Rev. Rul. 69-177, 1969-1 C.B. 150

An organization, wholly owned by a tax exempt college, that manufactures and sells wood products primarily to employ students of the college to enable them to continue their education does not qualify for exemption under section 501(c)(3) of the Code.

Advice has been requested whether an organization formed and operated in the manner described below is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization, which is wholly owned by a college exempt from Federal income tax under section 501(c)(3) of the Code, manufactures and sells wood and metal products. One of the principal purposes of the organization is to furnish employment for students of the college to enable them to continue their education. A majority of the organization's employees are students of the college. However, student employment is not related to the curriculum of the college. The organization turns over the profits from its business to the college.

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

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term 'charitable' includes the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term 'educational' relates to the instruction or training of the individual for the purpose of improving or developing his capabilities.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

The business of manufacturing and selling wood and metal products is not an educational activity in this case because the college students are not employed for the purpose of receiving instruction or training, or for the purpose of improving or developing their capabilities.

Granting scholarships to enable needy students to obtain an education may be a charitable activity in furtherance of education. See, for example, Rev. Rul. 64-274, C.B. 1964-2, 141. However, if an organization engages in a trade or business to obtain funds for scholarship purposes, it is not exempt merely because the profits were used for scholarships.
In this case the fact that the students receive funds to further their education in the form of compensation does not make the organization exempt. Furthermore, by reason of section 502 of the Code the organization is not exempt on the ground that the profits from its business activities are paid over to the college, which is exempt under section 501.

Accordingly, the organization is not exempt from Federal income tax under section 501(c)(3) of the Code.