



IRS, Private Letter Ruling, Section 501 - Exemption from Tax on Corporations,
Certain Trusts, etc, PLR 202422013

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Department of the Treasury
Internal Revenue Service
Private Letter Ruling

PLR 202422013 - Section 501 - Exemption from Tax on Corporations, Certain Trusts, etc

**Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities**

Release Number: 202422013

Release Date: 5/31/2024

UIL Code: 501.00-00, 501.03-05, 501.35-00

Date:

03/04/2024

Employer ID number:

Form you must file:

Tax years:

Person to contact:

Dear [redacted data]:

This letter is our final determination that you don't qualify for exemption from federal income tax under **Internal Revenue Code** (IRC) Section **501(a)** as an organization described in IRC Section **501(c)(3)** . Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under IRC Section **501(c)(3)** , donors generally can't deduct contributions to you under IRC Section **170** .

We may notify the appropriate state officials of our determination, as required by IRC Section **6104(c)** , by sending them a copy of this final letter along with the proposed determination letter.

You must file the federal income tax forms for the tax years shown above within 30 days from the date of this

letter unless you request an extension of time to file. For further instructions, forms, and information, visit www.irs.gov.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection after deleting certain identifying information, as required by IRC Section **6110**. Read the enclosed Letter 437, Notice of Intention to Disclose - Rulings, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Letter 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

If you have questions about this letter, you can call the contact person shown above. If you have questions about your federal income tax status and responsibilities, call our customer service number at 800-829-1040 (TTY 800-829-4933 for deaf or hard of hearing) or customer service for businesses at 800-829-4933.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

Letter 437

Redacted Letter 4034

Redacted Letter 4038

Department of the Treasury

Internal Revenue Service

PO Box 2508

Cincinnati, OH 45201

Date: 1/3/2024

Employer ID number:

Person to contact:

Name:

ID number:

Telephone:

Fax:

Legend: UIL: B = State 501.00-03 C = Date 501.03-05 D = Name 501.35-00 E = Name F = Name G = Name H = Name

Dear [redacted data]:

We considered your application for recognition of exemption from federal income tax under **Internal Revenue Code** (IRC) Section **501(a)** . We determined that you don't qualify for exemption under IRC Section **501(c)(3)** . This letter explains the reasons for our conclusion. Please keep it for your records.

Issues

Do you qualify for exemption under IRC Section **501(c)(3)** ? No, for the reasons stated below.

Facts

In the past, your founder using a for-profit limited liability company (LLC) in conjunction with the for the profit companies, E and H, ran a large-scale artificial intelligence (AI) competition that was designed to be inclusive for all by catering to beginner and expert competitors. The participants competed for free and were eligible for potential prizes as well as were provided a forum for connecting with companies that sponsored the competition.

Your founder subsequently formed you as a tax-exempt organization on C in B to conduct these same AI competitions. According to your Articles of Incorporation, you are organized exclusively for purposes set forth within the meaning of **Internal Revenue Code** Section **501(c)(3)** . Your specific purpose is to build and run novel, inclusive, and accessible AI program competitions. They further state that you hope to achieve the goals of educating people on AI and programming as well as provide new AI research to advance society.

You explained that every year you will host a few AI competitions, with various mini competitions held during the main ones. The competition requires a game engine/AI environment that takes actions from one or more team's submitted AI agents and returns new observations to those agents. An agent is a user submission of code that defines logic for how the agent should respond to game observations. The game engine/AI environment is always built by and owned by you, but the code will always be open sourced under the D license.

You explained that you collaborate with E who is providing compute resources for running your competition, as well as giving you public visibility to their community. The competitions will be hosted on E's Platform. H will provide the services for the competitions (such as the development, consulting, hosting and administration of the competition on E's Platform). A review of E's website (which states that E is the world's largest data science community) shows that E hosts a number of different competitions, including competitions for businesses to solve various problems. H's parent is a recognized leader among generative AI companies.

To compete, participants will form a team and submit their own code which is typically run against other teams'

code to compute rankings, like an online game leaderboard. The code is intellectual property and is always owned by the submitting team. They may choose whichever open-source license they want, typically also D. Participants individually may post public code onto the competition forums for others to use.

To participate in your activities or competitions, you explained there are no requirements, nor are there plans for such requirements in the future. The only implicit requirements are that participants need to know the basics of programming.

The only anticipated requirement is that participants who win prizes will need written consent from their guardian if under 18 years of age. You further state that potential competitions which run in collaboration with universities may be limited to students from that university.

