

Halfway house operating furniture shop. A halfway house, organized to provide room, board, therapy, and counseling for persons discharged from alcoholic treatment centers, which also operates a furniture shop to provide full-time employment for its residents with any profits applied to operating costs of the halfway house, qualifies for exemption under section 501(c)(3) of the Code and is not conducting an unrelated trade or business within the meaning of section 513.

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for charitable and educational purposes; and, if it is so operated, whether its operation of a furniture shop in the manner described below is the conduct of unrelated trade or business within the meaning of section 513.

The organization operates a halfway house to provide room, board, therapy, and counseling for persons discharged for alcoholic treatment centers after receiving short-term intensive care for alcoholism. Such persons are admitted because they are not currently capable of achieving a satisfactory social and employment adjustment on their own and they need a temporary home and a transitional atmosphere as a means of regaining their emotional and physical health, of reacquiring self-respect and confidence in their own capabilities, and thereby of becoming productive and contributing members of society.

As part of its program, the organization also operates a furniture shop to provide full-time employment for residents of the halfway house. Other persons are not employed in the shop except to provide training and supervision of the residents. All work in the shop is performed by the residents and those few other employees who train and supervise them.

Residents who work in the shop receive compensation at the comparatively low hourly rates currently prevailing in the woodworking and furniture assembly trade. Each resident is required to pay a reasonable fee for his room and board that is applied toward the total costs incurred in operating the halfway house.

The work in the furniture shop is transitional employment, rather than occupational training. The instruction or training received at the shop is not intended to achieve a significant increase in saleable skills since most of the residents already have other saleable skills. They are not expected to continue working in the furniture shop beyond the time when they attain a reasonable degree of self-respect and reliability, and thus become able to secure regular employment elsewhere. Residents usually stay from six to nine months.

Any profits realized from furniture shop operations are applied toward the cost of operating the halfway house, and any operating deficits for the overall activities are taken care of by procuring contributions for that purpose.

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 defines the term 'charitable' as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the underprivileged and the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i)(a) of the regulations defines the term 'educational' as including the instruction or training of the individual for the purpose of improving or developing his capabilities.

The organization's program is designed to bridge the span between the end of the residents' intensive treatment for alcoholism and the return to a normal and productive life through the integration of residential and work-related experience. When the residents are released from intensive care they have many emotional problems that require counseling and group therapy. The homelike atmosphere of the residence and the professional care that is received assists them in regaining their physical and mental health. The work shop helps the residents to develop regular work habits and a sense of self discipline and independence at a time when they are not able to cope emotionally with the outside pressures of the everyday world.

The activities described above serve to promote the health of the individual and improve his capabilities and thus further charitable and educational purposes. Accordingly, the organization is operated exclusively for charitable and educational purposes and thus qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

See. Rev. Rul. 67-150, 1967-1 C.B. 133, which holds that a nonprofit organization operating to rehabilitate ex-convicts and parolees in order to make them self-supporting and useful citizens may be exempt from Federal income tax under section 501(c)(3) of the Code. See also Rev. Rul. 72-16, 1972-1 C.B. 143, which holds that an organization providing a residence facility and therapeutic 'group living program' for individuals recently released from a mental institution qualifies for exemption under section 501(c)(3).

Section 513(a) of the Code defines the term 'unrelated trade or business' as any trade or business of an organization subject to tax under section 511 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 profit derived) to the exercise or performance by such organization of its exempt functions.

Section 1.513-1(d)(2) of the regulations states that trade or business is 'related' to exempt purposes only where the conduct of the business activity has causal relationship to the achievement of an exempt purpose; and is 'substantially related' for purposes of section 513 of the Code only if the causal relationship is a substantial one. Thus, for the conduct of trade or business to be substantially related to the purposes for which exemption is granted, the production or distribution of goods or the performance of services must contribute importantly to the accomplishment of those purposes.

The operation of the work shop in the manner described affords the residents gainful employment and enables them to develop the ability to cope with emotional problems. It thus contributes importantly to the organization's exempt purposes. Accordingly, the operation of the work shop is not the conduct of unrelated trade or business within the meaning of section 513 of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See sections 1.508-1(a) and 1.501(a)-1 of the regulations.