Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date:
January 21, 2015
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.03-00; 501.33-00

Number: **201516066**
Release Date: 4/17/2015

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). 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 Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) 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 the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

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If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Director, Exempt Organizations

Enclosure:
Notice 437
Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*
Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: November 5, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:
b = dollar amount
c = dollar amount
N = city
P = state
Q = date
r = percentage
s = percentage

UIL:
501.03-00
501.33-00

Dear :

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

Issues
Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons stated below.

Facts
You incorporated in the state of P on Q for charitable and educational purposes. You amended your Articles of Incorporation to also add that your purpose is to educate the community on contemporary art.

You are an artist co-operative that operates an art gallery. The gallery is open free to the public on Fridays and Saturdays. You are also open by appointment, Monday through Thursday. You provide art exhibitions for the community, including a physical

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location where individuals from N can come and learn about contemporary art.

Works from different artists are on display. You send out announcements to artists nationwide for samples then select work you are looking to exhibit. An exhibit is usually on display for two months. Artists can list prices for their works and sell them; you expect to retain r% commission from each sale. Not all artwork is for sale as some is retained solely for exhibition – estimated between one and five percent of total art work on display. Artists are responsible for setting the prices of their art as well as hanging their works in your gallery. Representation on your website is provided for work on display.

You are a membership organization which solicits members through word of mouth, association with current members and via your website. You currently have 21 members. Artists are invited to become members for an annual fee of b dollars. Members must submit an application for consideration and selected members sign a contract. Members are listed as a member in information given to patrons of your exhibits.

Member requirements include:

- One year commitment
- Work 6 hours/month in gallery – members are charged a fee for hours not completed
- Attend every 3rd Saturday of month for local art walk
- Attend monthly meeting
- Serve on one gallery committee
- Participate in annual review to determine if the artist's contract is to be renewed

Members are selected based upon the following criteria:

- Demonstrate competence and knowledge in chosen medium
- Have unique, interesting, original work using materials of high quality and presented in a professional manner
- Have work that is marketable
- Able to produce enough work to keep gallery stocked
- Fulfillment of membership requirements

Members' financial obligations include:

- Annual dues/fees of b dollars
- The gallery receives a r% commission of all sales (original sales price in event artist negotiates a lower price with patron)

Member benefits are listed as including:

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- Great opportunities to exhibit work
- Discuss new ideas, collaborate with each other and N to cultivate an artistic movement
- Plan and participate in fairs, art walks, workshops, classes, parties, openings
- Have the opportunity for a solo show
- Have the opportunity to teach art classes
- Learn new skills and choose when and what gallery projects you wish to explore
- Bring supplies and work on art during gallery hours
- Gain publicity and exposure through our website with a link to your own website and/or web portfolio

Members submit up to five pieces of art work each month for consideration of exhibition. Each artist must take down/put up work, have work gallery-ready, and print and attach price tags and bio displays. Your curating committee will select between one and five pieces from each artist for your gallery depending upon the size, professionalism, artistic merit and content. The curating committee is five of your members that select work each Monday before a monthly opening. Art is on exhibit for one month.

Sales of works go directly through your gallery with the amount, minus commission, paid to the artist one month later.

You mainly exhibit member artwork. Since you have opened, you estimate less than r% of works displayed have been from non-members. There is a monthly featured artist that occupies one quarter of the exhibition gallery. The featured artist chooses his/her theme and work for display and how to exhibit the show. In addition to the regular membership fee, a c dollar fee is charged to that artist to cover show expenses (title wall, front feature space of gallery, designed and printed invitations, postage). Only two nonmember artists have been featured in the past two years (May 2011 and January 2013). The featured artist has his/her show on display for one month.

Your board is comprised of three artist members who are also your president, secretary and treasurer. Two of your directors co-founded the co-operative and have been featured artists three times since the gallery opened.

In addition to the gallery you engage in the following educational and charitable activities:

- Organize and host an annual 5K and fun run
- Award three $500 art scholarships to N High School seniors
- Provide community art/artist talks (6 hours/year)
- Member artist/art critiques of local artists' work (24 hours/year)

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- Provide school/youth group tours of gallery (5 hours/year)
- Provide one day art workshops (20 hours/year)
- You plan to begin providing art classes in late 2013 (60 hours/year)

You indicate you work cooperatively with the N Main Street program and allow occasional use of your gallery by nonprofits and for-profits for art related events.

Your income is derived from membership fees, commissions, donations and fundraisers.

Law

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

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for exempt purposes under section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of 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.

Section 1.501(c)(3)-1(d)(1)(iii) of the Income Tax Regulations provides examples to illustrate the requirement of paragraph (d)(1)(ii) of this section that an organization serve a public rather than a private interest. Example 2 states:

(i) O is an art museum. O's principal activity is exhibiting art created by a group of unknown but promising local artists. O's activity, including organized tours of its art collection, promotes the arts. O is governed by a board of trustees unrelated to the artists whose work O exhibits. All of the art exhibited is offered for sale at prices set by the artist. Each artist whose work is exhibited has a consignment arrangement with O. Under this arrangement, when art is sold, the museum retains 10 percent of the selling price to cover the costs of operating the museum and gives the artist 90 percent.

(ii) The artists in this situation directly benefit from the exhibition and sale of their art. As a result, the sole activity of O serves the private interests of these artists. Because O gives 90 percent of the proceeds from its sole activity to the individual artists, the direct benefits to the artists are substantial and O's provision of these benefits to the artists is more than incidental to its other purposes and activities. This arrangement causes O to be operated for the benefit of private interests in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section. Based on these facts and

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circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

Revenue Ruling 66-178, 1966-1 C.B. 138, found that a nonprofit organization created to foster and develop the arts by sponsoring a public art exhibit is exempt under section 501(c)(3) of the Code. The organization's sole activity is sponsoring an annual public art exhibit at which works of unknown but promising artists are displayed. Artists eligible to have their works displayed are those who are not affiliated with art galleries and who have no medium for exhibiting their creations. The works exhibited are selected by a panel of qualified art experts. The organization does not charge the artists any fees for the privilege of having their works displayed. Nor does the organization sell or offer the displayed works for sale.

Revenue Ruing 71-395, 1971-2 C.B. 228, found that a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code. The gallery was formed and is operated by a group of approximately 50 artists for the purposes of exhibiting and selling their works. Additional artists are admitted to membership by approval of the existing members. The gallery is open to the public six days a week. No admission is charged. Works of the member artists are exhibited and offered for sale. A panel chosen by the members selects those works for exhibition that in its opinion meet certain minimal artistic standards. Special showings by individual members are also held on a rotating basis. All works may be purchased by the public and many may be rented. The gallery retains a commission from sales and rental sufficient to cover the cost of operating the gallery. The ruling found that the gallery is a vehicle for advancing the careers of the members and for promoting the sale of their work. The organization served the private purposes of its members even though exhibiting and selling the paintings may be an educational activity.

Revenue Ruling 76-152, 1976-1 C.B. 151, found that a nonprofit organization formed by a group of art patrons to promote community understanding of modern art trends by selecting exhibiting, and selling art works of local artists, and which retained ten percent commission on sales less than customary commercial charges but insufficient to cover the cost of operating the gallery, does not qualify for exemption under section 501(c)(3) of the Code. The ruling concluded that the direct benefits to artists cannot be dismissed as being merely incidental to other purposes and activities since ninety percent of all sales proceeds are turned over to the individual artists.

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

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"underlying commercial motive" that distinguished its educational program from that carried out by a university.

In Goldsboro Art League, Inc., Petitioner v. Commissioner of Internal Revenue, 75 T.C. 337, (1980), the court found that an organization operating an art gallery and art market was exempt under section 501(c)(3) of the Code. Its purpose was primarily to foster community awareness, encourage appreciation of contemporary artists and provide a constant flow of art for students to study art and painting techniques. The organization conducted many charitable and educational activities apart from operating the art gallery and art market including: the operation of an art center which sponsored 20-25 art classes quarterly at the community college, offered art courses to children, sponsored various art demonstrations and film series, gave a series of art lectures and workshops, owned a permanent art collection which it displayed and offered tours of. Artwork displayed at the gallery/market was selected by jury procedures. None of the art was by anyone on the board or officer of the petitioner and only 2 of over 100 artists whose art was displayed were members of the petitioner. No other art museum, gallery or similar facility was available in the county or any adjacent county. The organization contended that the sale of artwork in its galleries was an incidental activity but one that helped to further its exempt purposes. The court accepted this argument.

In Salvation Navy v. Commissioner, T.C.M. 2002-275 (2002), the Tax Court found that one of the reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that it was not organized to serve the private interests of its founder.

Application of Law

You are not described in section 1.501(c)(3)-1(d)(1)(ii) of the Regulations because you are operating for the private interest of your artist members whose art you sell. You are like the organization described in Example 2 of Section 1.501(c)(3)-1(d)(1)(iii) of the Regulations. Providing a display and retail space for member artists and allowing each member artist to set the sales price, select the works for sale, and receive a commission promotes the private interests of the artist members. Any education of the public by display of the artwork is secondary to the promotion of the artists by operation of the co-op. Section 1.501(c)(3)-1(a)(1) of regulations states that to be tax exempt, an organization must be both organized and operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code. Since you are serving private rather than public interests, you are not operated exclusively for exempt purposes. You fail the operational test and do not qualify for exemption under section 501(c)(3) of the Code.

You are not like the organization in Revenue Ruling 66-178. The organization in that ruling conducted an annual exhibit, did not sell art, had artists not affiliated in any way to any gallery and charged no fees for exhibition. You have a gallery that is open to the public on a regular basis. You sell the works of member artists and retain commissions,

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have member artists affiliated with your gallery, and charge membership fees to a majority of the artists who wish to display their work at your gallery. Unlike the organization in the ruling, you are not formed primarily to further charitable or educational purposes, but are formed instead for the benefit of your members.

You are similar to the organization described in Revenue Ruling 71-395. You were formed by a group of artists and are operating an art gallery open to the general public which displays and sells members' artwork. One advantage of membership is listed as the ability to show works. In addition, like the organization in the revenue ruling, a committee consisting of artist members selects works that will be displayed and offered for sale. Additional members are admitted to membership by approval of the existing members. Your gallery is open free to the public on certain days and by appointment on others. Nearly all work is for sale, and you retain a commission of the original sales price of artwork that is sold. Consequently, like the organization in the revenue ruling, you are a vehicle for advancing members' careers and are promoting the sale of members' artwork. This serves the private purposes of your members, even though the exhibition of art may be an educational activity in other respects.

In Revenue Ruling 76-152, a gallery that retained 10% of sales and turned over the remainder of revenue to the artist was held to not be exempt. Direct benefits to artists in this case could not be dismissed as being merely incidental to any other qualifying purposes. You turn s% of proceeds over to the artist. The artists have control over selecting works, setting prices and even, in the case of being a featured artist, promoting select exhibits of their works. Any qualifying activities that may be conducted, such as workshops and classes, are incidental to your purpose of promoting and selling works of art for your member artists. As these direct benefits cannot be overlooked, much as in the ruling, you do not qualify for exemption under Section 501(c)(3) of the Code.

You are different from the organization in Goldsboro Art League, Inc., Petitioner v. Commissioner of Internal Revenue, 75 T.C. 337, 1980. Unlike Goldsboro, your operation of the gallery and sale of artwork by member artists is a substantial portion of your activities. The gallery is used exclusively for the co-op members' art displays, except for the occasional use by other organizations (for-profit and nonprofit) for arts related events. Your charitable and educational activities (i.e. scholarships, art talks/critiques/workshops/tours) currently comprise approximately 60 hours (verified) of members time annually. Even with planned additional classes set to begin later in the year, your educational and charitable activities do not constitute exclusive activity required for section 501(c)(3) of the Code.

Furthermore, since the individuals who will be selling and retaining any proceeds are members they are also insiders. As insiders, any direct benefit derived through your

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operations is inurement. As seen in Salvation Navy v. Commissioner, when an organization is formed to benefit insiders it does not qualify for exemption.

In Better Business Bureau of Washington D.C., Inc. v. United States, 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. You devote more than an insubstantial amount of time and activities in supporting the sale of artworks displayed by your members and for this reason do not meet the qualifications under 501(c)(3) of the Code.

Applicant's Position
You maintain you are organized and operated for charitable and educational purposes under section 501(c)(3) and that no part of the net earnings of the organization inure to the benefit of members. You indicate that you have patterned your organization after other organizations which have received exemption under section 501(c)(3). You provided the names of some of those organizations to justify receiving exemption as a similar organization.

Service Response to Applicant's Position
While some of your activities may constitute charitable and educational activity, the operation of the gallery is more than an insubstantial part of your activities and is for the benefit of your members, thereby serving private interests. The Service bases its determination of qualification for exemption on the application of the law and analysis of the applicant's particular facts and circumstances. Qualification of another entity is not a basis for a similar ruling as each application for exemption is reviewed on its own merits.

Conclusion
Based on the facts and information provided, you are not operated exclusively for exempt purposes. You fail the operational test and operate primarily for the private purposes of your members and not the public. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

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

- Your name, address, employer identification number (EIN), and a daytime phone number

- A copy of this letter highlighting the findings you disagree with

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- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

  For an officer, director, trustee, or other official who is authorized to sign for the organization:
  Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

  For authorized representatives:
  Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts 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 he or she hasn'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 provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status.*

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

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

U.S. mail:

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

Street address for delivery service:

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

You can also fax your statement 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 he or she received it.

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.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

[We sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Director, Exempt Organizations

Enclosure: Publication 892

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