



# DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

MC: 4911 CHI 17<sup>th</sup> Floor  
230 South Dearborn Street  
Chicago, IL 60604

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

June 6, 2008

Release Number: **200842044**

Release Date: 10/17/08

Legend

ORG = Organization name

UIL Code: 501.03-01

ORG

ADDRESS

XX = Date      Address = address

Employer Identification #

Person To Contact/ID#:

Contact Telephone Number

Fax:

## CERTIFIED MAIL LAST DATE TO FILE A PETITION IN TAX COURT

Dear      :      September 4, 20XX

This is a final adverse determination that you do not qualify for exemption from income tax under section 501(a) of the Internal Revenue Code (I.R.C.) as an organization described in I.R.C. § 501(c)(3). In addition, you do not qualify as an organization described in I.R.C. § 509(a)(1) & 170(b)(1)(a)(vi). Internal Revenue Service recognition of your status as an organization described in I.R.C. section 501(c)(3) is revoked, effective January 1, 20XX. Our adverse determination is made for the following reason(s):

A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance you rely on home seller 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).

Contributions made to you are no longer deductible as charitable contributions by donors for purposes of computing taxable income for federal income tax purposes. See Rev. Proc. 82-39 1982-2 C.B. 759, for the rules concerning the deduction of contributions made to you between January 1, 20XX and the date a public announcement, such as publication in the Internal Revenue Bulletin, is made stating that contributions to you are no longer deductible.

You are required to file income tax returns on Form 1120 for all years beginning after January 1, 20XX. Returns for the years ending December 31, 20XX, December 20XX, December 31, 20XX, and December 31, 20XX, must be filed with this office within 60

days from the date of this letter, unless a request for an extension of time is granted.  
Send such returns to the following address:

Tax returns for subsequent years are to be filed with the appropriate Campus identified in the instructions for those returns. If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in 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 rules for initiating suits for declaratory judgment. . You may write to the Tax Court at the following address:

The processing of income tax returns and assessment of any taxes due will not be delayed because a petition for declaratory judgment has been filed under I.R.C. section 7428. The last day for filing a petition for declaratory judgment is September 4, 20XX.

If you have questions about this letter, please write to the person whose name and address are shown on this letter. If you write, please attach a copy of this letter to help identify your account. Keep a copy for your records. Also, please include your telephone number and the most convenient time for us to call, so we can contact you if we need additional information.

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. Or you can contact the Taxpayer Advocate office located nearest you at the address and telephone number shown in the heading of this letter.

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 I.R.C. section 6104(c).

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Enclosures;  
Pub. 892

Fbrm <b>886-A</b> (Rev. January 1994)	<b>EXPLANATION OF ITEMS</b>	Schedule number or exhibit
Name of Organization/Taxpayer	Tax Identification Number	Year/Period ended
ORG		12/31/20XX

**LEGEND**

ORG = Organization name      XX = Date      XYZ = State      DIR-1, DIR-2 & DIR-3 = 1<sup>st</sup>, 2<sup>nd</sup> & 3<sup>rd</sup> directors      City = city      motto = motto      GP Application = GP Application  
CO-1 = 1<sup>st</sup> company

**ISSUE**

Whether ORG (ORG) is operated exclusively for exempt purposes within the meaning of Internal Revenue Code § 501(c) (3) and the Regulations thereunder?

**FACTS**

**Organizational Information:**

ORG was incorporated as a XYZ corporation on October 17, 20XX. The three directors listed in its Articles of Incorporation are DIR-1, DIR-2, and DIR-3.

On November 19, 20XX ORG applied for recognition as a tax-exempt organization under Internal Revenue Code (IRC or the Code) § 501(c) (3) on Form 1023, *Application for Recognition of Exemption Under Section 501(c) (3) of the Internal Revenue Code*. DIR-2 signed the Form 1023 as the president of ORG and described ORG's activities as follows:

- 1) (a) ORG will provide gifts ranging from two percent to five percent of the contract sales price to low and moderate income homebuyers for homes included in our program.  
(b) We will begin on September 11, 20XX.  
(c) This will be a national motto for people that are low to moderate income homebuyers. DIR-2 will implement the program from the office located in City, XYZ.

We expect this to be 47.5% of our activity and 75% of our expenditures.

- 2) (a) We will be collecting service fees for the home Seller and Builders in the amount ranging from 2.75% to 5.75% of the contract sales price for their homes to be included in this program. This will provide an on-going source of income with which to provide future gifts to low and moderate income homebuyers.  
(b) We will begin on September 11, 20XX.  
(c) This will be a national program, implemented by DIR-2 from the office in City, XYZ.

We expect this to be 47.5% of our activity and 97% of our revenue.

- 3) (a) We will be seeking charitable contributions from people working in the real estate industry like Builders, Real Estate Agents, Settlement Agents and Mortgage Brokers.  
(b) We will begin on September 11, 20XX.  
(c) This will be a small but important part of our program so that we may promote ourselves to home buyers in need of assistance.

We expect this to be 5% of our activity and 3% of our Revenue.

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The sources of financial support stated as follows:

Service fees 97%, Contributions 3%

The following individuals were listed as the governing body of ORG:

<u>Name</u>	<u>Address</u>	<u>Title</u>
DIR-2	Address	President/Executive Director
DIR-1	Address	Treasurer/Director
DIR-3	Address	Secretary/Director

The list above indicated the organization was governed by the \_\_\_\_\_ family.

On February 19, 20XX, the Internal Revenue Service (IRS), after reviewing the Form 1023, concluded that the organization's activities may not qualify for exemption under 501(c)(3) of the Code. The reason listed was as follows:

First, you indicate an important part of your operation, and your only source of income will be the performance of services to persons attempting to market their homes in exchange for a fee comprised of a percentage of the final sales price. There is no information from which it can be concluded that the services you describe will further or advance any charitable purpose. It appears the described services provide a convenience and a benefit to homeowners who are not members of a charitable class of persons. Because services you describe further no exempt purpose, and because they result in benefits to private person, you do not meet the operational test of section 501(c)(3) of the Code which requires that you operate exclusively for charitable purposes.

Secondly, you indicate another important part of your operations will be providing financial benefits to persons of low and moderate income to assist them in acquiring a home. While the providing of assistance to low income or needy individuals to enable them to acquire housing would otherwise be considered a charitable activity, providing these benefits to moderate income persons would not be deemed charitable. You have not explained how benefits you propose to provide to moderate income persons furthers a charitable purpose and you have therefore not described activities that are exclusively charitable in compliance with the requirements of section 501(c)(3) of the Code.

On March 25, 20XX, the \_\_\_\_\_ family responded to the IRS' concerns regarding qualifying for exempt status as follows:

Declaration of Compliance with Revenue Procedure 96-32:

ORG hereby agrees that for each housing project that (a) at least 75 percent of the units will be occupied by residents that qualify as low-income; and (b) either at least 20 percent of the units will be occupied by residents that also meet the very low-income limit for the area or 40 percent of the units will be occupied by residents that also do not exceed 120 percent of the area's very low-income limit. Up to 25 percent of the



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units may be provided at market rates to persons who have in excess of the low-income limit.

ORG hereby agrees that we will not require that sellers pay a fee to participate in our motto.

DIR-2, DIR-1, and DIR-3 signed the above declaration and statement.

On April 25, 20XX, the IRS recognized ORG as a tax exempt organization under Code §501(c) (3) and issued a letter to that effect.

**Operational Information:**

On September 21, 20XX, a phone conversation was held with DIR-1 about ORG's activities. DIR-1 stated that the sellers of homes provided motto to the buyers of the homes through ORG. Fees of \$ on each transaction are charged by ORG to the sellers. ORG reduced the fee to \$ during May of 20XX.

ORG reported the following financial information on its Form 990 for fiscal years ended December 31, 20XX and December 31, 20XX as follows (with percentages):

	12/31/20XX	12/31/20XX
<b>Revenue</b>		
Program Service Revenue		
Interest on Savings		
Total Revenue		
<b>Expenses</b>		
Motto		
Legal Fees		
Supplies		
Telephone		
Postage & Shipping		
Printing & Publication		
Travel		
Other		
Total Expenses		
<b>Net Income</b>		

On its Form 990 for 20XX, ORG stated in the statement of program service accomplishments:

Promote home ownership & provided down payment gifts totaling \$ to 45 low-to-moderate income homebuyers.

It is apparent that ORG's primary source of income is from home sellers and its major expenses are mottos to home buyers. Mottos to buyers of homes ranged from \$ to \$ for each transaction which ranged from 2% to 5% of the purchase price of the home. The fees collected by ORG were \$ for the year 20XX. ORG receives funds for providing motto (plus service fees) from the escrow company or the title company.

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ORG then wires the motto back to the same escrow or title company.

**Advertising materials:**

ORG's pamphlet promotes its motto (motto) program to buyers, builders, and sellers as follows:

**Buyers...**

*How We Can Help*

ORG will make buying a home possible by providing the financial assistance you need as a "GIFT" to you. The gift – up to 6% of the purchase price – can be put towards the down payment and/or closing costs for the purchase of your home.

.....  
*How You Get The Money*

For you to receive the financial gift you must purchase a home from a Seller/Builder who is willing to participate in our program. Simply complete the ORG GP Application from your lender. We will take care of the rest.

*How You Qualify*

Our program is not just for first-time homebuyers. We often assist homeowners who need our program to purchase their next home. You must first qualify for a mortgage that will allow our charitable contribution to be used as your down payment and/or closing costs. FHA mortgages do allow our financial gift to be used in the home buying process. Your lender will have the "Gift Application" for you to sign. Once the necessary paperwork is completed we will make arrangements with the Settlement/Closing Agent to have your gift funds waiting for you at the time of closing. You, the homebuyer, must also agree to return the entire gift if the home does not close.

**Seller/Builder...**

*Sell Your Home Faster and Easier...*

In today's market there is a growing need to assist buyers with what they need. By expanding the number of qualified potential homebuyers for your home will mean...

- Less Money Spent on Payments
- Less Marketing Time
- Less Advertising Costs

*How Much Does It Cost?*

Being a part of ORG "Down Payment Gift Program" will cost you less than you may think! The cost of the program equals the amount of the financial assistance the buyer needs plus \$ – it's that simple! Often times Sellers/Builders will discount the price of the home or provide free options to make the sale. There is a good chance that you will not need to "negotiate" the purchase price and/or provide free options and also participate in program.

*The benefit can be easily seen...*

Negotiated Real Estate Transaction  
List Price                      \$

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Sales Price	\$ (5% Reduction in price)
Minus Commission	\$ (7%)
Subtotal	\$
Less Closing Costs	\$ (2%)
Net Amount	\$
ORG Transaction (3% Gift)	
List Price	\$
Sales Price	\$ (Full Price)
Minus Commission	\$ (7%)
Minus Service Fee	\$ (3% + \$)
Subtotal	\$
Less Closing Costs	\$ (2%)
Net Amount	\$

*How Does It Work?*

The gift funds ORG provided to the buyer do not come from you the Seller/Builder. The gift funds we provide the buyer come from a pre-existing pool of money that we have raised. When the home closes, the service fee you provide ORG Inc. will help replenish the funds and help cover the administration costs of the program. We also receive contributions from individuals to help the pool grow. By replenishing the pool we can provide more people with the opportunity of becoming homeowners throughout the United States.

*What is The Seller's Obligation?*

You only pay the service fee if your buyer uses the "Down Payment Gift Program."

*How To Get Started*

Simply have your Real Estate agent contact us to order the Seller Enrollment Form. There is no cost to enroll your home into the program. You can then begin advertising your home as a "No Down Payment" property. Therefore, you can offer your home to a larger audience of potential buyers. With the ORG program, most Sellers/Builders are able to receive the full list price because of the larger number of qualified buyers. If you are in the process of signing a purchase agreement with a buyer that wants the financial assistance, have your Real Estate agent contact us for the suggested language to be included in the purchase agreement.

Based on the pamphlet, ORG's motto program operates as follows:

Buyers receive a "gift" of funds that are used for the down payment. House buyers are eligible to participate in the motto program when they qualify for financing from a lender.

Upon closing of escrow, the seller pays ORG service fees which equals the "gift" funds plus the \$ - \$ processing fees. In effect, the gifts of funds to the buyers directly or indirectly come from the sellers. These transactions result in a circular flow of the money with ORG as the intermediary. ORG does not have any income limitations for its motto program and does not screen applicants for motto based on income.

**Seller Enrollment Form and/or Purchase Agreement Addendum**

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The Seller Enrollment Form was required to be signed by the seller to enroll in ORG's motto program. The form contains the following language:

.....  
I the Seller enter into this agreement on DATE with ORG and agree to enroll the property indicated below into the ORG Down Payment Gift Program.

The enrolled Property is known as: ADDRESS

Seller agrees to pay a service fee (gift amount + \$) to ORG equaling \$ in consideration of the service fee, ORG agrees to include the above-mentioned property into the Down Payment Gift Program.

.....  
The Seller is only obligated to pay the service fee at the time of settlement/closing. The Seller understands that they are not under any obligation to pay the service fee if the Buyer does not purchase the enrolled home from the Seller or the Buyer does not elect to utilize the Down Payment Gift Program.

