



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
TE/GE Division

September 14, 2006

Release Number: **200732020**

Release Date: 8/10/2007

UIL: 501.03-01

ORG

Taxpayer Identification Number:

Form:  
990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, 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. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

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, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)  
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

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:

Internal Revenue Service  
Office of the Taxpayer Advocate

Phone

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,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

January 17, 2007

Legend:  
ORG= Name of Organization  
NUM= EIN Number  
Date1 = Effective Date  
Date2= Year end after effective date

UIL: 501.03-01

ORG

Person to Contact:  
Identification Number:  
Contact Telephone Number:  
In Reply Refer to:  
EIN: NUM

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT: \_\_\_\_\_

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c) (3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c) (3) of the code is hereby revoked effective Date1

Our adverse determination was made for the following reasons:

A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated primarily to further your insiders' business interests. Therefore, you are operated for a substantial nonexempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c) (3).

You failed to meet the requirements of IRC section 501(c) (3) and Treas. Reg. section 1.501(c) (3) -1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for the benefit of private interests and a part of your net earnings inured to the benefit of outsiders, your founder and board members...

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending Date2 and for all years thereafter.

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling (410) 962-2082, or writing to: , Taxpayer Advocates Office,

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax 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.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Marsha A. Ramirez  
Director, EO Examinations

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> ORG		<b>Year/Period Ended</b> Date2

**Legend:**

ORG= Name of Organization

Bank=Name of Bank

NUM= EIN Number

Office=Address

Date1 = Effective Date

Date2= Year end after effective date

**ISSUE**

1. Whether an organization, whose primary purpose is operating a "down-payment assistance" programs is operated exclusively for charitable purposes within the meaning of IRC 501(c)(3)?

**FACTS**

**Overview**

ORG is a not-for-profit corporation incorporated on xx/xx/xx. Ms. Officer is ORG's Initial Incorporator, President, Executive Director, and Acting Secretary. The corporation is formed under the nonprofit laws specifically for the purpose of providing charitable cash assistance in the forms of grants to qualified home purchasers for down payment, closing cost, or debt repayment in order to for them to complete a home purchase transaction.

**Application for Recognition of Tax-Exempt Status**

The organization filed Form 1023, Application for Recognition of Exemption, in xx/xx/xx. In Part II of the application, ORG described in past, present and planned activities as follows:

1. a) ORG is a public service charity formed for the sole purpose of promoting affordable housing in America. The majority of our time, approximately 70%, is devoted to offering grants to qualified home buyers who demonstrate financial need and to identify worthy grant recipients.
- b) The program will start operations on XX/01/xx It is anticipated that the first grant will be made during the month of xx/01/xx.
- c) The program will be administered initially from our headquarters at Address by the executive director, Ms. Officer and hired assistance.
- d) In order to fund the program, ORG will seek donations and cash contributions from people engaged in the real estate industry, home builders, real estate brokers, mortgage lenders, title attorneys, and agents, closing/escrow companies as well as property owners and home sellers. We anticipate that approximately 30% of our time will be spent engaged in fundraising activities.
- e) To qualify for a grant, the home buyer must complete, demonstrate financial need based upon disclosure of income and assets, must

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otherwise he qualified for a mortgage and must purchase a home enrolled in the program.

2. The organization listed its source of support as follows:

97% - donations and contributions  
3% - other fundraising activities

3. The organization described its fundraising activities as follows:

It is planned that we will seek donations and contributions from members of the real estate industry, home sellers and property owners by contacting them through direct sales and direct mail media. No marketing materials have yet been designed for this purpose.

Additionally, on xx/xx/xx, the IRS sent a letter to the organization stating that based on the facts and applicable law, ORG may not qualify under § 501(c)(3) of the Code because:

"ORG's primary source of income will be the performance of service to persons attempting to market their homes in exchange for a fee comprised of a percentage of the final sales price." The organization's final response dated November 7, 2001 stated, "Based upon our discussion and my further examination of the Code, I have amended our program to restrict fundraising activities to solicitation of charitable contributions and cash donations only. Service fees will not be charged to any participant in the program. We will seek contributions to fund our program from members of the real estate industry and from real property owners."

On XX/xx/xx, based on the information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized, as of date1, as a tax-exempt organization as described in § 501(c)(3). The organization was given an advanced ruling period from date1 ending on date2. The advanced ruling follow up letter 1050 was dated xx/xx/xx declaring ORG's Public Charity Status as a §170(b)(1)(a)(vi).

