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Internal Revenue Service
Director, Exempt Organizations
Rulings and Agreements

Department of the Treasury
P.O. Box 2508 - EODQA Rm. 7008
Cincinnati, OH 45201

Date: MAR 16 2004

Employer Identification Number:

UIL: 501-00-00

Contact Person - I.D. Number

Contact Telephone Number:

Dear Sir or Madam:

We have considered your application for exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office.

If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

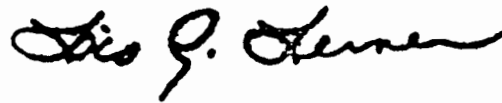
A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District

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of Columbia determines that the organization involved has exhausted administrative remedies available to it with the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

A handwritten signature in black ink, appearing to read "Lois G. Heren". The signature is fluid and cursive.

Director, Exempt Organizations Rulings and Agreements

Enclosures: 3

Enclosure I
Publication 892
Form 6018

Enclosure I

Issues

You are not organized and operated exclusively for 501(c)(3) purposes for the following reasons: (1) your Articles of Incorporation do not meet the organizational test of section 501(c)(3) of the Code and Income Tax Regulations and (2) you are operating for the private benefit of your members as opposed to the public.

Facts

You were incorporated as a non-profit organization under the _____ on _____.
Your Articles of Incorporation do not state your organization's purpose, powers, or the disposition of net assets in the event your organization dissolves or terminates.

Your application for tax-exempt status states that you were formed to introduce and educate the public to various art forms. You are currently located in a _____
Your activities, in part, consist of the following:

1. Events -
 - a. _____ - Conduct an _____ art show _____ to promote children's interest in art. The art show is open to children _____ years and under. Their arts and crafts are for sale at this event. The artists retains _____ of the sale proceeds and _____ goes to the _____.
 - b. Art Openings - _____ shows encouraging all members to expand their creative process. Each show runs _____ Contributing members are allowed to display and sell their artwork. Members are allowed to retain _____ of the proceeds from the sale of their work. The organization retains the remaining _____.
 - c. Art Openings - _____ to enable emerging and veteran artists to let the public experience different art forms. Any class of membership is eligible for selection as the designated artists. The artwork displayed is available for sale and a commission is retained by the artists depending on their level of membership.
2. Education % -
 - a. _____ Poetry - Poetry reading _____ one night a week. Writing workshops are also provided.
 - b. Lectures once a month such as _____

c. Internship - One member acts as a mentor to a local high school art student by exposing the student to the different elements of the art world.

3. Community Service % -

We printed pages from your website and asked that you review the information and sign the pages if you agreed with the material that was presented from your website. You returned the signed pages with minor corrections. Your home page states the _____ is a compilation of the finest regional artists from the _____. The gallery offers a variety of original paintings, sculpture, hand-made jewelry, gifts, and crafts for the discerning art enthusiasts. Another section states that you are a member-artist cooperative, including fine art, pottery and poets.

operated as a for-profit entity.

In response to our request for additional information on your different types of membership and the amount of sale's commission retained by the artists versus your organization, you responded as follows:

- Contributing Artist - the artist retains _____ of sale's commission; the organization retains _____.
The artist receives priority space at Exhibits and Shows; they are allowed to sell their artwork at the gallery twelve months of the year; they pay \$ _____ a month dues, and their portfolio is included in your website for free.
- Exhibiting Artist - the artist retains _____ of sale's commission; the organization retains _____.
They are allowed space on your website for \$ _____ a year and the opportunity to sell their artwork at the gallery twelve months of the year. Of your total membership of _____ members, _____ are listed in this category.
- Allied Artist - the artist retains _____ commission from any revenue of performances at _____.
Allied artists non-visual artists such as singers, dancers, writers and musicians.
- Benefit Artist - the artist retains _____ of sale's commission; the remainder _____ goes to charity. They have the opportunity to sell their artwork at the gallery on a yearly basis. Artwork is displayed for the sole purpose of a designated benefit.
- Associate Artist - the artist retains _____ of sale's commission; the organization retains _____.
They have the opportunity to sell their artwork at the gallery on a yearly basis. They pay \$ _____ a month dues.

Student Artist - the artist retains _____ of sale's commission. They can display their artwork year-round at the gallery.

All work that is displayed in your gallery must first be juried by your directors. The jurying takes place once a month and between _____ of the submitted work is not accepted by the jury panel.

