



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

3730 Elizabeth Avenue

Independence, MO 64057

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: 200743034

Release Date: 10/26/07

Date: May, 11, 2007

A= Organization  
NUM = Employer ID Number  
Date 1 = Tax Year Ended  
Date 2 = Specific Date  
Y = Year(s)  
TAN = Taxpayer's Advocates Number  
TA = Taxpayer's Advocates Address

Person To Contact:  
Identification Number:  
Contact Telephone Number:

Form: 990

Tax Year Ended: Date 1

In Reply Refer to: TE/GE Review Staff

EIN: NUM

UIL: 501.03-01

A

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

Dear :

This is a Final Adverse Determination as to the exempt status of A under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

A has not been operating exclusively for exempt purposes within the meaning of I.R.C. §501(c)(3) and Tres. Reg. §1.501(c)(3)-1(d). It is not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. It has been operating substantially for a non-exempt purpose and its earnings inure to the benefit of private individuals.

Based upon these reasons, we are retroactively revoking A IRC §501(c)(3) tax exempt status for all years beginning on or after Date 2.

Contributions to your organization are no longer deductible under IRC §170.

A is required to file Form 1120, U.S. Corporation Income Tax Return, for the years ended Date 2 through Y with the appropriate Service Center immediately and by the due date of Form 1120 for all subsequent years. Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under §7428.

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 Claims Court or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date that this determination was mailed to

you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment by referring to the enclosed Publication 892.

You 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 TAN or writing to:

Internal Revenue Service  
Taxpayer Advocates Office  
TA

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.

We will notify the appropriate state officials of this action, as required by IRC §6104(c).

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter.

Sincerely,

Lois Lerner  
Director, Exempt Organizations

Enclosure: Publication 892

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer A	Tax Identification Number NUM	Year/Period Ended Date 1

A = Organization  
 C = Company Name  
 L = Location  
 S = State  
 X = Type of Activity  
 Y = Year(s)  
 AP = Accounting Period  
 CC = City  
 Date 1 = Tax Year Ended  
 Date 2 = Specific Date  
 NUM = Employer ID Number  
 \* = Dollar Amounts

### ISSUE

Whether the A operated exclusively for tax exempt purposes within meaning of Internal Revenue Code § 501(c)(3)?

### FACTS

#### Overview

The A is a S not-for-profit corporation.

On Date 2, based on information that the A provided in its application Form 1023 for tax exemption and on the assumption that the A would operate in the manner represented in its application, the A was recognized as a tax-exempt organization as described in § 501(c)(3).

The organization's charitable purpose is to combat community deterioration within the meaning of Revenue Procedure 96-32, section 6.01(1), Revenue Ruling 68-17, Revenue Ruling 68-655, Revenue Ruling 70-585 and Revenue Ruling 76-147. The A's down payment assistance (DPA) activities targeted neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination. The corporation planned to relieve and prevent community deterioration through the renewal and rehabilitation of homes located in Housing and Urban Development's (HUD) revitalization area and other areas. The other areas are defined as areas with actual or potential deterioration that shows signs of significant concentration of vacant properties (including properties needing extensive repairs) and exhibiting other characteristics of economic distress.

A's down payment assistance program's primary purpose is to provide homeownership opportunities to purchasers determined to be low and moderate income individuals (those whose income is at or below 115% of the median income in the area when adjusted for family size under the federal housing program).

On Date 2, the organization received confirmation from the I.R.S. regarding continued exemption status based on the planned expansion of its DPA program. Such expansion would extend assistance to those qualified buyers outside of the A's original acquisition program under HUD. The original application provided that down payment assistance would be provided to people who purchased property from the A. Initially, the buyer applied for assistance through the A, which operated the program in conjunction with HUD guidelines. The planned expansion would include properties that were not owned by the A. Such expansion caused the A to promote and operate 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

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collects the same amount, plus an additional fee, from the house sellers. Properties could have been located anywhere as long as it was qualified property.

As of Date 2, the organization was approved by HUD in the Down Payment Assistance Program and HUD's Single Family Direct Sales Program. The A was, also, recognized by the C to perform the purchase of HUD foreclosed properties for CC. C was one of the lenders with which the A cooperated.

