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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Significant Index No.
4943.04-03

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Contact Person:

ID Number:

Contact Telephone:

Reference:
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Dear Sir or Madam:

This is in response to M's request for a ruling under sections 4942 and 4943 of the Internal Revenue Code, as amended and supplemented by M's authorized legal representative.

Facts:

M has been recognized as exempt under section 501(c)(3) and classified as a

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private operating foundation under section 4942(j)(3) of the Code. M's primary activity is the operation of a museum facility. The museum's activities are devoted to the procurement, restoration, maintenance, and display of vintage motor sport vehicles.

M currently maintains a collection of vintage motorcycles and automobiles. In addition to providing exhibits of its collection of motorcycles and autos at its museum located in the business district of downtown O, M also lends certain pieces of its collection to other museums and exhibitions for display.

In addition to the operation of the museum facility, M also sponsors the M Racing Team. The Racing Team's activities are devoted to promoting and encouraging interest in vintage motor sports. The taxpayer states that currently the Racing Team does not have a permanent facility conducive to testing and preparing the motorcycles for events in which they participate.

M states that it has determined that the size of its current space is not adequate to display its collection and to test and operate its vintage motorcycles. M proposes to build a new museum facility and a racetrack to display and operate its collection of motorcycles and automobiles.

M has entered into a lease agreement with the city of O to lease 700 acres of land valued at x dollars for the construction of a new museum facility, a racetrack, and campgrounds. The terms of the agreement requires M to pay y dollars per year to the City of O.

M will sublease a portion of the property to its wholly owned limited liability company (LLC), N, which will be an entity disregarded for federal tax purposes. M states that N will build, own, operate, and lease a 2½-mile road racetrack and campground facility at a construction cost of z dollars. M will provide sufficient funding to N for the construction of the track and campground facilities.

M represents that the racetrack will be leased and or used by N for the following purposes:

(1) Demonstrations and tests of motorcycles and automobiles restored at M;
(2) Testing and practicing for the M Racing Team;
(3) Hosting various motorcycles and automotive racing events (leasing of track to an independent promoter);
(4) Allowing area colleges and technical schools to have access for mechanic training and defensive driving training schools;
(5) Providing a facility for fundraising events; and
(6) Leasing of track to third parties (i.e. manufacturers, dealers, and parts suppliers)

for use as a testing facility or marketing purposes.

M states that in future years the track will allow promoters to host both vintage and professional events. N will lease the track to race or event promoters for a flat fee and or a percentage of the gross receipts for admission. M states that it anticipates that no more than four major events and six middle market events would be held at the track each year.

M further states that it anticipates that the track would be available approximately 50% of the year for lease to manufacturers, dealers, parts suppliers, etc. as a testing facility or for marketing purposes. These activities would take place primarily during the week, and only when M is not using the track. M states that auto and motorcycle manufacturers might use the facility to test new models, and to film commercials. Dealers would have the opportunity to preview new models to preferred customers. Part suppliers would have the opportunity to demonstrate their products to clients or test their products on the track. Daily fees would be charged.

M states that the services provided by N and M during the leasing activities, for races, testing by third parties, driving schools, etc. will include basic track maintenance and security. In addition, N will also contract for concession services by local civic groups and gasoline services during racing events. N will receive a percentage of the gross receipts from concession sales as well as sales by any outside gasoline suppliers. Parking will also be provided to the general public during the events.

In addition to the racetrack, M, through N, will also construct and operate a campground. M represents that the campground will be marketed as an additional attraction to the museum, since 80% of the visitors to the museum may be from out of state. The campground will contain 50 improved campsites with water and power hookups and 100 unimproved sites. The rates for use of the campground facility will be a dollars per day for unimproved sites and b dollars for improved sites with a maximum stay of 4 days. It is anticipated that many camp users will visit the museum.

Applicable Law:

Section 4943(a)(1) of the Code imposes an excise tax on the excess business holdings of a private foundation in a business enterprise.

Section 4943(d)(3)(A) of the Code provides that the term business enterprise does not include –

(A) a functionally related business (as defined in section 4942(j)(4) of the Code) or

(B) a trade or business at least 95 percent of the gross income of which is derived from passive sources.

Section 4942(j)(4) of the Code provides that the term 'functionally related business' means-

(1) A trade or business which is not an unrelated trade or business (as defined in section 513), or

(2) An activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the charitable, educational, or other similar exempt purpose of the organization.

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

Section 511(a)(1) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c)(3).

Section 512(a)(1) of the Code describes the term "unrelated business taxable income" as the gross income derived by an exempt organization from any unrelated trade or business, as defined under section 513, regularly carried on by it, less certain deductions, but with modifications provided in section 512(b).

For purposes of determining unrelated business taxable income, section 512(b)(3) excludes rents from real property.

Section 513(a)(1) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to tax under section 511, any trade or business the conduct of which is not substantially related
(Aside from the need of such organization for the 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 constituting the basis of its exemption under section 501.

Section 513(c) of the Code and section 1.513-(b) of the regulations provides that trade or business includes any activity, which is carried on for the production of income from the sale of goods. An activity does not lose its identity as trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors, which may not be related to the exempt purposes of the

organization.

