

Internal Revenue Service
Appeals Office

Release Number: **201441017**
Release Date: 10/10/2014
Date: July 18, 2014

Officer

Department of the Treasury

Employer Identification Number:
Person to Contact:

Employee ID Number:
Tel:
Fax

UIL: 501.03-30

Certified Mail

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code: effective January 1, 2009.

Our revocation was made for the following reasons:

You are not operated exclusively for charitable, educational, or other exempt purposes. You did not engage primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3). More than an insubstantial part of your activities were in furtherance of a non-exempt purpose..

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write

to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Acting Appeals Team Manager

cc: .

Enclosure: Publication 892 and/or 556

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
Attention: Jeremy Elliott, Mail Stop 39
4905 Koger Boulevard Suite 102
Greensboro, NC 27407

Department of the Treasury

Date: April 18, 2012

Taxpayer Identification Number:

Form:

990-EZ

Tax Year(s) Ended:

December 31, 20XX

Person to Contact/ID Number:

Certified Mail – Return Receipt Requested

Contact Numbers:

Telephone:

Fax:

Dear

We propose to revoke our recognition of your exempt status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). We enclose our report of examination explaining why we are proposing this action.

If you accept our proposal, please sign and return the enclosed Form 6018, *Consent to Proposed Action - Section 7428*, unless you have already provided us a signed Form 6018. We will issue a final revocation letter determining you are not an organization described in section 501(c)(3). After the issuance of the final revocation letter we will publish an announcement that you have been deleted from the cumulative list of organizations contributions to which are deductible under section 170 of the Code. If you do not respond to this proposal, we will similarly issue a final revocation letter. Failing to respond to this proposal may adversely impact your legal standing to seek a declaratory judgment because you may be deemed to have failed to exhaust administrative remedies.

If you do not agree with our proposed revocation and wish to protest our proposed revocation to the Appeals Office of the Internal Revenue Service, then you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. This written request is called a protest. For your protest to be valid it needs to contain certain specific information which generally includes a statement of the facts, the applicable law, and arguments in support of your position. For the specific information needed for a valid protest, please refer to page 6 of the enclosed Publication 3498, *The Examination Process*, and page 2 of the enclosed Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*. These documents also explain how to appeal an IRS proposed action.

In Lieu of Letter 3618

If you do submit a valid protest, then an Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498 and Publication 892 explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collections process. Please note that Fast Track Mediation Services referred to in Publication 3498, generally do not apply after issuance of this letter.

You may also request that we refer this matter for Technical Advice as explained in Publication 892 and an annual revenue procedure. Please contact the individual identified on the first page of this letter if you are considering requesting Technical Advice. If we issue a determination letter to you based on a Technical Advice Memorandum issued by the EO Rulings and Agreements function, then no further administrative appeal will be available to you within the IRS on the matter.

If you agreed with the proposed revocation or you receive a final revocation letter, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 30 days of the date you agreed with the revocation or the date of your final revocation letter, whichever is sooner, unless a request for extension of time is granted. File returns for the later tax years with the appropriate service center indicated in the instructions for those returns.

We will notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code. Currently, only certain states are eligible to receive notification of proposed revocation actions. You can call the person at the heading of this letter to find out if your State is eligible to receive a notice of revocation of your tax-exempt status.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Form 6018 (2)
Envelope

886-A Addendum

LEGEND

ORG - Organization name XX - Date Address - address
City - city State - state Market - market
President - president

ISSUE

1. Whether the tax-exempt status of ORG, which displays and sells art created by its members should be revoked?

BRIEF EXPLANATION OF FACTS

ORG is recognized as a section 501(c)(3) tax-exempt organization. According to its articles of incorporation, the primary purpose of the organization is to provide an outlet for crafts people, to provide an association of people interested in crafts who are willing to work together toward the mutual benefit in promoting the learning, participation and selling of various crafts and to promote the cultural, education and recreational enrichment of the community through crafts.

The ORG (ORG) was established in 19XX. The members are artists and crafts people who engage in a wide range of artistic venues. The organization's purpose; according to organization President; is to expose the general public to arts and crafts by sponsoring annual shows in the City area. In addition, the organization donates various sums for the purpose of enabling senior citizens and youth to participate in arts and crafts.

ORG has 6 classes of members, Regular, Senior Citizen, Regular Family, Senior Family, Inactive and Life Member. Membership fees vary based on the class. In order to become a ORG member, the artist must submit a jury application regarding the type of handmade crafts. When the application is received the actual art/craft items are reviewed by the Executive Board. The board members rate the handmade crafts using a point system to determine if the applicant meets the eligibility requirements.

Members of the organization that participate in shows are charged a booth fee which varies for each show. The funds are expended in support of the show through advertising expenses. In addition to the booth fee, participants contribute a percentage of their tag sales to offset the cost of credit card capability provided by the ORG. Currently the rate charged is 5%. Only members of ORG are allowed to participate in the shows and rent booths to sell their personal art.

In addition to operating annual shows for their members, ORG also has started operating a shop/facility to sale the crafts/art of their members. ORG newsletter for Winter 20XX, contains a section entitled "Holiday Shop Update!" The update goes on to say "Well done. This was our 2nd year of hosting the Holiday Shop at the Market. We had fun, we learned a lot and we are already gearing up for the next Christmas season. Our final totals were \$ and 30 members participating."

LAW

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations 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 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)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of education.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F.2d. 340 (4th Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or

indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. Am. Campaign Acad. v. Commissioner, supra at 1065-1066.

Rev. Rul. 66-178, 1966-1 C.B. 178, the Service recognized an organization that sponsored an annual public art exhibit that displayed the works of unknown and promising artists to be exempt under section 501(c)(3) of the Code. Although the organization charged a nominal admission fee to the exhibit and sold a catalogue describing the exhibit, the organization did not sell or offer the displayed works for sale.

Rev. Rul. 71-395, 1971-2 C.B. 228, a cooperative art gallery was formed by a group of artists to exhibit and sell their works. Additional artists were admitted to membership only on approval of existing members. All works displayed at the gallery could be purchased by the public and many could also be rented. The gallery retained a commission from the sales and rentals to cover its cost of operation. In concluding that the art gallery was not entitled to recognition of exempt status, the ruling emphasized that the gallery was a vehicle for advancing the careers of its members and for promoting the sale of their work. As such, it "serves the private purposes of its members, even though the exhibition and sale of paintings may be an educational activity in other respects."

Rev. Rul. 76-152, 1976-1 C.B. 151, a group of art patrons formed an organization to promote community understanding of modern art trends. Its sole activity was the selection of modern art works of local artists for exhibition and for possible sale at its gallery, which was open to the public. A modern art work of any local artist was eligible for consideration for exhibition and, if selected, the artist's work was displayed on a consignment basis with the artist setting the selling price. The artists had no control over the organization or its selection process. The organization kept a ten percent commission on sales. On these facts, the Service ruled, as in Rev. Rul. 71-395, that the artists were being directly benefited by the exhibition and sale of their works with the result that a major activity of the organization was serving the private interests of those artists whose works were displayed.

In Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980), a section 501(c)(3) organization operated two commercial-type art galleries in connection with an art center which furnished various educational and charitable services to the community. The art galleries sold works of arts created by various artists on a consignment basis. The organization would set the sales price of each work of art and advertise the sale of the art works to the general public. Under the informal arrangement with the artists, the organization would turn over approximately 80 percent of the proceeds to the artists while retaining the remainder to cover expenses. The Tax Court held that the organization qualified for exemption under section 501(c)(3) because the primary purpose of the two galleries was to foster community awareness and appreciation of

contemporary artists and to provide a constant flow of visual art for students to study techniques.

In making its decision, the Tax Court considered the following factors to be critical to its determination: (1) there were no other museums or galleries in the area, thus, the exhibition of art works showed a purpose primarily to educate rather than to sell and the selling activity served merely as an incentive to attract artists to exhibit their work; (2) works were selected for their representation of modern trends rather than salability; (3) the organization's convincing record of dedication to teach the public, through a variety of means, to appreciate art indicated that its sales activities were "secondary and incidental" to furthering its exempt purposes; and (4) of the more than 100 works of arts exhibited in the two galleries, only the art of works of 2 members of the organization were exhibited in the galleries.

TAXPAYER'S POSITION

ORG believes that it is entitled to exemption under section 501(c)(3) because its primary purpose is to educate and promote the arts to the general public. In support of its position, the organizations President submitted A written response dated April 12, 20XX. The response states "As President of the ORG, I am writing today to reiterate and clarify how the ORG intends to address and remedy past failure to address that specific part of our stated exempt purpose..."to expose the community to a diverse range of arts and crafts, donate time and funds to foster awareness and interest in the arts, provide educational opportunities to...the community...to demonstrate and market their arts and crafts".

ORG believes their exempt purpose is accomplished through but is not limited to the following events: Award in 20XX. This program is sanctioned by the City Senior Games, which is sponsored statewide by the City Division of Aging and Adult Services, Educational workshops for members in 20XX, Demonstrations by show participants at two shows in the following areas: stain glass, cold casting, bead weaving, kaleidoscopes and folk art painting. ORG plans to provide an arts fest day at local charter schools to educate, inform and expose youth to a diverse range of artistic venues. To help accomplish their exempt purpose, ORG also plans to perform a mentoring program for young artists, to provide member education in visual marketing and starting/maintaining a small business.

GOVERNMENT'S POSITION

Based on the facts of the examination, the organization does not qualify for exemption since the operation of its art shows and shop confers a private benefit to its members. Although the purpose in operating the art shows and shops may arguably benefit the public in the education of art, the display and

sale of these items created by its active members clearly benefit their private interest. See Rev. Rul. 71-395 and Rev. Rul. 76-152. As noted above, an organization that operates for the benefit of private interests, such as designated individuals, by definition does not operate exclusively for exempt purposes. This case is unlike Goldsboro Arts League, where the two galleries displayed and exhibited works of various artists, a majority of whom were not members of the organization. In the instant case, only art and crafts created by the organization's members are displayed and sold at the art shows and shops, clearly serving a specific designated non charitable class. Moreover, unlike Goldsboro Art League, other galleries/organizations that display and sell art works and crafts are located in the same vicinity. By advertising the sale of its art work in local publications and in the city's newspapers, the organization is directly competing with these other commercial galleries/organizations, evidencing a commercial nature and purpose in operating its art shows and shops.

CONCLUSION

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked.