

## PRIVATE TAXPAYER RULING LR96-007

July 10, 1996

The following private taxpayer ruling is provided in response to your letter dated April 4, 1996, and in the documents submitted with your letter dated May 15, 1996, in which you requested the department to re-evaluate our private taxpayer ruling issued June 7, 1994, regarding the amendments to the Restated ... Partners in Excellence Incentive Plan.

The following is a restatement of the facts as presented in your letter.

### Statement of Facts:

..., the corporate owner of ..., is an Arizona nonprofit corporation which is exempt from federal and state income taxes under Internal Revenue Code Section 501(c)(3) and Arizona Revised Statutes (A.R.S.) § 43-1201.4. ... is a "qualifying hospital" under A.R.S. § 42-1301.10(a) and exempt from property tax under A.R.S. § 42-271.A.5. An affiliate of ... - Phoenix, is an Arizona nonprofit corporation that operates a sub-acute extended care facility and is engaged in other activities in the health care field.

... adopted an incentive compensation program on January 1, 1993. On January 7, 1993, May 18, 1993, November 19, 1993, and June 7, 1994, the Arizona Department of Revenue issued private taxpayer rulings finding that the adoption and amendment of the original plan and the restatement of the plan would not affect ...'s tax-exempt status for state income taxes under A.R.S. § 43-1201.4; its classification as a "qualifying hospital" under A.R.S. § 42-1301.10 for purposes of an exemption from certain transaction privilege and use taxes; nor its tax-exempt status under A.R.S. § 42-271.A.5 for property tax purposes. The private taxpayer rulings were limited to the plans as presented to the department at that time.

On January 29, 1996, ... amended the restated plan which the department last reviewed on June 7, 1994. As a result, ... is requesting that the department review the amendments to the restated plan and issue a new private taxpayer ruling.

The amendments to the restated plan are as follows:

- (1) The definitions of the terms "employee" and "employer" have been changed
  - (a) so as to delete references to ... because the company was merged into ...,
  - (b) add entities owned or controlled by ... as plan sponsors if approved by the plan's administrative committee, and
  - (c) allow employees of employers referred to in clause (b) to participate in the plan.

- (2) References to ... have been removed from throughout the document.
- (3) The term "plan year" has been clarified and a definition for the term "1995 plan year" has been added so as to limit some plan rules to the plan year that began in July 1995 and ended June 1996.
- (4) The terms "prior plan" and "restatement effective date" have been updated.
- (5) Plan sections 3.1, 4.1, 4.2, 5.1, 5.2, 5.3 and 5.4 have been modified to refer to the 1995 plan year. Section 3.1 has also been modified to refer to a performance rating of at least 3.
- (6) Plan section 4.1 has been modified to refer to the 1995 plan year and to contain a new final sentence that terminates a plan participant's right to a plan payment if her/her employment is terminated for cause.
- (7) Plan section 5.1 has been modified so as to required ... departments to submit a mission report that includes a social accountability report.
- (8) Plan section 5.3(b) has been modified to refer to the Gordon Black Patient Satisfaction Survey" instead of the "Gordon Black In-patient Satisfaction Survey."
- (9) Plan Article 6.1 has been modified to provide that the ... President will select a "Director" instead of a "Vice President" to serve on the Administrative Committee.
- (10) A new Appendix A has been added to the plan.

#### Applicable Statutory Provisions:

A.R.S. § 42-271.A.5 provides an exemption from property taxation for hospitals and other charitable institutions for relief of the indigent or afflicted and the lands appurtenant to such buildings, with their fixtures and equipment, not used or held for profit.

A.R.S. § 42-271.F.1 provides that for purposes of this article, a nonprofit organization status may be shown by a letter of determination issued in the name of the organization by the United States Internal Revenue Service or the department recognizing the organization's tax-exempt status under Section 501(c)(3) of the United States Internal Revenue Code or A.R.S. § 43-1201.

A.R.S. § 42-1301.11 defines a "qualifying hospital" as a licensed hospital which is organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

A.R.S. 42-1310.01.A.25(a) provides an exemption from transaction privilege tax for tangible personal property sold to a qualifying hospital as defined in § 42-1301.

A.R.S. § 43-1201.4 provides an exemption from Arizona corporate income taxes for corporations organized and operated exclusively for religious, charitable, scientific, literary or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation.

### Discussion:

..., Inc. is an Arizona nonprofit corporation which is exempt from Arizona income taxes, transaction privilege and use taxes, and property taxes under various provisions of the Arizona tax statutes. The Arizona statutes providing for tax-exempt status for certain nonprofit corporations parallel the provisions for granting tax-exempt status for nonprofit organizations included in Section 501(c)(3) of the Internal Revenue Code.

Both the Arizona statutes and the Internal Revenue Code limit the exemption to organizations which are organized and operated exclusively for charitable purposes and no part of its net earnings may inure to any private shareholder or individual.

The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. (Treas. Reg. § 1.501(a)-1(c).) In addition, to qualify for the exemption, an organization must demonstrate 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. (Treas. Reg. § 1-501(c)(3)-1(d)(1)(ii).)

However, it is well established that a tax-exempt organization may pay reasonable compensation for services provided to it without violating the requirements of exemption. See *Willingham v. Home Oil Mill*, 50-1 USTC para. 9268, *cert. denied*, 340 U.S. 582; *B. H. W. Anesthesia Foundation, Inc.* [Dec. 36,188], 72 TC 681 (1979).

### Conclusion and Ruling:

On the basis of the information provided, we rule that the adoption of the amendments to the restated Incentive Compensation Plan, adopted on January 29, 1996, and described in the request for the private taxpayer ruling, does not result in a material change to the plan as adopted on January 1, 1993. Therefore, the adoption of the amendments to the restated plan will not change the private taxpayer rulings issued January 7, 1993, May 18, 1993,

November 19, 1993, and June 7, 1994.

This ruling is conditioned on the requirement that the compensation received by the Incentive Compensation Plan participants, as a whole, constitutes reasonable compensation and no determination is being made with respect to that issue.

In addition, this ruling is contingent upon ..., Inc. and ... retaining their tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. In the event that ... or its affiliates to lose their tax-exempt status under Section 501(c)(3) of the Internal Revenue Code for any reason, ... will lose its tax-exempt status under A.R.S. §§ 43-1201.4, 42-1301.10 and 42-271.A.5.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.