

Internal Revenue Service
Appeals Office

Release Number: 201015044
Release Date: 4/16/10

Date: **JAN 21 2010**

UIL: 501.03-00

A
B
C

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

EO Revocation

Form Required to be Filed:

Tax Period(s) Ended:

**Last Date for Filing a Petition with
the United States Tax Court:**

APR 21 2010

Certified Mail

LEGEND:

A =

B =

C =

D =

Dear

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Recognition of your exemption under IRC Section 501(c)(3) is revoked effective April 26, 2002.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the Clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

Our adverse determination was made for the following reason:

A substantial part of your activities consists of providing down payment assistance to buyers. To finance the assistance, you rely on home sellers and other real-estate businesses that benefit from these down payment assistance transactions. This

is considered a substantial non-exempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you have failed to establish that you are operated exclusively for exempt purposes described in IRC section 501(c)(3) and Treas. Reg. Section 1.501(c)(3)-1(d).

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on form 1120 for any years which are still open under the statute of limitations. Based on the information you furnished, it appears that returns should be filed beginning with the year ending December 31, 1999. You should file any returns due for these years or later years with the Internal Revenue Service Center, Cincinnati, OH 45999-0012 (as applicable for 1120). Processing of income tax returns will not be delayed because you have filed a petition for a declaratory judgment under Code section 7428.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance, or you can contact the nearest Taxpayer Advocate office by calling (405) 297-4055 or writing to Local Taxpayer Advocate, 55 N. Robinson, Stop 1005 OKC, Oklahoma City, OK 73102. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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.

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

Sincerely,

Appeals Team Manager

cc: D



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
MC:4923CH:
230 S. Dearborn Street Room 1700
Chicago, IL 60604

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.

Letter 3618 (04-2002)
Catalog Number 34809F

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

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

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,

Vicki L. Hansen
Acting Director, EO Examination

Enclosures:
Publication 892
Publication 3498
Report of Examination

Name of Taxpayer
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Year/Period Ended
20XX12

LEGEND

ORG = Organization name XX = Date Address = address City = city
 State = state President = President Ercker = Ercker CC-1, CC-2 &
 CC-3 = 1st Company 2nd Company & 3rd Company

ISSUE:

1. Whether ORG operated exclusively for exempt purposes within meaning of I.R.C. § 501(c)(3)?

FACTS:

Overview

ORG (ORG or Organization) is a State not-for-profit corporation incorporated on October 23, 20XX. President is the Organization's Founder and President. The Organization's address is Address City, State

On October 19, 20XX ORG applied, under penalties of perjury, for recognition as an organization entitled to tax-exempt status under I.R.C. § 501(c)(3) on Form 1023 (application for exemption). On April 26, 20XX, based on the information provided in its application for exemption and in subsequent correspondence between the Organization and Internal Revenue Service (IRS) and on the assumption that ORG would operate in the manner represented in its application, the IRS recognized ORG, as of April 26, 20XX, as a tax-exempt organization as described in §501(c)(3).

The correspondence referred to above discussed ORG's intention to provide gifts to those in need of assistance for the down payment or closing costs needed to purchase a home. In that correspondence the Organization explicitly stated:

ORG will not focus on specific geographic areas, and ORG's proposed program will not have the express goal of lessening neighborhood tensions, eliminating prejudice and discrimination, or combating community deterioration. It is fair to say, however, that a collateral benefit of ORG's assistance program may yield any of these goals. ORG's primary goal in implementing its assistance program is to increase opportunities for individuals to enjoy the benefits and stability that home ownership offers. ORG's program will fulfill this mission by providing assistance to individuals (who will primarily be low income individuals) to be utilized for down payment and closing costs for the purchase of a home.

Since October 23, 20XX ORG has promoted and operated a down payment assistance (DPA) program for house buyers under which it provides funds to the buyers to use as their down payment or for closing costs and collects the same amount, plus an additional fee, from the house sellers. As more fully described below, under ORG's program, down payment assistance was provided for all types of housing loan programs, including federally insured mortgages, to

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buyers, whether first time or not. Furthermore, the down payment assistance was provided without any income or asset limitations, as noted in the organization's correspondence dated January 25, 20XX responding to the IRS's request for a list of its criteria and income guidelines when considering applicants for its program: "There is no income guidelines requirement in connection with the ORG program. However, a copy of the program materials describing the criteria for applicants of ORG's program is attached hereto as Exhibit D."

