



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: 200836031
Release Date: 9/5/08
Date: April 25, 2008

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

- A. Board Member, Treasurer, CFO
- B. Board Member, President, CEO
- C. Board Member
- D. Board Member, Secretary
- M. Applicant
- N. State
- O. Date
- P. Thoroughbred Racing Circuit
- Q. County #1
- R. County #2
- S. County #3
- T. State #1
- U. State #2
- V. State #3

UIL No.:

- 501.35-00
- 501.36-01
- 502.01-00

Dear

We have considered your (hereinafter M's) application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that M does not qualify for exemption under Code section 501(c)(3). We have also considered whether M qualifies for any other subsection under section 501(c) and have determined it does not. The basis for our conclusion is set forth below.

ISSUE:

Does M qualify for tax exemption under section 501(c)(3) of the Code?

Letter 4036(CG) (11-2005)
Catalog Number 47630W

FACTS:

Articles of Incorporation were filed with the State of N on O date. M's operations will be conducted in a state different from its state of incorporation.

Article THIRD of M's articles states that one of its purposes is "To solicit donations to sponsor race horses with all of the net proceeds after expenses supporting charities."

Article FIFTH: contains the following "The Corporation shall be a membership corporation and shall have no authority issue capital stock. The conditions of membership in the Corporation and the voting powers of the members shall be as set forth in the by-laws of the Corporation."

A review of M's bylaws indicates no requirements for membership in M.

Article II, Section 2.2 of M's bylaws state: "the purpose or purposes of the corporation shall be: to solicit donations to sponsor race horses with all net proceeds after expenses supporting charities."

An attachment to M's Form 1023 application states under its mission statement that "... (M) seeks to raise money in order [sic] increase public awareness for Thoroughbred Horse Racing while simultaneously raising capital for philanthropic purposes." The attachment goes on to say:

(M) will seek to rally public support by creating a thoroughbred "racing team" which will participate in the P racing circuit and donors will have the unique opportunity to have all or part of the "racing team" operation named in their honor for a specific period of time. For instance, sponsors donating to (M) will have their names prominently displayed on all "racing team" wardrobe, equipment, and training facilities. This "racing team concept" has already proven successful in NASCAR Racing and INDY Racing and is the same concept that M will employ except, in this case, all net revenue (including purse revenue and horse sales) will be used to promote the sport of thoroughbred racing and to support public charitable organizations (emphasis added).

Attachment 3c of the application states that "(M) will participate in gaming activities in the Southern U region in the following counties: Q, R and S. Stables will be operated in T, U and V."

M's fund raising program is to focus on 4 types of donors: Corporate donors, VIP Private donors, General Public donors and Thoroughbred Breeder donors.

Corporate donors have the opportunity to have their name and/or products incorporated into the daily activity of M's racing stable. The larger the financial support, the more visibility corporate donors will have for their products and/or services. In addition, corporate sponsors will be allowed to attend all training, race day and special event functions.

VIP Private donors are similar to Corporate donors except they wish to remain discreet about their public visibility. They are also invited to attend training, race day and special event functions.

General Public donors will only have an opportunity to attend selected race day activities and special event functions.

Thoroughbred Breeder donors are those that wish to donate their own thoroughbreds to the "racing team." M will manage and train the horses, nominate them into appropriate races which may maximize subsequent income potential for the breeder through award programs.

Attachment 4d to the application indicates that "Fundraising will be conducted on a nation-wide basis, although, the majority of donations are expected to originate from Southern (U)."

M has chosen 3 organizations currently exempt under SECTION § 501(c)(3) to receive donations.

M's Board of Directors consist of A, B, C and D. A is the treasurer and CFO of M. B is the president and CEO of M and has more than 12 years experience in the thoroughbred racing industry and will be overseeing M's operations. C is a director of M. D is the secretary of M. A is the father of B and C and the father-in-law of D. B and C are brothers. B and D are husband and wife. When asked by the Service to consider expanding its Board of Directors to ensure that public interests are placed above private interests, M responded by saying "...the organization has been unable to recruit unrelated individuals to serve on the board of directors and probably will not be able to do so until the Exemption Application is approved. In short, outside parties are reluctant to commit their efforts to a charitable organization that does not have tax-exempt status."

In correspondence from M dated August 11, 2005, it states: "the goal of the organization is to distribute, at a minimum, 10% of the projected revenue. Thus, in this amount would be approximately \$ and \$ in ."

Supplemental information sent with the same correspondence shows the following: Total revenues for the year of over \$ total expenses of over \$ leaving an excess of revenues over expenses of \$ This computes to around 81% of the revenues being dedicated to the payment of expenses, with approximately one half of the excess of revenues over expenses being dedicated to charity of over \$ Also, nearly \$ of the estimated revenue is projected to be from the sale of horses, just under \$ is projected to be from "Racing income / Purse Revenue". Of the total projected revenues of over \$ a total of around \$ is shown as "Public Donations/Other revenues".

Total revenues for the year of over \$ with an excess of revenues over expenses of over \$ which also computes to around 81% of the Letter 4036(CG) (11-2005) Catalog Number 47630W

revenues being dedicated to the payment of expenses, with approximately 50% of the excess of revenues over expenses being dedicated to charity computed in the same manner as the year. Of the total projected revenues of over \$, a total of around is shown as "Other revenues / donations". None of other sources of revenue noted relate to contributions from the general public.

LAW:

Section 501(c)(3) of the Code of 1986 provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Section 502 of the Code states 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 under section 501 from taxation.

Section 6110(k)(3) of the Code states that a written determination may not be used or cited as precedent.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(i) of the Regulations provides, in part, that an organization may be exempt under section 501(c)(3) of the Code if it is organized and operated for exempt purposes. However, under section 1.501(c)(3)-1(d)(1)(ii), an organization is not organized and operated exclusively for an exempt purpose unless it serves a public as opposed to a private interest. Thus, an organization must establish that it is not operated for the benefit of designated individuals.

Section 1.502-1(a) of the Income Tax Regulations states that in determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States held that the presence of a single non-exempt purpose, if substantial in

nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In North American Sequential Sweepstakes v. Commissioner, 77 T.C. 1087 (1981), the Court held that the petitioner, organized and operated to educate the public and the skydiving community with respect to team skydiving, was operated for the for a substantial nonexempt purpose, to further the recreational interests of its creators. The Court stated:

...we are convinced that the predominate motivation underlying petitioner's activities was to further the recreational interests of its creators... . Although petitioner was operated in a manner that may have incidentally furthered educational purposes and advanced amateur athletics, we must conclude that petitioner primarily served the private interests of its creators... All three (creators) were on petitioner's board of directors. Each of them was an avid skydiver and had developed a keen interest in the (sport). It is clear that they wanted to pursue their personal interests in skydiving and used petitioner for that purpose.

In Rev. Rul. 64-182, 1964-1 C.B. 186, the Service published the commensurate test. In this ruling, an organization was organized exclusively for charitable purposes by which it derived its income principally from the rental of space in a large commercial office building which it owned, maintained and operated. The charitable purposes of the corporation were carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes. In the ruling, the Service held that the organization was deemed to meet the primary purpose test of section 1.501(c)(3)-1(e)(1) of the Income Tax Regulations, and was to be entitled to exemption from Federal income tax as a corporation organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code, where it was shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.

In Rev. Rul. 68-505, 1928-2 C.B. 248, the Service ruled on whether an activity of an organization was subject to the unrelated business income tax under Section 513 of the Code. The organization conducted a two-week horse racing meet that featured pari-mutuel betting. The races were conducted in the same general manner as at commercial tracks. Under the pari-mutuel system the organization received a commission on the total amount wagered. Other race income is derived from gate admissions and the sale of programs. Disbursements are for purses and race expenses. The net income from the races was used for the exempt purposes of the organization. The Service ruled that since the races, with pari-mutuel betting, were carried on in a manner similar to commercial race tracks, they constituted a trade or business. Furthermore, the business was regularly carried on because it is usual to carry on such trade or business only during a particular season. The Service further stated that the conduct of the racing meet with pari-mutuel betting was not related to the organization's exempt purpose because it neither contributed importantly to the educational objectives of the fair (section 1.513-1 (d) (2) of the regulations), nor was it the type of recreational activity that is intended to attract the public to the fair's educational features. Therefore, the conduct of the horse racing meet with pari-mutuel betting by the organization constituted unrelated trade or business under

section 513 of the Code, and the organization was subject to the tax imposed by section 511 of the Code on unrelated taxable income with respect to the income derived from said activity.

