

**Down Payment Assistance Programs
Questions and Answers
August 29, 2011**

1. What is a down payment assistance program operated by a tax-exempt organization?

Traditionally, down payment assistance programs operated by tax-exempt organizations provided cash assistance to low income homebuyers who could not afford to make the minimum down payment or pay the closing costs involved in obtaining a mortgage. Funds for these programs came from government agencies or from a charitable organization's public funds.

2. Why is the IRS focusing on down payment assistance programs?

Increasingly, the IRS has found that organizations claiming to be charities are being used to funnel down payment assistance from sellers to buyers through self-serving, circular-financing arrangements (seller-funded programs). Typically, there is a direct correlation between the amount of down payment assistance provided to the buyer and the payment received from the seller. Moreover, the seller pays the organization only if the sale closes, and the organization usually charges an additional fee for its services.

Seller-funded programs are operated to benefit sellers who participate. Thus, such organizations are not operated exclusively for an exempt purpose, a requirement of tax-exemption under section 501(c)(3) of the Internal Revenue Code.

3. How does an exempt organization's seller-funded down payment assistance program generally work?

The charitable organization provides the purchaser's down payment funds to the escrow/closing agent before settlement. At closing, the down payment assistance amount is deducted from the seller's proceeds and remitted to the organization. Usually, the seller pays a service fee to the organization. If the property is not sold, the seller is not obligated to make any down payment assistance payments and some organizations refund the service fee.

4. Doesn't a seller-funded down payment assistance program facilitate the ability of low-income individuals and families to purchase affordable housing, and therefore further the exempt purposes of a tax-exempt organization that sponsors the program?

A March 2005 report entitled *An Examination of Downpayment Gift Programs Administered By Non-Profit Organizations*, commissioned by the U.S. Department of Housing and Urban Development (HUD), found that seller-funded

down payment assistance has led to underwriting problems and resulted in an increase in the effective cost of homeownership. A report from November 2005 entitled *Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance*, conducted by the U.S. Government Accounting Office (GAO), found similar results.

Moreover, because the service fees generated by property sales keep seller-funded down payment assistance organizations financially viable, these organizations may be more interested in closing sales of property to generate service fees than they are in taking responsible steps to ensure that buyers acquire safe, decent, sanitary and affordable housing.

5. What is the IRS doing to stop abuses involving down payment assistance programs sponsored by exempt organizations?

On May 4, 2006, the IRS issued [Revenue Ruling 2006-27](#), which details the criteria under which organizations providing down payment assistance qualify for tax exemption under section 501(c)(3) of the Internal Revenue Code, and explains why seller-financed down payment assistance will have a negative effect on tax-exempt status. In addition, we are examining down payment assistance organizations, and we are scrutinizing applications for tax-exempt status to ensure that applicants are not operating seller-funded programs.

Interested parties can verify an organization's tax-exempt status using the on-line database at IRS.gov (click on [Charities & Non-Profits](#) and then click on [Search for Charities](#)). The on-line database also provides a list of organizations [whose exemption determination the IRS has recently revoked](#).

6. Has the IRS issued any guidance on the criteria for exemption, under section 501(c)(3), of organizations that sponsor down payment assistance programs?

[Revenue Ruling 2006-27](#) provides guidance to organizations applying for tax exemption and those exempt under section 501(c)(3) that provide down payment assistance to homebuyers. The ruling affirms that down payment assistance programs that are not seller-funded can further exempt purpose by assisting low-income home buyers or by combating community deterioration. The ruling makes it clear that organizations providing seller-funded down payment assistance will not qualify for exemption. The ruling also describes the tax treatment of down payment assistance to buyers for purposes of the exclusion from gross income as a gift under Code section 102 or inclusion in the home's basis under section 1012.

7. How does Revenue Ruling 2006-27 affect seller-funded down payment assistance programs sponsored by tax-exempt organizations?

[Revenue Ruling 2006-27](#) states that organizations operating seller-funded programs do not meet the legal requirements for tax exemption under section 501(c)(3). Because the ruling is a statement of current law, it will apply to any tax period for which the statute of limitations is open.

8. Is down payment assistance provided under a program sponsored by a tax-exempt organization includable in the homebuyer's income?

Generally, down payment assistance will not be included in the homebuyer's gross income for federal income tax purposes. However, if the buyer receives down payment assistance from a seller-funded program, the homebuyer must reduce the cost basis of the home because the down payment assistance represents a rebate or reduction in the purchase price thus lowering the homebuyer's cost basis under IRC section 1012.