

Internal Revenue Service
Appeals Office

Department of the Treasury

Taxpayer Identification Number:

Person to Contact:

Number: **201322053**

Employee ID #:

Release Date: 5/31/2013

Tel:

Fax:

Contact Hours:

Tax Period(s) Ended:

Date: March 6, 2013

UIL:

501.33-00

501.35-00

Dear :

We considered your appeal of the adverse action proposed by the Director, Exempt Organizations, Rulings and Agreements. This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in section 501(c)(3) of the Code.

Our adverse determination was made for the following reasons:

1. You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code § 501(c)(3) and Treasury Regulations § 1.501(c)(3)-1(d). You do not engage primarily in activities that accomplish one or more of the exempt purposes specified in Internal Revenue Code § 501(c)(3).
2. Your net earnings inure to the benefit of private shareholders and individuals, which is prohibited by Internal Revenue Code § 501(c)(3).
3. You are operated for a substantial private purpose rather than a public purpose, which is prohibited by Internal Revenue Code § 501(c)(3) and Treasury Regulations § 1.501(c)(3)-1(d)(1)(ii).

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

Pursuant to a closing agreement, you have waived your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this

letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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.

Sincerely Yours,

Karen A. Skinder
Appeals Team Manager

Enclosure: Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: February 22, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification
Number:

Legend:

B = Organization 1
C = Chief Executive Officer
D = City
E = Award
F = Organization 2
G = Date
H = City
J = State
x = Dollar amount

UIL Index:

501.33-00
501.35-00

Dear :

We have considered your 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 you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issues:

- 1) Did the transfer of your predecessor's assets and liabilities to you result in inurement that precludes exemption under section 501(c)(3) of the Code? Yes, for the reasons described below.
- 2) Are you operated exclusively for charitable or educational purposes within the meaning of section 501(c)(3) of the Code. No, for the reasons described below.

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

Facts:

You were incorporated in the state of J on G. Your Articles of Incorporation list several general purposes and also includes as a purpose "to financially support, assist, promote, expand and strengthen institutions affiliated with and under the governance of the City of H."

Your application for exemption shows that your primary activity is to plan, organize, promote and foster a national truck and tractor pulling event and all related activities annually. The activities promote, advance and enrich the sport of truck and tractor pulling; expand, upgrade and improve the facilities for the participants' benefit; and foster contacts, relationships and tourism in H and the surrounding area.

You state, "To the extent that the promotion of travel and tourism constitutes 'economic development' the organization engages in economic development. The general public and local area businesses benefit."

You provided a percentage breakdown of your activities as follows:

- % - Administrative
- % - Fundraising relating to the planning of the fundraising event
- % - Determination of improvements of the City's facilities
- % - Determining distribution of scholarship funds
- % - Determination of distribution of funds to other charitable organizations

You are a member of the B, which sanctions truck and tractor pulling events, and provides necessary personnel and specialized equipment for the events. You do not share common officers, directors, trustees or independent contractors with B. However, you have as a common goal to promote and organize truck and tractor pulling events.

You entered into a Sanctioning Contract with B that states in part, "...We pride ourselves on the cooperation of our pullers with our promoters. We mail newsletters periodically. We will send your flyers in our newsletter, if they are provided to us, promoting your pull..."

You submitted copies of various newspaper articles with your exemption application. The articles note the large number of spectators your event has drawn. Your chief executive officer and events coordinator, C, was quoted as saying "We think in two to three years, we could be the D of the west." This statement referred to the nation's largest truck and tractor pull event which attracts 65,000 people annually.

Your event was voted one year as the "E" out of roughly 50 pulls nationally by the F. Your pull is one of the largest pulls in the United States.

Another article submitted, which promoted the event, states, "C said the event is growing faster than he imagined." His quote states, "It's going to require full-time employees pretty soon..."

One newspaper article reported that C was planning for next year's pull, which included expanding the seating and adding some additional classification in the truck pull. It indicated that "there has been tremendous community support, which has helped the pull to become so successful so quickly."

Your revenue primarily comes from ticket sales, gate sales, concession sales, and beer sales. Almost all of your expenses go towards paying prize purses and other expenses related to your pulling event.

You have indicated that a small percentage of your gross revenue will be given to charity and you will also provide student scholarships.

You are a successor to a for-profit limited liability corporation, which has not yet been dissolved. The predecessor intends to be administratively dissolved by not filing the required biennial report.

Your predecessor was formed in an attempt to bring a national truck and tractor pull event to H. There were approximately 50 initial members, who made a capital contribution of x each. You indicated you were formed because the predecessor "failed to make a profit and it soon became apparent that in a town of approximately 1300 people, the event simply could not be continued without substantial effort from volunteers." Your directors are identical to the predecessor and your volunteers are comprised of the predecessor's membership.

Although there is no memorialized date on which the transfer occurred, your predecessor transferred all of its assets and liabilities to you. At the time of transfer, the predecessor's liabilities exceeded its assets.

The total value of assets transferred to you was less than \$_____ which consisted of telephone poles, frisbees, T-shirts and a bank account. The predecessor's only liability was a bank note due. At the time of transfer, the principal balance that you assumed was approximately \$_____. You provided a payment history from the bank to show that you subsequently paid off the balance. Therefore, your received liabilities outweighed your received assets by more than \$_____.

Law:

Section 501(c)(3) of the Internal Revenue Code provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)1 of the federal Tax Regulations provides that in order for an organization to be exempt under section 501(c)(3) of the Code it 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 or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the regulations provides an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an exempt organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated to benefit private interests such as "designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Thus, if an organization is operated to benefit private interests rather than for public purposes, or is operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals, it may not retain its exempt status.

Revenue Ruling 67-149, 1967-1 CB 133 described an organization that was formed for the purpose of providing financial assistance to several different types of organizations which are exempt from federal income tax under section 501(c)(3). It carried on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals. The organization does not accumulate its investment income. This particular organization qualified for 501(c)(3) exemption.

Revenue Ruling 68-224 granted exemption under section 501(c)(4), not 501(c)(3) to an organization of which their primary purpose was to conduct an annual festival that depicts regional customs and traditions. In a typical year, it features a banquet or barbecue, a parade, various contests, and a rodeo. At the banquet or barbecue the winners of the various contests are announced. The parade is made up of school bands, local riding clubs, and floats built by local organizations. Contests relate to dress and costumes concerning the traditions of the area. Floats generally depict the community history and customs. The festival is climaxed on the final day with the rodeo. The ruling stated, "In

carrying on the activities described, the organization provides recreation for the community, publicizes the community and attracts persons to it, promotes community growth, and provides a means whereby citizens may express their interest in local history, customs, and traditions. These activities promote the common good and general welfare of the people of the community and bring about civic betterments and social improvements. Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(4) of the Code.

Revenue Ruling 76-441, 1976-2 C.B. 147, presents two situations concerning school operations. In the first scenario a nonprofit school succeeded to the assets of a for-profit school. While the former owners were employed in the new school, the board of directors was completely different. The ruling concludes that the transfer did not serve private interests. Part of that conclusion was based on the independence of the board. In the second scenario, the for-profit school converted to a nonprofit school. The former owners became the new school's directors. The former owners/new directors benefited financially from the conversion. The ruling concludes that private interests were served.

Better Business Bureau of Washington, D.C., Inc v. United States, 326 U. S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

In B. S. W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), it was stated that free or below cost service is only one of several factors to consider in determining commerciality. Others include the particular manner in which the organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. All of these must be considered, for no single factor alone is determinative. The Court concluded that the petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial.

In Orange County Agricultural Society, Inc. v. C.I.R., T.C. Memo. 1988-380, 1988 WL 83923, it was held that a petitioner's involvement in a stock car racing enterprise (a nonexempt purpose) constituted more than an insubstantial part of its activities. The organization, which was organized to promote agriculture and horticulture, sponsored an annual fair. Although the organization was not involved in the actual operation of the automobile races, the Court determined that it was associated in the operation of a commercial enterprise because it received all the profits derived from the automobile races.

Application of Law:

You are not described in section 501(c)(3) of the Code because you are not operated exclusively for charitable purposes.

You do not meet the requirements of section 1.501(c)(3)-1(a)1 of the Regulations because although you meet the organizational test, you do not meet the operational test. Although your Articles of Incorporation state that you are organized "to financially support, assist, promote, expand and strengthen institutions affiliated with and under the governance of the city of H," the facts show that you exist merely to conduct a large annual pulling event. The only resources you have used to "support" the local government have been to upgrade the pulling arena that is owned by the city. This further shows your primary purpose is to conduct the annual pulling event and not to conduct charitable activities.

You indicated that the pulling event is used as a fundraiser and that you contribute funds to other charities and provide scholarships. However, the facts show that the pulling event is not a fundraiser but is actually your primary purpose. This is evidenced by the fact that you conduct fundraisers to raise funds to conduct the pulling event. The overwhelming majority of your expenses are for the conduct of the pulling event and a very small percentage of your gross revenue is used for charitable purposes if there are any funds left after the expenses of the pulling event have been paid.

You do not meet the requirements of section 1.501(c)(3)-1(c)(2) of the regulations because your earnings inure to the benefit of private individuals. More specifically, the transfer of assets and liabilities from your predecessor LLC to you resulted in private benefit to the owners of the LLC. The LLC was liable for a loan in which approximately \$_____ was still owed. By transferring this debt and only approximately \$_____ of assets to you, the burden of the LLC and therefore its owners, was relieved. This shows that your earnings substantially benefit private individuals.

You do not meet the requirements of section 1.501(c)(3)-1(d)(1)(ii) of the regulations. By using your funds to pay off the transferred loan, your earnings substantially benefitted the owners of your predecessor LLC. Since the owners of the LLC are also "insiders" to you, this private benefit constitutes inurement.

You are not like the organization described in Revenue Ruling 67-149 because your financial support to other charitable organizations is incidental to your primary purpose of conducting a nationally recognized pulling event. Unlike the organization in the ruling that simply collected contributions and donated them to various charities, the facts show that your entire reason for forming was to conduct the annual pulling event; not to raise

money for other charities.

Your conduct of an annual truck and tractor pull is similar to the festival/rodeo activities of the organization described in Revenue Ruling 68-224. Like this organization, your pulling event provides recreation for the community, publicizes the community and attracts persons to it, and promotes community growth. As the ruling states, these activities promote the common good and general welfare of the people of the community and bring about civic betterments and social improvements. These activities are not exclusively charitable and educational and therefore are not exempt under section 501(c)(3) of the Code. The organization in the ruling was granted exemption under section 501(c)(4), not 501(c)(3) of the Code. However, unlike the organization in the ruling, the community benefit you provide is incidental to your primary purpose of promoting, organizing, and operating a truck and tractor pull event. Even if benefitting the community was your primary purpose, exemption would not be allowed under any section of the Code due to the fact that you are operating in a commercial manner and your earnings inure to the benefit of individuals.

You are similar to the second organization described in Revenue Ruling 76-441. By assuming the liabilities of the predecessor, which exceeded assets transferred, the predecessor's members who also serve as your volunteers benefitted from the conversion. Like the organization described in the ruling, this transfer served private interests.

As explained in Better Business Bureau of Washington, D.C., Inc v. United States, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes. Even though you do have some charitable activities consisting of contributing funds to charitable organizations and providing scholarships, you are not exclusively charitable. As explained above, your primary purpose is to conduct an annual truck and tractor pull for recreational purposes and to bring people to the community. Also, your transfer of liabilities created inurement. These facts show that you not only have a single non-exempt purpose, but you have two non-exempt purposes.

Similar to the organization in B. S. W. Group, Inc. v. Commissioner you are operating in a commercial manner. The facts show that the majority of your revenue is derived from ticket sales, gate sales, concession sales, and beer sales. The conduct of your annual pulling event is similar to any other commercial event in which tickets and concessions are sold to the general public at a market rate. Also, the facts show that you advertise and market the event in the same manner as any other commercial event. There are many similar entities that conduct the same activities for profit at commercial venues. In fact, you operated the same activities as a for-profit entity prior to converting to a non-profit.

Orange County Agricultural Society, Inc. v. C.I.R is applicable in your situation. Truck and tractor pulling is similar to stock car racing being that both are motorsports in which prize money is awarded. As quoted in an article, "[You] are an elite pull fashioned after the NASCAR races..." Since your time and funds are devoted almost entirely to organizing, promoting and conducting the annual tractor pull event, you have not shown that you are operated exclusively for charitable purposes as described in section 501(c)(3) of the Code.

Applicant's Position:

You contend that your exempt purpose is community betterment for H and that the pulling event is merely a fundraiser to accomplish this purpose.

You stated, "economic development' is not a primary function of the organization as such is only tangential to the extent the fundraising activity showcases H and, to the extent the event increases traffic and activity, local and area business are benefited by increased sales."

You assert that your activities are analogous to charitable golf events and your fundraising activity "allows the organization to fulfill its charitable purposes" by dedicating all of the event's profits to be used for charitable purposes. You have contributed funds to local organizations such as local fire and rescue, youth groups, public schools, and scholarships.

Besides contributions donated to local organizations and scholarships awarded to graduating seniors, you note that nearly \$[redacted] was contributed to H collectively by you and your predecessor for tax years 20[redacted] through 20[redacted]. The contributions consisted of park and track improvements including the construction, improvement and/or purchase of guard rails, announcer's stand, track, lighting, roadway, spectator tent, security barrier, fencing, etc.

You contend that your tractor pull event furthers charitable purposes based on the following factors:

- You make substantial improvements to the H's park,
- Through the substantial improvements, you work cooperatively with the H,
- You will continue to make improvements to the park as well as provide other benefits to H,
- Without you, H would be unable to make the improvements,
- Aside from the annual tractor-pull weekend event, the improvements may be used by the community year round,

- You established scholarships and expect to increase scholarship awards after H improvements are reduced,
- Your activities are conducted entirely by volunteers,
- By demonstrating that the community is strong and vibrant, the interest of H has been advanced,
- You encourage and enhance community volunteerism,
- You worked cooperatively with H to gain regional and national recognition,
- The increase in consumer activity during the event generates sales tax revenue,
- You benefit the local and area economy, and
- You do not accumulate income.

Service Response to Applicant's Position:

Economically benefitting the community is not your primary purpose. The facts show that your primary purpose is to organize, promote, and conduct an annual truck and tractor pull event. Any benefit to the community is an incidental byproduct of conducting the recreational pulling event in a commercial manner. Even if your primary purpose were to economically benefit the community, you have not shown that you are located within an economically depressed area or that your activities target an economically disadvantaged group. Also, you are not relieving the poor, lessening the burdens of government, or furthering any other exclusively charitable purpose.

Even though the predecessor and you made improvements on a city-owned park, this is not your primary purpose. In fact, these improvements were only made so you can adequately conduct your annual truck and tractor pull event. Also, the overwhelming majority of the improvements were made by your predecessor, not you.

We do not dispute the charitable aspect of contributing funds to other charitable organizations. However, this charitable activity is incidental to your primary purpose of conducting a nationally-recognized truck and tractor pull.

Based on all of the facts and circumstances, it is obvious your primary purpose is to conduct a large-scale truck and tractor pull event that will provide recreation to the community in a commercial manner. Any benefit to the community or other charitable activities that you conduct is merely incidental to this primary purpose.

Even if your activities were found to be conducted in a charitable manner, you still would not qualify for exemption based on the fact that your earnings inure to the benefit of your members who were the owners of your predecessor.

Conclusion:

Your activities of organizing, promoting and conducting an annual pulling event are not exclusively charitable or educational. Also, the manner in which the activity is conducted is indistinguishable from a commercial business. Therefore, you do not meet the operational test under section 501(c)(3). Secondly, private benefit and inurement resulted when your predecessor's assets and liabilities were transferred to you.

Accordingly, you are not exempt 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
P.O. Box 2508 Room 7-008
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,

Lois G. Lerner
Director, Exempt Organizations

Enclosure:
Publication 892

Cc: Thomas B. Donner