APPLICATION OF LAW:

Thoroughbred racing is a for-profit commercial industry. M's stated intent in its mission statement to raise public awareness for thoroughbred horse racing is not an exempt purpose under section 501(c)(3) of the Code, and its thoroughbred racing activities are more than an insubstantial part of its total activities. Also, the fact that approximately 80% of all revenues collected will be used to support the horse racing team, and that just over half of the 20% remaining excess of revenues over expenses will be dedicated to charitable work demonstrates that M's primary activities are not dedicated to charitable purposes. M has not provided evidence that its activities are dedicated to charitable purposes, as was stated in both the application narrative and correspondence received during the application review. Both M's dedication to raising public awareness for thoroughbred racing and the financial information presented above demonstrate that the applicant's primary activities do not meet the requirements of Treas. Reg. 1.501(c)(3)-1(c)(1) that the applicant must be operated exclusively for one or more exempt purposes, and that not more than insubstantial part of its activities is not furtherance of an exempt purpose.

Because approximately 80% of all revenues collected will be used to support the horse racing team, and because just over half of the 20% remaining excess of revenues over expenses will be dedicated to charitable work the planned contributions and grants will not be commensurate in scope with its financial resources, which is a requirement for a section 501(c)(3) fundraising organization as stated in Rev. Rul. 64-182.

The financial information contained in the file, M's proposed horse racing/sales activities, and the limited educational activities in proportion to the applicant's overall activities demonstrate that M is operated to further the recreational interests of its board members, which is both a substantial and a nonexempt purpose.

Further, since M is operated to further the recreational interests of its board members, it does not meet the Regulation 1.501(c)(3)-1(d)(1)(ii) requirement that it not be operated or organized for the benefit of private interests.

M's stated intent to race horses and to share in the betting proceeds from such races constitutes participation in pari-mutuel betting, which is an activity that was determined to be unrelated business income in Rev. Rul. 68-505, and is described in section 513 of the Code. Since unrelated business income activities are not considered to be related to a section 501(c)(3) organization's tax-exempt function, such activities are not considered to be described under section 501(c)(3). When considering the amount of projected income to be produced by pari-mutuel activities, and the amount of the applicant's resources that will be dedicated to this activity, the pari-mutuel activities are determined to be more than an "insubstantial" part of the part of the applicants overall activities, and thus the applicant is not operated exclusively for charitable and educational purposes as is required by Treas. Reg. 501(c)(3)-1(c).

Competing in horse racing events for a share of the purses and the use of the applicant organization's assets primarily for this purpose is determined to have the characteristics of a trade or business, as these activities are involved with pari-mutuel betting which has been determined to be an unrelated trade or business activity. As such, the organization is best described under section 502 and related Regulations as a trade or business that turns over net proceeds from its operations to charitable organizations. Such section 502 organizations are not organizations that can be described under section 501(c)(3).

M is similar to the organization described in North American Sequential Sweepstakes. In that case, the court ruled that the petitioner was operated for the substantial nonexempt purpose of furthering the recreational interests (skydiving) of its creators. In the case at hand, M will be operating for the substantial nonexempt purpose of furthering the recreational interests (thoroughbred racing) of its creators. As stated in Better Business Bureau, the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

M's activities do not meet the commensurate test as stated in Rev. Rul. 64-182. M states that 10 percent of its projected revenues will be donated to charitable organizations. This means that nearly 90 percent of its activities are to further the non-exempt purpose of furthering the recreational interests of its founders.

APPLICANT'S POSITION:

In correspondence dated July 12, 2007, M stated:

... (M) should qualify for tax-exempt status. Its primary purpose is to raise revenue for the purpose of benefiting existing 501(c)(3) organizations, especially those that are closely related to the horseracing industry. Its secondary purpose is two [sic] stimulate public awareness of thoroughbred racing as described in the organization's exemption application via the 'Meet and Greet' sessions and classes that will be conducted for the general public. The majority of the funds raised by the organization will be via donations from the general public. The use of horses by the organization in any state sanctioned race, not operated in any way by the organization, is essentially a way of generating public interest in the organization's charitable purpose and would be no different, for instance, than placing an advertisement in a local newspaper or trade publication or even creating an internet website for the purpose of raising the public's awareness and encouraging public donations.

M cites Private Letter Ruling 9050002 in support of its contention that it should be recognized as exempt under section 501(c)(3). M summarizes the facts in the PLR as:

(The) organization accomplished its exempt purpose by establishing registers of thoroughbred stallions and broodmares and by obtaining fees and contributions from owners of those thoroughbred stallions and broodmares and from others. The fees and contributions, in turn, are used to fund purses for races for which the foals of the thoroughbred stallions and broodmares would be eligible. The organization's largest activity is its efforts to create a "super Bowl" of racing so that the general public may become more knowledgeable about thoroughbred racing. The activity consists of a series of races that offer purses. The host racetrack is responsible for collecting pre-entry and entry fees and

Letter 4036(CG) (11-2005)
Catalog Number 47630W

regulation the competition. In no instance did the exempt organization regulate the races. The organization's second largest activity was to enhance various stakes races at racetracks and to provide a year-round promotional framework. The contributions it received were used to publicize the thoroughbred industry, to fund public relations programs, and to pay purses and nominator awards.

M's correspondence states that approximately 70% of the organization's time would be dedicated to charitable purposes, 20% to educating the public, and 10% to actually racing and selling horses, which the applicant believes are activities that should qualify it for a tax-exemption letter under IRC 501(c)(3).

M's subsequent correspondence, states that its primary purpose is to raise revenue for charitable organizations, and that its secondary purpose is to stimulate public awareness of the horseracing industry through educational activities such as the "Meet and Greet" sessions and classes. M maintains that its planned activities to operate a horseracing team, as well as training and selling horses produces the necessary income and the setting necessary with which to achieve its stated exempt purposes of charitable fundraising and educating the public.

M does not believe that it is participating in pari-mutuel betting since the horse races that it participates in are operated by state sanctioned tracks, and because its participation in horse racing assists it in achieving its stated purposes, which are charitable, religious, scientific and educational. Considering this, the applicant also does not believe that it is a trade or business that turns over its net proceeds to charity as is described in section 502 of the Code.

GOVERNMENT'S RESPONSE TO APPLICANT'S POSITION:

M states in an attachment to its application that all net revenues will be used to promote the sport of thoroughbred racing. The promotion of thoroughbred racing is not an exempt purpose as stated in Treas. Reg. 1.501(c)(3)-1(d)(1)(i).

Section 6110(k)(3) of the Code states a written determination may not be used or cited as precedent. Nevertheless, it is the Government's contention that PLR 9050002 is not on-point with M's activities because the PLR held that the organization in that ruling was held to be exempt under section 501(c)(6) of the Code. In this case, M is applying for exemption under section 501(c)(3) of the Code as a charitable and educational organization. M has not indicated it wishes to amend its application by applying under section 501(c)(6) of the Code. The fact that the activities described in the letter ruling were determined not to have an adverse effect on the tax-exempt status of an organization described under section 501(c)(6) does not indicate that the same activities will not prevent an organization from qualifying for tax-exempt status under section 501(c)(3). Activities that further section 501(c)(6) purposes which relate to promoting an industry or line of business are not charitable or educational purposes as described under section 501(c)(3). Further, part of the rationale for determining that the letter ruling applicant did not have unrelated business income was based upon that fact that such organization was determined not to engage in pari-mutuel betting, and that it merely received a donation from tracks. In this case, M is [or planning to be] involved in pari-mutuel betting because: a) it receives purses when its horses finish races in certain positions; b) fees and contributions will be used to fund purses for races for which the foals of thoroughbred stallions and broodmares would be eligible; and c) M

plans to create "a 'Super Bowl' of racing.

The application and the information submitted during the application review indicate that the majority of the activities will concern horseracing in addition to related training and horse sales activities, which are not by themselves considered to be tax-exempt activities under section 501(c)(3) of the Code. The financial information submitted demonstrates that the majority of M's revenues are used for the payment of its operating expenses and that a small proportion of the revenues remain for charitable distribution and that approximately half of those remaining revenues will be distributed for charitable purposes. Also, the financial information does not support M's statement that "The majority of funds raised by the organization will be via donations from the general public."

The meet and greet sessions to be held at the stables, in addition to the plans for two, 1 to 2 hour classes are not significant in proportion to the other activities planned by M (even if determined to be educational) and M's secondary goal of stimulating public awareness of thoroughbred horseracing is not an activity described under IRC 501(c)(3) since it promotes thoroughbred horseracing, which is a for-profit commercial industry.

Considering all of the above, M has not proven its assertion that 70% of its activities are dedicated to charitable purposes, 20% to educating the public, and 10% to actually selling and racing horses as it has stated.

Competing in horse racing activities which involve both betting and a share of the purse for finishing such races in a certain position constitutes participation in pari-mutuel betting, which is an unrelated trade or business activity. Therefore, the applicant's activities related to the pari-mutuel are unrelated business income, which are trade or business activities, and turning over proceeds from those activities to charitable organizations are activities described under section 502 of the Code.

CONCLUSION:

Accordingly, for the reasons stated above, M does not qualify for tax exempt status under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can

find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosures



**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: JUN 12 2008

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure