Hospital Authority, bonds offered to LLC

Number: INFORMAL

Date: September 13, 2005

Mr. Patrick A. White
Chairman
Highlands County Health Facilities Authority
425 South Commerce Avenue
Sebring , Florida 33870

Dear Mr. White:

On behalf of the Highlands County Health Facilities Authority, you ask whether the participation of Florida Hospital Waterman, Inc., a not for profit corporation, in the sale of the bonds to a limited liability company (LLC) constitutes authorized business under Florida's Not for Profit Corporation Act, Chapter 617, Florida Statutes. You also inquire whether the payment of interest on the bonds to the LLC unit holders violates section 617.0505, Florida Statutes, as a payment of dividends, income or profit of the borrower to its members.

The Highlands County Health Facilities Authority (authority) is a public entity created pursuant to the Health Facilities Authorities Law, Part III of Chapter 154, Florida Statutes. The authority has entered into an interlocal agreement with the City of Tavares, located in Lake County, to issue bonds, the proceeds of which will fund capital improvements to Florida Hospital Waterman, Inc. (Waterman), a non-profit hospital owned by Adventis and located in Tavares. The bonds have been validated by the Tenth Judicial Circuit Court for Highlands County.[1] Accordingly, no comment is expressed herein regarding the authority's power to issue bonds in this instance. You have not asked for this office's opinion regarding the applicability of Florida health care laws to this transaction and accordingly, no comment is expressed on this issue.

This office has been advised that forty percent of the bonds will be sold to a bond limited liability company which will have as investors physicians on the staff of Waterman. Pursuant to the participation agreement of the bond LLC, physician investors are prohibited from affiliating with any person or entity engaged in providing health care services that are competitive with Waterman. The remaining sixty percent of the bond issue will be sold as a private placement to accredited institutional investors or accredited individual investors who are not referring physician investors. The underwriter, who has no interest in Waterman other than providing brokerage services, will establish the interest rate on the bonds at fair market value and certify that determination to the authority. Interest on the bonds will accrue semi-annually, but payment of interest is contingent on Waterman meeting two separate performance levels (a financial target and a quality and patient satisfaction target) during the applicable interest accrual period. If the targets are not met, interest is not paid for that period but accrues until a later interest period when both targets have been met or exceeded. All principal and interest, however, will be due and payable at the maturity of the bonds or upon their early redemption.

Chapter 617, Florida Statutes, the Florida Not for Profit Corporation Act, governs the activities of

not for profit corporations operating within this state. Section 617.01401(5), Florida Statutes, in defining "Corporation not for profit" states that no part of the income or profit of the corporation is distributable to its members, directors, or officers. In addition, section 617.0505(1), Florida Statutes, provides in pertinent part:

"A dividend may not be paid, and any part of the income or profit of a corporation may not be distributed, to its members, directors, or officers. A corporation may pay compensation in a reasonable amount to its members, directors, or officers for services rendered, may confer benefits upon its members in conformity with its purposes, and, upon dissolution or final liquidation, may make distributions to its members as permitted by this act. . . ."

A concern has been raised that the payment of interest to the limited liability corporation for distribution to unit holders who are physicians on staff with Waterman may implicate the prohibitions against payment of dividends and jeopardize Waterman's tax exempt status as a not for profit corporation.

This office has been advised that the Department of the Treasury, Internal Revenue Service, has ruled on a similar transaction and determined that the activities of a not for profit hospital in the sale of the bonds did not adversely affect the hospital's tax exempt status.[2] The ruling recognized that in order for a not for profit corporation to maintain its tax exempt status, it must engage primarily in activities that accomplish an exempt purpose. By concluding that the sale of the bonds at fair market value did not serve a private interest more than incidentally, the ruling determined that the hospital was acting within the scope of its charitable purpose.

The ruling also recognized that for an organization to be exempt pursuant to 26 United States Code section 501(c)(3), no part of the net earnings of the organization may inure to the benefit of any private shareholder or individual. The federal regulations provide that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.[3] The ruling concluded that the sale of bonds and the payment of interest did not constitute an inurement under federal law.

While the federal private ruling addressed federal law, the rationale expressed therein would appear to be applicable to a consideration of Chapter 617, Florida Statutes, which regulates the activities of not for profit corporations and prohibits the payment of income, profit or dividends to members of such corporations. Under the rationale of the private ruling by the Internal Revenue Service, the payment of interest in the instant inquiry to physician members of the limited liability company would not appear to constitute a prohibited payment of income, profit, or dividends.

I trust that the above advisory comments will be of assistance to you in resolving this matter.

Sincerely,

Joslyn Wilson
Assistant Attorney General

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[1] *See Highlands County Health Facilities Authority v. State of Florida*, Case No. GC 05-276 (10th Jud. Cir. Highlands Co. June 7, 2005).

[2] Private Ruling, dated December 30, 2003, prepared by Marvin Friedlander, Manager, Exempt Organizations Technical Group 1, Department of the Treasury, Internal Revenue Service. A not for profit hospital proposed the sale of bonds to finance capital improvements. The subordinated bonds had a fixed interest rate determined by an underwriter based upon competitive bids on the open market. A limited liability company (LLC) owned by medical staff physicians and the company's manager would acquire 40% of the bonds. It was anticipated that the voting or nonvoting directors of the hospital would own membership units. LLC members were prohibited from competing with the hospital within a designated area for two years after membership had ended.

[3] 26 CFR 1.501(c)(3)-1(c)(2).