Application for Recognition of Tax-Exempt Status

As discussed above, on October 19, 20XX ORG filed its application for exemption. In the application ORG stated that its purpose was to:

Operate a program which makes gifts to individuals that desire to purchase a home but do not have the required funds related to the home purchase. Typically these gifts will be made in connection with FHA loans and ORG intends for this program to meet HUD/FHA requirements; however, ORG will also provide gifts to individuals using conventional financing, if applicable. ORG will make this program available to any individual, real estate agent or lender that desires this assistance to complete a home purchase.

The application described ORG's program as follows:

To participate in the program, a home seller will enroll his or her home with ORG and will be charged a fee by ORG in consideration for allowing his or her home to participate in the program. The fee to be charged to the home seller will be equal to the (a) the gift which ORG will make to any prospective purchase of the home; plus (b) 1-3% of the purchase price of the home which will be used to further provide assistance to further home buyers.

To participate in the program, a home buyer will need to qualify for a home loan which allows gift funds from ORG; in addition, the home buyer will need to contract for a home enrolled in the ORG program. If those criteria are met, an the home buyer should make a written request for a gift from the program then upon approval from ORG the home buyer will be able to utilize the gift funds. The gift funds, which do not have to be repaid in case or services, may be used for the down payment, lender's closing costs, or for the payment of debts, collections and/or judgments which are required by the lender to close the proposed loan. Any unused funds will be returned and repaid to ORG. The receipt [sic] of the gift funds shall be expected to comply with the lender's financing and closing requirements and will be expected to close on the purchase of a home that is enrolled with ORG's program.

The gift funds will come from ORG's pre-existing pool of funds and no part of the home seller participation fee will be given to the home buyer. Except for the making of the gift outlined above, ORG will not be a party (expressly or implicitly) to the purchase of the home or the financing of said purchase and ORG will not warrant the condition of the property. The making of any gift under ORG's program shall be subject to availability of

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pre-existing funds and ORG shall not be obligated to make any gift if sufficient gift funds are not available.

ORG's application for exemption stated that its sources of financial support were:

1. Seller's Fees;
2. Initial Capitalization; and
3. Other contributions

Regarding fundraising and contributions, ORG's application for exemption stated:

ORG will not have any fundraising programs.

The application also stated that ORG was a "membership organization," with membership requiring membership dues. According to the application for exemption the benefit the members would receive in exchange for their payments was the ability to sell their homes to individuals who would not otherwise qualify for financing. Part IV of the application showed that for the tax years ended December 31, 20XX, 20XX and 20XX the membership fees received or anticipated to be received were \$ \$ and \$ respectively. The information for the years ended December 31, 20XX and 20XX was taken from the Organization's proposed budget for those years.

Federal Returns

ORG filed Form 990 for the calendar year ended December 31, 20XX. It was not required to file and did not file Form 990-T. The Organization was required to file Form 941; however, no Form 941 was filed.

In 20XX ORG's only reported activity consisted of operating its DPA program, as described in more detail below. During 20XX ORG received \$ _____ in gross revenue from amounts paid to it by sellers participating in ORG's DPA program. ORG reported these payments as program service revenue. ORG reported the total amount of contributions and gifts it received from all sources as zero. ORG also reported that it distributed \$ _____ in down payment assistance to twenty homebuyers who did not have the required funds for down payments and/or to pay for closing costs. As a result, ORG reported a profit of \$ _____ from its DPA program for 20XX.

Operation of ORG Foundation Inc.'s Down Payment Assistance Program

ORG, through its website (www.ORG.org), promotes its DPA program to lenders, loan officers, mortgage brokers, real estate agents, title insurers, buyers, and sellers. Many of the participants in ORG's DPA program utilized various mortgage companies or banks for the financing for their home purchase. Seventy per cent of the loans were FHA loans. To qualify for a federally insured mortgage, a buyer must make a down payment in a specified minimum amount, generally equal to 3% of the purchase price. To qualify under applicable Department of Housing and

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

The ORG website sets forth the following "guidelines" for how its down payment assistance program works:

1. The Homebuyer must be fully approved for a loan that allows the use of gift funds for down payment and/or closing costs.
2. The Homebuyer must purchase a property that is enrolled with ORG Foundation and acceptable to the lender. Gift funds can be used to purchase homes, condominiums, townhouses and even apartment buildings up to four units. The property must be the homebuyer's primary residence.
3. The purchase must be closed through a licensed and insured closing agent acceptable to ORG Foundation in its sole discretion. ORG Foundation will not be directly responsible for any settlement charges.
4. It is understood that a Settlement Statement for this property sale will be provided to ORG Foundation for their review prior to closing.
5. The Homebuyer may not receive any cash back from closing and all unused Gift Funds will be returned to ORG Foundation.
6. If closing and funding are not complete within three (3) days of the contractually scheduled close date then all parties agree to the unrestricted, un-depleted, and immediate return of ORG Foundation gift funds.
7. All parties acknowledge that ORG Foundation is not a party to the sales contract and agree to hold ORG Foundation is not a party to the sales contract and agree to hold ORG Foundation harmless for the actions of any party or otherwise associated with said contract.

In addition, the website sets forth the following procedures for ORG's down payment assistance program:

1. Seller completes the Sellers Application/Participating Home Addendum.
2. Pre-approved buyer contracts for the purchase of seller's home and makes a request for gift funds from ORG Foundation using the Homebuyer Application and Gift Request.
3. A complete lender's copy package along with completed Homebuyer Application and Gift Request is submitted to ORG Foundation for approval and gift award. The copy package

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and ORG Foundation forms must be received within 12 days of purchase contract execution or three business days prior to closing, whichever is sooner. Documents can be faxed toll free.

4. ORG Foundation contacts title/escrow agent for wiring instructions and forwards ORG Foundation closing instructions for their review. Upon title/escrow agent's written acceptance of ORG Foundation closing instructions gift funds are wired for the benefit of homebuyer.
5. Prior to closing, ORG Foundation receives a preliminary settlement statement for review and approval.
6. After successful closing the title/escrow agent forwards all ATC completed conditions to ORG Foundation and receives a funding number for disbursement.

Under the terms of ORG's Sellers Application/Participating Home Addendum (Sellers Application), the seller agrees to "contribute" a specified fee to ORG upon closing and funding of the sale of the home. The fee comes from the proceeds of the sale. The Sellers Application also provides that in the event the sale does not close or complete, the seller does not pay the fee. For individual sellers the fees ranged from % to % of the total sale price, with sales prices ranging from \$ to \$ as reported on the U.S. Department of Housing and Urban Development Settlement Statements for the transactions.

The Organization's website informs homebuyers that "Gift Funds" can be used to pay for any of the following home-purchase related costs:

- **Down payment.** The portion of the home's value that the lender requires as a cash investment. Typically the ORG Foundation works in conjunction with high loan to value (LTV) loan programs requiring no more than a % down payment.
- **Closing or settlement costs.** Charges for services provided by third parties and required by the insuring or lending entity. These charges may include the actual amounts expended for a survey, title examination, title insurance, attorney's fees, credit reports, flood certification, tax service, termite inspection, appraisal fees, mortgage insurance, document preparation fees, filing and recording fees, as well as city, county and state transfer or mortgage tax.
- **Mortgage broker's fees.** ORG Foundation gift funds may only be used to pay broker processing fees up to \$ and documented courier fees up to \$. ORG Foundation gift funds may not be used to pay any fee that is not reasonable for the service provided.
- **Prepaid expenses.** Funds required for the establishment of an escrow account to be used for the future payment of property taxes, homeowners insurance, or association fees.

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Schedule No. of
Exhibit 990

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- **Repayment of bad debts.** ORG Foundation gift funds can be used to repay only those collections, charge offs, liens and judgments that are conditioned by the lender and required for loan approval. ORG Foundation, in its sole discretion, will determine the maximum allotment for this purpose. Please note that some loan programs do not allow the use of gift funds for this purpose.

As can be seen from the above, under ORG's DPA program buyers receive "gifts" of the funds needed for their down payments. Buyers were eligible to participate only if they purchased houses from sellers that had agreed to ORG's contractual terms requiring sellers to pay ORG amounts equal to the down payment "gifts" buyers received under ORG's DPA program. In addition, ORG required sellers to pay it an "administrative fee" ranging from . % to . % of the purchase price.

ORG claimed that the sellers' payments were not provided directly to the buyers, but instead were used to "replenish" the pool of funds used to provide "gifts" to subsequent buyers. The Organization's application for exemption, Insert 1, explicitly states that the down payment "gift" to a buyer comes from preexisting ORG funds rather than from the seller's "contribution" in the transaction. However, ORG does not solicit outside public contributions and does not have any source of funds other than "contributions" from sellers and the related fees. Since the amount of the "contribution" is always equal to the amount of the down payment assistance provided to the buyer, plus the service fee, it is apparent that, in fact, the actual source of the down payment assistance is the seller's "contribution."

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. The Organization provides those same funds to the buyers who, in turn, use the funds to make the down payments necessary to purchase the sellers' homes, thereby returning the funds to the sellers.

In its contract with each seller ORG also falsely and misleadingly labeled the seller's payment to it as both a "gift" and a "contribution." These contracts obligate the seller, in consideration for participating in ORG's program, to pay ORG an amount equal to the amount of the DPA received by the buyer. The contract, which was required to be signed by each participating seller, stated: "Seller further understands that the seller is only obligated to make the contribution if a home buyer utilizing the down payment assistance program purchases the participating home."

The parties to the down payment assisted real estate transactions, including the realtors, mortgage brokers and lenders, benefited more than incidentally from ORG's operations. The references below, from the Organization's website, clearly demonstrate this benefit.

Sellers ORG's website advertised that its DPA program financially benefits sellers by providing them with ready buyers, enabling the sellers to sell for higher prices and allowing them to sell faster due to the larger pool of potential buyers, thereby reducing the costs associated with real estate remaining unsold for an extended period. For example, ORG advertised on its website as follows:

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Reduced marketing time. Imagine what adding the words "no down payment or closing costs" to your ad or yard sign will do for your selling opportunities. **Higher Sales Price.** Seller's using the ORG to facilitate the sale of their property can expect to receive a full market value offer from the homebuyer. **Hassle Free.** The initial offer from the homebuyer will be full price. Imagine that, no messy or illegible counteroffers. **Increase your market of available buyers.** Every American wants to own a home however many do not have the initial cash investment for down payment and closing costs. ORG Foundation gives this initial cash investment to capable and qualified home buyers provided they purchase a home that is enrolled in the program. To enroll your home in the program and increase your selling opportunities complete the Sellers Application / Participating Home Addendum. **Tax deduction.** A seller's contribution to the ORG Foundation is considered a cost of completing the sale and therefore an allowable deduction. It is the Seller's responsibility to consult a tax professional for the exact amount of the deduction

Realtors ORG's website tells realtors "[i]f you are representing a buyer with special financial needs or a seller whose property is languishing, allow ORG Foundation to match its available gift funds to your buyer or supply a qualified buyer to your seller. Whatever the case, ORG Foundation's goal is to eliminate the barriers to homeownership."

Lenders and Mortgage Brokers ORG's website advertises that lenders and mortgage brokers can increase their government and conventional originations. The website states "[i]f you have a borrower whose credit and income are approved but lack the funds for their down payment, closing costs, or the repayment of minor derogatory credit then let ORG Foundation provide gift funds to complete the transaction."

In addition to lenders and mortgage brokers being able to increase government and conventional originations, review of the HUD settlement documents for the down payment assistance transactions revealed the presence of yield spread premiums (YSPs) paid to mortgage brokers. The YSPs were identified on the settlement documents on line item 800, "ITEMS PAYABLE IN CONNECTION WITH LOAN." The Organization's president, President, indicated that YSPs were paid to the mortgage brokers by the lenders for getting a buyer to take a higher interest rate loan versus a lower interest rate for which the home buyer was eligible, stating "the broker gets kickback from mortgage company for higher interest rate, instead of charging originations fees that could result in higher closing costs." Buyers were unaware that YSPs were being paid. Although the homebuyers were receiving down payment assistance from ORG, they were obligated to making higher mortgage payments as a result of (1) YSPs, (2) purchase prices that were increased to account for the down payment assistance and (3) higher interest rates and other closing costs spread over the life of the loan.

ORG's program materials explicitly state:

Broker's fees. ORG expects brokers or retail lenders to earn their contribution through yield spread premium or up-selling the rate. ORG gift funds may only be used to pay broker processing fees up to \$ and documented courier fees up to \$. ORG gift funds

may not be used to pay origination or discount points, or any fee that is not reasonable for the service provided.

In addition, the organization's website states:

Mortgage broker's fees. ORG Foundation gift funds may only be used to pay broker processing fees up to \$ and documented courier fees up to \$. ORG Foundation gift funds may not be used to pay any fee that is not reasonable for the service provided.

In 20XX ORG assisted the following brokers in receiving a total of \$ in Yield Spread Premiums, as follows:

- CO-1 \$
- CO-2
- CO-3

Other Parties Benefited by ORG's DPA Program

In addition to the intended benefit to the sellers, buyers, realtors, mortgage brokers and lenders described above, other individuals/entities also were the intended beneficiaries of ORG's operations during the years examined, as follows.

Broker. President's daughter-in-law, Broker, was the sole broker for the City, State office of CO-1 (CO-1), a national firm. In 20XX, the City, State office of CO-1 brokered of ORG's DPA transactions between buyers and sellers. CO-1 received a YSP for each of these transactions.

LAW & ARGUMENT:

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

Treasury Regulation 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."

Treasury Regulation 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

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meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

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

Treasury Regulation 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.

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

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court

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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. "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.

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Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families eligible for loans under a Federal housing program for those who 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.

In early 2006 the IRS issued Revenue Ruling 2006-27, 2006-1 C.B. 915, which describes three organizations involved in providing down payment assistance and determines whether each qualifies for exempt status under § 501(c)(3). The organization described in Situation 1 makes assistance available to low-income families to purchase decent and safe homes throughout the metropolitan area in which it is located. Individuals are eligible to participate if they are low-income and have the employment history and financial history to qualify for a mortgage with the exception that they do not have the funds necessary for down payments.

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Explanation of Items

The organization in Situation 1 offers financial seminars, conducts educational activities to prepare the individuals for home ownership, and requires a home inspection report before providing funds for down payment assistance. To fund the program, the organization conducts broad based fundraising that attracts gifts, grants, and contributions from the general public. Further, the organization has policies in place to ensure that the grantmaking staff does not know the identity or contributor status of the home seller or other parties who may benefit from the sale and does not accept contributions contingent on the sale of particular properties.

Because the organization described in Situation 1 relieves the poor and distressed, requires a home inspection to insure that the house is habitable, conducts educational seminars, has a broad based funding program, and has policies to ensure that the organization is not beholden to particular donors, the Service held that the organization is operated exclusively for charitable purposes and qualifies for exemption from federal taxation as an organization described in section 501(c)(3).

The organization described in Situation 2 of Revenue Ruling 2006-27 is like that described in Situation 1 except that (1) its staff knows the identity of the party selling the home and may know the identity of other parties involved in the sale; (2) the organization receives a payment from the seller (the amount of which bears a direct correlation to the amount of down payment assistance provided) in substantially all the cases in which the organization provides assistance to the home buyers; and (3) most of its financial support comes from home sellers and related businesses that may benefit from the sale of homes to buyers who receive assistance from the organization.

Because the organization described in Situation 2 provides down payment assistance amounts that directly correlate to the amounts provided by home sellers and relies primarily on payments from home sellers and real-estate related businesses that stand to benefit from the transactions to finance its program, the Service held that the organization described in Situation 2 is not operated exclusively for exempt purposes and does not qualify for exemption from federal income tax as an organization described in section 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 Treas. Reg. 1.501(c)(3)-1(d)(1).

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

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

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. 20XX-9, §14.01 (cross-referencing §13.01 *et seq.*), 20XX-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. 20XX-9, § 14.01 (cross-referencing § 13.01 *et seq.*).

GOVERNMENT'S POSITION:

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

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Explanation of Items

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Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. The Organization'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, ORG's program was not limited to low-income buyers, nor was it limited to first-time buyers. The Organization's electronic records did not include data on the buyers' incomes. It is clear that ORG had no income limitations and did not screen applicants for down payment assistance based on income. Instead, ORG's DPA program was open to anyone who otherwise qualified for loans. Review of ORG's records revealed that, in fact, during the year at issue the Organization's DPA program provided down payment assistance on a home purchased for over \$.

ORG's DPA program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Down payment assistance 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.

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, *supra*, 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 ORG's DPA program were directed to exclusively low-income individuals or disadvantaged communities, reliance entirely on home sellers or other real-estate related businesses that stand to benefit from the transactions to finance down payment assistance activities demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy, ORG was structured and operated to assist the private parties who funded it and gave it business. Sellers who participated in ORG's DPA program benefited from achieving access to a wider pool of buyers. They also benefited 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 benefited from participating in ORG's DPA program by being able to purchase a home without having to commit more of their own funds. In the case of buyers who did not belong to a charitable class, the private benefit flowing from their receipt of down payment assistance from ORG is not outweighed by public benefits flowing from their homeownership. Real estate professionals who participated in ORG's DPA program, from real estate brokers to escrow companies, benefited from increased sales volume and the attendant increase in their compensation. Mortgage brokers benefited, not only from increased business volume, but from yield spread premiums.

The manner in which ORG operated its DPA program shows that the private benefit to the various participants in ORG's activities was the intended outcome of ORG's operations rather than a mere incident of such operations. The Organization's down payment assistance procedures were

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designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, ORG relied exclusively on sellers and other real-estate related businesses that stood to benefit from the transactions it facilitated. The Organization did no fundraising and received no funds from other sources. Before providing down payment assistance, ORG's grantmaking staff took into account whether there was a home seller willing to make a payment to cover the down payment assistance the applicant requested. The Organization required the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of ranging from \$ to \$ per home sale, with the average fee being \$. ORG secured an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions took place unless ORG was assured the amount of the down payment plus the fee had been or would be paid by the seller upon closing. As stated in ORG's instructions to title and escrow companies, after the close of escrow the seller's contribution, along with any ORG fees, had to be sent to ORG within 48 hours. Escrow companies that did not appropriately disburse funds in a timely manner were prohibited from utilizing the ORG DPA program. The Organization's receipt of payments from home sellers corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to home sellers (and others involved in the transaction) was not a mere accident but, rather, an intended outcome of ORG's operations. In this respect, ORG is like the organization considered in Easter House that 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 it operated in 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 DPA program shows that the Organization was in the business of facilitating 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, *supra*.

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, 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. The Organization did not market its services primarily to persons within a charitable class. ORG's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. The Organization 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 and Easter House, a substantial part of ORG's activities furthered commercial rather than exempt purposes.

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

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Explanation of Items

Year/Period Ended
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ORG's exemption is proposed to be revoked back to the organization's inception because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption, signed under penalties of perjury on , ORC represented that its purpose was to "provide down payment assistance program for low income individuals and families ..." and that its "down payment assistance w[ould] be provided only to individuals who have a financial need for such services, and who complete the educational requirements designed to increase the likelihood of permanent home ownership." Despite these representations in its application for exemption, ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The electronic records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened on such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. ORG has never engaged in any educational activities. Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 20XX-9, § 14.01. Because ORG has operated in a manner materially different from that represented in its application for exemption, retroactive revocation of ORG's determination letter is justified.

CONCLUSION:

In order to qualify for exemption under IRC 501(c)(3) an organization must be both organized and operated to achieve a purpose which is described under that Code section. ORG's DPA program was not operated in accordance with the Internal Revenue Code and Regulations that govern qualification for tax exemption under § 501(c)(3) of the Code. The Organization provided down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. ORG offered its down payment assistance to interested buyers regardless of the buyers' income level or need. The Organization's DPA activities did not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

ORG operated in a manner indistinguishable from a commercial enterprise. The Organization's primary activity was brokering transactions to facilitate the selling of homes. ORG's primary goal was to maximize the fees from these transactions. ORG's brokering services were marketed to homebuyers, sellers, realtors, lenders, and title companies regardless of the buyers' income levels or need and regardless of the condition of the community in which the homes were located. Alliances were built with the realtors, lenders, home builders, mortgage brokers and title companies to ensure future business for the mutual benefit of the participants. ORG did not engage in any educational or counseling activities or in any other activities that further charitable purposes. Because ORG's primary activity was not conducted in a manner designed to further § 501(c)(3) purposes, ORG was not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

For the foregoing reasons, revocation of exempt status is proposed.

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Explanation of Items

The facts show that, in 20XX ORG operated in a manner materially different from that represented in its Form 1023 application. Accordingly, the revocation is proposed to be effective retroactively to April 26, 20XX.

TAXPAYER'S POSITION:

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