In 2003 ORG promoted and operated a down payment assistance (DPA) program for house buyers under which it provides funds to the buyers to use as their down payment or for closing costs and collects the same amount, plus an additional fee, from the house sellers. Under ORG's program down payment assistance is opened to anyone who qualifies for a FHA loan.

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**Federal Returns**

ORG filed Form 990 for the calendar years ended December 31, xxxx. It was not required to file and did not file Forms 990-T. ORG was also required to file and did not file Forms 941. In 2003 ORG's only reported activity consisted of operating its DPA program as described in more detail below.

According to Part III of ORG's 2003 Form 990 "The organization was able to provide down payment assistance to 79 home buyers during xxxx. The average amount of assistance was almost 4,200." In xxxx ORG received \_\_\_\_\_ in gross revenue from amounts paid to it by sellers participating in ORG's DPA program. ORG reported the seller's payments as contributions instead reporting these payments as program service revenue. ORG also reported that it distributed \_\_\_\_\_ in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs.

**Operation of ORG's Down Payment Assistance Program**

According to its website visited on :

*ORG was organized with the purpose of offering grants to low and moderate income homebuyers who may not otherwise have the necessary cash to afford a home purchase.*

*The ORG, is a down payment assistance program designed not only for first time buyers, but also for move-up buyers who may not have sufficient equity or savings to afford the "move-up" purchase.*

*ORG was formed in response to the President's directive to make home ownership available to all Americans. Professionals from various areas of real estate, business and education organized the charity for purposes of advancing home ownership and community revitalization across the nation. Contributions obtained from property owners, builders, developers and various segments of the real estate profession fund the program.*

ORG, through its website (note: website is no longer active), promoted its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, buyers, and sellers. Many of the participants in ORG's DPA program utilize Federal Housing Administration (FHA) financing for their home purchase. To qualify for a federally insured mortgage, a buyer must make a down payment in a specified minimum amount, generally equal to 3% of the purchase price. To qualify under applicable Department of Housing and Urban Development (HUD) rules, such a

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buyer may only receive gifts to use for the down payment from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The seller cannot loan money to the buyer for the down payment.

The ORG website explained how the down payment assistance program works as follows:

1) ORG provides a cash gift to the Home Buyer for their downpayment (once the mortgage loan application has been approved and prior to closing).

2) The Seller makes a contribution back to ORG from the proceeds of sales to replenish the funds ORG used to provide the gift to their Buyer.

Why does this work? Because mortgage lenders do not allow the seller to make a direct contribution to the Buyer to pay for their downpayment. Lenders only allow the Seller to pay for the Buyer's closing costs.

The Buyer is allowed to obtain a gift, however, to satisfy the funds needed for downpayment. The gift can come from only three possible sources: an immediate relative, an employer, or a Non-Profit public service charity--like ORG!

If the home buyer qualifies for a mortgage loan that permits gifts from a non-profit group as an acceptable source of funds, then ORG will provide the grant. The gift is Paperwork is minimal. It's very fast, too. Gifts can be obtained within 48 hours from the time we receive the request. ORG will continue as long as funding remains available.

The organization was approved an advanced line of credit for with Bank. The buyers were sent to ORG by real estate agents after a home buyer was approved to receive an FHA loan. ORG would have the homes appraised by FHA approved appraisers. The appraisers would raise the sale price of the house by . The organization would make a payment of as a gift to the home buyer. The Seller was required to make a specific contribution to ORG by agreeing to sign a Home Enrolment Agreement. The specific contribution was of the final sales price of the enrolled property or a flat fee of .

Through ORG's DPA program, buyers receive a "gift" of the funds that they use for the down payment. A house buyer was eligible to participate in ORG's DPA program only if the buyer purchased a home from a seller that agreed to ORG's contractual terms. ORG and sellers entered into agreements that required sellers to pay ORG an amount equal to the down payment "gift" that the buyer received under ORG's DPA program. ORG claimed that the seller's payment was not provided directly to the buyer,

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but instead it was used to "replenish" the pool of funds that was used to provide "gifts" to subsequent buyers. In addition to requiring the seller to pay an amount equal the amount of the "gift" provided to the house buyer, ORG required sellers to pay ORG an "administrative fee," typically equal to either of the purchase price or a set amount (e.g., ).

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. ORG provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller's home.

ORG does not have any other source of funds other than "contributions" from sellers and related fees. Because the amount of the "contributions" were directly related to the amount of the down payment assistance provided to the buyers plus the service fee, the actual source of the down payment assistance is the seller's "contribution."

#### **LAW & ARGUMENT**

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual. See § 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an

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organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) defines the term "charitable" for § 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education. Id.

Section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" for § 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.), the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under § 501(c)(3). The court concluded that the organization did not qualify for exemption under § 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman's child sponsored the care financially.

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Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of § 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of § 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the organization's activity was to benefit disadvantaged communities. The organization's commercial

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activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in § 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

See also, Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Rev. Rul. 2006-27, discussed three situations of organizations providing financial help to low-income home buyers and whether each qualified as charitable within the meaning of § 501(c)(3).

Situation 1 described an organization (x) formed to help low-income families purchase decent, safe and sanitary homes throughout the metropolitan area in which x was located. x made assistance available exclusively to low-income individuals and families to provide all or part of the funds they need to make a down payment on the purchase of a home. X used standards set by Federal housing statutes and administered by HUD to determine who is low-income. x offered financial counseling seminars and

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conducted other educational activities to help prepare the potential low-income home buyers for the responsibility of home ownership. x would require a home inspection report for the property that the applicant intended to buy to ensure the house is habitable before making the grant. To fund its down payment assistance program and other activities, x conducted a broad based fundraising program that attracted gifts, grants, and contributions from several foundations, businesses and the general public. X's staff did not know the identity of the party selling the home to the grant applicant or identities of any other parties such as real estate agents, or developers, who may have received a financial benefit from the sale. Further, x did not accept any contributions contingent on the sale of a particular property or properties. The revenue ruling held that by providing financial assistance to low-income families for the down payment on a home, the organization relieved the poor and distressed.

Situation 2 Y is a nonprofit corporation that is like X in all respects as set forth in Situation 1, except as follows. Under Y's grant making procedures, Y's staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which Y provides down payment assistance to a home buyer, Y receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by Y in connection with each of these transactions and the amount of the home seller's payment to Y. Finally, Y does not conduct a broad based fundraising campaign to attract financial support. Rather, most of Y's support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive Y's down payment assistance. Y's reliance on the seller's payments for most of its funding indicate that the benefit to the home seller is a critical aspect of Y's operations. In this respect, Y is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose. Y does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

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Situation 3 Z is a nonprofit corporation formed to combat community deterioration in an economically depressed area that has suffered a major loss of population and jobs. Studies have shown that the average income in the area is below the median level for the State. Z cooperates with government agencies and community groups to develop an overall plan to attract new businesses to the area and to provide stable sources of decent, safe and sanitary housing for the area residents without relocating them outside the area. As part of the renewal project, Z receives funding from government agencies to build affordable housing units for sale to low and moderate-income families. As a substantial part of its activities, Z makes down payment assistance available to eligible home buyers who wish to purchase the newly-constructed units from Z. Z also offers financial counseling seminars and conducts other educational activities to help prepare potential low and moderate-income home buyers for the responsibility of home ownership.

To fund its down payment assistance program and other activities, Z conducts a broad based fundraising program that attracts gifts, grants and contributions from several foundations, businesses and the general public.

In Situation 3, although Z does not limit its down payment assistance program to low-income recipients, Z's down payment assistance program still serves a charitable purpose described in § 501(c)(3) because it combats community deterioration in a specific, economically depressed area that has suffered a major loss of population and jobs. Z is operated exclusively for charitable purposes, Z qualifies for exemption from federal taxation as an organization described in § 501(c)(3).

Down payment assistance payments for home buyers in Situations 1 and 3 are made by those organizations out of a detached and disinterested generosity and from charitable or like impulse, rather than to fulfill any moral or legal duty, and thus qualify for exclusion from such home buyers' gross incomes as "gifts" under § 102.

In Situation 2, in substantially all of the cases in which Y provides down payment assistance to a home buyer, Y receives a payment from the home seller that directly correlates to the amount of the down payment assistance Y provides to the home buyer. In those cases, the payments received by the home buyers do not qualify for exclusion from gross income as gifts under § 102.

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Unlike in Situations 1 and 3, in Situation 2, the down payment assistance received by those home buyers represents a rebate or purchase price reduction. As a rebate or purchase price reduction, the down payment assistance is not includible in a home buyer's gross income under § 61 and the amount of the down payment assistance is not included in the home buyer's cost basis under § 1012, as adjusted under § 1016.

Rev. Rul. 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. In Rev. Rul. 67-138, the organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities

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were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of § 501(c)(3).

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate income families with a preference given to residents of the area. The revenue ruling held that the organization was described in § 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under § 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of § 501(c)(3) and the regulations.

#### Benefiting Private Interests

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of § 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Reg. § 1.501(c)(3)-1(d)(1).

