

**Internal Revenue Service**  
Appeals Office

**Department of the Treasury**

Release Number: 201021036  
Release Date: 5/28/10  
Date: 3/1/10

**Person to Contact:**

**Refer Reply to:**

UIL: 501.03-00

**In Re:**

EO Revocation

**Tax Period(s) Ended:**

A  
B  
C  
D

**Form Number:**

990

**Employer Identification Number:**

**LEGEND:**

**LAST DAY TO FILE A PETITION  
WITH THE UNITED STATES TAX  
COURT: JUN 01 2010**

A=  
B=  
C=  
D=  
E=  
F=

**CERTIFIED MAIL**

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated August 7, 1998 is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 2003.

The revocation of your exempt status was 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 sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. 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 to your organization are no longer deductible under IRC §170 after December 31, 2002.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 2003, and for all tax years thereafter in accordance with the instructions of the return.

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

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

You also 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:

See the enclosed Notice 1546, Taxpayer Advocate Service – Your Voice at the IRS, for Taxpayer Advocate telephone numbers and addresses.

We will notify the appropriate State Officials of this action, as required by Code section 6104(c). You should contact your State officials if you have any questions about how this final determination may affect your State responsibilities and requirements.

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

Sincerely,

\s\  
Team Manager

Enclosures:  
Publication 892  
Notice 1546  
Notice 437

cc:

**Internal Revenue Service**

**Department of the Treasury**  
TE/GE Exempt Organizations Examinations

Date:

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 Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  <b>ORG</b>	Tax Identification Number	Year/Period ended  20XX12

**LEGEND**

ORG - Organization name      XX = Date      Address = address      City = city      State = state  
 website = website      ATTN = Attorney      CO-1, CO-2, CO-3 & Co-4 = 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup> & 4<sup>th</sup> Companies,  
 Chairman = chairman      Turstee-1, Turstee-2 = 1<sup>st</sup> & 2<sup>nd</sup> Trustees  
 DIR, DIR-1 & DIR-2 = Director, 1<sup>st</sup> & 2<sup>nd</sup> Director      EMP-1 & EMP-2 = 1<sup>st</sup> & 2<sup>nd</sup> Employee  
 MD-1 = Managing Director

**ISSUE:**

Is ORG operated exclusively for exempt purposes under section 501(c)(3) of the Internal Revenue Code?

**FACTS:**

**Overview**

ORG (ORG) was incorporated February 16, 20XX in the State of State. Also, on February 16, 20XX, ORG applied for recognition as a tax exempt organization under Internal Revenue Code section 501(c)(3) on Form 1023. On August 20, 20XX, based on information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized, effective February 16, 20XX, as a tax-exempt organization as described in section 501(c)(3) with an advanced ruling for foundation status under section 509(a)(2).

Since 20XX ORG has promoted and operated a down payment assistance program that facilitated home sales on behalf of home sellers. The program was funded by home sellers. Homebuyers received funds from the program that they used to make the down payments, and pay closing costs, to buy the home sellers' homes. ORG charged home sellers fees for facilitating these transactions.

ORG utilizes a for-profit internet organization, CO-1 (CO-1), to electronically administer and process its down payment gift transactions via the internet through loan officers, processors, escrow officers, and CO-2 (CO-2). CO-2 is a for-profit entity. Per ORG, CO-2, the parent company of CO-1, brokers and administrates the online down payment assistance processing tool services of CO-1.

ORG stated that it does not become involved in the down payment assistance transactions until near closing and, at that point, ORG works with escrow officers regarding wiring instructions, closing time, and gift amount requested. Under ORG's program, there are no income limitations and down payment assistance is provided as long as the home buyer is able to qualify for mortgage financing program.

In a letter dated March 6, 20XX, ORG was sent a copy of its year 20XX and 20XX Form 990 as well as a copy of a February 20XX GAO report regarding Mortgage Financing. Also, in a letter

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  ORG	Tax Identification Number	Year/Period ended  20XX12

dated March 27, 20XX, ORG was sent a copy of an updated Mortgage Financing GAO report dated November 20XX.

**Articles of Incorporation**

The purposes of the organization as stipulated by Article III (a) of the Articles of Incorporation, dated February 16, 20XX, are:

“To operate exclusively for the promotion of nonprofit, charitable and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 19XX, as amended, including:

1. To create home ownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.
2. To provide home ownership educational materials and counseling to families in need of adequate housing.
3. To, on a reasonable and fair basis, aid financially those families eligible for affordable mortgage financing programs who do not have the necessary down payment and/or closing costs.
4. To promote better understanding among the general public about home financing and the costs and problems associated therewith and to provide workable answers and solutions thereto.
5. To promote ethical and professional standards in the home mortgage financing arena.
6. To engage in fund raising activities such as, but not limited to, the soliciting for and accepting of bequests, endowments, donations, contribution, grants, loans, gifts-in-kind, etc. from private individuals, private businesses, federal or state government agencies and other nonprofit organizations, as well as the generation of gross receipts and/or fees from admissions, sales and/or services.”

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

On February 15, 20XX, ORG filed Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code. The application was signed by Chairman. Page 3 of Form 1023 shows Chairman as Chairman/Trustee.

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  <b>ORG</b>	Tax Identification Number	Year/Period ended  20XX12

Page 2, item 1, of the application contained the following information about ORG and its intended purposes:

“(a) ORG (ORG) will participate in a home ownership program designed to create home ownership opportunities for families that cannot afford to purchase safe and decent housing.

The organization’s activities will be two fold:

1. Provide home ownership educational materials and counseling to families in need of adequate housing.
2. Aid financially those families eligible for loans (FHA, FNMA, FHLMC, etc. affordable mortgage financing programs) who do not have the necessary down payment and/or closing costs.

No charge is made for any of these services.

The organization will work in concert with established Federal, State and Local Government housing agencies, including The U.S. Department of Housing and Urban Development, the State Housing Authority, City Housing and Neighborhood Development Agency, Housing Services of State County, and City Redevelopment Agency, to promote existing government sponsored home ownership assistance programs and affordable mortgage financing programs, and to coordinate information sharing, consumer outreach, and event planning.

The above activities, and fund raising, will consume 100% of the organization’s time. Priority ranking and time allocation for each activity will be determined in the future, with subsequent periodic reviews and adjustments to be made as needed.

(b) The organization’s activities must commence no later than March 31, 20XX in order to qualify for a \$ private grant pledged to ORG for start-up capital.

(c) Activities will initially be conducted by the organization’s trustees. Trustees will receive no compensation for their services. Until such time as additional space is required, activities will be conducted within the offices of CO-3, located at Address, City, State. Use of a desk, telephone, office equipment, receptionist, reception area, and conference room will be donated free of charge. CO-3 and Chairman, owner of CO-3 and Chairman of ORG, will receive no benefit in return for this contribution.”

