

The operation of a gift shop, patronized by patients, visitors making purchases for patients, and employees, by a section 501(c)(3) hospital does not constitute unrelated trade or business under section 513 of the Code.

Advice has been requested whether, under the circumstances described below, the operation of a gift shop by a hospital exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 is unrelated trade or business within the meaning of section 513 of the Code.

The hospital maintains a gift shop operated by a full-time, salaried manager assisted by members of the hospital auxiliary. The gift shop sells candy, newspapers, books, magazines, flowers, and other small gift items. It handles rental orders for television sets for patients. It also operates a 'gift cart' that is taken throughout the hospital.

The gift shop is patronized by patients, visitors making purchases for patients, and hospital employees. Its operation results in an annual net profit which is made part of the hospital's general operating fund.

Section 513 of the Code defines the term 'unrelated trade or business' as any trade or business, the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt functions.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is 'substantially related' only if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption was granted.

One of the purposes of the hospital is to provide health care for members of the community. By providing a facility for the purchase of merchandise and services to improve the physical comfort and mental well-being of its patients, the hospital is carrying on an activity that encourages their recovery and therefore contributes importantly to its exempt purposes. Furthermore, since it is to the hospital's advantage to keep its employees and medical staff on its premises throughout their working days, the sale of reading materials, candy, and other personal effects by the gift shop to hospital personnel increases the hospital's efficiency and contributes importantly to its exempt purpose. Accordingly, it is held that this activity is substantially related to the purpose of constituting the basis for the hospital's exemption and does not constitute unrelated trade or business under section 513 of the Code.