, consequently, that Plan X, which is sponsored by the Employer, is a governmental plan as that term is defined by section 414(d) of the Code.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. We do not express an opinion on whether wages paid by the Employer are subject to tax under the Federal Insurance Contributions Act.

This ruling is based on the assumption that an official or officials of the Employer formally execute Plan X, as amended and restated to incorporate Amendments One and Two.

Because the request presents more than one issue and because your authorized representative requested separate letter rulings, a separate letter ruling will be issued with respect to the ruling request that Plan X meets the requirements of section 403(b) of the Code.

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

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely,

John G. Riddle, Jr.

John G. Riddle, Jr., Manager
Employee Plans Technical Group 4
Tax Exempt & Government Entities Division

Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose, Notice 437