



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201838009**
Release Date: 9/21/2018
UIL Code: 501.03-00
501.03-30

Date: June 26, 2018

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years: All

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.

We sent a copy of this letter to your representative as indicated in your power of attorney.

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*

[cc: Name]



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date:
April 30, 2018
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = Date
C = State
D = Date
e dollars = Amount
f percent = Percentage
g dollars = Amount

UIL:

501.00-00
501.03-05
501.03-30
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.

Issues

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

Facts

You were formed on B in the State of C as a for-profit Limited Liability Company (LLC). You converted to a non-profit corporation on D. Your Articles of Incorporation states that your activities are restricted to the following: education, public art sales and events, and scholarship programs.

Your Bylaws state that your mission is to provide support and opportunities for local artists as well as offer art activities and education to the community. You achieve your mission by (1) providing display and sale opportunities, (2) providing art classes for children, teens and adults, (3) providing organized activities for the community to experience and appreciate the arts, and (4) providing scholarships for students.

You converted to a non-profit corporation so you can continue to service artists who cannot afford the expense of a commercial gallery. Also, it enables you to make use of many fundraising opportunities that you could not utilize as an LLC. You stated that there are other art galleries and an artist showplace approximately 20 to 25 miles away, however, they don't provide any art education.

You showcase local artists and artisans. You display their artwork, which is for sale, and have several special events each year to aid their ability to place their creations into the hands of art lovers. You feature a different

set of artists each month and work with each shopper to help them find the perfect piece for their home or business. You currently have artwork from 40 artists on display. The art includes oils, watercolors, ceramics, graphite, ink, mixed media, acrylics and photography. You offer your clients the full package.

Artists must become exhibiting artist members to display artwork in your gallery. The membership fee is e dollars per year. Membership benefits include the right to show five pieces of artwork for sale for the year of membership. Each piece must be approved by your board of directors before display. In addition, artists must sign an agreement regarding your policies and guidelines and pay their membership dues. Artists are not permitted to display artwork which is already sold and cannot be purchased by the public. A tag is posted with each piece including the title, medium, artist name, and price. All prices are determined by the artists.

If dues are not kept current you terminate the membership of the artist and sell any artwork to cover payment of dues and late fees. Each day at least one artist and/or a board member is on site to assist buyers in artwork selection. You train and work closely with the artists to assure customer satisfaction. The artwork is consigned to you and f percent of the sales amount will go to the artist while you retain the remainder. Artists are expected to pay their percentage on all art commissioned if it comes through your gallery. This includes private sales, online sales, and any pieces loaned from you to other companies.

The community can also join as society members for a membership fee of g dollars. Their benefits include participating in art demos and special events. Society members also get preview invitations for all special art sales and future events for new artists.

Your facility includes a main gallery and a classroom. Hallway spaces are also utilized for artwork exhibition. You are open Tuesday to Friday for six hours and Saturday for three hours. Also, once a month, you open for a late night special art activity. The artwork is always on display and is available for sale while you're open.

You provide weekly art classes in oils, watercolor, drawing, acrylics, glass and art basics for all ages and abilities of artists. Scholarships will be provided to those with financial need as you can afford to do so. In addition, you are in the process of establishing an art society to serve local artists. No specific details were provided for the art society.

You said your art sales are distinguishable from those of a for-profit art gallery because you charge much lower fees and the artists receive a higher commission percentage than other galleries.

You provided financial data that indicates that your sources of income include art sales, membership fees, and class fees.

Law

Section 501(c)(3) of the Code provides for the recognition of exemption of organizations that are organized and operated exclusively for religious, charitable or other purposes as specified in the statute. No part of the net earnings may inure to the benefit of any private shareholder or individual.

Treasury Regulation Section 1.501(c)(3)-1(a)(1) states that, in order to be exempt as an organization described in Section 501(c)(3) of the Code, 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.

Treas. Reg. Section 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Treas. Reg. Section 1.501(c)(3)-1(b)(1)(iv) provides that in no case shall an organization be considered to be organized exclusively for one, or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created are broader than the purposes specified in Section 501(c)(3) of the Code.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) 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) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

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

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(iii), *Example 2*, provides examples to illustrate the requirement that an organization serve a public rather than a private interest. denies exemption to an art museum whose principal activity is exhibiting art created by a group of unknown but promising local artists, including organizing tours of the exhibited art. All of the art exhibited is offered for sale at prices set by the artist. The museum sales the art under consignment whereby the artists keep ninety percent of the proceeds providing ten percent to the museum to cover costs. None of the artists exhibited were on or related to the board of trustees that determined who was shown. The organization is denied exemption since a substantial purpose of the museum is to advance the private interests of the artists shown.

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 if the organization does not sell or offer the displayed works for sale.

Rev. Rul. 71-395, 1971-2 C.B. 228, holds that a co-operative 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.

Rev. Rul. 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 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 because the artists are being directly benefited by the exhibition and sale of their works. The organization is serving the private interest of the artists.

In Goldsboro Art League vs. Commissioner, 75 T.C. 337 (1980), the organization that sold artworks and turned most of the proceeds over to the individual artists was exempt. The gallery operated in a part of the country

where there were no nearby art museums. In addition, a jury selected the artworks for displays and artworks were not chosen for their salability but for their representation of modern trends.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), 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 Old Dominion Box Co., Inc. v. United States, 477 F.2d 340 (4th Cir. 1973), the Court said operating for the benefit of private parties who are not members of a charitable class constitutes such a substantial non-exempt purpose.

Application of law

As explained in Treas. Reg. Section 1.501(c)(3)-1(a)(1), to be exempt as an organization described in Section 501(c)(3) of the Code, you must be both organized and operated exclusively for one or more of the purposes specified in such section. Because you are neither organized nor operated exclusively for exempt purposes, you are not exempt.

One of your purposes, as described in your Articles of Incorporation, is to hold public art sales and events. Your Articles do not limit your purposes to those described under Section 501(c)(3) of the Code; therefore, you do not satisfy the organizational test described in Treas. Reg. Section 1.501(c)(3)-1(b)(1)(i). Also, your Articles contain a purpose clause which is broader than acceptable, as explained in Treas. Reg. Section 1.501(c)(3)-1(b)(1)(iv).

Additionally, you are not described in Section 501(c)(3) of the Code because you are not operated exclusively for an exempt purpose as required by Treas. Reg. Section 1.501(c)(3)-1(c)(1). More than an insubstantial amount of your time is spent promoting the private interests of your members, which is not an exempt purpose.

You are not as defined in Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) because you are operating for the private interests of your artist members whose art you sell. Providing a display and retail space for member artists, allowing each member artist to set the sales price, select the works for sale, and receive a commission, promotes the private interests of the artist members. Moreover, the education of the public is secondary to the sale of artwork. You are very similar to Example 2 in Treas. Reg. Section 1.501(c)(3)-1(d)(1)(iii) because more than an insubstantial part of your operations serve private interests of your artist members.

You are not like the organization described in Rev. Rul. 66-178 because you display and sell the art of your members, who earn a percentage of commission for any of their work that is sold. Unlike the organization in the ruling, you are not formed to further charitable or educational purposes, but are formed instead for the benefit of your members.

You are like the organizations described in Rev. Rul. 71-395 and 76-152. You turn f percent of your proceeds over to the artists. Any qualifying activities that may be conducted, such as workshops and classes, are incidental to your non-exempt purpose of promoting and selling works of art for your member artists.

You are distinguishable from the organization described in Goldsboro Art League, Inc. Unlike the organization described in this case, your operation of a gallery where you sell artwork created by member artists is a

substantial portion of your activities. Your educational and charitable activities do not constitute exclusive activities as required for Section 501(c)(3) of the Code.

You are similar to the organizations in Better Business Bureau of Washington, D.C., Inc. and Old Dominion Box Co., Inc. because you devote a substantial amount of time and activities in supporting a non-exempt purpose, the sale of artworks displayed by your members. Accordingly, you are not exempt under Section 501(c)(3) of the Code.

Conclusion

Based on the information submitted, you are neither organized nor operating exclusively for one or more exempt purposes described in Section 501(c)(3) of the Code. Even though some of your activities are educational, you are operating substantially for benefit the private interests of your member artists. Accordingly, you are not exempt under 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