You further state that you primarily host competitions for educational purposes. All your competitions and efforts are designed to be accessible to as wide a range of programmers and backgrounds as possible. You do not provide explicit training programs for your participants, nor do you plan to. You do not focus on or devote time to working with and improving the performance of a few programmers. You further explained that you do not participate or explicitly prepare participants of your competitions for other national or international competitions.

In addition, you provide open-sourcing code for others to use for research in the area of multi-agent reinforcement learning. You may release public code serving as tutorials on various topics in AI on your forum and teach participants how to compete in the current competition. Additionally, you occasionally host live streams where anyone can join and listen to you discuss the strategies of the top teams in the competition at the moment.

You look at all feedback from participants and make changes based on that to create a better competition experience and education for the public.

Any research using the competition (whether through submitting an agent and testing one's research or utilizing just the AI environment that powers the competition) is owned entirely by the researchers who produce that research, which can be in the form of a patent, research paper, or publication, for example.

The participants are required to have valid E Website accounts. Although you provide funds for prizes, the majority of the prize money is contributed by H, E's parent.

One of your board members is an employee of E. The board member helps facilitate communication between you and E and provides competition support via engineering. No private code is shared between you and E, only open-source code. You do not pay or perform any monetary transactions to E other than providing E/H with prize pool money so E/H can help distribute it to competition prize winners. You have indicated that E

through hosting the competitions on its platform and collaboration with you may receive potential new subscribers and benefit from well-run competitions. You may pay for various technological services such as E Cloud compute in the future. All fees and expenses, if any, will be paid to H.

You indicated that you have sponsoring relationships with the same for-profit entities as the for-profit LLC. You also explained that you primarily reach out to companies who have an interest in leveraging artificial intelligence in their company and are looking for potential new employees. These entities sponsor your competitions or provide donations to you. You will advertise sponsors or donors on various platforms including the competition website, your own website, F, and G. Depending on the amount of funding provided by the sponsor, you may also give out special prizes in their name.

Some sponsoring entities will provide various opportunities such as job opportunities in the AI technology space to participants. Specifically, you state that the sponsors/donors receive increased visibility and access to potential new candidates for hire. These sponsors often will contact the top competitors and give them opportunities for interviews. You stated that you do not share any resources with your for-profit sponsors.

Your primary source of revenue is from sponsorships. Your expenses consist of prizes for the competitions. You may pay for technological services.

Law

IRC Section **501(a)** provides for the exemption from federal income tax for organizations described in Section **501(c)(3)**. Such organizations are recognized if they are organized and operated exclusively for religious, charitable, educational purposes, or other exempt purposes.

IRC Section **501(c)(3)** provides for exemption from federal income tax of organizations organized and operated exclusively for charitable, educational, scientific, and other purposes, provided that no part of the net earnings inures to the benefit of any private shareholder or individual.

IRC Section **501(j)** states that for a qualified amateur sports organization the requirement of subsection (c)(3) that no part of its activities involve the provision of athletic facilities or equipment shall not apply and such organization shall not fail to meet the requirements of subsection (c)(3) merely because its membership is local or regional in nature. In addition, a qualified amateur sports organization S defined as an organization organized and operated exclusively to foster national or international amateur sports competition if such organization is also organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports.

Treas. Reg. Section 1.501(a)-1(c) defines a private shareholder or individual as one having a personal and private interest in the activities of the organization.

Treas. Reg. Section 1.501(c)(3)-1(a)(1) provides that, in order to be exempt as an organization described in IRC Section **501(c)(3)**, an organization must be both organized and operated exclusively for one or more of the purposes specified in IRC Section **501(c)(3)**. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) 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 IRC 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.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Treas. Reg. Section 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in IRC Section **501(c)(3)** in its generally accepted legal sense and includes, among other things, lessening the burdens of government, relief of the poor and distressed or of the underprivileged, advancement of education or science, erection or maintenance of public buildings, monuments, or works, and promotion of social welfare by organizations designed to accomplish any of the above purposes, or in part to defend human and civil rights secured by law.

Treas. Reg. Section 1.501(c)(3)-1(d)(3) defines educational as the instruction or training of the individual for the purpose of improving or developing their capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Treas. Reg. Section 1.501(c)(3)-1(d)(5) provides that a scientific organization must be organized and operated in the public interest. Therefore, the term scientific, as used in IRC Section **501(c)(3)**, includes the carrying on of scientific research in the public interest. Research when taken alone is a word with various meanings; it is not synonymous with scientific; and the nature of particular research depends upon the purpose which it serves. For research to be scientific, within the meaning of Section **501(c)**, it must be carried on in furtherance of a scientific purpose. Scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc.