The A relied on annual income schedules issued by the CC to define low and moderate income households. "Qualified Homes" were homes that were located in areas that were considered "revitalized." Generally, the A purchased properties from HUD.

Currently the organization has discontinued its DPA program. The A is committed to the revitalization of the community through education and the economic empowerment of the individuals in the community it serves. It offers homeowner's education from its facilities in CC, S and hosts a X near downtown CC. Based on the anticipated increase in homes on the foreclosure market, the A foresees a return to its original purpose: to purchase and rehabilitate foreclosed properties and sell them to low and moderate income families. The A, also, intends to expand its operations to include a new project that provides shelter for paroles in an effort to assist former prisoners in a successful return to society.

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

Form 1023 was filed by the A with the IRS to apply for recognition of tax-exempt status under penalties of perjury. On Form 1023 the A stated that its purpose was to:

Provide home ownership opportunities to purchasers determined to be low and moderate income individuals, those whose income is at or below 115% of the median income in the area when adjusted for family size under the federal housing program. By this means the [A's] board of directors intend to improve the economic [well] being of such families by participating in a housing program designed to provide affordable housing and providing home ownership programs designed to provide home ownership opportunities for families that cannot otherwise afford to purchase safe and decent housing therefore combating the potential for community deterioration.

The A will achieve its goal through the purchase of single and multi-family properties from governmental, financial institutions and private parties. The A will renovate the properties and then resell them to low and moderate income families, gifting to the purchasers all or a portion of the down payment and closing cost. A gift through a grant from A will cover a large portion of the Buyer's down payment and closing costs required to purchase a participating home. The corporation will provide gift funds not to exceed FHA's allowed gift funds. In selecting grantees, the corporation will not discriminate on the basis of race, color, creed, religion, sex, handicap, familial status or national origin.

More specifically, the A plans to participate in the Single Family Property Disposition Program. The Regulations provide that the purpose of the program is "to reduce the inventory of HUD acquired properties in a manner than expands home ownership opportunities [and] strengthens neighborhoods and communities."

The A also plans to explore other ways of creating home ownership opportunities for Low and Moderate Income families. For example, the A will seek other sources of single family and multi-family properties suitable for re-habilitation and grants for down payment and closing costs assistance. The A will re-sell all of the homes it rehabilitates only to low and moderate

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income individuals and at a price which will limit its profit to no more than ten percent of the Net Development Costs and which will include the gifting of all or a portion of the down payment and closing cost to buyers.

Regarding income limits and financial need, the application stated that:

The down payment assistance will be provided only to individuals who demonstrate a financial need for such services, and who qualify for a home loan.

Regarding fundraising and contributions, the A's application for exemption stated that financial support will be as follows:

- 1) Net profits from the sale of homes pursuant to the program
- 2) Net profits from the sales of homes not within the program; grants from profit corporations and from grant making charitable organizations
- 3) Grants from property owners in areas of economic distress
- 4) Contributions from board members and the general public

### **Federal Returns**

The A filed Forms 990 for the AP ended Y, Y, Y; it was not required to file and did not file Forms 990-T. The A also filed Forms 940 and 941.

In Date 2 the A's only reported activity consisted of operating its DPA program as described in more detail below. Losses were recognized for other revenue generating activities, including real estate sales, equipment sales and gross rents. As provided by the A, rental loss was recognized because the organization subleases its facilities to two other businesses to minimize its costs. Although income was generated, the organization has recognized more costs than revenue generated from subleasing the property. Additionally, the organization recognized a loss on the sale of real estate from one property that suffered a major loss.

According to Part III of the A's Y Form 990 "[the A issued] grants of \$\* to eighty-five low and moderate income individuals to enable them to become first-time home buyers.

In Y, the A received \$\* in gross revenue, mainly from amounts paid to it by sellers participating in A's DPA program. The A's Form 990, Part IV, line 73 shows that as of Date 2 the A had total unrestricted/net assets of \$\*.

