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

200150038

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: 9/18/2001

UNIFORM ISSUE LIST
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Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:

H =
Q =

Dear Applicant:

This is in response to H's ruling request dated March 20, 2001, concerning the tax consequences of H's proposed fee for services plan.

The information submitted shows that H is a non-profit entity organized to operate a retirement home for elderly Q members. This home includes a 40-bed medical clinic, which is no longer in use. H has been recognized by the Internal Revenue Service as an organization described in section 501(c)(3) of the Internal Revenue Code, and has been classified as an organization which is not a private foundation because it is a publicly supported organization as described in sections 170(b)(1)(A)(vi) and 509(a)(1) of the Code.

All of H's current occupants are defined as "traditional" residents. A traditional resident, upon entering the facility, assigns all of his or her assets and income to H, including any and all gifts made by him/her within the last three years. H is currently operating at less than half of its capacity.

H proposes that a fee for services plan be implemented to accommodate those persons who would like to be residents of H without assigning their assets and income to it. H hopes to operate at a full occupancy rate by filling its vacancies with fee residents. The proposed fee residents will be required to make a deposit upon entry. A resident who withdraws or passes away within 48 months of entry into H will be refunded the unearned portion of the entrance fee.

H plans on earning the deposit at the rate of 5% the first month and 2% every month thereafter until the funds are depleted. In addition, H will charge a daily fee for the retirement facility. Each fee resident will have the same access to doctors and nurses that traditional residents have.

The daily rates charged to the fee resident will be the same as that charged to a

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traditional resident.

Fee residents will not be evicted should they become unable to pay the monthly fee. In the event that a fee resident can no longer pay pursuant to the fee plan, the resident will have the option to transfer over to the traditional plan so long as the resident makes the required assignment of assets and income to H. No fee resident will be denied admission under the traditional plan. All residents will have access to doctors and nurses paid for by H.

Currently, H does not carry any indebtedness beyond monthly bills and maintenance. It maintains adequate reserves in order to care for the residents after their resources have been depleted as well as for upkeep and physical expansion.

Section 501(c)(3) of the Code provides exemption for organizations organized and operated exclusively for purposes that are educational and charitable.

Section 1.501(c)(3)-1(c)(1) of the Income Tax 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 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 is not in furtherance of an exempt purpose.

Section 511(a)(1) of the Code imposes a tax on the unrelated business income of every organization exempt from taxation under section 501(a).

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

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 an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt functions.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "substantially related" only if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption was granted.

Rev. Rul. 72-124, 1972-1 C.B. 145, provides the requirements that the "homes for the aged" must meet to qualify for exemption under section 501(c)(3) of the Code. It is recognized in this ruling that the aged, apart from considerations of financial distress, are also, as a class, highly susceptible to other forms of distress in the sense that they have special needs because of their advanced years. An organization, otherwise qualified for charitable status under section 501(c)(3), that devotes its resources to the operation of a home for the aged will qualify for charitable status for purposes of Federal tax law if it operates in a manner designed to satisfy the three primary needs of aged persons. These are the need for housing, the need for health

care, and the need for financial security. The fact that the organization charges an entrance fee and only accepts residents with the financial ability to pay its established rates does not hinder its exemption since it provides the security that if, subsequently, a resident could no longer pay, the home would incur all costs.

H conforms to the requirements of Rev. Rul. 72-124, supra, since it provides the three primary criteria necessary for homes for the aged, and is operating to provide its services to the aged at the lowest feasible cost.

Based on the above, H's fee for services plan is furthering H's exempt purpose and is substantially related to the purpose for which H was recognized as exempt. Therefore, income derived from H's fee residents will not be classified as "unrelated taxable business income" as described in section 512 of the Code.

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

1. Implementation of the proposed fee for services plan will not jeopardize the tax-exempt status of H under section 501(c)(3) of the Code.

2. Implementation of the proposed fee for services plan will not constitute unrelated trade or business, nor will the fees and deposits received constitute unrelated trade or business income, within the meaning of sections 511-514 of the Code.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that that it cannot be used or cited as precedent.

Because this letter could help resolve any future questions about your exempt status and unrelated trade or business activities, you should keep it for your permanent records.

We are sending a copy of this ruling to the Ohio TE/GE office. Because this letter could help resolve any questions about your exempt status, you should keep it with your permanent records.

If you should have any questions, please contact the person whose name and telephone number are shown above.

Sincerely yours,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

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