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Internal Revenue Service

Department of the Treasury

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Legend

Authority =

State =

Community =

Date 1 =

Date 2 =

1987 Bonds =

1998 Bonds =

A =

B =

C =

D =

E =

22

F =

G =

H =

J =

K =

L =

M =

N =

O =

P =

Q =

x =

y =

z =

Dear

This is in further reply to your request for rulings regarding the effect of implementing the joint operating agreement between A and B on the tax-exempt status of the 1987 Bonds and the 1998 Bonds.

FACTS

A is a tax-exempt corporation under § 501(c)(3). As more fully described below, A is the sole member of C, D, E, and F, a group of tax-exempt corporations under § 501(c)(3). We subsequently refer to C, D, E, and F, as "the Exempt Entities". The Exempt Entities, in the aggregate, operate two acute care hospital facilities and provide health care and related services to residents of the Community. A is also the sole member of G, a tax-exempt corporation under § 501(c)(2). Finally, A is the sole stockholder of H, a taxable State corporation. As more fully described below, H holds interests in businesses that are engaged

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in health care activities and related services in the Community. We subsequently refer to G and H, collectively, as "the Non-501(c)(3) Entities".

B is a tax-exempt corporation under § 501(c)(3). B delivers health care services to residents of the metropolitan area, which includes Community, through the operation of an acute care hospital. B is not related to A or to any of A's affiliates. B's sole corporate member is P, a tax-exempt organization under § 501(c)(3).

The Exempt Entities have been described as follows:

(1) C is exempt from federal income tax under § 501(c)(3) and operates an acute care hospital facility located in the Community. The acquisition costs of substantially all of the plant, property, and equipment of C's acute care hospital facility were financed by a portion of the proceeds of the 1987 Bonds (Bond-Financed Facility 1). C has proposed to construct a new acute care hospital facility (the New Hospital) to replace its existing acute care hospital facility. As more fully described below, a portion of the 1998 Bonds will be used to finance certain costs of the New Hospital (Bond-Financed Facility 2);

(2) D is exempt from federal income tax under § 501(c)(3) and operates an acute care hospital facility located in the Community. The acquisition, construction, and rehabilitation costs of the plant, property, and equipment of D's acute care hospital facility were financed, in part, by a portion of the 1987 Bonds (Bond-Financed Facility 3);

(3) E is exempt from federal income tax under § 501(c)(3) and provides home healthcare and hospice services in the Community; and

(4) F is exempt from federal income tax under § 501(c)(3) and manages medical care facilities and contracts for the provision of health services in the Community.

The Non-501(c)(3) Entities have been described as follows:

(1) G holds title to certain residential properties located in the Community. G occasionally permits A's employees or those having business with A to use one of the properties for short-term overnight lodging in connection with work or business with respect to A. Other than this arrangement, G does not have and does not reasonably expect to have any contracts, agreements, or

any other arrangements within the meaning of § 1.141-3(b) with respect to Bond-Financed Facility 1, Bond-Financed Facility 2, or Bond-Financed Facility 3.

(2) H is a taxable State corporation formed by A to hold interests in taxable health care ventures located in the Community. Accordingly, H holds the following interests: x percent of the stock of J, which operates an occupational health services business in the Community; x percent of the stock of K, which operates a medical office building in the Community; y percent of the stock of L, which provides primary care medical services; a noncontrolling interest in M, which operates a nursing home facility; a noncontrolling interest in N, which operates a nursing home facility; and a noncontrolling interest in O, which operates an assisted living center. Neither H nor any of the affiliates of H have or reasonably expect to have any contracts, agreements, or any other arrangements within the meaning of § 1.141-3(b) with respect to Bond-Financed Facility 1, Bond-Financed Facility 2, or Bond-Financed Facility 3 (collectively, "the Bond-Financed Facilities").

A, B, the Exempt Entities, and G have determined that it is in the best interests of the Community, and in furtherance of their respective purposes, for A and B to combine their respective resources in order to improve treatment options and to expand the range and quality of health care services available to residents of the Community. Accordingly, under the terms of the proposed joint operating agreement between A and B, A and B will form Q to oversee and monitor the delivery of health care services to the Community, which includes overseeing and monitoring the construction and operation of Bond-Financed Facility 3.

Under the terms of the joint operating agreement, A and B will form Q as a limited liability company under State law. Q will not elect to be treated as a corporation for federal tax purposes. Q's sole members will be A and B. Q's purposes will specifically include carrying out the charitable missions of A and B. To further Q's purposes and objectives with respect to advancing and supporting the health care needs of the Community, A and B intend that Q will support and facilitate the development, financing, and construction of Bond-Financed Facility 3 in a timely and efficient manner.

According to the terms of the joint operating agreement between A and B, the revenues of the Exempt Entities and Non-501(c)(3) Entities, over and above their respective necessary operational costs and expenses, will be periodically distributed to Q. At the end of each calendar year, Q's available cash will be shared between A and B in proportion to their respective ownership interests in Q. The joint operating agreement between

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A and B also provides that A will, in furtherance of its tax-exempt purpose, contribute its distribution from Q back to Q for use by the Exempt Entities and the Non-501(c)(3) Entities. Q may, but is not required or obligated to, make any cash contributions to any Non-501(c)(3) Entity under the joint operating agreement. Any cash contributions which may be made by Q shall be exclusively within the discretion of A and B acting through their representatives appointed to Q's board of directors. Other than for start-up expenses, it is expected that neither H nor any of the affiliates of H will receive income derived from the Bond-Financed Facilities for operating or capital expenses.

Under the terms of the contribution agreement between A and B, A will cause Q to be appointed as the sole member of G and the Exempt Entities, and A will contribute its stock interest in H to Q in exchange for A's interest in Q . Pursuant to the contribution agreement between A and B, B will contribute $z to Q in exchange for B's interest in Q.

The Authority issued the 1998 Bonds on Date 1. A portion of the 1998 Bonds will be used to finance, in part, the costs of acquisition, construction, and equipment for Bond-Financed Facility 3. In addition, a portion of the proceeds of the 1998 Bonds was also used to currently refund the outstanding amount of the 1987 Bonds. As previously noted, a portion of the proceeds of the 1987 Bonds was used to finance certain costs of Bond-Financed Facility 1 and Bond-Financed Facility 2. The 1987 Bonds were redeemed in their entirety on Date 2. In addition, on Date 1, a portion of the proceeds of the 1998 Bonds was used to repay other indebtedness incurred by C and D in 1995 (the 1995 Loan) to finance certain capital expenditures for Bond-Financed Facility 1 and Bond-Financed Facility 2. The 1995 Loan also financed C's acquisition of a portion of the site on which Bond-Financed Facility 3 will be located.

In a prior ruling letter, the Chief, Exempt Organizations, Technical Branch 1, responded to four of your requests and concluded, in part, as follows:

(1) Neither A nor B's exempt status under § 501(c)(3) will be adversely affected by the implementation of the joint operating agreement and the resulting substitution of Q as the sole member of each of the Exempt Entities and of G, and as the sole stockholder of various stock entities, including H; and

(2) Implementation of the joint operating agreement as described in (1) will not result in A or B being engaged in an activity that is an unrelated trade or business within the meaning of § 513(a).

LAW AND ANALYSIS

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond within the meaning of § 141.

Section 141(a) provides that the term "private activity bond" includes any bond issued as part of an issue that meets the private business use test of § 141(b)(1), or meets the private loan financing test of § 141(c). Section 141(b)(1) provides that, except as otherwise provided in the subsection, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6)(A) provides that for purposes of § 141(b), the term "private business use" means use (directly or indirectly) in a trade or business carried on by an person other than a governmental unit. Section 141(b)(6)(B) provides that any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(e)(1)(G) provides that a "qualified bond" includes a qualified 501(c)(3) bond. Under § 145(a), qualified 501(c)(3) bonds are defined as bonds that would not be private activity bonds if § 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses by applying § 513. In making this determination, a 5 percent of net proceeds test (rather than the 10 percent of proceeds test applicable to governmental bonds) is used in applying the private business tests of § 141(b)(1) and (2) in § 145(a).

Under § 7701(a)(1), the term "person" means and includes a partnership where not otherwise distinctly expressed in, or manifestly incompatible with, the intent of the provision under Title 26 where the term is used. Under § 7701(a)(2), the term "partnership" includes any group, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not a trust, estate, or corporation. Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. However, § 301.7701-3(b)(1) provides, in part, that if a domestic eligible entity does not elect its classification otherwise, that entity is, by default (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner if it has a single owner.

Because Q will have two initial members and will not elect its classification otherwise, Q is treated as a partnership by default under the above-noted regulations.

Under subchapter K of the Code, a partnership is considered for various purposes to be either an aggregate of its partners or an entity independent of its partners. S. Rep. 1622, 83d Cong., 2d Sess. 89 (1954); H.R. Rep. 2543, 83d Cong., 2d Sess. 59 (1954). Under the aggregate approach, each partner is treated as an owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is treated as a separate entity in which partners have no direct interest in the partnership's assets and operations. According to Rev. Rul. 75-62, 1975-1 C.B. 188, there is no exclusive rule as to when a partnership will be viewed as an entity or an aggregate. The resolution generally depends upon the question to be resolved.

In this case, the question to be resolved is whether the 1987 Bonds and the 1998 Bonds will fail to meet the requirements for a qualified 501(c)(3) bond under § 145 solely as a result of the proposed formation of Q and Q's replacement of A as the sole member of the Exempt Entities and G and as the sole stockholder of H. We conclude that the purposes of § 145 are furthered if Q is treated as an aggregate instead of as a separate entity. Therefore, following the implementation of the proposed joint operating agreement, A and B, the sole members of Q, will each be treated as an owner of an undivided interest in the Bond-Financed Facilities. As a result, the Bond-Financed Facilities will be owned by § 501(c)(3) organizations.

According to the prior ruling letter, implementation of the joint operating agreement will not result in A or B being engaged in an activity that is an unrelated trade or business within the meaning of § 513(a). Furthermore, G does not have and does not reasonably expect to have any contracts, agreements, or any other arrangements within the meaning of § 1.141-3(b) with respect to Bond-Financed Facility 1 or Bond-Financed Facility 2. Finally, neither G nor H and the affiliates of H (1) receive or reasonably expect to receive income (other than start-up expenses) derived from the Bond-Financed Facilities; (2) have or reasonably expect to have any rights to income derived from the Bond-Financed Facilities; and (3) have or reasonably expect to have any contracts, agreements, or other arrangements within the meaning of § 1.141-3(b) with respect to the Bond-Financed Facilities.

CONCLUSION

Based solely on the information presented, the representations made, the prior ruling letter, and applying the foregoing analysis, we conclude that the implementation of the

joint operating agreement, which will result in Q being substituted for A as the sole member of the Exempt Entities and G and as the sole stockholder of H, will not cause the Bond-Financed Facilities to be owned or used in the trade or business of a person other than a governmental unit or an organization described in § 501(c)(3). We further conclude that implementation of the joint operating agreement, which will result in Q being substituted for A as the sole member of the Exempt Entities and G and as the sole stockholder of H will not cause the Bond-Financed Facilities to be treated as used for any private business use within the meaning of §§ 141 or 145.

This ruling letter is directed solely to the effect of the transaction described on the 1987 Bonds and the 1998 Bonds. Thus, no opinion is expressed or implied regarding the transaction described herein under any section of the Code, the Income Tax Regulations, or the temporary Income Tax Regulations, except as specifically stated in this ruling. In particular, no opinion is expressed as to whether interest on the 1987 Bonds or the 1998 Bonds is or was excludable from the gross income of the respective holders thereof under § 103 prior to the transaction described.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Assistant Chief Counsel
Financial Institutions & Products

By _____
Timothy L. Jones
Assistant to the Chief
Branch 5

Enclosure:
Copy for § 6110 purposes