### **Operation of A's Down Payment Assistance Program**

The A's DPA program required that a buyer makes a cash investment equal to 1% of the purchase price or demonstrates the ability to make such investment. The A's DPA program requires that buyers qualify under a single family mortgage loan product that permits charitable organizations to provide gift funds towards a buyer's down payment and closing costs. To qualify under applicable Department of Housing and Urban Development (HUD) rules, such 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.

Escrow companies [must] coordinate the down payment assistance process. A will only fund to escrows.

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The down payment assistance program works as follows.

1. Escrow submits completed forms via fax to A
  - a. Request for Gift Funds Form
  - b. Seller Application
  - c. Homebuyer Form
  - d. Sellers Estimated closing statement
2. A will fax Irrevocable Escrow Instructions to escrow holder for escrow officer to acknowledge receipt and acceptance of the instructions.
3. Escrow holder returns instructions to A by both fax and original forms with package upon closing.
4. Upon receipt of all faxed items, A will deliver funds to escrow holder.
5. Escrow companies are responsible for payment of seller's service fee to A no later than three (3) business days following close of escrow.
6. Escrow companies deliver the following documents and fees to A
  - a. Fully executed A documents (original signatures) and Settlement Statement
  - b. The Administrative Service fee indicated on Escrow Instructions

Through the A's DPA program, buyers receive a "gift" of the funds that they use for the down payment. The seller agrees to pay for the cost of repairs required by the lender, if any, in order to satisfy the appraisal inspection report. The seller, also, agrees to accept the buyer's terms for financing utilizing an eligible program that accepts charitable funds from the A. By signing the application form, the seller consents to making a contribution to the A in the amount equal to 2% of the sales price or the A gift amount (which ever is greater) in addition to a \$\* processing fee.

The A declares that they are aware of Revenue Ruling 2006-27 and has taken the required preventive steps to mitigate any compliance issues and conduct its business practices in strict accordance with all regulatory agencies governing the foundation. The A claims that funding of the gift came from a pre-existing pool of funds, and that such funds are earned in performance of A's other activities. However, in essence, these transactions result in a circular flow of the money. The sellers make payments to the A. The A provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller's home.

Despite the representations in its application for exemption, the A does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The records provided by the A did not include data on the buyers' incomes and gave no indication that the A screened on such data. Rather, the A's program provided "gifts" to any homebuyers who qualified for a loan. The references below (to the A's Homebuyer Form) clearly demonstrate that the organization did not require any information from the buyer that indicated that income limitations were monitored.

The A's Homebuyer Form provided that:

- 1) The participating lender has requirements that must be met in order for the homebuyer to be approved to receive a gift in the amount indicated on A's gift letter/escrow instructions to assist in the purchase of the new home.

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- 2) The gift will be made provided that the transaction closes and that the funds are used in compliance with all applicable government regulations.
- 3) The seller of the subject property agrees to pay for the cost of repairs required by the lender in order to satisfy the appraisal inspection report. A does not guarantee or offer any warranties on the seller's property and will not be liable for any problems after the closing of the escrow.

The A relied on the lenders to ensure that home buyers qualified as low or moderate income individuals. Such lenders were aware of the A's policies and were expected to offer the program only to qualified buyers. The A chose to discontinue operation of its DPA program at the end of Y when the real estate market sky-rocketed. Home prices became far too high for buyers who fit into the "low and moderate income" category to qualify for assistance.

In Y, there existed no evidence that the A solicited any outside public contributions or had any other source of funds other than "contributions" from sellers and related fees. Because the amount of the "contribution" is always equal to the amount of the down payment assistance provided to the buyer plus the service fee, in fact the actual source of the down payment assistance is the seller's "contribution."

The parties to the down payment assisted real estate transactions, including the realtors and lenders, benefited more than incidentally from the A's operations. The references below, from the A program guidelines, clearly demonstrate this benefit.

**Sellers** The Seller agreement is an agreement wherein the Seller or Homebuilder agrees to take the appropriate steps to qualify the home for participating in the A. Under the Seller Application, the Seller agrees to the following:

- 1) The Seller agrees to accept the buyer's terms for financing utilizing an eligible loan program that accepts charitable gifts from A.
- 2) The Seller agrees to pay for the costs of repair required by the lender, if any, in order to satisfy the appraisal inspection report. If the Seller determines that the costs of repairs are more than acceptable to the Seller, the Seller may disqualify the home from participation in the A Program at no cost or penalty to the Seller.
- 3) The Seller agrees to deliver or cause to be delivered the real estate purchase contract and receipt for deposit to an escrow office.
- 4) The Seller agrees to make a contribution to the A in the amount specified in the Seller Application Form.
- 5) Seller should discuss with their real estate agent how using the A can assist in obtaining a full price offer on the home that can offset the costs of participating in the A purchases Seller's home. The contribution fee is paid at closing from the proceeds of sale.
- 6) The Seller agrees to instruct and authorize the escrow officer or closing agent to return A's funds to A if the buyer is unsuccessful in obtaining a loan or the loan does not close within three (3) days after A's down payment gift assistance funds are deposited to escrow or with the closing agent. Seller understands that they are not obligated to make the contribution if the escrow/closing is terminated.

Note: A **Participating Home** is a home owned by a seller who is willing to enter into agreement with A. The seller agrees to satisfy lender's requirements with respect to the condition of the property at the time of the sale to a A assisted buyer. Upon the sale of the property, the seller will make a contribution to A for A's efforts in promoting affordable housing to low and moderate income buyers. A Participating Home may be an existing home or a new home offered by a homebuilder.

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A Participating Home is a home owned by a seller who has entered into agreement with A. The seller of the property must sign the A Seller Application Form to satisfy this requirement.

A does not provide the seller for professional real estate services in exchange for contributions. Contributions are made to A for the sole and express purpose of assisting A to continue its charitable purpose of promoting affordable housing and homeownership.

A **Home Inspection** gives the buyer an impartial, physical evaluation of the structural components, exterior, roofing, plumbing, electrical, heating, insulation and ventilation, air conditioning, and interiors of the home.

A does not guarantee or offer warranties on the seller's property and will not be liable for any problems after the closing of the escrow.

**Real Estate Agent** The A Program is for use by any licensed real estate agent in good standing with his/her state-licensing agency.

**The Escrow Officer** The Escrow Office is responsible for ensuring that items set forth on the Request for Gift Funds Form are forwarded to A, that the gift funds have been received from A and applied towards the Buyer's home purchase, and for collecting and disbursing the seller's contribution to A.

Escrow office ensures that A have received all documents set forth on the Request for Gift Funds Form. Priority gift funds distribution is based on receipt of complete and correct documentation accompanying a RGF Form. Upon receipt of a completed RGF Package, A will verify the information and then forward the Irrevocable Escrow Instructions to the Escrow. In addition, the Escrow Office is responsible for ensuring that the gift funds have been received from A and applied toward the Buyer's home purchase, and that the Sellers paid contribution to A has been remitted to A and that the Seller paid processing fee is remitted to A.

The Lender, Real Estate Agent, Buyer and Seller must ensure that documentation has been provided to the Escrow Office for delivery to A. Once all closing requirements have been met, A will deliver funds to Escrow Office on behalf of the qualified buyer.

A will also submit Irrevocable Escrow Instructions for payment of its contributions from the seller based upon the Seller Form. The Escrow Officer must deliver the payment of the seller's contribution based on the Signed Seller Form to A after closing.

**Lenders** The A program is for use by any Eligible Loan Program. Buyers must qualify under a single-family mortgage loan product that permits charitable organizations to provide gift funds toward a buyer's down payment and closing costs.

**Homeownership Education** The home ownership education course is not a requirement for funding; however, A encourages borrowers to take a Home Ownership Education Course, which is available at the C at L in CC, S. HUD-approved housing counseling agencies may approve Home Ownership Education Courses to borrowers to reduce the up front MIP premium.

## LAW

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).

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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 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.

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. 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

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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 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. 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

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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 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.

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.

