

Tax Exemption Criteria Update

Tax exemption for profitable, luxury CCRCs for affluent Americans is grounded in an Internal Revenue Service administrative ruling. It's not in statute. Yet, it has given rise to a privileged industry. The argument is that caring for old people, "apart from considerations of financial distress alone," is in itself a charitable activity because old people are "highly susceptible to other forms of distress in the sense that they have special needs because of their advanced years."

These citations are from Revenue Ruling 72-124 issued in 1972 during the Nixon administration, when the CCRC industry successfully lobbied the IRS for special treatment. Revenue Ruling 72-124 (appended to this issue paper) has not been reviewed for forty years. Moreover, if a subsequent Presidential administration were to decide that such tax favoring for affluent older Americans is unwarranted, it could revoke the Ruling as readily as it was enacted originally.

Revenue Ruling 72-124 contains three requirements for a profitable CCRC to continue exempt from taxation. "These are the need for housing, the need for health care, and the need for financial security."

1. "The need for housing will generally be satisfied if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons."
2. "The need for health care will generally be satisfied if the organization either directly provides some form of health care, or in the alternative, maintains some continuing arrangement with other organizations, facilities, or

health personnel, designed to maintain the physical, and if necessary, mental well-being of its residents.”

3. “The need for financial security, i.e., the aged person's need for protection against the financial risks associated with later years of life, will generally be satisfied if two conditions exist.
 - i. “First, the organization must be committed to the established policy, whether written or in actual practice, of maintaining in residence any persons who become unable to pay their regular charges....”.
 - ii. Second, “the organization must operate so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization.”

Missing from this list of criteria is the need of the elderly for ongoing respect as human beings. Thus, provider organizations are able to structure themselves without members meaning that the executives and board members are accountable only to themselves, to the providers of debt financing, and to the IRS within the limited scope of the three enumerated requirements. Despite the common requirement of sizable entry fees, there is no requirement of organizational accountability to the residents.

This missing need for respect and empowerment could be met by amending Revenue Ruling 72-124 to add a fourth criterion requiring that such tax favored entities include their beneficiaries, the residents, as governing members in the non-profit organization. That does not mean that there would be a necessary change in the directors or executives. It would simply mean that instead of the limited accountability that they now have, they would also be accountable to the residents who provide working capital to the organization in the form of entry fees.

Amending the Revenue Ruling to bring it up to date is a simple administrative action and wouldn't require legislation. Still, obtaining a review of a Revenue Ruling is a costly undertaking. In theory, any citizen can approach the National Office of the Internal Revenue Service seeking such a review, but in practice access to the National Office requires retention of a Washington, DC law firm with strong IRS contacts. That can cost \$50,000 to \$100,000 and neither NaCCRA nor Active Aging Advocates has such resources. This costly hurdle disadvantages consumer interests relative to corporate interests but that is the reality of the Federal government today.

With a simple administrative change, an update of Revenue Ruling 72-124, a "home for the aged" could qualify for continued tax exemption if it operates in a manner designed to satisfy four primary needs of aged persons. These are the need for housing, the need for health care, the need for financial security, and **the need for ongoing self-determination.**

A second commonsense administrative change would update Revenue Ruling 72-124 second condition, financial security, to include a requirement that financial

security requires a positive balance sheet. Thus, exempt organizations under RR 72-124 should have a positive net asset position.

Active Aging Advocates
July 3, 2016

Text of Revenue Ruling 72-124

Rev. Rul. 72-124, 1972-1 C.B. 145

Requirements that 'homes for the aged' must meet to qualify for exemption under section 501(c)(3) of the Code are explained; Revenue Ruling 57-467 superseded.

Advice has been requested whether an organization that otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 is operated for charitable purposes by reason of the activities described below.

The organization was formed under the sponsorship of leaders of a church congregation in a particular community for the purpose of establishing and operating a home for the aged. Its board of trustees is composed of leaders of the congregation, as well as other civic leaders in the community. It provides housing, limited nursing care, and other services and facilities needed to enable its elderly residents to live safe, useful, and independent lives. Admission to the home is generally limited to persons who are at least 65 years of age.

The organization is self-supporting in that its operating funds are derived principally from fees charged for residence in the home. An entrance fee is charged upon admission, with monthly fees charged thereafter for the life of each resident. Fees vary according to the size of the accommodations furnished.

Because of the necessity of retiring its indebtedness, the organization ordinarily admits only those who are able to pay its established rates. However, once persons are admitted by established policy to maintaining them as residents, even if they subsequently become unable to pay its monthly charges. It does this by maintaining such individuals out of its own reserves to the extent available, by seeking whatever support is available under local and Federal welfare programs, by soliciting members of the church congregation and the general public, or by some combination of these means.

The organization's receipts are used exclusively in furtherance of its stated purposes. Its charges are set at an amount sufficient to amortize indebtedness, maintain reserves adequate to provide for the life care of its residents, and set aside enough for a limited amount of expansion sufficient to meet the community's needs. Net earnings are thus generally used to improve the care provided, retire indebtedness, subsidize any resident unable to continue making his monthly payments, or expand the facilities of the home where the needs of the community warrant such expansion. No part of the organization's net earnings inures, directly or indirectly, to the benefit of any private shareholder or individual. All employees receive no more than reasonable compensation for services rendered.

Section 501(c)(3) of the Code provides for exemption from Federal income tax or organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal

sense. Such term includes the relief of the poor and distressed or of the underprivileged.

Providing for the special needs of the aged has long been recognized as a charitable purpose for Federal tax purposes where the requisite elements of relief of distress and community benefit have been found to be present.

Of principal importance are three rulings in which the Internal Revenue Service has given consideration to the tax exempt status of homes for the aged as charitable organizations described in section 501(c)(3) of the Code: Revenue Ruling 57-467, C.B. 1957-2, 313; Revenue Ruling 61-72, C.B. 1961-1, 188; and Revenue Ruling 64-231, C.B. 1964-2, 139.

Revenue Ruling 57-467 holds that a home for aged people that does not accept charity guests and that requires the discharge of guests who fail to make certain required monthly payments is not organized and operated exclusively for charitable purposes and is, therefore, not entitled to exemption from Federal income tax under section 501(c)(3) of the Code.

Revenue Ruling 61-72 holds that, if otherwise qualified, a home for the aged is exempt under section 501(c)(3) of the Code if "(1) the organization is dedicated to providing, and in fact furnishes, care and housing to aged individuals who would otherwise be unable to provide for themselves without hardship, (2) such services are rendered to all or a reasonable proportion of its residents at substantially below the actual costs thereof, to the extent of the organization's financial ability, and (3) the services are of the type which minister to the needs and the relief of hardship or distress of aged individuals."

Revenue Ruling 64-231 holds that an entrance fee paid in addition to a required lump sum life-care payment as a prerequisite to obtaining direct personal services and residence in a home for the aged must be included along with the required lump-sum life-care payments to the home in determining whether the home meets the "below cost" requirement of Revenue Ruling 61-72.

Under the Revenue Rulings referred to above, exemption from Federal income tax under section 501(c)(3) of the Code is conditioned, in effect, upon whether an organization relieves the financial distress of aged persons by providing care and housing for them on a gratuitous, or below cost, basis.

However, it is now generally recognized that the aged, apart from considerations of financial distress alone, are also, as a class, highly susceptible to other forms of distress in sense that they have special needs because of their advanced years. For example, it is recognized in the Congressional declaration of objectives, Older Americans Act of 1965, Public Law 89-73, 89th Congress, 42 U.S.C. 3001, that such need include suitable housing, physical and mental health care, civic, cultural, and recreational activities, and an overall environment conducive to dignity and independence, all specially designed to meet the needs of the aged. Satisfaction of these special needs contributes to the prevention and elimination of the causes of the unique forms of "distress" to which the aged, as a class, are highly susceptible and may in the proper context constitute charitable purposes for functions even though direct financial assistance in the sense of relief of poverty may not be involved.

Thus, an organization, otherwise qualified for charitable status under section 501(c)(3) of the Code, which 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 need for housing will generally be satisfied if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons.

The need for health care will generally be satisfied if the organization either directly provides some form of health care, or in the alternative, maintains some continuing arrangement with other organizations, facilities, or health personnel, designed to maintain the physical, and if necessary, mental well-being of its residents.

The need for financial security, i.e., the aged person's need for protection against the financial risks associated with later years of life, will generally be satisfied if two conditions exist. First, the organization must be committed to the established policy, whether written or in actual practice, of maintaining in residence any persons who become unable to pay their regular charges. This may be done by utilizing the organization's own reserves, seeking funds from local and Federal welfare units, soliciting funds from its sponsoring organization, its members, or the general public, or by some combination thereof. However, an organization that is required by reason of Federal or state conditions imposed with respect to the terms

of its financing agreements to devote its facilities to housing only aged persons of low or moderate income not exceeding specified levels and to recover operating costs from such residents may satisfy this condition even though it may not be committed to continue care of individuals who are no longer able to pay the established rates for residency because of a change in their financial circumstances. See, for example, section 236 of the National Housing Act, P.L. 90-448, 82 Stat. 476, 498 (12 U.S.C. 1715 z-1).

As to the second condition respecting the provision of financial security, the organization must operate so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization. In case of doubt as to whether the organization is operating at the lowest feasible cost, the fact that an organization makes some part of its facilities available at rates below its customary charges for such facilities to persons of more limited means than its regular residents will constitute additional evidence that the organization is attempting to satisfy the need for financial security, provided the organization fulfills the first condition regarding the provision of financial security. The amount of any entrance life care, founder's, or monthly fee charged is not, per se, determinative of whether an organization is operating at the lowest feasible cost, but must be considered in relation to all items of expense, including indebtedness and reserves.

The organization described in the instant case is relieving the distress of aged persons by providing for the primary needs of such individuals for housing, health care, and financial security in conformity with the criteria specified above. Accordingly, it is held that the organization is exempt from Federal income tax under section 501(c)(3) of the Code as an organization organized and operated exclusively for charitable purposes.

Revenue Ruling 57-467 is hereby superseded. Revenue Rulings 61-72 and 64-231 provide alternative criteria for charitable qualification of homes for the aged which are primarily concerned with providing care and housing for financially distressed aged persons. To the extent that a home for the aged can satisfy those criteria, those Revenue Rulings continue to remain in effect. However, Revenue Rulings 61-72 and 64-231 do not constitute the exclusive criteria for exemption from Federal income tax under section 501(c)(3) of the Code and any organization which meets the criteria set forth in this Revenue Ruling may also qualify for exemption under section 501(c)(3).

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the Income Tax Regulations.

-- <http://www.irs.gov/pub/irs-tege/rr72-124.pdf> accessed September 25, 2015