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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN: 512.06-00
513.04-00

Contact Person:

Telephone Number:

In Reference to:

Date: FEB 23 1999

Employer Identification Number:
Key District:

Legend:

A =
B =
C =
D =
E =
F =
G =

Dear Applicant:

We have considered your request for a ruling as to whether the operation of a mushroom growing and processing facility may adversely affect the exempt status of or impose liability for unrelated business income tax on A.

Specifically, you have requested a ruling that:

1. A's tax-exempt status under section 501(c)(3) of the Internal Revenue Code will not be adversely affected by its operation of the mushroom growing and processing facility.

2. The income realized from the operation of the facility and from the sale of the mushrooms generated by it will not constitute unrelated business income within the meaning of section 512 because the activities are substantially related to A's charitable purposes.

The information indicates that A is an organization recognized exempt from federal income tax under section 501(c)(3) of the Code. A's articles of incorporation indicate that its purpose is to "rehabilitate needy people and restore them to useful life in the community."

A is currently inactive. However, it plans to re-establish a live-in care facility and vocational training operation for poor and/or drug-addicted individuals in C. A will purchase and renovate a building to be used as a mushroom growing and processing facility.

This facility plans to employ predominantly poor and/or drug-addicted individuals. They will be trained to harvest mushrooms grown at the facility and package them for direct sale to retailers. The facility will employ a total work force of approximately D. Approximately E will serve as managers. Some of the managers will be recovering clients who will act as role models for those who are receiving treatment and work experience. A intends to provide a sheltered and supportive work environment for the client during the recovery process so that he may take the marketable skills obtained at the facility and apply them to the outside world.

Clients will be paid from F to G per hour for work at the facility. This income will allow clients to pay a portion of their living costs at the facility as well as allow those clients who may not otherwise be able to attend without a regular income to enter A's treatment program.

In addition, A will employ certified drug counselors to provide on-site counseling and assistance and conduct drug abuse education and prevention programs at the facility. Such programs will be conducted on a weekly basis. Attendance is required for everyone who works at the facility. Eventually, A will supplement these programs with workshops in skill areas so that clients can expand their knowledge base.

All mushroom sale proceeds will fund the re-establishment and operation of the live-in drug recovery facility, the operation of the mushroom facility and the drug abuse education and prevention programs.

Section 501(c)(3) of the Code provides for the exemption of organizations which are organized and operated exclusively for charitable purposes and no part of the earnings of which inures to the benefit of an individual.

Section 511 of the Code imposes a tax on the unrelated business taxable income of certain tax-exempt organizations, including charitable organizations described in section 501(c)(3) of the Code.

Section 512(a)(1) of the Code defines unrelated business taxable income, with certain modifications, as the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business.

Section 513(a) of the Code provides that an unrelated trade or business is, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code defines "trade or business" as any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(a) of the Income Tax regulations provides that the gross income of an exempt organization is includible in the computation of unrelated business taxable income if certain factors are present. Such factors include the following:

1. The activity producing such income must constitute a trade or business.

2. The trade or business must be regularly carried on.

3. The trade or business must not be substantially related to the organization's exempt purpose.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes. It is "substantially related," for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

A's mushroom growing, processing and sales activity provides employment training for the poor and furthers the rehabilitation of drug-addicted individuals by providing a supportive work experience designed to aid their physical and emotional recovery. Therefore, the operation of the proposed work/training facility contributes importantly to your charitable purpose by providing employment training for the poor and by furthering the rehabilitation process of recovering addicts. By providing recovering drug addicts with training and work experience, your facility will increase the self-esteem of the recovering addict thus aiding his recovery.

Furthermore, because of the substantial relationship between your training program and A's exempt purpose, the operation of the mushroom business is related to your exempt purpose.

Based on the facts, law and rationale as presented herein, we rule as follows:

1. A's tax-exempt status under section 501(c)(3) of the Internal Revenue Code will not be adversely affected by its operation of the mushroom growing and processing facility.

2. The income realized from the operation of the facility and from the sale of the mushrooms generated by it will not constitute unrelated business income within the meaning of section 512 because the activities are substantially related to A's charitable purposes.

This ruling is directed only to A. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve any future questions about A's tax-exempt status and other matters, A should keep a copy of this ruling in its permanent records.

We are informing A's key District Director of this ruling.

Sincerely yours,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2