

An exempt county fair association that conducts a horse racing meet with pari-mutual betting is engaged in unrelated trade or business within the meaning of section 513 of the Code.

Advice has been requested whether a county fair association exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 carries on unrelated business within the meaning of section 513 of the Code where it conducts a horse racing meet with pari-mutuel betting.

The organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code. See Rev. Rul. 67-216, C.B. 1967-2, 180.

However, in conjunction with its annual fair the organization also conducts a two-week horse racing meet featuring pari-mutuel betting. The races are conducted in the same general manner as at commercial tracks. Under the pari-mutual system the organization receives 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 is used for the exempt purposes of the organization.

Section 511 of the Code imposes a tax upon unrelated business taxable income of organizations exempt from Federal income tax under section 501(c)(3) of the Code, with certain exceptions not here pertinent.

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 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 forming the basis for its exemption under section 501 of the Code.

Section 1.513-1(a) of the Income Tax Regulations provides that gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if (1) it is income from a trade or business, (2) such trade or business is regularly carried on by the organization, and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Since the races, with pari-mutual betting, are carried on in a manner similar to commercial race tracks, they constitute a trade or business. Furthermore, the business is regularly carried on because it is usual to carry on such trade or business only during a particular season. See section 1.513-1(c)(2)(i) of

the regulations.

The conduct of the racing meet with pari-mutual betting is not related to the organization's exempt purpose because it neither contributes importantly to the educational objectives of the fair (section 1.513-1(d)(2) of the regulations), nor is it the type of recreational activity that is intended to attract the public to the fair's educational features.

Accordingly, the conduct of the horse racing meet with pari-mutuel betting by the organization constitutes unrelated trade or business under section 513 of the Code, and the organization is subject to the tax imposed by section 511 of the Code on unrelated taxable income with respect to the income derived from such activity.