

[REDACTED]
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[REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code.

You were incorporated [REDACTED]
[REDACTED] Your purposes, as stated in your articles of incorporation, are charitable. Your specific purposes are

to exhibit and promote visual art and special events in gallery and outdoor museum settings, to create a permanent collection of art, and to provide classes in the visual and performing arts. . . .

You exhibit large sculptures in a park, as well as smaller pieces in a gallery. The park has been operating for [REDACTED]. It is owned, and was previously operated, by [REDACTED], who is your [REDACTED]. A newspaper article describing the original establishment of the park quotes [REDACTED] as saying that the park was established to expand their more traditional indoor gallery: "The idea came to us fairly simply. We wanted to sell large sculptural works that we just couldn't show in an indoor space. So this was the obvious direction for us to go." A financial statement for the year ending [REDACTED] indicates that the sculpture park operated at a loss.

[REDACTED] you were created to operate the park. The park is widely advertised, and is open to the public upon payment of an admission charge. Other than the creation of a board of directors, your current activities do not differ in any way from the operation of the park as a business by [REDACTED]. You lease the property from [REDACTED] for \$ [REDACTED] per year. Despite a request to do so, you have provided no evidence to support a finding that this amount represents fair market value for the use of the property. [REDACTED] will reside on the property. You also intend to pay him a salary of \$ [REDACTED] per year. Under the

terms of the lease you are required to pay for insurance coverage, utilities, and any business or personal property taxes.

All of the artworks displayed in the park and in the gallery are for sale under consignment agreements with the individual artists. The park is available to the public for hosting special events such as weddings, and you provide food and beverage services for these events. Your proposed budgets indicate that your sources of income will be admissions (●%), food and beverage sales (●%), art sales (●%), events (●%), and sales of gifts and souvenirs (●%). You state that in _____ you will establish a school for teaching all of the performing and visual arts. You have stated that you have a small instructional program in place for a limited number of sculpture students, but financial information you have submitted shows no receipts or disbursements associated with this activity.

Section 501(c)(3) of the Internal Revenue Code describes, in relevant part, corporations organized and operated exclusively for charitable 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 Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization 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 test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations 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 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.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that 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 organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, 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(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In Texas Trade School v. Commissioner, 30 T.C. 642 (1958), aff'd 272 F.2d 168 (5th Circ. 1959), the Tax Court held, and the Court of Appeals affirmed, that payment of excessive and unreasonable rentals to insiders constituted inurement and was a bar to exemption under section 501(c)(3) of the Code.

In Goldsboro Art League, Inc. v. Comm. 75 TC 337 (1980), the Tax Court considered the qualification for exemption under IRC 501(c)(3) of an organization which operated an art center furnishing various educational services to the community. The League sponsored art classes in conjunction with the local community college, and also offered art courses for children. It sponsored art demonstrations and workshops in various art techniques. In conjunction with the local college and the North Carolina Art Society, it sponsored educational film series. It owned and maintained a permanent art collection displayed in various local public buildings. Its director gave a series of art lectures in local public schools. It conducted workshops for local public school teachers, and public exhibits of children's artwork. Besides these activities, the League operated two galleries in which the works of artists were displayed and sold. A jury selected works to be displayed based on their representation of modern trends, not their salability. The League retained a 20% commission on works sold; remaining sales proceeds were paid to the artists. The Court agreed with the League that the purpose of the sales activity was primarily 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. The court found the sales activities to be incidental to the League's educational activities.

[REDACTED]

In Rev. Rul. 69-266, 1969-2 C. B. 151, the Service determined that an organization formed and controlled by a doctor engaged in the practice of medicine was not exempt under section 501(c)(3) of the Code. The organization hired the doctor to conduct research programs which consisted of the doctor examining patients. The organization charged the patients the prevailing fees for services rendered and it carried on no other substantial activity. In return for services, the doctor received a salary. The Service determined that the operation of the medical practice by the organization did not differ significantly from the private practice of medicine. The organization was operated by its creator essentially for his private benefit because it reduced his Federal tax liability while he enjoyed the benefit of his earnings.

Rev. Rul. 76-152, 1976-1 C.B. 152, describes 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. As its sole activity, the organization selects modern art works of local artists for exhibit at its gallery and for possible sale. The gallery is open to the general public. Works of art are displayed on a consignment basis with the artist setting the selling price. In this case, the artists are being directly benefitted by the exhibition and sale of their works, with the result that a major activity of the organization is serving the private interests of those artists whose works are displayed for sale. Such direct benefits are substantial by any measure and the organization's provision of them cannot be dismissed as being merely incidental to its other purposes and activities. The organization is not operated exclusively for educational purposes and thus does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

All of your time and efforts appear to be devoted to activities which can only be described as commercial in nature, namely the operation of an art gallery and a facility for hosting special events. Your gallery does not differ in any material respect from [REDACTED] prior business activities. Displaying and selling works of art is a trade or business that is ordinarily carried on for profit. Providing a site and catering services for special events is likewise a trade or business that is ordinarily carried on for profit. These activities are substantial, and do not further any exempt purpose. In this respect, and in the similarity of your activities to [REDACTED] prior operation of the sculpture park, you are similar to the organization described in Rev. Rul. 69-266. The operation of a trade or business in this manner represents a substantial nonexempt purpose which would preclude exemption even if you had substantial exempt purposes and activities. See Better Business Bureau of Washington, D.C., Inc. v. U. S.

[REDACTED]

Furthermore, like the organization described in Rev. Rul. 76-152, you provide a substantial degree of private benefit to the artists whose works you exhibit and sell. Such a substantial degree of private benefit is inconsistent with exemption under section 501(c)(3) of the Code. You are readily distinguishable from the organization described in Goldsboro Art League, Inc. v. Comm. since you do not carry on any of the educational activities described in that case.

Finally, your payment to [REDACTED] of rent whose amount has not been justified with any evidence as to its reasonableness constitutes inurement. In addition, you provide him with living quarters and pay him a substantial salary. You have presented no evidence to show that this arrangement is reasonable and in furtherance of an exempt purpose. See Texas Trade School v. Comm.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption under section 501(c)(3) of the Code. Contributions to you are not deductible under section 170 and you are required to file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling 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 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 of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

NOT RECORDED RECEIVED
Internal Revenue Service District
Date 9/24/97

[Redacted]

You will expedite our receipt of your reply by using the following address on the envelope:

Internal Revenue Service
CP:E:EO:T:4, Room 6236
1111 Constitution Avenue, NW
Washington, DC 20224

Sincerely,

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

Code	CP:E:EO:T:4	CP:E:EO:T:4			
Surname	[Redacted]	[Redacted]			
Date	[Redacted]	[Redacted]			