Page 2, item 2, of the application contained the following information about ORG’s sources of financial support:

“In addition to private individuals (see #1b above), ORG will seek to raise funds via gifts, grants, contributions, and donations from community businesses, governmental agencies, and other nonprofit organizations, as well as gross receipts and/or fees from admissions, sales and/or services.”

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
Name of taxpayer  ORG	Tax Identification Number	Year/Period ended  20XX12

Page 2, item 3, of the application contained the following information about ORG's fundraising program:

"No specific fund raising program has been put into effect at this time. The organization intends to explore all possibilities (see #2 above), including the use of professional fund raising organizations. ORG will also investigate and possibly incorporate the successful fund raising strategies of similar existing 501(c)(3) organizations."

In addition to the Form 1023 filed by ORG, there was also correspondence between the IRS and ORG regarding its application. Form 1023 correspondence from ORG included, in part, the following:

ORG stated that it would use seller paid service fees for the purpose of providing an ongoing source of revenue to fund ORG operating expenses and future financial grants."

ORG stated that in regards to the service fee charged to seller the amount would be 4% to 6% of the final sales price.

ORG stated that the downpayment assistance grant would be 3% to 5% of the sales price of the home based on the downpayment requirements for affordable mortgage financing programs that allow a borrower's downpayment to be gifted by a charitable nonprofit organization.

### **Federal Returns**

ORG filed Forms 990 for the calendar years ended December 31, 20XX. ORG also filed Forms 941 and W-2 for the year ended December 31, 20XX.

In addition, ORG also filed Forms 990 for the years ended December 31, 20XX, and 20XX. The years 20XX and 20XX Forms 990 were similarly reported as the year 20XX Form 990, except that each year the gross revenues from amounts paid to it by sellers and the down payment assistance amounts paid from ORG to buyers grew each year.

Per ORG' 20XX, 20XX, and 20XX Forms 990, ORG's only reported activity consisted of operating its down payment assistance program as described in more detail below.

According to Part III of ORG's 20XX Form 990, ORG's primary exempt purpose is "financial aid to qualified home buyers." Also, Part III (a) states "[ORG] provided 696 families (home buyers) with gift funds for downpayments or closing costs on purchase of a principal residence." For years 20XX and 20XX, ORG provided the same statement except that the number of families was for the year 20XX and was for the year 20XX.



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Name of taxpayer	Tax Identification Number	Year/Period ended	
ORG		20XX12	

Income Items:

For the year 20XX ORG received \$ in gross revenue from amounts paid to it by sellers participating in ORG's down payment assistance program. ORG's reported these payments as program service revenue. The \$ figure is inclusive of all service fees paid by sellers to ORG in connection with ORG's 20XX down payment assistance transactions and does not include fees for either CO-2 or CO-1. ORG reported the total amount of contributions and gifts it received, from all sources, as zero.

Form 990 for the years 20XX and 20XX shows that ORG received \$ and \$ respectively in gross revenue from amounts paid to it by sellers participating in the down payment assistance program and reported these payments as program service revenue. Also, for the years 20XX and 20XX, ORG reported the total amount of contributions and gifts it received, from all sources, as zero

Expense Items – Specific Assistance to Individuals

For the year 20XX ORG distributed \$ in down payment assistance gifts to individuals. ORG did not pay any fees to either CO-2 or CO-1 from the \$ paid by ORG to specific individuals.

Form 990 for the years 20XX and 20XX shows that ORG distributed \$ and \$ in down payment assistance gifts to individuals.

Employees and Independent Contractors

The only wages ORG paid during 20XX were to EMP-2 in the amount of \$. However, per ORG's financial records there was also a net salary payment of \$ to EMP-1 during January 20XX for work performed in 20XX. The following are ORG's statements describing the work performed by ORG's employees as stated in a letter dated December 18, 20XX.

EMP-1

ORG stated that EMP-1 was a college student who began working part-time for ORG in 20XX. ORG stated that during 20XX EMP-1 contacted wholesale lenders to secure ORG's approval with them as a down payment assistance provider. In addition, ORG stated that EMP-1's other duties included clerical services such as confirming and updating transaction information including, closing companies, wiring instructions, closing times, and gift amounts requested, as well as the collecting, organizing and filing of closing documents.

Per ORG, its records indicate that EMP-1 worked approximately 20 hours per week in 20XX and that all of his hours worked each week were for doing down payment assistance work for ORG. ORG stated that by the end of 20XX, EMP-1 had successfully completed the task of securing ORG's approval with a number of wholesale lenders and with this accomplished his part-time employee services were no longer needed.

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ORG		20XX12	

## EMP-2

EMP-2 was shown on Form 990 as the Managing Director. She received wages of \$ for work performed during November and December 20XX.

Per ORG, EMP-2 worked part-time as an employee and volunteer for ORG beginning in April 20XX. ORG stated that it was run with EMP-2's volunteer work from January 1, 20XX, to October 20XX. ORG stated that by late October of 20XX ORG's transaction volume had increased three fold over the volume at the beginning of the year and at that time EMP-2 was appointed President/Managing Director and began working for ORG as a full-time salaried employee. ORG also stated that there were no other workers or volunteers for ORG in 20XX other than EMP-2.

Per ORG, as a paid part-time employee in 20XX, she worked approximately 20 hours per week. ORG stated that her volunteer work during 20XX – 20XX was on an "as needed basis" (generally less than ten hours per month) based on ORG transaction volume and demand and that all of her hours worked each week were for doing down payment assistance work for ORG.

Per ORG, EMP-2 had management, and real estate and mortgage lending experience. ORG stated that she oversaw the management of ORG, determined the relevant duties to be performed (i.e. securing wholesale lender approvals for ORG, confirming and updating transaction information, collecting, organizing and filing closing documents, etc.). Also, ORG stated that she oversaw the fulfillment of these duties and wired gift funds.

## Relationships:

### **CO-3**

Per ORG, other than Chairman (a 20% owner of CO-3, a for-profit corporation) being on ORG board of trustees, there is no relationship between ORG and CO-3. Per ORG, it does not have common employees with CO-3 Company. Also, per ORG, EMP-2 and EMP-1 (employees of ORG) were not employees of CO-3 and it did not pay any individuals to conduct downpayment assistance for ORG. However, per ORG, there was an additional circumstantial relationship between ORG and CO-3 Company during the year under examination in which CO-3 facilitated two real estate purchase transaction closings involving ORG gift funds in 20XX.

ORG stated that to the best of its understanding, CO-3 does not have any relationships with CO-1 and/or CO-2.

ORG stated that it does not share common office space with CO-3, CO-1 or CO-2. However, ORG also stated that it rented a single office space in the same building in which CO-3 leased space, and within the suite in which CO-1 and/or CO-2 also rented a single office space.

### **CO-1 and CO-2**

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ORG		20XX12

Per ORG, DIR is CO-1's only officer and CO-1 has no employees. ORG believes, to the best of its knowledge that CO-2 employs between one dozen and two dozen employees that maintain CO-1. DIR is involved with ORG as a result of being the President of CO-2 and managing member of CO-1. Per ORG, neither CO-1 nor CO-2 are related to ORG.

ORG stated that it is unaware of CO-1's and/or CO-2's history prior to working with ORG. ORG stated during the start-up phase it found CO-2 and its online downpayment assistance-processing tool, CO-1. ORG also stated that it determined that CO-1 and/or CO-2 met its standards for providing such services, as their unique use of the Internet to electronically process and administer downpayment assistance gift transactions online, would assist ORG in maximizing its efficiency in processing transactions. ORG stated that it was able to rent space within the same building, which also helped to facilitate efficiency.

ORG stated that it does not have any exclusive agreements with any company. However, ORG has not used any other service provider and ORG stated that it has no knowledge of CO-1 and/or CO-2 providing any services for any other companies and/or 501(c)(3) organizations.

Per Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, ORG had an address of Address, City State and the current address is Address, City, State.

IRS research shows that DIR is the registered agent and an officer of CO-2 and he is the registered agent and manager of CO-1. One of the addresses listed for CO-1 was Address, City, State.

Also, IRS research shows that DIR is the owner of CO-4 and the address shown was Address, City, State.

Per ORG, CO-1 and/or CO-2 do not work for ORG and it does not have common board members with CO-1 and/or CO-2. In addition, ORG stated that it does not have common employees and does not have employees shared between ORG and any companies associated with DIR, owner of CO-1 and CO-2. ORG is unaware of DIR or DIR-2 relationship with CO-4. ORG stated that CO-4 was a pre-existing co-tenant in suite #150, at Address, City, State and that there is no other relationship between CO-4 and ORG other than through DIR who per IRS records, is the registered agent, owner, and member of CO-4 and, who is also, the owner and an officer of CO-2 and CO-1.

Although ORG stated that there are no relationships between ORG and CO-1 / CO-2, one of the sampled ORG transactions involved DIR (owner of CO-1 and CO-2) and DIR-2 as buyers.

#### **ORG's Private Line of Credit with DIR**

During the year 20XX, ORG was provided a private line of credit of \$ from DIR-1. an officer and owner of CO-2 and CO-1. ORG was asked to provide copies of the loan notes or other documentation that established lines of credit, to provide the terms of the note and the dates,

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Name of taxpayer  ORG	Tax Identification Number	Year/Period ended  20XX12

amounts, interest rate(s), and repayments made on the lines of credit. ORG did not provide any documentation, but stated that there was no note and/or other written document for the line of credit and there was no amortization scheduled used. Per ORG, the loan, made to ORG by DIR, originated in 20XX, had an outstanding balance of \$ on 01/01/XX, and an outstanding balance of \$\$ as of 12/31/XX. The loan was made to ORG without interest or other charges, and was not collateralized. Per ORG, the proceeds from the loan were used exclusively for purposes specified in ORG's Form 1023 Application for Recognition for Exemption and in compliance with section 501(c)(3) of the Code. ORG stated that no repayment of the loan was made during the year in question, 20XX. Also, ORG stated that in 20XX, the loan was paid off in full.

**Other Relationships**

ORG stated no entities associated/owned by ORG's Trustees (Chairman, TRUSTEE-1, and/or TRUSTEE-2) have dealings with ORG and/or CO-1 and/or CO-2.

ORG stated that no entities associated/owned by MD-1, Managing Director of ORG have any relationships or dealings with ORG and/or CO-1 and or CO-2.

Per ORG, no entities associated/owned by DIR and/or DIR-1 (other than CO-1 and CO-2, owned by DIR) have any relationship or dealings with ORG.

**Services Provided by CO-1 and CO-2 – As Described by ORG**

ORG stated in a letter dated January 12, 20XX, that in addition to CO-1 administering and processing its downpayment gift transactions, CO-2 and CO-1 services include:

CO-1 accurately presenting ORG's downpayment assistance qualification guidelines, to loan officers;

Insuring that CO-1's registered loan officers, are knowledgeable of ORG's required criteria for delivering its downpayment assistance services, and that their potential buyer/donees have been determined to meet such criteria by certified affordable mortgage home loan underwriters;

Representing ORG's best interest in obtaining ORG fundraising service fees sufficient to replenish depleted ORG funds and support the organization within those parameters established under ORG's Form 1023 Application for Recognition of Exemption;

Upon receipt of gift transaction applications submitted through CO-1, instantly providing escrow officers those links necessary to access documents required of ORG to be signed at closing, and

Efficiently providing ORG, registered loan officers, processors, and escrow officers the online access, tools and services necessary to perform their individual respective

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duties relative to effectively processing, administering, and executing a ORG gift transaction.

ORG stated that in addition to the above services, CO-2 and CO-1 independently engage in those activities which ORG cannot engage in, as a 501(c)(3) organization, as such engagement by ORG might be construed as operating a trade or business. ORG also stated that no fees or considerations are required of ORG for its use of CO-2 and/or CO-1 tools and services.

ORG stated that CO-2 and the CO-1 website primarily promote the services of CO-1's online downpayment assistance processing tool. Per ORG, within the CO-1 website, ORG is identified as its downpayment assistance provider source, and those restrictions to which potential buyer/donees must comply in order to qualify for ORG's downpayment assistance are addressed, as set forth in ORG's Form 1023 Application for Recognition of Exemption. ORG stated that as a result, ORG receives market exposure as a byproduct of CO-2 marketing CO-1's online downpayment assistance processing tool services to affordable mortgage home loan officers nationwide.

**ORG's Down Payment Assistance Program from start to finish – Per ORG's Description**

The examination of ORG's 20XX Form 990 was performed by correspondence. Therefore, ORG was asked to describe its down payment assistance program from start to finish.

The steps involved with ORG's down payment assistance program from start (buyer becoming aware of the program) to finish (closing), as provided in ORG's letter dated January 12, 20XX, is summarized as follows:

Per ORG, it does not directly interact with, or promote its downpayment assistance program and guidelines to, potential buyer/donees, loan officers, individual sellers, seller builders, and/or Realtors. Rather, ORG stated that it instructs potential buyer/donees interested in ORG's downpayment assistance services, to locate an acceptable local loan officer of their choosing.

Per ORG, if not already registered with CO-1, local loan officers may visit CO-1, register, and become educated regarding ORG's downpayment assistance program and qualifying criteria.