Law

Section 501(c)(3) of the Code provides for the exemption from federal income tax:

"Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in any political campaign on behalf of (or opposition to) any candidate for public office."

Section 1.501(c)(3)-1(a)(1) of the 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(c)(1) states 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 exempt purposes specified in section 501(c)(3).

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

Section 1.501(a)-1(c) defines the words "private shareholder or individual" as persons having a personal and private interest in the activities of an organization.

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized and operated "exclusively" for one or more exempt purposes unless it serves public rather than private interests. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creators, shareholders of the organization or persons controlled, directly or indirectly, by such private interests.

Revenue Ruling 66-178, 1966-1 C.B. 138, holds that an organization that fosters and develops the arts by sponsoring a public art exhibit at which the works of unknown but promising artists are gratuitously displayed but not offered for sale, may qualify for exemption under section

501(c)(3) of the Code. The organization conducts an annual public art exhibit, which exhibited the artwork of unknown artists. A panel of qualified art experts selects the artwork. The artists do not pay a fee for the privilege of having their artwork displayed and the organizers do not sell or promote the sale of the artwork.

Revenue Ruling 71-395, 1971-2 C.B. 228, holds that a cooperative art gallery formed and operated by a group of approximately fifty artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code. It is open to the public six days a week. The gallery retains a commission from sales and rental sufficient to cover the cost of operating the gallery. The ruling holds that the gallery is showing and selling the works of its own members and is a vehicle for advancing their careers and promoting the sale of their work.

Revenue Ruling 76-152, 1976-1 C.B. 151, holds that a nonprofit organization formed by art patrons to promote community understanding of modern art trends by selecting for exhibit, exhibiting, and selling art works of local artists, retaining a commission on sales, that is less than customary commercial charges and not sufficient to cover the cost of operating the gallery, does not qualify for exemption under section 501(c)(3) of the Code. The organization selects modern artwork of local artists for exhibit and possible sale. The gallery is open to the general public. The ruling holds the artists are being directly benefited by the exhibition and sale of their artwork and the major activity of the organization is serving the private interests of those artists that are displayed for sale.

Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945), the Supreme Court interpreted the requirement of section 501(c)(3) that an organization be "operated exclusively" by indicating that in order to fall within the claimed exemption, an organization must be devoted to exempt purposes "exclusively". 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.

Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980) - The Tax Court found that an art gallery's primary purpose is to foster community awareness and appreciation of contemporary artists, and to provide a constant flow of art for students to study art and painting techniques. Thus the organization qualifies for tax-exempt status under section 501(c)(3) of the Code. The organization operates an art center in conjunction with a local college. It sponsors to art classes for approximately students; it offers courses for children in it co-sponsors an educational film series and provides tours of the center to interested persons. There are hundreds of persons involved in the center's activities each week. The organization conducts art workshops for teachers and sponsors public exhibits of the artwork of public school children.

The organization also operates public art galleries. All exhibited artwork is selected by jury procedures and is available for sale to the public. The organization collects and turns over any sales proceeds to the artist less a ten percent commission for expenses. The gross amount the center receives from art sales represents approximately 18-20% of the center's total revenues. The Court held that the sales activities were incidental to the overall activities of the organization and that there was no private benefit to the artists whose works were sold as the artists had not control over the jury selection.

Application of Law

Section 501(c)(3) of the Code sets forth two main tests for qualification for exempt status. An organization must be both organized and operated "exclusively" for purposes described in section 501(c)(3) of the Code and Regulations. Your organization does not meet either test. Your Articles of Incorporation do not state the purpose of your organization, the powers of your organization, or the disposition of net assets in the event of your organization dissolves. Therefore, it does not meet the organizational test of section 501(c)(3).

To satisfy the operational test, you must be operated "exclusively" for one or more exempt purposes. To determine whether the operational test is satisfied, section 1.501(c)(3)-1(c)(1) of the Regulations directs the Service to determine if your organization engages primarily in activities that accomplish one or more exempt purposes.

Better Business Bureau of Washington, D.C. v. United States, held that a single non-exempt purpose, if substantial, would preclude tax exemption under section 501(c)(3) of the Code.

Your organization is similar to the organization discussed in Rev. Rul. 71-395 in that you are also formed and operated by a group of artists for the purpose of selling their works. Your members jury the work of other member artists and very few are rejected. Therefore, it appears that any artist that chooses to become a member can be assured they have a place to exhibit and sell their art. The arrangement you have with your members is a means for advancing their careers and promoting the sale of their work. As the ruling states, you are serving the private purposes of your members even though the exhibition and sale of paintings may be an educational activity in other respects.

You can also be compared with the organization discussed in the above Rev. Rul. 76-152 that was formed by art patrons who juried the artwork to be displayed and sold to the public. The ruling holds that the artists, not the general public, are being directly benefited. The exhibition and sale of artwork is the organization's only activity. Although your organization conducts other artistic and cultural activities, your primary activity is, like this organization, the exhibition and sale of your member's artwork.

You can be distinguished from the organization described in Rev. Rul. 66-178 that exhibited, but did not sell, the works of unknown but promising artists. The artists are not members of the organization and a panel of experts selects the artwork to be displayed. Your organization, on the other hand, displays and holds for sale the artwork of dues-paying members. The organization described in the ruling exhibited artwork for the benefit of the public's viewing. The artwork that is sold in your art gallery is exhibited and sold for the benefit of your members.

The Court in Goldsboro Art League, Inc. v. Commissioner lists the following factors in determining whether an organization, that operated two public art galleries as part of their activities, was operating more for the benefit of the community instead of the artists who sold their work at the two galleries: there were no other art museums or galleries in the area, an independent jury selects the works that are displayed; works are not chosen for salability but for their representation of modern trends; an artist's more daring works are exhibited; other activities are educational and art sales are not conducted at a profit. The Court believed that the sales

activities were incidental to the organization's other activities. The sales activities were seen as secondary and incidental to furthering an exempt purpose.

Your organization can be distinguished from this art center in that your educational and cultural activities are incidental to your primary activity of operating an artist co-operative for the purpose of selling your member's artwork. The time your organization devotes to the operation of the gallery and the amount of the financial support you receive from the gallery sales demonstrates that the art gallery is your primary activity. Although you do conduct educational and cultural activities, you are not operated "exclusively" for these activities, which is required by section 501(c)(3) of the Code.

Applicant's position

In response to our inquiry as to why you feel your organization qualifies for tax exempt status under section 501(c)(3), you state that you "develop the artist through education, exhibition, and a stimulating, supporting environment, while sharing the experience of the visual arts with the community".

We asked your organization to explain how the operation of your art gallery can be distinguished from that of a for-profit art gallery especially as it relates to the sale of artwork. In your response you state that all monies over the normal cost of operations are funneled into the restoration of the building, community services, and scholarships. You state that, unlike a for-profit gallery, you assume the entire cost of exhibiting for all your artists and you do not expect your artists to assume any expenses to exhibit artwork. You state that this policy allows the artists a place to sell their artwork without the costs of exhibition and to sell their artwork without an enormous markup.

Service's response to applicant's position

Your own statements concerning how you differ from a for-profit art gallery are evidence that you are operating for the benefit of your artist members. You are providing a place for them to exhibit and sell their artwork without incurring exhibition costs and they are allowed to retain between of the sale's proceeds. These statements confirm that you realize you are operating for the benefit of your artist members. The artists must first become members of your organization and at some levels pay monthly or yearly dues. In exchange for their dues or commissions, you are providing the artists a showcase for their artwork. You are providing a benefit to the artists that far outweigh the benefit to the community. The number of community events and classes you devote time and financial resources to are insubstantial when compared to the time and resources devoted to the art gallery.

Conclusion

Based on the information submitted, it is the position of the Internal Revenue Service that you do not qualify for exemption under section 501(c)(3) of the Code inasmuch as you are not organized and operated exclusively for any of the specified purposes within that section. Your Articles of Incorporation do not state that you are organized for any of the purposes described in section 501(c)(3) of the Code. They do not provide for the distributions of the organization's assets to

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another organization that is exempt under section 501(c)(3) or to a government for public purposes. Thus, you do not meet the organizational test of section 501(c)(3) of the Code and Income Tax Regulations. Although you conduct a few educational and cultural activities, they are not your primary on-going activity. You are primarily engaged in the operation of an . As you are operated primarily for the benefit of your members and not the public you do not meet the operational test of section 501(c)(3) of the Code and Income Tax Regulations.