Section 53.4942(a)-2(c)(3)(f)(iii) of the regulations provides that the term 'functionally related business' means-

(1) A trade or business which is not an unrelated trade or business (as defined in section 513), or

(2) An activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the charitable, educational, or other similar exempt purpose of the organization.

Examples1 and 2 of section 53.4942(a)-2(c)(3)(f)(iii) provides the following illustrations of a functionally related business.

Example (1) X, a private foundation, maintains a community of historic value, which is open to the general public. For the convenience of the public, X, through a wholly owned, separately incorporated, taxable entity maintains a restaurant and hotel in such community. Such facilities are within the larger aggregate of activities which makes available for public enjoyment the various buildings of historic interest and which is related to X's exempt purpose. Thus, the operation of the restaurant and hotel under such circumstances constitutes a functionally related business.

Example (2). Y, a private foundation, as part of its medical research program under section 501(c)(3), publishes a medical journal in carrying out its exempt purpose. Space in the journal is sold for commercial advertising. Notwithstanding the fact that the advertising activity may be subject to the tax imposed by section 511, such activity is within a larger complex of endeavors which makes available to the scientific community and the general public developments with respect to medical research and is therefore a functionally related business.

The General Explanation of the Tax Reform Act of 1969, (Blue Book) prepared by the staff of the Joint Committee On Internal Revenue Taxation (December 3, 1970) includes the following explanation to the exception:

> An exception to the limitation on the holding of business interests in provided in the case of a business which is related under the provisions dealing with taxes on unrelated business income. Another exception is provided, even where the business, although unrelated to the direct activities of the foundation, "is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of such organization for income or

funds or the use if makes of the profits derived) to the exempt purposes of the organization."

These exceptions are intended to make clear that certain types of business activities may continue to be held by the foundation notwithstanding the general rule. For example, the Inn and Lodge at Colonial Williamsburg are separately incorporated taxable entities, but are owned by the foundation for the convenience of the general public visiting Williamsburg. Also, many museums maintain cafeterias and snack bars for the convenience of the public visiting the museums. Although advertising in a foundation's journal may be an unrelated trade or business it comes under the second of these exceptions if the foundation's journal is related to the foundation's exempt purposes. Such business activities do not have to be disposed of under these provisions.

Rev. Rul. 80-297, 1980-2 CB 196, situation 1, provides that a school operating a tennis club through its own employees, who performed substantial services for the participants in the club, could not exclude the income received as rent from real property.

Situation 2 of Rev. Rul. 80-297 describes a school that merely provides its tennis facilities available to an unrelated individual for ten weeks at a fixed fee which does not depend, in whole or in part, on the income or profits from the leased property. In Situation 2, the school provided the leased facilities without the provision of any services. Situation 2 provides that unlike Situation 1, where the school itself provided services, the school in situation 2 furnishes the facilities without services for a fixed fee which does not depend on the income or profits derived from the leased property. Situation 2 concludes that the income received from the leased property constitutes rents from real property under section 512(b)(3) of the Code.

Rev. Rul. 80-298, 1980-2 CB 197, provides that a university leasing its stadium to a professional football team and furnishing grounds and playing field maintenance, dressing room linens, and stadium dressing rooms was furnishing substantial services for the convenience of the lessee. The provision of such substantial services for the convenience of the lessee go beyond those usually rendered in connection with the rental of space for occupancy only. Rev. 80-298 concludes that the income derived from the university's leasing of its stadium is not excluded from unrelated business taxable income as rent from real property under section 512(b)(3) of the Code.

Rationale:

M will construct a new museum facility to display its collection of vintage automobiles and motorcycles. In addition, M will also finance the construction of a

racetrack and campground facility in close proximity to the museum. The racetrack will be used by the M Racing Team to conduct demonstration races which will be open to the public and otherwise operate vehicles in its collection of vintage motorcycles and automobiles. The campground facility will also be provided for use by visitors to the museum. The racetrack and campground facility will be owned and operated by N, M's wholly owned, separately incorporated, limited liability company, in a manner similar to the organizations described in Examples 1 and 2 of section 53.4942(a)-2(c)(3)(f)(iii) of the regulations. Such facilities are within the larger aggregate of N's endeavors, which promote M's exempt purposes of making available displays of M's vintage autos and motorcycles and encouraging interest in vintage motor sports. Thus, N's racetrack and campground, under such circumstances, constitute functionally related businesses pursuant to section 4942(j)(4) of the Code. Therefore, the ownership and operation of the racetrack and campground facility by N will not constitute business enterprises for purposes of section 4943(d)(3)(A) of the Code.

Rulings:

Based on the above, we rule as follows:

The ownership and operation of the racetrack and campground by N will constitute functionally related businesses as defined in section 4942(j)(4). Therefore, N is not a business enterprise pursuant to section 4943(d)(3)(A) and the excess business holdings excise tax imposed by section 4943(a)(1) will not apply to M's holdings in N.

This ruling does not purport to rule on any other provisions of the Code and specifically does not purport to rule on whether any activities described herein are subject to the unrelated business income tax under section 511 of the Code. This ruling is directed only to M and N. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3