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under § 501(c)(3) because it gave preference to employees of business operated by the individual who also controlled the organization. The ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

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In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 1998 U.S. App. LEXIS 27982 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under § 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

An organization does not serve a public rather than a private interest within the meaning of Reg. 1.501(c)(3)-1(d)(1) if any of its assets or earnings inure to the benefit of any insiders (or disqualified persons). Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Inurement is any transfer of charitable assets to the organization's insiders for which the organization does not receive adequate consideration. Inurement can take many forms.

Generally, to be deductible as a charitable contribution under § 170, a transfer to a charitable organization must be a contribution or gift. A charitable contribution is a transfer of money or property without receipt of adequate

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consideration, made with charitable intent. United States v. American Bar Endowment, 477 U.S. 105, 117-18 (1986). A payment generally cannot be a charitable contribution if the payor expects a substantial benefit in return. American Bar Endowment at 116-117; see also Singer Co. v. U.S., 449 F. 2d 413, 423 (Ct. Cl. 1971). Substantial benefits are those that are greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely incidental to the transfer). Singer at 423.

Section 102 provides that the value of property acquired by gift is excluded from gross income. A gift "proceeds from a 'detached and disinterested generosity,' ... 'out of affection, respect, admiration, charity or like impulses.'" Commissioner v. Duberstein, 363 U.S. 278, 285 (1960). Payments that proceed from "the constraining force of any moral or legal duty," or from " ... 'the incentive of anticipated benefit' of an economic nature," are not gifts. Duberstein, 363 U.S. at 285. Thus, payments attendant to ordinary business or commercial transactions, or that proceed primarily from the moral or legal obligations attendant to such transactions, are not gifts.

Effective date of revocation

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. § 1.501(a)-1(a)(2); Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, § 13.02, 1990-1 C.B. 514.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 et seq.).

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### ANALYSIS

ORG does not qualify as an organization described in I.R.C. § 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), (2) provides substantial private benefit to persons who do not belong to a charitable class, the home sellers.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. ORG's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in ORG's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. Real estate professionals who participate in ORG's DPA program, from real estate brokers to escrow companies, benefit from increased sales volume and the attendant increase in their compensation. It is evident from the foregoing that ORG's DPA program provides ample private benefit to the various parties in each home sale.

ORG's down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, ORG relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. ORG does not receive funds from any other sources.

ORG requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of

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several hundred dollars per home sale. ORG secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless ORG is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. ORG's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of ORG's operations. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. ORG provided services to home sellers for which it charged a market rate fee. ORG did not receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy, supra, and Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.) a substantial part of ORG's activities furthered commercial rather than exempt purposes.

Based on the foregoing, ORG has not operated exclusively for exempt purposes, and, accordingly, is not entitled to exemption under § 501(c)(3).

A seller's payment to ORG is not tax deductible as a charitable contribution under § 170 because the seller receives valuable consideration in return for the payment. In addition, the seller's payment to ORG is not tax deductible to the seller because the payment is compulsory. Furthermore, the payments from the home sellers to ORG also do not qualify as gifts under § 102. The payments from the home sellers do not proceed from detached and disinterested generosity but, rather, in response to an anticipated economic benefit, namely facilitating the sale of the seller's home. Under Commissioner v. Duberstein, 363 U.S. 278 (1960), such payments are not gifts for purposes of § 102.

The government proposes revoking ORG's exemption back to 2003 because the organization operated in a manner materially

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different from that represented in its application for exemption. In its application for exemption signed under penalties of perjury on date1, ORG represented that 97% of the organization's financial support would be derived from donations and contributions. Despite these representations in its application for exemption, ORG did not receive any donations. All of the organization's income was derived from the 3.75% fees required of the seller to pay. ORG's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of ORG's determination letter.

**Conclusion:**

In order to qualify for exemption under IRC § 501(c)(3) an organization must be both organized and operated to achieve a purpose that is described under that Code section. ORG's DPA program is not operated in accordance with Internal Revenue Code § 501(c)(3) and the regulations thereunder governing qualification for tax exemption under Code. ORG provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home.

ORG operates in a manner indistinguishable from a commercial enterprise. ORG's primary activity is brokering transactions to facilitate the selling of homes. ORG's primary goal is to maximize the fees from these transactions. ORG does not engage in any counseling or other activities that further charitable purposes. Because ORG's primary activity is not conducted in a manner designed to further § 501(c)(3) purposes, ORG is not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in 2003, ORG operated in a manner materially different from that represented in its Form 1023 application the government proposes that the revocation be effective retroactively to the year under audit date2.

**Taxpayer's Position**

ORG's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown.