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## Mayo Clinic Convinces Federal District Court (Minn.) That It Is an “Educational Organization” Entitled to Treat Its Debt-Financed Income as Tax Exempt Even Though Unrelated to Its Charitable Mission

### SUMMARY

The Mayo Clinic is granted a tax refund of \$11.5 million, claiming that the income, even though unrelated to its exempt purposes and debt-financed, is nevertheless exempt from tax since the Mayo Clinic qualifies as an “educational organization” under section 514(c)(9)(C) of the Internal Revenue Code.

#### Factual Background

The Mayo organization is composed of a number of integrated, nonprofit corporations tax-exempt under section 501(c)(3) of the Internal Revenue Code (“Code”), the parent of which is the “Mayo Clinic,” (formerly the “Mayo Foundation”). The various components of the Mayo organization provide world-renowned healthcare services, but they also operate schools and programs providing medical education. The Mayo Clinic holds a number of investments in real estate partnerships through which it receives substantial income. Some of those investment partnerships use debt to finance their own operations and businesses. The character of the income, including the debt-financed nature of the income, flows through to the Mayo Clinic. The Mayo Clinic claimed that such income, even though debt-financed and even though unrelated to its exempt purposes, was nevertheless exempt from taxation because the Mayo Clinic is an “educational organization” entitled to the exception from the unrelated debt-financed income rules provided under section 514(c)(9)(C) of the Code.

#### Statutory/Regulatory Background

Section 514(c)(9)(C) of the Code provides an exception from the unrelated debt-financed income rules for certain tax-exempt organizations, including educational organizations described in section 170(b)(1)(A)(ii). Those organizations are generally considered “schools” because the statute requires that the educational organization “normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of . . . students in attendance at the place where its educational activities are regularly carried on.” The Treasury Regulations under 170(b)(1)(A)(ii) require that the educational organization must have as its primary function the presentation of formal instruction.

#### District Court Decision

The Federal District Court in Minnesota (home to the Mayo Clinic) decided that the Mayo Clinic was entitled to the benefit of the exception provided by section 514(c)(9)(C) of the Code because it met the statutory requirements set forth in section 170(b)(1)(A)(ii) of the Code even though much of its activities involved the provision of healthcare services to its patients. The net result is that the income of the Mayo Clinic from its investments in partnerships which utilized debt-financing are not subject to taxation even though the activities of the partnerships are not necessarily supportive of the charitable mission of the Mayo Clinic.

The decision of the District Court has been appealed by the government to the 8th Circuit Court of Appeals which will ultimately decide the correctness of the District Court’s decision.

#### Implications

If upheld by the 8th Circuit, the decision presents many planning opportunities for tax-exempt organizations, particularly academic medical centers, institutions of learning, and institutions with educational components. Even if the decision is reversed by the 8th Circuit, it is still an important reminder to all sorts of educational organizations of the availability of the exception under section 514(c)(9)(C) when structuring their investment portfolios.

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