In Rev. Rul. **65-1**, 1965-1 C.B. 226, an organization that made research grants for the development of new machinery to be used in commercial operations and retained all the rights to the new developments, did not qualify for exemption under IRC Section **501(c)(3)**.

Rev. Rul. **65-2**, 1965-1 C.B. 227, holds that a foundation operated exclusively to teach children a sport by holding clinics conducted by qualified instructors in schools, playgrounds, and parks and by providing free instruction, equipment, and facilities qualify for exemption under IRC Section **501(c)(3)**.

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Rev. Rul. [66-179](#) , 1966-1 C.B. 139, provides illustrations under which garden clubs may establish exemption as charitable or educational organizations, civic organizations, horticultural organizations, or as social clubs.

Rev. Rul. [66-255](#) , 1966-2 C.B. 210, holds that a nonprofit organization which through meetings, films, forums, and publications educates the public in a particular method of painless childbirth is entitled to exemption.

Rev. Rul. [68-373](#) , 1968-2 C.B. 206, held that an organization which primarily engaged in testing drugs for commercial pharmaceutical companies did not qualify for exemption under IRC Section [501\(c\)\(3\)](#) .

In *Better Business Bureau of Washington D.C., Inc. v. United States*, [326 U.S. 279](#) (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In *Universal Oil Products. Co. v. Campbell*, [181 F.2d 451, 464](#) (7th Cir. 1950), it was found that a business corporation engaging in development of refining processes was not organized nor operated exclusively for scientific or educational purposes. The court quoted another case in nothing that: "It did not operate on the basis of science for the sake of science. It was science for the sake of business. The fact that scientific methods were used by the petitioner does not alter the case. Most business today uses some kind of scientific processes or methods."

In *Retired Teachers Legal Defense Fund v. Commissioner*, [78 T.C. 280, 286](#) (1982), the Tax Court defined private benefit to include any "advantage; profit; fruit; privilege; gain or interest."

Application of law

Operational Test

IRC Section [501\(a\)](#) provides for the exemption from federal income tax for organizations described in Section [501\(c\)\(3\)](#) . As stated in [Treas. Reg. Section 1.501\(c\)\(3\)-1\(a\)\(1\)](#) , an organization must be both organized and operated exclusively for purposes described in Section [501\(c\)\(3\)](#) . You do not meet the requirements under Section [501\(c\)\(3\)](#) because you fail the operational test as explained below.

To satisfy the operational test, an organization must be operated exclusively for one or more exempt purposes specified in IRC 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 as explained in [Treas. Reg. Section 1.501\(c\)\(3\)-1\(c\)\(1\)](#) . You do not meet [Treas. Reg. Section 1.501\(c\)\(3\)-1\(d\)\(1\)\(ii\)](#) which provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a

private purpose. Your AI competitions are opened to all. In addition, sponsors use the activities to find potential employees.

In **Retired Teachers Legal Defense Fund**, the tax court defined private benefit to include any "advantage; profit; fruit; privilege; gain or interest". This shows you serve the private interests of the participants and the sponsors. You are also operated for a substantial nonexempt purpose in contravention of the requirements of **Treas. Reg. Section 1.501(c)(3)-1(c)(1)**. In **Better Business Bureau of Washington, D.C., Inc.**, the United States Supreme Court provided that "the presence of a single [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes".

You do not meet IRC Section 501(j)

IRC Section **501(j)** requires the organization to "conduct national or international competitions in sports or to support and develop amateur athletes for national or international competition in sports". You state you do not participate or explicitly prepare participants of your competitions for other national or international competitions. Therefore, you do not meet IRC Section **501(j)**.

You do not further charitable purposes

You have not shown that your activities further a charitable purpose within the meaning of **Treas. Reg. Section 1.501(c)(3)-1(d)(2)**. Further, you do not limit your services to a specific charitable class. You claim that developing AI code will benefit the general public; but the general public is not a defined charitable class, as it includes all persons, not just those with charitable characteristics, such as the poor and distressed.

Moreover, whatever public good you claim your competition provides, it is not the type of public benefit contemplated by IRC Section **501(c)(3)**. Not all organizations which incidentally enhance the public good will be classified as "public" organizations within Section **501(c)(3)**. For example, some forms of commerce provide an economic benefit to the community, but **Treas. Reg. Section 1.501(c)(3)-1(c)(1)** 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 IRC Section **501(c)(3)**. Your activities are not charitable within the meaning of **501(c)(3)**.

You do not further educational purposes

You state you primarily host competitions for educational purposes in addition to open-sourcing code for others to use for research in the area of multi-agent reinforcement learning. **Treas. Reg. Section 1.501(c)(3)-1(d)(3)** defines educational as the instruction or training of the individual for the purpose of improving or developing their capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. While you may conduct some activities with educational aspects, you are not operated exclusively for exempt purposes, and you are operated for substantial nonexempt purposes. Unlike the organizations in

Rev. Rul. [65-2](#) , Rev. Rul. [66-179](#) , and Rev. Rul. [66-255](#) , which provided instructional training, lectures, workshops, exhibits and presentations, you primarily develop and host competitions on a platform owned by a for-profit entity to develop AI coding with sponsors who have an interest in leveraging AI in their respective companies and are looking for potential new employees. You do not provide explicit training programs for your participants now, nor do you plan to. At most, you release public code serving as tutorials on various topics in AI and teach participants how to compete in the current competition. Even if a portion of your activities further educational purposes, a substantial portion of your activities are not primarily educational and are not otherwise exempt.

You do not further scientific purposes

You do not qualify for tax-exemption as a scientific research organization for your activities related to the development of AI code. To qualify as an IRC Section [501\(c\)\(3\)](#) scientific research organization, an organization must (1) engage in scientific research; (2) the scientific research must not include activities that are incident to commercial or industrial operations; and (3) the scientific research must be undertaken in the public's interest. See [Treas. Reg. Section 1.501\(c\)\(3\)-1\(d\)\(5\)](#) .

Your self-described activities of research and development of technology such as software or other innovations are like the two organizations described in Rev. Rul. [65-1](#) and Rev. Rul. [68-373](#) , in that you are engaging in, or otherwise, funding routine software and technology design, development, and testing, similar to that which a commercial software company in to create new products or adapt their products to new uses to be competitive in the market.

You are also like the organization in [Universal Oil Products. Co. v. Campbell](#) . The organization's main objective in that case was to develop and acquire oil refining processes. The court found that such activities did not constitute scientific research. The court indicated that the organization's activities were "science for the sake of business". Your activities which you claim to be scientific research are primarily for the sake of business your activities benefit the entire for-profit industry that develops AI.

Your activity is of a type ordinarily carried on as an incident to commercial or industrial operations. Through your relationships with companies that are focused on the development of AI, your competitions enhance those companies' opportunities for leverage in that industry. Any research resulting from the competitions is not made available to the public as it is owned by the creators of the code. You have not demonstrated that you conduct scientific research because your activities are an incident to commercial operations and the code created by the competitions is not shared with the public.

Conclusion

Based on the foregoing, we have determined that you were formed for the purpose of creating and developing AI to benefit private interests, both for profit entities and private individuals. You are operated for substantial

non-exempt purposes and for the private interests of your participants and sponsors. In addition, you do not further a scientific purpose, do not serve a charitable purpose, and you do not further an educational purpose. Therefore, you do not qualify for exemption under Section **501(c)(3)** and donations to you are not deductible by the donor.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

If you don't agree

You have a right to protest if you don't agree with our proposed adverse determination. To do so, send us a protest within 30 days of the date of this letter. You must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization or your authorized representative
- The following declaration:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a **Form 2848**, Power of Attorney and Declaration of Representative, with us if they haven't already done so. You can find more information about representation in **Publication 947**, Practice Before the IRS and Power of Attorney.

We'll review your protest statement and decide if you gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information in **Publication 892**, How to Appeal an IRS Determination on Tax-Exempt Status.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court later because the law

requires that you use the IRC administrative process first (IRC Section [7428\(b\)\(2\)](#)).

Where to send your protest

Send your protest, [Form 2848](#) , if applicable, and any supporting documents to the applicable address:

U.S. mail:

Street address for delivery service:

Internal Revenue Service

Internal Revenue Service

EO Determinations Quality Assurance

EO Determinations Quality Assurance

Mail Stop 6403

550 Main Street, Mail Stop 6403

PO Box 2508

Cincinnati, OH 45202

Cincinnati, OH 45201

You can also fax your protest and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that they received it.

You can get the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

Contacting the Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or if you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations

