



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

Date: AUG - 5 2004

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170.07-03

Contact Person:

Identification Number:

Telephone Number:

T:EO:BR2

Employer Identification Number:

**Legend:**

M=

C=

Dear \_\_\_\_\_

M requests rulings on the tax effects of its proposed transaction under sections 501(c)(3), 509(a)(1) and 511 through 514 of the Internal Revenue Code.

**Statement of Facts**

M operates rehabilitation facilities offering many highly specialized programs and services for children and adults suffering a traumatic brain injury, stroke, spinal cord injury or other injuries and illness. More than students from colleges and universities train at M. M also operates an assisted living facility providing housing for people who have severe disabilities. M provides health education activities and programs to support the community. M provides health care services regardless of race, creed, sex, national origin, handicap, and age. M offers free care and/or subsidized care and care provided to persons covered by all governmental programs.

**Description of C**

M plans to develop a medically based, clinically integrated comprehensive health center, referred to herein as C. M states C will serve its charitable purpose of improving the health as follows: by providing various rehabilitation services to M's patients, offering medically and non-medically supervised comprehensive exercise programs to members of C, and providing prevention services and comprehensive educational programs to members and non-members in the community. M states its general charity care policy will be used to assure the C is available to all persons in its community. C's charity care policy will cover the following: (1) strength and resistance training, (2) cardiovascular fitness, (3) multipurpose gymnasium, (4) group fitness, (5) nutritional counseling, (6) stress management, (7) indoor lap swimming pool, (8) warm water therapy pool, (9) locker room facilities, (10) cardiac rehab nursing station, and (11) telemetry

station. C will have conference rooms for education, a snack bar, exercise apparel shop, and administrative support areas all which are operated solely for the convenience of M's rehab patients, C's employees and C's members utilizing the facilities and services of C.

C will be attached to a medical office building (MOB) owned by M. C and the MOB will be functionally and physically separate components of a single structure (Building). M will not lease or charge C for its usage of the space in the Building. The proposed size of the Building is approximately            square feet, consisting of approximately            square feet for C and            square feet for the MOB. C's portion of the Building is proposed to be financed with qualified section 501(c)(3) bonds, as defined in section 145(a) of the Code. No portion of the MOB will be financed with qualified 501(c)(3) bonds. An independent party or parties will own and manage the MOB.

### **Uses of the Facility**

In general, utilization of C will consist of three segments of the community: (1) M's current rehabilitation patients, (2) former M rehabilitation patients and members from the general public, and (3) M's employees. C states its hours of operation are intended to make the facilities available to the vast majority of the community on a daily basis. M will utilize C for various programs, such as outpatient cardiac rehabilitation, arthritis rehabilitation, women's health, orthopedic injury, sports medicine, sports enhancement, therapeutically- supervised obesity reduction and injury prevention. C states in this regard, C is an extension of and is integrated into M's continuum of care. All members of C will receive extensive health screening and risk assessment by health professionals as well as supervised exercise programs tailored to individual health needs.

C will also perform research studies integrating M's research institute and its state-of- the-art motion analysis technology. C will analyze movement patterns and motor control of individuals to assess gait, improve rehabilitation techniques or improve biomechanics.

M will offer education and outreach services in its education center. C will support the activities of M's support groups, community education and other outreach programs. C will include approximately            square feet of classroom space to support the hospital's current community education programs and newly developed courses formulated to target special needs populations. In some case, C's educational programs will be free to the general public. If an educational program involves a substantial cost, a nominal fee may be charged but that fee will be subject to C's charity care policy.

### **Demographic Survey/Accessibility to the Community**

In M hired a professional consulting firm to conduct a thorough demographic analysis of M's community to measure, among other things, whether C is affordable to a broad segment of the community. The analysis concluded: the community would support a medically-based fitness and wellness center; it would be both accessible and affordable to a broad segment of the community; and approximately , of the community would have a minute drive to the facility. The study also analyzed households in the community to determine average household income.

C states as a result of the survey, membership rates will be set at a level to assure affordability to the average household in the community and M plans to update its survey periodically to assure rates remain at affordable levels. In addition, to the above discussed charity care policy, several options will be available for those individuals who cannot afford to pay the regular membership fees. Those having a medical need with decreased means will be allowed to enter into a transition program giving them access to C via an educational program or clinical integration supervised by an exercise physiologist, physical therapist or other healthcare professional for a reduced price. Another option includes a reserve being set aside for scholarships. These scholarships allow individuals with decreased means the ability to join C and become proactive in health and wellness. Other options include making C accessible to special populations, including disadvantaged youth, the disabled and the elderly for no charge or only a nominal charge, and to waive initiation fees for rehab patients who become members of C.