The Settlement and/or Closing Agent is instructed by the Seller to retain and forward the service fee amount as indicated above to ORG upon successful completion of the settlement/closing. The Seller instructs the Settlement and/or Closing Agent to return any funds not used by the Buyer to ORG

This agreement is contingent upon Buyer receiving a Gift (service fee - \$) in the amount of \$ from ORG at the time of closing.

Both the buyer and the seller sign and date the form.

The enrollment form also indicates that the gift received by the buyer comes, either directly or indirectly, from the seller.

### GP Application

The GP Application was required to be signed by the buyers. The application includes the following items:

Buyers' names, annual income, social security number, property address being purchased, sellers' names, sales price, closing date, loan file number, HUD ID number, seller's contribution to ORG minus servicing fee of \$ equals buyer's "gift" amount, county, mortgage company name and address, loan officer's name, phone number, and fax number, settlement company name and address, closing agent's name and phone number.

### Minutes

ORG did not provide Minutes of Board meetings. According to a phone conversation with DIR-1 on October 11, 20XX, her husband and she run the organization and make all of the decisions.

### Dissolution



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According to the phone conversation with DIR-1, she and her husband decided to dissolve the business of ORG since ORG did not have any transactions for the last six months. DIR-1 filed a Statement of Foreign Entity Withdrawal with the State of XYZ at the end of September 20XX. A foreign entity withdraws from doing business in XYZ by filing a Statement of Foreign Entity Withdrawal with the XYZ Secretary of State.

### APPLICABLE LEGAL PRINCIPLES

Section 501(c)(3) 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.

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 the Code § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) the Regulations 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) the Regulations defines the term "charitable" 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) the Regulations provides, in part, that the term "educational" 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) the Regulations provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of the Code § 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 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."

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

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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). CO-1, 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 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:



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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. 2006-27 discusses three examples of organizations providing motto and whether each qualified as an organization described in section 501(c)(3) of the Code.

Situation 1 describes X, a non-profit corporation, that helps low-income individuals and families purchase decent, safe and sanitary homes throughout the metropolitan area in which it is located. As a substantial part of its activities, X makes assistance available exclusively to low-income individuals and families to provide part or all of the funds they need to make a down payment on the purchase of a home. Individuals are eligible to receive assistance from the downpayment assistance program if they are low-income individuals, have the employment history and financial history necessary to qualify for a mortgage, and would so qualify but for the lack of a down payment. To fund its down payment assistance program and other activities, the organization conducts a broad based fundraising program that attracts gifts, grants and contributions from several foundations, businesses and the general public.

In Situation 1, X's grantmaking process is structured to ensure that its staff awarding grants does not know the identity of the party selling the home to the grant applicant or the identities of any other parties, such as real estate agents or developers, who may receive a financial benefit from the sale. The staff also does not know whether any of the interested parties to the transaction have been solicited for contributions to the organization or have made pledges or actual contributions to the organization. Further, the organization does not accept any contributions contingent on the sale of a particular property or properties.

In Situation 1, the revenue ruling held the organization qualifies for exemption because its purposes and activities relieve the poor, distressed and underprivileged by enabling low-income individuals and families to obtain decent, safe and sanitary homes. The way the organization conducts its down payment assistance program establishes that its primary purpose is to address the needs of its low-income grantees. The organization conducts a broad based fundraising program, and receives support from a wide array of sources. Their policies of ensuring that its grantmaking staff does not know the identity or contributor status of the party selling the home to the grant applicant (or any other party who may receive a financial benefit from the sale),



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and of not accepting contributions contingent on the sale of any particular properties, ensure that it is not beholden to any particular donors or other supporters whose interest may conflict with that of the low-income buyers the organization is working to help.

In 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 grantmaking 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.

In Situation 2, the revenue ruling held Y does not qualify as an organization described in § 501(c)(3). To finance its down payment assistance activities, Y relies on sellers and other real-estate related businesses that stand to benefit from the transactions Y facilitates. Furthermore, in deciding whether to provide assistance to a low-income applicant, Y's grantmaking staff knows the identity of the home seller and may also know the identities of other interested parties and is able to take into account whether the home seller or another interested party is willing to make a payment to Y. Y's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and Y's reliance on these contributions 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. Like the organization considered in American Campaign Academy, Y is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in American Campaign Academy, Easter House, and Columbia Park Recreation Association, Y also serves an exempt purpose, but because Y is not operated exclusively for exempt purposes, Y does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

In 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.



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In Situation 3, the revenue ruling held that 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. Through a combination of counseling and financial assistance, Z helps low and moderate-income families in that area to acquire decent, safe and sanitary housing and to prepare for the responsibilities of home ownership. In this respect, Z is like the organization described in Situation 3 of Rev. Rul. 70-585. Because Z is operated exclusively for charitable purposes, Z qualifies for exemption from federal taxation as an organization described in § 501(c)(3).

