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

Date: SEP 08 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T:1

Employer Identification Number:
Key District Office:

Legend :

J =
K =
L =
M =

Dear Sir or Madam:

This is in response to a letter from your authorized representative requesting a series of rulings on your behalf regarding the tax consequences associated with the transaction described below.

J is recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and is classified as a nonprivate foundation under section 509(a) of the Code. It is organized and operated to improve health care services in rural areas by coordinating resources, providing technical assistance and advocating for an accessible and quality health care delivery system. It is governed by a Board of Directors composed of thirteen individuals, seven of whom occupy full time governmental health care positions.

You have requested rulings concerning your operation of a Rural Health Infrastructure Revolving Loan Fund Program. The primary purpose of this activity is to improve health care access and delivery by funding appropriate health care services in Health Professions Shortage Areas, Medically Underserved Areas and economically depressed areas in rural K. You have stated that the viability of this activity is dependent, among other things, upon receipt of a loan for L dollars from M. M is a governmental unit.

You have stated that loan funds will be available to a wide range of both nonprofit and for profit health care organizations, including primary care centers, governmental and nonprofit hospitals, outpatient primary care clinics, mental health providers, emergency medical service organizations, county health departments, long term care organizations, and physicians and mid-level medical specialists such as nurse practitioners and health care networks. You state that social welfare and trade associations exempt under sections 501(c)(4) and 501(c)(6) of the Internal Revenue Code may also be recipients of these loans.

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You have stated that you will not enter into any joint venture with a for profit health care provider or any other for profit entity. Every loan recipient will be required to demonstrate that it is unable to finance the proposed project from its own resources or through commercial credit or governmental programs at reasonable rates and terms.

You have stated that the priority of the loan fund is aimed at improved access to health care services in areas presently devoid of such services and you forsee using the loan fund to recruit health care providers into underserved areas, improve the availability of services or retain existing services where continued availability is at risk.

You provided the following examples of situations involving retention as opposed to recruitment in which you would give serious consideration: (a) the medical office of a health care provider is damaged by fire, flood, etc., and insurance proceeds and sources of funds from commercial institutions are insufficient or commercially unreasonable to restore the structure and resume the provision of health care services; (b) a sole family practice physician needs a second practitioner to handle the caseload and the medical office would then need expansion but funding from commercial sources are unavailable or offered at unreasonable terms and (c) a particular item of medical equipment which is unavailable is needed to fight disease and the medical practitioner cannot secure a commercial loan with reasonable terms. You have stated that in each of these situations you would also require a for profit entity to provide some reasonable amount of free care and to render care to Medicare and Medicaid beneficiaries, current evidence of community need and compliance with the rules and regulations of M.

You have stated that pricing or interest rates on loans will be determined by arm's length negotiation, but if a for profit entity is involved, the rate of interest will never be less than the prime rate. You have also stated that no loans may be granted to organizations or for activities related to your officers, directors, employees or members of their families.

You have requested the following rulings in connection with this transaction:

1. Whether the activities proposed to be conducted in connection with the loan program further a charitable purpose.

2. Whether the activities proposed to be conducted in connection with the loan program would threaten your tax exempt status under section 501(c)(3) of the Code.

3. Whether the operation of the loan fund is substantially related to your charitable purposes and therefore not subject to the unrelated business income tax within the meaning of sections 511 through 514 of the Code.

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) of the Code in its generally accepted legal sense.

Revenue Ruling 69-545, 1969-2 C.B. 117, recognizes that the promotion of health is a charitable purpose within the meaning of section 501(c)(3) of the Code.

Revenue Ruling 67-149, 1967-1 C.B. 133, provides that an organization providing only financial assistance to organizations exempt under section 501(c)(3) of the Code may qualify for exemption under section 501(c)(3).

Revenue Ruling 73-313, 1973-2 C.B. 174, provides that an organization formed and supported by residents of an isolated rural community to provide a medical building and facilities at reasonable rent to attract a doctor who would provide medical services to the entire community is exempt under section 501(c)(3) of the Code.

Revenue Ruling 74-587, 1974-2 C.B. 162, provides that a nonprofit organization formed to relieve poverty and fight community deterioration through a program of financial assistance in the form of low cost or long term loans to various businesses in economically depressed areas is exempt under section 501(c)(3) of the Code. Although some of the individuals receiving financial assistance in their business endeavors may not themselves qualify for charitable assistance, that fact does not detract from the charitable nature of the program. The recipients of the loans are merely the instruments by which the charitable purposes are sought to be accomplished.

Revenue Ruling 77-69, 1977-1 C.B. 143, states that an organization engaged in health planning and resources development aimed at providing adequate health care for a specific geographic area is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Revenue Ruling 97-21, 1997-1 C.B. 121, provides examples illustrating whether nonprofit hospitals that provide incentives to physicians to join their medical staffs or to provide medical services in the community violate the requirements for exemption as organizations described in section 501(c)(3) of the Code.

Section 501(c)(3) organizations do not jeopardize their exempt status by transferring their assets to other organizations exempt under section 501(c)(3) where the assets transferred are used to further exempt charitable purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides, in part, that an organization is not organized or operated for charitable purposes unless it serves a public rather than a private interest. Thus, to meet the requirements for exemption, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly, by such private interests.

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 512(b)(3) of the Code provides that rents from real property (and its incidental related personal property) are not treated as unrelated business income unless the real property is debt-

financed under section 514. Debt-financed property does not include any property substantially related to the exercise or performance by such organization of its exempt purposes.

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, in part, that a trade or business is related to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes; and it is substantially related for purposes of section 513 of the Code only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived 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.

Section 514(b) of the Code defines debt-financed property as any property which is held to produce income and with respect to which there is an acquisition indebtedness at any time during the taxable year.

J will not adversely affect its exempt status under section 501(c)(3) of the Code by the proposed transaction as the operation of the loan program is designed to promote health in medically underserved and economically depressed areas. Like the organization operating a loan program described in Revenue Ruling 74-587 supra, and the organizations in Revenue Rulings 73-313 and 97-21, supra, seeking to recruit and retain essential medical service providers in a community, your loan program furthers a recognized charitable goal. In this case it is to promote the health of the communities where your loans will be made. You have incorporated adequate safeguards in your loan program to insure that your program does not constitute the inurement of your assets into the hands of private individuals. Any benefit derived by for profit entities is incidental to the benefit derived by the members of the communities that will be able to obtain essential health care services as a result of your loan program.

Your loan program is substantially related to your charitable purposes and activities, therefore, it is not an unrelated trade or business and is not subject to the unrelated business income tax.

Accordingly, based on all the facts and circumstances described above, we rule as follows:

1. The activities proposed to be conducted in connection with the loan program further a charitable purpose.

2. The activities proposed to be conducted in connection with the loan program would not threaten your tax exempt status under section 501(c)(3) of the Code.

3. The operation of the loan fund is substantially related to your charitable purposes and therefore not subject to the unrelated business income tax within the meaning of sections 511 through 514 of the Code.

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

These rulings are directed only to the organization that requested them. Section 6110(j)(3) of the Code provides that they may not be used or cited by others as precedent.

These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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

Sincerely,

Marvin Friedlander

Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1

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