Rev. Rul. 2006-27 sets forth the applicable rules and standards for determining whether organizations that provide down payment assistance to home buyers qualify as tax-exempt charities. Situation 2 describes a nonprofit corporation, Y, that does not qualify for exemption under IRC section 501(c)(3). 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

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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.

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.).

**ANALYSIS**

The A 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.

Charitable purposes include combating community deterioration. See section 1.501(c)(3)-1(d)(2) of the regulations. The A's down payment assistance program does not operate in a manner that establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1. The down payment assistance program did not serve exclusively low-income persons. Despite the representations in its application for exemption, the A does not have any income limitations for participation in its DPA program. The A did not screen applicants for down payment assistance based on income. The A's records do not even include data on the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. The program is not even limited to first-time homebuyers. The A simply relies on lenders to ensure that income limitations have been met.

It appears that the A's DPA program limited assistance to certain geographic areas and targeted those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. As reported by the A, most of the organization's properties were located HUD recognized areas. Review of settlement statements provided by the escrow companies shows that the price of homes within the program were modest and did not represent extravagant properties that benefited a higher class of individuals. However, properties could have been accepted in any area as long as they met the criteria of a "qualified home." Although the ability to arrange or facilitate the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code, it appears that the organization did maintain its projects within income limitations.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer A	Tax Identification Number NUM	Year/Period Ended Date 1

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. Even if the A's DPA program were directed to exclusively low-income individuals or disadvantaged communities, the A'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), the A is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in the A'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. Buyers who participate in the A's DPA program benefit by being able to purchase a home without having to commit more of their own funds. The A's real estate professionals who participate in the A'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 the A's DPA program provides ample private benefit to the various parties in each home sale.

The manner in which the A operated its DPA program shows that the private benefit to the various participants in the A's activities was the intended outcome of the A's operations rather than a mere incident of such operations. The A'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. Sellers are instructed to discuss with their real estate agents regarding how using the A Program can assist in obtaining a full price offer on the home that can offset the costs of participating in the program. To finance its down payment assistance activities, the A relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. For the year under examination, it is apparent that the A neither solicited nor received funds from other sources.

Before providing down payment assistance, the A's grant making procedures took into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. The A required the home seller to contribute either 2 percent of the contract sales price or 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 \$\*. The A secures an agreement from the seller stipulating to this arrangement prior to the closing. The A's instructions to title and escrow companies provide that at the close of escrow the seller's service fees must be sent to the A within three (3) days. The A'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 the A's operations. In this respect, the A 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.

The manner in which the A operated its DPA program shows that the A was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect the A's operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003).

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer A	Tax Identification Number NUM	Year/Period Ended Date 1

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), the A's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. The A provided services to home sellers for which it charged a market rate fee. The A did not solicit or 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 the A's activities furthered commercial rather than exempt purposes.

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

The government proposes revoking the A's exemption back to the beginning of the year under examination, Date 2, because the organization operated in a manner that served private interests in a commercial like manner.

### 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. The A'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 the Code.

The A provided down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. Alliances were built with realtors and lenders to provide business for the mutual benefit of the participants. Because the A's primary activity was not conducted in a manner designed to further § 501(c)(3) purposes, the A was not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

Although the A has, as of current, discontinued its DPA program, its Form 1023 explicitly allows it to participate in such program and does not accurately represent its current activities for disclosure purposes as required under IRC section 6104(a) which requires that the application for tax exemption be available for public inspection.

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that in Y the A operated in a manner that served to benefit private interests as prohibited under IRC section 501(c)(3), the government proposes that the revocation be effective retroactively to Date 2.

### TAXPAYER'S POSITION

The A's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. The A will be allowed 30 days to review this report and respond with a rebuttal if considered necessary.

Note: After the 30-day letter was issued, A agreed to the proposed revocation and signed Form 6018.



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
701 B Street, Suite 902  
San Diego, CA 92101

A = Organization  
NUM = Employer ID Number  
Date 1 = Tax Year Ended  
O = Officer  
TA = Taxpayer Advocate Address  
TAN = Taxpayer Advocate Number

A

Taxpayer Identification Number:

NUM

Form:

990

Tax Year(s) Ended:

Date 1

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.

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:

TA  
TAN

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