



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: September 27, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

UIL: 501.32-01, 501.33-00

Number: **201751016**

Release Date: 12/22/2017

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.

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,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements

Enclosures:

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*



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Date: July 20, 2017

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

N = Date 1
P = State
Q = Gallery
R = Date 2
S = City
T = Area
V = website
W = Board Members
x = Number of Working Members
y = Number of Consignment Members
z percent = Commission

UIL:

501.32-01
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.

Issue

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

Facts

You incorporated on date N in the state of P as a nonprofit corporation. Prior to this date, you operated as a for-profit called Q. On date R, Q conveyed all of its assets and liabilities to you as the nonprofit corporation and filed articles of dissolution with the state of P.

According to your articles, you are organized and operated exclusively for charitable, education, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt

organizations under Section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue Law).

Your articles further state that you are

... an evolving collective of local creatives, exhibiting and inspiring artistic expression for the aesthetic enrichment of S and our global community. (Your purpose is to provide) ... gallery space to member and consignment artists to display, promote, and sell their works, fostering public exposure to the arts for S and the T region of southern P.

Membership is open to all artists living within approximately 50-60 miles of S who are actively engaged in creating and producing artwork. Your bylaws indicate you have two types of members: Working Members and Consignment Members.

Working Membership is for practicing artists who are actively engaged in the management and operation of the Gallery. Working members, numbering x, are expected to provide high quality original work for exhibition/display in the Gallery and:

- 1) Shall be willing and able to tend the Gallery as a shopkeeper for the number of days designated in the Gallery's Policies and Procedures
- 2) Must be a member of at least one of the Gallery's committees
- 3) May display works in the Gallery after a jurying process, according to the Gallery's Policies and Procedures
- 4) May individually sell their works at the Gallery under terms established in the Policies and Procedures, paying to the Gallery a uniform and reasonable sales commission, determined annually by the Board of Directors, in order to support the nonprofit purposes and mission of the Gallery
- 5) Shall have voting privileges at all Gallery meetings, with one vote per Working Member; they shall participate in Gallery shows and special events and in related activities of the Gallery, and
- 6) Shall be required to attend at least two quarterly membership meetings

Consignment Membership is for practicing artists or persons wishing to be affiliated with the Gallery but who cannot or do not wish to meet the requirements of a Working Member. Consignment members, of which there are y in number:

- 1) May display their work after a jurying process, but do not serve on committees or attend meetings
- 2) Do not have voting privileges, and
- 3) May individually sell their works at the Gallery under terms established in the Policies and Procedures, paying to the Gallery a uniform and reasonable sales commission, determined annually by the Board of Directors, in order to support the nonprofit purposes and mission of the Gallery

Article VII, section 3 of your bylaws states your 7-member board of directors shall be elected by your voting members at your annual meeting.

You provide a space where local artists and artisans show their work, collaborate with each other and sell their creations to the general public. You state that membership is growing and the space has become a central hub

for creative activity. The shared space is run like an association or a cooperative, with everything being done by volunteers, with a part time bookkeeper being the only regularly paid person.

The Gallery provides space, a central networking hub, and a facility in which your Working and Consignment Members can exhibit and sell their artwork. The Gallery itself is owned by two individuals unrelated to you. You do not purchase any artwork or art products, but simply provide a holding place for them on behalf of your artist members and consignment members. In addition to exhibition space, you provide advertising, shop-keeping services and Gallery-based marketing and sales service to the collective group of Working Members and Consignment Members of the Gallery.

Activities at the Gallery include featuring local musicians and poets at community and Gallery-based events; supporting K-12 artists through visiting artist programs in the local school district, teacher trainings and mentoring; hosting art-centered activities for holidays such as Halloween and the 4th of July; holding open house artist receptions at the Gallery throughout the year; and participating in activities sponsored by the S Creative District. Commissions from art sales fund all activities.

You are preparing to more actively collaborate with S's Creative District; to build your financial capacity; to begin to pay for shop-keeping work by your members; to eventually hire an Executive Director; and to capitalize the long-awaited expansion of the gallery to accommodate your growing schedule of events and activities. You intend to create more display space and more studio and workshop space, with perhaps the development of a fine art gallery annex.

The Gallery is staffed with volunteer Working Members who promote, inform, educate, and otherwise encourage visitors to the Gallery to purchase the artworks of its Working Members and Consignment Members. These members are not only exhibiting artists, but they may also be heads of committees, directors on the board and/or officers of the Gallery. The Gallery's Policies and Procedures and the contract it signs with exhibiting artists establish the terms between the Gallery and its members, ensuring that the jurying system, the selling price, terms of the sale, and the percentage of the commission paid to the Gallery conform to the terms of the conflict of interest policy.

Working Members may individually sell their works at the Gallery under terms established in the Policies and Procedures, paying to the Gallery a uniform and reasonable sales commission, determined annually by the board of directors, in order to support the nonprofit purposes and mission of the Gallery.

You provided a copy of your member contract, which establishes the terms between the Gallery, cooperatively run by the participating artists, and the artists whose works are displayed for sale to the public. The contract provides that the Gallery sets a z percent commission on all works for sale to be deducted from the original price set by the artist.

Your website, V, provides links to various artists' websites whose artwork is displayed at the Gallery. The artists whose work you promote include W, members of your board of directors.

According to your financial information, you were exclusively funded by item sales and a small amount of investment income in your first year of operations as a nonprofit corporation. While you have budgeted grants and donations in future years, a substantial amount of your revenue will continue to be derived from sales income.

Law

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

Treasury Regulation § 1.501(c)(3)-1(a)(1) 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.

Treas. Reg. § 1.501(c)(3)-1(c)(1) asserts 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 are not in furtherance of exempt purposes.

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

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

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) 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.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii) 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 circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

Rev. Rul. 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 was exempt under section 501(c)(3) of the Code. The organization's sole activity was sponsoring an annual public art exhibit at which works of unknown but promising artists were displayed. Artists eligible to have their works displayed were those who were not affiliated with art galleries and who had no medium for exhibiting their creations. The works exhibited were selected by a panel of qualified art experts. The organization did not charge the artists any fees for the privilege of having their works displayed. Nor did the organization sell or offer the displayed works for sale.

Rev. Rul. 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 did not qualify for exemption under section 501(c)(3) of the Code. The gallery was formed and operated by a group of approximately 50 artists for the purposes of exhibiting and selling their works. Additional artists were admitted to membership by approval of the existing members. The gallery was open to the public six days a week. No admission was charged. Works of the member artists were exhibited and offered for sale. A panel chosen by the members selected those works for exhibition that in its opinion meet certain minimal artistic standards. Special showings by individual members were also held on a rotating basis. All works could be purchased by the public and many could be rented. The gallery retained a commission from sales and rental sufficient to cover the cost of operating the gallery. The ruling found that the gallery was 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.

Rev. Rul. 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, did not qualify for exemption under section 501(c)(3) of the Code. The ruling concluded that the direct benefits to artists could not be dismissed as being merely incidental to other purposes and activities since ninety percent of all sales proceeds were 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 an exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In *Goldsboro Art League, Inc. 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 a 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 two 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.

In *Salvation Navy v. Commissioner*, T.C. Memo. 2002-275, 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 501(c)(3) of the Code because you are not operated exclusively for an exempt purpose or purposes (Treas. Reg. § 1.501(c)(3)-1(c)(1)) and because your net earnings inure to the benefit of your members (Treas. Reg. § 1.501(c)(3)-(c)(2)).

You are not described in Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) because you are operating for the private interest of your artist members whose artworks you sell. You are also like the organization described in Example 2 of Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii). Providing a display and retail space for member artists and allowing each member artist to set the sales price, selecting the works for sale, and receiving 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 cooperative. Treas. Reg. § 1.501(c)(3)-1(a)(1) 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.

You are not like the organization in Rev. Rul. 66-178. The organization in that ruling conducted an annual exhibit, did not sell any artworks, did not have any artists affiliated in any way to any gallery and did not charge any fees for exhibition. In contrast, you have a gallery that is open to the public on a regular basis. You are a membership organization consisting of artists who select and sell members' artwork in a gallery operated by you. Your artist members also earn commissions on works that are sold. Thus, you are operating for the private purposes of your members. 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 Rev. Rul. 71-395 because you were formed by a group of artists and are operating an art gallery open to the general public, which displayed and sold members' artwork. All of your artwork 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.

Your activities are analogous to the organization in Rev. Rul. 76-152, where 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 z percent of your 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.

You are different from the organization in Goldsboro Art League, Inc. Unlike Goldsboro, your operation of the gallery and sale of artwork by member artists is a substantial portion of your activities. In addition, all artists that display and sell art works are your members. Even with planned additional educational activities, 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, including your Directors, they are considered insiders. As insiders, any direct or indirect benefits derived through your operations is inurement under Treas. Reg. § 1.501(c)(3)-1(c)(2).

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

Similar to *Salvation Navy*, you have not proven you were not organized and operated to serve the private interests of your members.

Conclusion

Based on the information submitted, you are not operating exclusively for one or more purposes described in section 501(c)(3) of the Code. You serve the private interests of your members, and therefore, are not operated exclusively for exempt purposes. In addition, the private interests you serve include members of your board of directors, resulting in inurement, which is prohibited under section 501(c)(3). Even though some of your activities are educational, you are primarily operating to benefit your member artists and therefore, you are not described in section 501(c)(3).

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
- 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).

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.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892