### **Rulings Requested**

1. M's operation of C contributes importantly and substantially to the accomplishment of M's section 501(c)(3) exempt purposes.
2. M will continue to be recognized as exempt under section 501(c)(3) of the Code.
3. M will continue to be described in sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code.
4. M's operation of C is not an unrelated trade or business under section 513(a) of the Code and income derived from C's operation will not be subject to the tax on unrelated business income tax under section 511(a).
5. M's operation of C will not result in debt-financed property under section 514(b)(1) of the Code.

**Law**

Section 501(c)(3) of the Code describes in pertinent part organizations organized and operated exclusively for charitable, educational or scientific purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. In the law of charity, the promotion of health is considered to be a charitable purpose. See Restatement (Second) of Trusts, sections 368, 372; IV Scott on Trusts, sections 368, 372 (3rd Ed. 1967).

Rev. Rul. 69-545, 1969-2 C.B. 117, provides that a nonprofit organization whose purpose and activity are providing hospital care is promoting health and it may, therefore, qualify as organized and operated in furtherance of a charitable purpose if it meets the other requirements of section 501(c)(3) of the Code.

Rev. Rul. 59-310, 1959-2 C.B. 146, holds a nonprofit corporation organized for the purpose of establishing, maintaining and operating a public swimming pool, playground and other recreational facilities for the children and other residents of a community is exempt from federal income tax under section 501(c)(3) of the Code. The organization operates in a community consisting principally of low-income groups who are unable to pay the cost of privately sponsored recreation facilities. The income derived from charges for admission to the pool was minor in amount.

Rev. Rul. 59-310 also discussed the case of Isabel Peters v. Commissioner, 21 T.C. 55 (1953), nonacq., 1955-1 C.B. 8, withdrawn and acq. substituted therefore, 1959-2 C.B. 6. In that case the Tax Court held that an organization operating a public beach, playground and bathing facility was charitable within the meaning of section 501(c)(3) of the Code. The revenue ruling acquiesced in the court case but only under the limited facts presented, which included the fact that no fees were charged to use the facilities. However, it emphasized that every organization dedicated solely to the promotion of social welfare should not be classified as charitable.

Rev. Rul. 67-325, 1967-2 C.B. 113, holds an organization which provides recreational facilities without charge to the residents of a township is not organized and operated exclusively for charitable purposes where the basis for charitable qualification is dedication of the facilities involved to community use and the use of the facilities is restricted to less than the entire community on the basis of race. This revenue ruling indicated that the basis for recognizing organizations which provided recreational facilities to the community were exempt under section 501(c)(3) because they tend to lessen the burdens of government.

Rev. Rul. 79-360, 1979-2 C.B. 237, holds that the operation of health club facilities in a commercial manner by an organization exempt from tax under section 501(c)(3) of the Code constitutes unrelated trade or business under section 513. In this revenue ruling, the organization had recreational facilities used in its general physical fitness programs. These facilities include a track, gymnasium, swimming pool, and courts for racquetball, handball, and squash. Members use these facilities as often as they wish and at a nominal fee. However, the organization also organized a health club program that its members could join for an advance annual fee sufficiently

high to restrict participation to a limited number of the members of the community. The annual fee is comparable to fees charged by similar local commercial health clubs. The advance annual fee is in addition to the nominal annual dues for membership in the organization. In addition, those who were not health club members paid admission fees comparable to fees charged by similar local commercial health club facilities. The Service concluded the health club program did not have a causal relationship with the achievement of the organization's exempt purposes and the income generated by the program was unrelated business taxable income within the meaning of section 513 of the Code.

Section 509(a) of the Code provides the term private foundation means an organization described in section 501(c)(3) other than one described in section 509(a)(1), (2), (3), or (4).

Section 509(a)(1) of the Code provides that the term private foundation means a domestic or foreign organization described in section 501(c)(3) of the Code other than an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)). Organizations described in section 170(b)(1)(A)(iii) of the Code include organizations whose principal purpose is the provision of medical or hospital care.

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

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions, computed with the modifications listed in section 512(b).

Section 512(b)(3) of the Code provides generally that rents from real property (and its incidental related personal property) are not unrelated business income unless the property is debt-financed under section 514 of the Code. Debt-financed property does not include any property substantially related to the exercise or performance by such organization of its charitable functions.

Section 512(b)(4) of the Code requires that notwithstanding paragraphs (1), (2), (3) or (5), the net income realized with respect to debt-financed property must be included in unrelated business taxable income.

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 income or funds or the use it makes of the profits derived) to the exercise of the organization's exempt purposes or functions.

Section 513(a)(2) of the Code provides, in part, 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), by the organization primarily for the convenience of its employees.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is related to exempt purposes, in the relevant sense, only where the conduct of business activities has a causal relationship to the achievement of exempt purposes; and it is substantially related only if the causal

relationship is a substantial one. The regulation states that 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 the goods or performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 514(a)(1) of the Code provides that income from debt-financed property that is not related to the organization's exempt function is included as unrelated business taxable income.

Section 514(b)(1) of the Code defines debt-financed property as any property which is held to produce income with respect to which there is acquisition indebtedness. Section 514(c)(1) provides, in part, that acquisition indebtedness means the unpaid amount of the indebtedness incurred by an organization in acquiring or improving the property.

Section 514(b)(1)(A) of the Code provides that any property 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 the organization of its charitable purpose will not be included in the term debt-financed property.

### **Analysis**

An exempt organization operating a fitness center may be charitable on the grounds it promotes health. The charitable purpose of promoting the health of a community is a basis for tax-exempt status under section 501(c)(3) of the Code. See Rev. Rul. 69-545, supra. Also, providing recreational facilities to the general public can be an exempt purpose under section 501(c)(3) of the Code, as long as the facilities are available to a broad segment of the community. Similarly, in order to be exempt from unrelated business income tax under section 511, a fitness center conducted as an activity of an exempt organization must benefit a significant segment of the population.

C's provision of rehabilitative services to M's patients, who have, for example, undergone orthopedic surgery, is an exempt activity. By rehabilitating patients in accordance with treatment plans prescribed by physicians and hospital personnel, M's exempt purpose of providing for the health care needs of the community is served through C.

M's use of C for health improvement and recreation of C's members can be related to M's further charitable purpose of providing community recreational facilities only if the fees charged are affordable to the community served. See Rev. Rul. 79-360, supra. M's charitable purpose is demonstrated by the fact fees charged for memberships are affordable to a broad cross-section of the residents of the community. M conducted a survey to determine if its fees allow for all segments of its community to participate. C's fee structure was based on the survey. In addition, the survey will be updated with any new information used to adjust C's fees to assure all income levels in the community use the facility. Further, C uses M's charity care policy to ensure C's availability to everyone in the community. C also offers scholarships and accessibility for no charge or a nominal fee to special populations, including disadvantaged youth, the disabled and the elderly. Another significant charitable activity of M and C is the provision of extensive community education and prevention programs, including an array of free

or reduced cost programs conducted by M and C that benefit the community. Many of these programs can be accessed by the community without membership in C and are free of charge. However, if fees are charged they are reasonable, and scholarships are offered for the financially needy. Under these circumstances, the operation of C furthers M's exempt purpose under section 501(c)(3) of the Code. Further, M's primary charitable activities will not change as a result of C so M will continue to be described in sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code.

The facts submitted indicate M's employees are members of C. The use of an exempt fitness center by its own employees or employees of an affiliated entity is excepted from unrelated trade or business under the "convenience exception" contained in section 513(a)(2) of the Code. Lastly, M's operation of C will not result in debt-financed property under section 514(b)(1) of the Code because C's use of its portion of the Building is substantially related to M's exempt purposes and there is no rental income received by M for C's use of the Building.

### **Conclusion**

We rule as follows:

1. M's operation of C contributes importantly and substantially to the accomplishment of M's section 501(c)(3) exempt purposes.
2. M will continue to be recognized as exempt under section 501(c)(3) of the Code.
3. M will continue to be described in sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code.
4. M's operation of C is not an unrelated trade or business under section 513(a) of the Code and income derived from C's operation will not be subject to the tax on unrelated business income tax under section 511(a).
5. M's operation of C will not result in debt-financed property under section 514(b)(1) of the Code.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. 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.

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

Please keep a copy of this ruling letter in your permanent records.

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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.

Sincerely,

MS

Michael Seto  
Manager, Exempt Organizations  
Technical Group 1