The revenue ruling concluded that 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. The benefits provided to the home buyers in these circumstances are sufficiently removed from the interests of any home sellers or sales agents that they proceed from a detached and disinterested generosity on the part of the donor organization, and such grants lack the indicia of a rebate, price adjustment, or *quid pro quo* incident to a sale. In Situation 2, the organization is not operated exclusively for charitable purposes, and consequently, does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

#### 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.

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

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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).

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.).

**GOVERNMENT'S POSITION:**

In order for an organization to be tax exempt it needs to demonstrate that it meets the both the organizational and the operational tests. The facts stated above indicate that ORG failed the operational test.

When ORG applied for exempt status in October 20XX the IRS initially concluded that ORG did not meet the operational test of section 501(c)(3) of the Code because the motto activities do not further an exempt purpose but, rather, provide benefits to private persons. ORG responded to the IRS' initial position with a declaration that ORG will comply with Revenue Procedure 96-32 to provide services to charitable classes and agree not to require sellers to pay a fee to participate in the motto. However, based on the examination, ORG did not operate as it stated it would.

ORG's motto 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. 2006-27, Situation 2. The motto did not serve exclusively low-income persons. ORG does not have any income limitations for participation in its motto program. The program is open to every homebuyer, without any income limitations, who otherwise qualified for financing from a lender.

ORG's motto program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 2006-27, Situation 3. Motto is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating 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.



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ORG's motto program provided a private benefit to various 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 motto 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 ORG's motto program benefit by being able to purchase a home without having to commit more of their own funds. It is evident from the foregoing that ORG's motto program provides ample private benefit to the various parties in each home sale.

The manner in which ORG operated its motto program shows that the private benefit to the various participants in ORG's activities was the intended outcome of ORG's operations. ORG's motto 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 motto activities, ORG relies exclusively on sellers. ORG neither solicits nor receives funds from other sources. ORG requires the home seller to pay it, dollar-for-dollar, for the amount of funds expended to provide motto on the seller's home, plus an administrative fee of several hundred dollars per home sale. ORG's receipt of a payment from the home seller corresponding to the amount of the motto 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 CO-1 which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

ORG's promotional material and its marketing activities show that ORG operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in § 501(c)(3). The manner in which ORG operated its motto program shows that ORG was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect ORG'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).

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 market its services primarily to persons within a charitable class. ORG 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 ORG's activities furthered commercial rather than exempt purposes.

ORG operates a program does not exclusively serve an exempt purpose described in section 501(c)(3). Therefore, the Service determines that ORG does not qualify for exemption from Federal Income Tax under section 501(c)(3), effective January 1, 20XX. ORG is liable to file corporate income tax return (Form 1120) for year 20XX and years after.

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**TAXPAYER'S POSITION:**

The taxpayer states that it provided the American dream of homeownership to low to moderate income families by providing motto. There were only out of the gifts granted to families above the median family income, which equals 11.36% of the total amount granted. The majority which equals 70.45% was given to families in the low and very low median family income range. The taxpayer provided properties' transaction documents to support the above figures.

**CONCLUSION:**

The taxpayer declared that ORG would comply with Revenue Procedure 96-32 to provide services to charitable classes and agree not to require sellers to pay a fee to participate in the motto when they applied for its exempt status in 20XX.

ORG did not comply with Revenue Procedure 96-32 for the year under examination. ORG gave motto grants, which equals 11.36% of its total grants, to families above the median family income. Therefore, ORG's motto did not serve exclusively low-income persons.

Also to finance its motto activities, ORG relies exclusively on sellers. ORG requires the home seller to pay it, dollar-for-dollar, for the amount of motto on the seller's home, plus an administrative fee. ORG's motto 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.

ORG's motto program provided a private benefit to various parties. ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in ORG's motto program benefit from achieving access to a wider pool of buyers, and 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 ORG's motto program benefit by being able to purchase a home without having to commit more of their own funds.

ORG operates a program that does not exclusively serve an exempt purpose described in section 501(c)(3) of the Code. Therefore, the Service determines that ORG does not qualify for exemption from Federal Income Tax under section 501(c) (3), effective January 1, 20XX. ORG is liable to file corporate income tax return (Form 1120) for year 20XX and years after.





TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
300 N. Los Angeles Street, MS 7300  
Los Angeles, CA 90012

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

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.

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:

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 E xaminations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination