

Art gallery. 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 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; Rev. Rul. 71-395 clarified.

Advice has been requested whether the nonprofit organization described below, which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, is operated exclusively for educational purposes.

A group of art patrons formed an organization to promote community understanding of modern art trends. 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.

A modern art work of any local artist is eligible for consideration for exhibition. If selected, the artist's work is displayed on a consignment basis with the artist setting the selling price. The artists have no control over the organization or its selection process.

The organization retains a ten percent commission on sales. The commissions are substantially less than customary commercial charges and are not sufficient to recover the cost of operating the gallery. The organization attempts to make up operating deficits by soliciting contributions from the general public.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized and operated exclusively for educational purposes unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term 'educational' relates to the instruction of the public on subjects useful to the individual and beneficial to the community. Museums are included in the examples of educational organizations which, if they otherwise meet the requirements of section 501(c)(3) of the Code, may qualify under this section.

Rev. Rul. 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 may qualify for exemption under section 501(c)(3) of the Code. The organization does not sell or offer

the displayed works for sale.

Rev. Rul. 71-395, 1971-2 C.B. 228, on the other hand, holds 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 under section 501(c)(3) of the Code.

As is the case in Rev. Rul. 71-395, the artists in the subject case 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. Since ninety percent of all sales proceeds are turned over to the individual artists, 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 fact that the artists have no control over the selection of their works for display does not change this conclusion.

Accordingly, 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.

Rev. Rul. 71-395 is clarified.