The operation of orchards and farms by the employees of a charitable trust under the supervision of the trustees is a profit-making enterprise not related to the charitable purposes of the trust and, therefore, constitutes an unrelated trade or business within the meaning of section 513 of the Internal Revenue Code of 1954. The income derived therefrom is taxable as unrelated business taxable income as defined in section 512 of the Code. However, farm income derived by the trust from a tenant under a lease, under the terms of which the trust is neither a joint venture nor a partner, is not unrelated business taxable income within the meaning of section 512 of the Code.

Advice has been requested whether the operation of orchards and farms by employees of a charitable trust under the circumstances set forth below constitutes an unrelated trade or business within the purview of section 513 of the Internal Revenue Code of 1954.

Under the last will and testament of the testator, his residuary estate was left to certain trustees to be administered as a charitable trust to provide for and protect the various stipulated charitable bequests therein. Included among the trust properties are farms and orchards.

One portion of the orchards and farms is operated by employees of the trust, under direct supervision of the trustees. Their work consists of harvesting crops raised on the land and storing, marketing, and processing juices and preserves derived from such crops. The remaining portion of the orchards and farms has been leased by the trust to a tenant who plants the corps and cares for and harvests them. The trust receives a share of the gross products raised by the tenant. All operating expenses with respect to this portion of the orchards and farms are borne by the tenant. The tenant occupies this property under the terms of a lease which gives him exclusive possession of the property and under which the trust is neither a joint venture nor a partner.

Section 511 of the Internal Revenue Code of 1954 imposes a tax on the unrelated business taxable income of certain organizations, otherwise exempt from tax under section 501(c)(3), that are engaged in an unrelated trade or business. The term 'unrelated business taxable income' as defined in section 512 of the Code means, with certain exceptions, additions and limitations, the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business. Section 512 provides specifically that the term 'unrelated business taxable income' does not include rents from real property. Section 513 of the 1954 Code defines the term 'unrelated trade or business,' in the case of any organization subject to the tax imposed by section 511 of the Code, as 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 of the Code.

In the instant case, it is apparent that the farms and orchards operated by the estate, although they constitute a part of the property received in the original inventory of the trust, are operated as profit-making enterprises in the same manner as a commercial operation and are not considered related to the charitable purpose of the trust other than through the use made of the profits derived therefrom. See Rev. Rul. 55-676, C.B. 1955-2, 266.

Accordingly, it is held that the operation of the orchard and farms by the employees under the supervision of the trustees of the trust is a profit-making enterprise which constitutes an unrelated trade or business as defined in section 513. The income derived therefrom is taxable as unrelated business taxable income under section 511 of the Code. It is further held that the proceeds derived by the trust from the lease constitute rents and are not unrelated business taxable income within the meaning of section 512 of the Code.