



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Number: **202044011**
Release Date: 10/30/2020

Date:
June 2, 2020
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

- B = Date
- C = Date
- D = State
- E = City
- f dollars = amount
- g dollars = amount
- h dollars = amount

UIL:

- 501.00-00
- 501.32-00
- 501.32-01
- 501.33-00

Dear :

We considered your application for recognition of exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a). We determined that you don't qualify for exemption under IRC Section 501(c)(3). This letter explains the reasons for our conclusion. Please keep it for your records.

Issues

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

Facts

You submitted Form 1023-EZ, Streamline Application for Recognition of Exemption Under IRC Section 501(c)(3), on B.

You attest that you are organized and operated exclusively to further charitable and educational purposes and that you have not conducted and will not conduct prohibited activities under IRC Section 501(c)(3). You indicated on the Form 1023-EZ that your mission is to promote, educate, and help sell artwork for local and aspiring artists within the community.

During the review of your Form 1023-EZ, detailed information was requested to supplement the above information. You submitted your Articles of Incorporation that were filed on C in the State of D which, in part, state you are organized exclusively for charitable, religious, educational, and scientific purposes. You further indicated that you are a membership organization consisting of local artists. You were formed to enable

struggling members to sell their artwork and benefit from working in a gallery. Specifically, you operate a gallery which enables your members to sell their work and retain the majority of the sales proceeds.

Your members are local artists of various artistic mediums. To join they must pay an initial fee of f dollars and sign a Cooperative Membership Contract. The contract also provides that members must pay a monthly membership fee of g dollars to display their work, but this will be reduced by h dollars per month when they work "shifts" at the gallery. In addition, the contract requires members agree to show their artwork exclusively at your gallery and may not show their work in any other gallery or business within the E area. However, there are exceptions for three specific organizations that promote E as well as the businesses within E.

All operational and financial decisions are made through a majority vote of members. Members work together to operate the gallery. For example, they recruit local artists, market and promote the gallery, clean the gallery and are responsible for administrative and accounting functions. You also provide opportunities for local artists to receive guidance on art pricing, show preparation, marketing, and other aspects pertaining to art as a business.

Your members occasionally teach workshops to the public for a fee. You also hold monthly featured artist shows that allow up and coming artists to show and sell their work. In both cases, the member and/or featured artist retains the majority of the sales proceeds.

You are supported by membership fees, workshop commissions, and art sales commissions. Your expenses consist of gallery space rent, utilities, insurance, licenses, marketing and supplies.

Your other activities include art invitationals, quarterly open-mic and poetry readings, and occasional speaking engagements to local schools and community groups.

Law

IRC Section 501(c)(3) provides, in part, for the exemption from federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treasury Regulation Section 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 IRC Section 501(c)(3). If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. Section 1.501(c)(3)-1(c)(1) states 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 IRC 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.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(iii) provides examples to illustrate the requirement 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. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in IRC Section 501(c)(3).

Revenue Ruling 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 IRC Section 501(c)(3). 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 describes a cooperative art gallery 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, 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 a 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 IRC Section 501(c)(3). The ruling concluded that the direct benefits to artists could not be dismissed as being merely incidental to other purposes and activities since 90 percent of all sales proceeds were turned over to the individual artists.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945), the Supreme Court determined that the presence of a single non-exempt purpose, if substantial in nature, will destroy exemption under IRC Section 501(c)(3) regardless of the number or importance of any other exempt purposes.

In Goldsboro Art League v. 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 organization conducted many charitable and educational activities apart from operating the art gallery and art market including: an art center which sponsored 20-25 art classes quarterly at a community college, a permanent art collection which it displayed and offered tours of, art courses for children, various art demonstrations and film series, and art lectures and workshops. Artwork displayed at the gallery/market was selected by jury procedures. It was not chosen for salability but for its representation of modern trends. 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.

Application of law

To meet IRC Section 501(c)(3), an organization must be organized and operated exclusively for exempt purposes. Per Treas. Reg. Section 1.501(c)(3)-1(a)(1), if an organization fails either the organizational or operational test, it is not exempt. You were formed for the substantial non-exempt purpose of providing a place for artists to sell their work, which causes you to fail the operational test as described in Treas. Reg. Section 1.501(c)(3)-1(c)(1). Therefore, you are not operated exclusively for exempt purposes under Section 501(c)(3).

You are not described in Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) because you serve a private rather than a public interest. You are like the organization described in Example 2 of Treas. Reg. Section 1.501(c)(3)-1(d)(1)(iii) because your members directly benefit from the exhibition and sale of their art at your gallery. As members keep a majority of the sales proceeds, the direct benefits are substantial. Consequently, like the organization in the example, you are operated for the benefit of private interests in violation of the restriction on private benefit.

In contrast to Rev. Rul. 66-178, you are an artists' cooperative that has a gallery open to the public on a regular basis where member artworks are exhibited and sold. Your artist members pay fees to exhibit and earn commissions on sold works. Thus, you were formed to benefit your members more than insubstantially, rather than to further exclusively charitable or educational purposes.

You are similar to Rev. Rul. 71-395 which found that a cooperative art gallery comprised of member artists that was formed and operated for the purpose of exhibiting and selling their works was not exempt. Like the organization in that ruling, your gallery is a vehicle for advancing the careers of your members and for promoting the sale of their work.

You are also comparable to the organization in Rev. Rul. 76-152, where a gallery that retained 10 percent of sales and turned over the remainder of revenue to the artist was held to not be exempt. Similarly, direct benefits to your artist members cannot be dismissed as being merely incidental to any other qualifying purposes.

In Better Business Bureau of Washington D.C., Inc., the Supreme Court held that a single nonexempt purpose, if substantial in nature, would preclude an organization from qualifying under IRC Section 501(c)(3) no matter the number or importance of truly exempt purposes. 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. For this reason, you do not meet the qualifications under Section 501(c)(3).

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, most 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 under IRC Section 501(c)(3).

Conclusion

Based on the information submitted, you are not operating exclusively for purposes described in IRC Section 501(c)(3). You operate for the substantial non-exempt purpose of benefitting the private interests of your members. Accordingly, you are not exempt under Section 501(c)(3).

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.

If you don't agree

You have a right to protest if you don't agree with our proposed adverse determination. To do so, send us a protest within 30 days of the date of this letter. You must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization or your authorized representative
- The following declaration:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, 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 they haven'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 gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information 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 later because the law requires that you use the IRC administrative process first (IRC Section 7428(b)(2)).

Where to send your protest

Send your protest, Form 2848, if applicable, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Mail Stop 6403
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Mail Stop 6403
Cincinnati, OH 45202

You can also fax your protest 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 they received it.

You can get the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

Contacting the Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or if you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

Sincerely,

Stephen A. Martin
Director, Exempt Organizations
Rulings and Agreements