Per ORG, once the registered loan officer has determined that the potential buyer /donee qualifies for an affordable mortgage home loan program in the area, lacks the sufficient funds necessary for his required downpayment, and meets ORG's program guidelines, the registered loan officer may educate the buyer/donee regarding CO-1's downpayment assistance services. ORG stated that in this way, it does not interact with potential buyer/ donee candidates or their loan officers regarding its downpayment assistance program. ORG stated that it believes that qualified potential buyer/donees in turn tell their Realtors and/or sellers how downpayment assistance through ORG might be a viable option for them in purchasing a home, as ORG does not market its services to, or interact directly with these parties either.

Form <b>886-A</b> (Rev. January 1994)	<b>EXPLANATIONS OF ITEMS</b>	Schedule number or exhibit
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Per ORG, once a fully executed purchase contract between the buyer and seller has been secured, CO-1 allows the registered loan officer to submit a gift transaction application through their CO-1 account. ORG stated that only CO-1 registered loan officers (or their processors) are allowed this capability and potential homebuyers do not request gift funds directly from ORG.

Per ORG, once CO-1 receives a ORG gift transaction application, a link to the registered loan officer's secured account at CO-1 is automatically sent via email to the escrow officer identified in the submitted application. ORG stated that through this link, the escrow officer can access and print the ORG forms relevant to the transaction from the registered loan officer's CO-1 account.

ORG stated that it is at this point, through CO-1, that ORG may elect to enter the transaction process or not.

ORG stated that under this procedure, ORG does not deliver its documents requiring signatures directly to the buyer, loan officer, seller or, escrow officer, nor does it require such documents be signed until closing, which would be the time and place when buyers and sellers usually received and sign the documents, unless such signatures are otherwise required by a mortgage underwriter at an earlier time. Should this be the case, the registered loan officer has access to these ORG documents within its CO-1 account, as well. Under this procedure, ORG is also relieved of any need to enter the transaction process until after a potential buyer/donee has found a loan officer, qualified for an affordable mortgage loan program, been determined to meet ORG's requirements, found an affordable home, negotiated an affordable purchase price, and secured a fully executed purchase contract with the seller, independent of ORG. Also ORG stated that, likewise, ORG does not enter the transaction process until after a seller has decided to sell its home, secured the services of a Realtor, determined a sales price, placed the home on the market, received an offer, negotiated an acceptable purchase price, and secured a fully executed purchase contract with the buyer, independent of ORG.

ORG stated that normally it takes thirty days or so, from the time a fully executed real estate purchase contract is secured, to the time a real estate purchase transaction closes, records and disburses funds. During this time, the registered loan officer submits the buyer/donee's loan application to the certified underwriter for the affordable mortgage home loan program. By underwriting and approving a potential buyer/donee's loan application package, the certified underwriter confirms the local registered loan officer's determination, that a potential buyer/donee qualifies for an affordable mortgage home loan, lacks the sufficient funds necessary for his required downpayment, and meets ORG's program guidelines. ORG also stated that as part of this process, certified underwriters require that both the potential homebuyer, and the home being purchased, meet the underwriting guidelines of the local affordable mortgage home loan program.

ORG stated that HUD certified appraisers, approved by HUD and chosen by the lender, affirm the market value of a purchased home, via written appraisals. HUD regulations require lenders to use many different certified appraisers to ensure the appraisals are as accurate as possible. Certified appraisers are also required to include a rigorous inspection of the safety and habitability of the property, as part of the appraisal, so that FHA may insure, and the lender may finance with

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confidence. Per ORG, as they are licensed to do so, ORG relies on local certified appraisers, familiar with such affordable mortgage home loan requirements, to determine during the appraisal process, that buyer/donee homes being purchased, meet such guidelines, and are therefore, safe, decent, and habitable.

ORG stated that generally, a day or two before closing, ORG contacts the escrow company, to confirm the buyer/donee's affordable mortgage home loan approval, and scheduled closing date. At this point, if the loan approval is secured, ORG begins working directly with escrow officers to perform those clerical services related to the actual gifting of its funds. ORG also stated that once such duties are accomplished, ORG is prepared to deliver its gift funds to be used at closing.

ORG stated that when ORG provides a downpayment assistance gift to a buyer/donee, it is financed by drawing down on, or invading, an existing account of available funds, designated for this purpose. When a gift is wired to the escrow company, it depletes the ORG's available funds by a like amount to that amount gifted. To replenish its depleted funds, and support its organization, ORG raises funds by collecting service fees from sellers, in like amounts to those amounts depleted as a result of gifting funds. ORG also stated that it is for this reason that a similarity exists, within the same transaction, between the Gift amount paid to the buyer before closing and the ORG Fee amount collected from the seller after closing and recording.

ORG stated that to deliver its downpayment assistance, ORG wires to the escrow company the required gift amount, as approved by the certified affordable mortgage home loan underwriter, and as needed by the buyer/donee to complete the transaction. ORG does not require closing to have occurred, HUD documents to be reviewed, or ORG closing documents to be signed, prior to wiring its funds. In some transactions, ORG gift funds are wired a day or two (or even more) in advance of closing date. As a confirmation that the funds wired have in fact originated from a bona fide source, ORG prints and faxes a Wire Transmission Summary, noting the actual account source from which the funds were wired to the escrow company. ORG also stated that once the ORG funds are received by the escrow company they are credited to the buyer/donee and held in the escrow company's designated escrow (bank) account until such time as they are disbursed to the lender that is providing the mortgage, as the required gifted funds necessary for the buyer/donee's downpayment to qualify for the affordable mortgage loan being provided.

ORG stated that at closing, the escrow officer conducting the closing follows the directions contained in the ORG closing documents to structure the HUD Settlement Statements and secure the signatures of the buyer and seller on the documents as required by ORG. Following the closing, and prior to the transaction recording and funding, all documents signed at closing are delivered, for review, to the lender providing the affordable mortgage home loan financing. This review of the closing package by the lender is conducted to insure that, amount other things, the required downpayment assistance has in fact been delivered, and provided to the buyer/donee by ORG, and not some unacceptable other source. ORG also stated that with this review completed, the lender wires the loan funds necessary to complete the transaction to the escrow company, authorizing them to record the completed transaction at the county recorder's office and to disburse funds per the HUD settlement statement.

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ORG stated that once recorded, the escrow company is authorized to disburse funds in connection with the transaction. It is at this time that ORG collects its seller-paid ORG Fee from seller's home sale proceeds from the escrow company via wire transmission or mail. At this time CO-2 also collects its fees for services render. ORG fees are wired or mailed via the escrow company directly to ORG's bank account, and CO-2 fees are wired directly to CO-2' bank account. ORG stated that it does not collect fees for, or pay fees to, CO-2.

### Fees Charged to Sellers by ORG and CO-2

Per ORG, it specifically works with the escrow company, escrow officer, contact information, wiring instructions, closing time, and gift amount requested, as well as to collect, organize, and file closing documents, etc. ORG stated that in exchange for performing such services, ORG collects seller paid service fees, as a form of fund raising, to support its organization and fund its charitable activities.

ORG stated that CO-2 also collects a seller-paid administration service fee, independent of ORG, for those services it renders to the gift transaction process. ORG stated that ORG does not receive fees for, or pay fees to CO-2 for services CO-2 renders, nor does it track or record services rendered by CO-2 for the administration fees it collects. ORG stated that ORG believes that CO-2's fees are collected in connection with CO-2 maintaining the CO-1 website, administrating and overseeing the involvement of all parties utilizing CO-1, and interacting with involved parties to provide customer support, training, troubleshooting services, and other activities necessary to the gift transaction process.

ORG stated that CO-1 and/or CO-2 do not receive fees for marketing ORG's downpayment assistance program. Nor does ORG determine service fee amounts for CO-2 and/or CO-1. ORG also stated that CO-2 determines its own fees and collects them directly from the seller after closing and recording, in exchange for services it renders to the seller (not in exchange for marketing ORG's downpayment assistance service).

ORG's Form 1023 Application for Recognition of Exemption sets forth its parameter ranges for seller paid service fees at 4% to 6%, as a percentage of the final sales price. ORG stated that within these parameters, ORG endeavors to accommodate the economic constraints of the individual transactions it services, by being flexible in the fees it collects. ORG stated that this practice allows ORG to help as many potential buyers as possible obtain homeownership. ORG stated that ORG has instructed CO-2 to set transaction fees via CO-1 within its IRS approved parameters. ORG stated that this allows CO-2 a certain degree of latitude within such parameters to negotiate fees according to market forces, as ORG believes such forces generally dictate fees. Per ORG, it is during a loan officer's registration with CO-1, that fees are discussed and generally determined independent of ORG. ORG also stated that under this procedure, ORG does not set individual transaction fees, as ORG does not enter the transaction process until after a fully executed purchase contract has been secured, the seller and transaction fees have already been



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established, independent of ORG, and a gift transaction application has been submitted by a registered loan officer through CO-1.

ORG stated that by raising funds through collecting seller-paid fees for service, not from donations and/or contributions from the general public, it is following its public charity classification and method of support under IRC section 509(a)(2) which provides:

...not more than one-third of its support from gross investment income and more than one-third of its support from contributions, membership fees, and gross receipts from activities related to its exempt functions.

ORG stated that inasmuch as ORG fees for services are disbursed to ORG after the transaction has closed and recorded, no portion of the seller-paid fundraising service fee can possibly be funneled to the buyer/donee purchasing that seller's home, but rather, upon ORG's receipt of the fee, a portion is used for operating expenses, while the remainder is held by ORG to be used in assisting other buyer/donees in future ORG gift transactions. Seller-paid ORG Fees are not collected to provide downpayment assistance to the buyer in the same transaction, as this would violate HUD policy prohibiting such. ORG also stated that it is not aware of any mortgage program that allows a seller to pay or gift a buyer's downpayment within the same transaction."

### **ORG's Downpayment Assistance Transactions and Closing Statements**

Closing statements for ORG's down payment assistance transactions showed that ORG had involvement with CO-1 (CO-1) and CO-2 (CO-2) in regards to its down payment assistance program.

For the year 20XX, there were 665 ORG down payment assistance transactions and closing statements provided on a DVD by ORG. Forms included with the closing statements were: Irrevocable Agreement to Issue Funds (instructions and an agreement regarding a particular buyer and seller and is signed by the closer with title company handling the closing); HUD Settlement Statement; Addendum to Real Estate Purchase Contract; Gift Letter; and Cooperating Home Registration Agreement.

In order to illustrate some of the forms used for ORG's transactions and seller-paid down payment assistance amounts and fees, representative randomly sampled transaction #19 is shown below:

#### **Irrevocable Agreement to Issue Funds (Excerpts)**

"ORG is prepared to gift the above Buyer(s) the amount of \$ to be used in the purchase of that property referenced above. This grant is made on condition that the above referenced Seller(s) proceeds be debited in the amount of \$ for Service Fees payable to ORG, and \$ for Administration Fees payable to CO-2, at closing." The agreement was conditioned upon the title company confirming that the seller had agreed in writing and was obligated to pay the Service and Administration Fee amounts, and it was also conditioned upon the funds being returned to ORG if the closing failed to take place.

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### **HUD Settlement Statement**

The HUD statement showed that the ORG Gift Funds were \$; Service Fee payable to ORG was \$; and the Administrative Fee to CO-2 was \$.

### **Addendum to Real Estate Purchase Contract**

The Addendum showed that the seller agreed to pay a service fee of \$ to ORG at closing and pay an administration fee of \$ to CO-2 at closing.

### **Cooperating Home Registration Agreement**

The Agreement provided that in the event said Cooperating Home was purchased by a buyer using down payment assistance in the form of gift funds provided by ORG, the seller would pay a Service Fee in the amount of \$ to ORG, and an Administration Fee of \$, to CO-2, Inc., for services render in educating, and effectuating the qualifying ability of said buyer. It also provided that the seller agreed that these fees will be paid at funding from Seller's Cooperating Home sale proceeds.

### **Analysis of Sampled Down Payment Assistance Transactions**

Of the 665 transactions, a random sample of 61 transactions (including sampled transaction #19) was selected. To illustrate service fees as actual amounts (rather than percentages) collected by ORG and CO-2, the 61 transactions were analyzed. The analysis of the transactions was sent to ORG.

ORG correctly stated in the analysis of the sample of 61 transactions that the average ORG Gift was 4.82%, as a percentage of the transaction sales price and that the average ORG Fee was 4.88%, as a percentage of the transaction sales price. ORG stated that both of these averages comply with those percentage ranges of 3% - 5% for grants, and 4% - 6% for service fees, as set forth in ORG's Form 1023 Application for Recognition of Exemption approved by the IRS."

The averages as stated by ORG were true for most of the 61 sampled transactions, except there were 11 transactions (18%) that exceeded those levels on an individual basis. The 11 transactions, which exceeded the Form 1023 specified amounts, ranged from a grant of 5.36% and service fees of 6.10% to a grant of 20% and service fees of 20.93%.

From the sampled 61 transactions, there were 41 transactions that appeared to be with sellers who were individuals, there were 15 transactions that appeared to be with sellers who were builders or investment groups, and there were 5 transactions that it was unknown who the seller was.

The sampled transactions show when the seller was an individual, the net service fees to ORG (computed as the down payment assistance fee received from the seller by ORG less the down payment assistance gift amount to be given to the buyer) were usually \$ and that the

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administration fees to CO-2 were usually \$. When the seller was a builder, the net service fees to ORG were usually \$ and that the administration fees to CO-2 were usually \$. See below:

### Individual Sellers

From the sample, 31 out of 41 of the transactions involving a buyer and an individual seller resulted in a net service fee amount of \$ to ORG after the gift amount to the buyer. Of those 31 transactions, 30 of the transactions each resulted in an administration fee to CO-2 (CO-2) of \$ and one of the transactions resulted in an administration fee to CO-2 of \$. The other 10 out of 41 transactions involving an individual seller resulted in net service fee amounts to ORG and administration fees to CO-2 as follows: one transaction ORG \$ and CO-2 \$; three transactions ORG \$ and CO-2 \$; one transaction ORG \$ and CO-2 \$; one transaction ORG \$ and CO-2 \$; three transactions ORG \$ and CO-2 \$; and one transaction ORG \$ and CO-2 \$.

### Builder Sellers and Investment Group Sellers

The other identifiable sellers involved 15 transactions with sellers who were either builders or investment groups. From the IRS Analysis, 11 out of 15 of those transactions involved sellers who were builders and those transactions resulted in a net service fees to ORG of \$ and an administration fee to CO-2 of \$. There were two transactions with builder sellers resulting in a net service fee to ORG of \$ and an administration fee to CO-2 of \$. Finally, there were two transactions with sellers who were investment groups resulting in a net service fees to ORG of \$ and an administration fee to CO-2 of \$.

### Down payment Assistance Transactions

Evidence that ORG was not following any type of low-income guidelines or "exclusively" providing charitable assistance to the poor or distressed was found during the random sample of ORG's transactions processed during the year 20XX. The 61 randomly sampled transactions did not have any information on the buyer's annual income within the documents provided by ORG's DVD.

HUD Settlement Statements showed that from the random sample of 61, there were 15 homes which sold for \$ or more as shown below:

Sample #	Price of Home	City & State
8	\$	City, State
11	\$	City, State
17	\$	City, State
21	\$	City, State
22	\$	City, State
24	\$	City, State
28	\$	City, State
29	\$	City, State
32	\$	City, State

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33	\$	City, State	
35	\$	City, State	
42	\$	City, State	
46	\$	City, State	
50	\$	City, State	
53	\$,	City, State	

In addition, one of the sampled ORG transactions, sample #30, ORG ID #910, showed that on August 25, 20XX, DIR (owner of CO-1 and CO-2) and DIR-2 were buyers for a property located at Address, City, State. The sales price of the property was \$ and the DIR's received a gift amount of \$. The service fees paid to ORG were \$ (includes gift amount) and the administration fees paid to CO-2 were \$.

**ORG's Website**

ORG did not have a website during the year 20XX, but stated in a letter dated January 12, 20XX, that "ORG's website was launched in November of 20XX." For the year 20XX up to the time ORG launched its own website, ORG stated that it was able to operate its down payment assistance program by utilizing the online down payment assistance processing tool of CO-1, therefore a ORG website was not necessary to operate ORG's down payment assistance program. ORG also stated that it created its website to further the homebuyer education aspect of its charitable activities."

Based on a copy of ORG's website (website) printed on July 6, 20XX, and included as Attachment 1 to IDR #3, ORG provided statements regarding its operations in a letter dated January 12, 20XX, as shown below.

ORG responded "Yes" that the website pages printed on July 6, 20XX, describe how ORG's down payment assistance program worked in the year 20XX. ORG stated that to the best of its knowledge that the copy of its website printed on July 6, 20XX, was accurate. However, ORG stated that since July 6, 20XX, it had updated its "Important Links" section of its website which now includes a link to "Classes" for State.

ORG also stated that numerous website updates have been posted since its inception. However, no copies were available since ORG does not archive previous versions of its website and does not maintain a change log. ORG states that changes made to its website since November 20XX include: a "Contact Us" link to its "Mission Statement" page was added to allow interested parties to quickly find ORG's contact web form; A "Press Room" section was added to its website, enabling ORG to post information regarding ORG organization changes, status, related letters, articles, industry activity, etc.; "Budget Worksheet" URL changes were made; a "Loan Officers Materials" link was added to its "Loan Officers" page; and miscellaneous aesthetic changes (colors, backgrounds, etc.) have been made to improve the appearance of the website."

**ORG's Webpages providing education – Per ORG**

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ORG stated that while ORG does provide potential homebuyers with homeownership information and educational materials via its website, ORG does not promote its downpayment assistance program to them.

In a letter dated January 12, 20XX, ORG stated that its webpages were designed to include its educational objectives, as follows:

**Mission Statement.** Includes education along with its primary function of increasing homeownership through downpayment assistance.

**FAQ:** Education of potential homebuyers about how downpayment assistance works.

**Homebuyers Guide:** This section includes information on preparing to buy a home, finding competent real estate professionals, and finding a home. Also, the section includes links for potential homebuyers to additional homeownership information resources.

**Links:** ORG provides several links to potential homebuyers. These links are resources outside of ORG's web site, but are helpful to homebuyers. The following list are the links currently offered in this section:

**Fannie Mae Guide To Buying a Home:** An additional homebuyers guide  
**Mortgage Calculators:** Online tools that help potential buyers understand mortgage payments

**Credit Basics:** A guide to understanding credit basics

**HUD Buyer Information:** An additional homebuyer's information guide.

**Online Homebuyer Education Class:** An online class potential homebuyers may attend to further their education.

**Glossary:** ORG included a glossary of important terms dealing with real estate transactions. ORG intentionally included this section for homebuyers to learn the vocabulary necessary to understand the process of buying a home.

**Contact Us:** ORG encourages potential homebuyers and others to contact ORG directly with any questions about homeownership.

### Summary of ORG's Website Printed on July 6, 20XX

ORG, through its website printed on July 6, 20XX, provides information about its program to homebuyers and loan officers through its "frequently asked questions" webpage. The "homebuyer's guide" webpage discusses the need for a homebuyer to find a professional mortgage loan officer in order to pre-qualify for ORG's down payment assistance program, the need to find a real estate professional, and the need to find a home.

Many of the participants in ORG's down payment assistance program utilize Federal Housing Administration (FHA) financing for their home purchase. Included on ORG's website was copy of a letter dated October 7, 20XX, showing that as of September 13, 20XX, Countrywide Home Loans approved ORG's program for loans made nationwide. ORG's webpages do not

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provide any forms for buyers or sellers since all down payment assistance transactions are done through CO-1

ORG's website "important links" section printed on July 6, 20XX, showed links to "Fannie Mae Guide to Buying a Home"; "Mortgage Calculators"; "Credit Basics"; and HUD Buyer Information". These are links to organizations outside of ORG's website.

In addition, per ORG, its website section "Frequently Asked Questions" (FAQ) states that "Reviewing our most frequently asked questions will provide a general overview of how ORG can work for you and your clients." ORG's FAQs are very similar to CO-1's "frequently asked questions", which is discussed later.

A summary of ORG's website answers to FAQs are shown below, in part:

The ORG states that ORG is a 501(c)(3) nonprofit organization which provides financial aid in the form of downpayment assistance gift funds to families and individuals. ORG restricts its gift funds to individuals who otherwise meet the guidelines for an affordable mortgage loan program, but who do not have the necessary downpayment and/or closing costs required, and cannot otherwise afford to purchase a home without such assistance.

ORG states that FHA-insured mortgages are most common affordable mortgage loan program and FHA regulations allow downpayment assistance to be gifted to buyers.

ORG states that as a 501(c)(3) nonprofit organization with a 509(a)(2) designation, ORG is authorized to raise funds from fees charged to home sellers for incidental services provided to them. Per ORG's gift funds are cash that is gifted to a home buyer at closing to be used for their downpayment and/or closing costs.

ORG states that none of the seller-paid fees pass directly to the buyer in the transaction. No portion of the fee is passed to the buyer or used to provide the downpayment assistance given to the buyer. Seller-paid fees are paid after the close of escrow from the proceeds of the sale of the home.

ORG states that seller-paid fees are fees for service, not a charitable donation, and therefore are not deductible as a charitable donation.

### **CO-1 Website printed July 6, 20XX**

Since CO-1's (CO-1) website (website) showed that its website promotes ORG's down payment assistance program, copies of CO-1's web pages printed on July 6, 20XX, were sent to ORG. Based on questions asked of ORG regarding CO-1's website pages, in a letter dated January 12, 20XX, ORG provided responses as shown below.

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ORG responded that the website pages printed on July 6, 20XX, from website describe how ORG's downpayment assistance program worked in the year 20XX with one exception. ORG stated that the enclosed copy of CO-1's website included a reference to certain Marketing Materials which, in the past, ORG had requested be removed from CO-1's website. ORG stated that CO-1 complied, removing the materials from the registered loan officer (Member) section of its Website. Per ORG, the July 6, 20XX, copy of CO-1's website indicated a reference to them in the Press "Link" section of the website as well. ORG stated that it has since brought this to CO-1's attention. ORG also stated that CO-1 has acknowledged its oversight, and, per ORG's request, has removed reference to these materials from the Press "Link" section of its website."

ORG responded that to the best of its knowledge, CO-1's website pages printed on July 6, 20XX, are accurate as of July 6, 20XX.

ORG also responded "While ORG periodically reviews CO-1's website, it does not control and/or monitor it. Your enclosed copy of CO-1's website included a reference to certain Marketing Materials which, in the past, ORG had requested be removed from CO-1's website..."

### **Summary of CO-1's Website Printed on July 6, 20XX**

CO-1 through its website (website) printed on July 6, 20XX, promotes the program for ORG to loan officers, realtors, home builders, and home buyers.

#### **Homepage**

The homepage of CO-1 states:

"Why CO-1?"

**As a service**, CO-1 facilitates the delivery of 501(c)(3) nonprofit gift funds to cash-challenged homebuyers to be used for their downpayment and/or closing costs in purchasing a home.

**As a tool**, CO-1's smart, online technology provides loan officers instant, paperless processing, and electronic delivery of requested gift funds for buyers who qualify for downpayment assistance.

**Simply put**, CO-1 is the quickest, most efficient, down payment assistance service in America."

#### **Frequently Asked Questions Page**

CO-1's (CO-1) "Frequently Asked Questions" (FAQ) is similar to ORG's website FAQ and it states "Reviewing our most frequently asked questions will provide a general overview of how CO-1 can work for you and your clients." The major difference is the FAQ "What does CO-1 do?" CO-1 answers: "CO-1 facilitates the delivery of 501(c)(3) nonprofit organization gift funds to cash-

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challenged home buyers to be used for their downpayment and/or closing costs in purchasing a home.”

### **Press Room Page**

The “Press Room” page of CO-1 states that the IRS renewed ORG’s 501(c)(3) status on March 24, 20XX. Also, from the “Press Room” page a link was provided to ORG’s March 24, 20XX, letter from the IRS for public charity foundation status under IRC section 509(a)(2).

In addition the “Press Room” page also shows that “ORG, CO-1 now approved with Countrywide”. The link to the Countrywide article states the following:

#### **“ORG now approved with Countrywide**

September 13, 20XX

ORG received (sic) a national approval as a downpayment assistance provider for Countrywide in September, 20XX. Countrywide is one of the nations largest and most respected home loan lenders in the United States.

ORG obtained its charitable designation as a 501(c)(3) non-profit organization from the IRS in 20XX. Since that time, ORG has generated millions of dollars in gift funds, helping thousands of potential homebuyers achieve the American Dream. The approval from Countrywide is a big step in ORG’s ability to help more families own their own homes.

CO-1 partners with ORG market its services throughout the country, and also provides online tools and support to mortgage companies and loan officers.

Countrywide’s approval process for downpayment assistance companies is stringent, with only a handful of nationwide companies approved. MD-1, Managing Director for ORG, points to ORG’s proper foundation and strong financial growth to explain the approval.

“We have done our best to do things the right way,” says MD-1. “Our company has established sizeable, consistent growth since inception.”

To view the official approval letter from Countrywide, please [click here](#).”

### **Marketing Materials Linked Pages**

The “Press Room” page also shows “Marketing Materials”. The documents from the “Press Room” explain CO-1’s program to potential clients, real estate agents, builders, and other mortgage officers. The documents are accessed through links from the “Press Room” page and are available in English and Spanish.



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As previously mentioned above, regarding ORG being asked if CO-1's website pages printed on July 6, 20XX, were accurate, ORG stated that in the past, it had requested that certain Marketing Materials be removed from CO-1's website and that CO-1 acknowledge the oversight and has removed the reference to those materials. Currently, per a review of CO-1's website, the Marketing Materials which were on CO-1's website as of July 6, 20XX, have been removed.

However, the Marketing Materials which existed on CO-1's website as of July 6, 20XX, are shown below. The first linked document in the "Marketing Materials" is "No cash for a Home? Not a Problem." which states:

**"No cash for a Home? Not a Problem.**

CO-1 downpayment assistance program

The number one obstacle to homeownership in America is "money for downpayment and closing costs."

**FANNIE MAY NATIONAL HOUSING SURVEY**

If you've dreamed of owning a home, but lacked the sufficient downpayment and/or closing cost funds required, CO-1 can help.

Many homebuyers are unaware that the money they lack for a downpayment and closing costs can be gifted to them by a nonprofit organization—with no repayment obligation.

CO-1 is a downpayment assistance program designed to create homeownership opportunities for cash-challenged buyers, via the Internet.

CO-1's Smart Online Processing System instantly links potential homebuyers with available nonprofit organization gift funds that can be used for their downpayment and/or closing costs.

Just have your loan consultant register with CO-1, submit an online gift application for you, print your gift letter confirming our commitment of funds to you, and we'll do the rest."

The second linked document in the "Marketing Materials" is "Create New Buyers!" which states:

**"Create New Buyers!**

CO-1 downpayment assistance program

The number one obstacle to homeownership in America is "money for downpayment and closing costs."

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## FANNIE MAY NATIONAL HOUSING SURVEY

While many potential homebuyers are still unaware that the money they lack for a downpayment and closings costs can be gifted to them by a nonprofit organization—with no repayment obligation, Downpayment Assistance gift fund transactions currently account for 20% of all FHA loan home purchases (approximately 18,000 per month).

### Utilizing Downpayment Assistance

- Creates new qualified buyers,
- Increases the marketability of property, and
- Sells more homes faster

CO-1 is a downpayment assistance program designed to create homeownership opportunities for cash-challenged homebuyers.

CO-1's Smart Online Processing System instantly links potential homebuyers with available nonprofit organization gift funds that can be used for their downpayment and/or closing costs—with no repayment obligation.

### Quick, Easy, and Efficient, CO-1 provides Registered Loan Consultants and their borrowers:

- Quick, Smart Online Applications that retain collected builder, Realtor, closing agent, and wholesale lender information for recall in future gift applications,
- Instant Approval of submitted gift fund applications allowing for immediate funding (when needed),
- Customized Dynamic Documents which are immediately accessible for inclusion in underwriting packages, and automatically emailed to the closing company upon submission of the gift application,
- Guaranteed Lowest Fees
- 130 Approved Wholesale Lenders

### Just Have Your Loan Consultant

- Register with CO-1
- Submit your client's gift application online,
- Print your client's Gift Letter confirming our commitment of funds, and **CO-1 does the rest.**"

The third and final linked document in the "Marketing Materials" is "Free Money to Buy a Home..." which states:

**"Free Money to Buy a Home..."**

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with no repayment obligation!

CO-1 is a downpayment assistance program designed to create homeownership opportunities for cash-challenged homebuyers.

CO-1's Smart Online Processing System instantly links potential homebuyers with available nonprofit organization gift funds that can be used for their downpayment and/or closing costs—with no repayment obligation.

**CO-1 delivers its service with:**

- No hidden fees
- No personal funds required
- No repayment obligation
- No educational course requirement
- No home protection plan requirement
- No roof inspection requirement
- No income restrictions
- No purchase price restrictions
- No % down limitations
- No geographic restrictions
- No complicated paperwork

**CO-1 provides Registered Loan Consultants and their borrowers:**

- Quick, Smart Online Applications that retain collected builder, Realtor, closing agent, and wholesale lender information for recall in future gift applications,
- Instant Approval of submitted gift fund applications allowing for immediate funding (when needed),
- Customized Dynamic Documents which are immediately accessible for inclusion in underwriting packages, and automatically emailed to the closing company upon submission of the gift application,
- Guaranteed Lowest Fees
- 130 Approved Wholesale Lenders

**Just Have Your Loan Consultant**

- Register with CO-1,
- Submit an online gift application for you,
- Print your Gift Letter confirming our commitment of funds to you, and
- Let CO-1 take care of the rest.”

**Loan Officer's Webpage**

CO-1's "Loan Officers" webpage states the following:

"Loan Officers

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Maximizing the power of the Internet, CO-1 delivers our registered loan officers a unique online tool for instantly reserving and securing downpayment assistance gift funds.

CO-1 restricts its downpayment assistance services to buyers who otherwise meet the guidelines for an affordable mortgage loan program, but who otherwise do not have the downpayment and/or closing costs (sic) required, and cannot otherwise afford to purchase a home.

If you are a loan officer with a cash-challenged buyer who qualifies for our service, and have a purchase contract in place, please register here.

### **One Easy Step**

Registered loan officers just log in and submit an online gift application for their buyers, and CO-1 instantaneously does the rest, delivering:

- **Quick, Smart, Online Gift Applications** that retain collected builder, Realtor, closing agent, and wholesale lender information for recall in future gift applications.
- **Real-Time Access** of submitted applications allowing for multiple updates right up to the moment of closing.
- **Instant, Customized, Dynamic Documents** which are immediately accessible for inclusion in underwriting packages, and automatically e-mailed to the closing company upon submission of the gift application.
- **Guaranteed Lowest Fees** which are often one-half to one-third that of our competition. See Fee Information for more details.”

### **LAW:**

Section 501(a) of the Code provides for the exemption from federal income taxation of corporations described in section 501(c)(3) of the Code. To be described in section 501(c)(3), an organization must be organized and operated exclusively for charitable, educational or other exempt purposes and may not permit any of its net earnings to inure 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 section 501(c)(3) of the Code. 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.” If a substantial part of an organization’s

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activities furthers non-charitable purposes, the organization is not operated exclusively for charitable purposes even though its other activities further charitable purposes. See *Old Dominion Box Co., Inc. v. U.S.*, 477 F.2d 340 (4<sup>th</sup> Cir. 1973), *cert. denied*, 413 U.S. 910 (1973).

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of 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) of the regulations defines the term "charitable" as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the underprivileged, advancement of education, combating community deterioration and lessening the burdens of government.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides, in part, that the term "educational" as used in section 501(c)(3) of the Code 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) of the regulations provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) of the Code if the trade or business furthers an exempt purpose, and provided 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.) *cert. denied*, 488 U.S. 907 (1988), the court held that an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that the organization did not qualify for exemption under section 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 section 501(c)(3). *Easter House*, 12 Cl. Ct. at 485-486.

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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 section 501(c)(3) of the Code 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 section 1.501(c)(3)-1(d)(1)(ii) of the regulations. 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."

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 nonprofit organizations and shops was operated for exclusively charitable purposes within the meaning of section 501(c)(3) of the Code. 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 by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from these communities of craftsmen. It did not select individual craftsmen based on the needs of the purchasers. The court concluded that the overall purpose of the activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but merely the means through which the organization pursued its charitable purposes. The method it 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.

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 to an organization that operated a conference center as its primary activity and derived most of its revenues from user fees. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. In reaching this conclusion, the court stated that "[a]mong 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." *Id.* at 63.

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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. The organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) coordinating and supervising joint construction projects, (2) purchasing home sites for resale at cost, and (3) helped low income people obtain home construction loans.

Rev. Rul. 2006-27 sets forth the applicable rules and standards for determining whether organizations that provide down payment assistance to home buyers qualify as tax-exempt charities. The ruling discussed three situations of organizations providing down payment assistance to home buyers and whether each qualified as charitable within the meaning of section 501(c)(3) of the Code.

Situation 1 described an organization that helps low-income individuals and families who qualify for a loan, but lack the down payment to purchase a home, by providing part or all of the funds they need to make a down payment. The organization conducted a broad based fundraising program, and it received support from a wide array of sources. The organization's policies of ensuring that its grantmaking staff did 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), and of not accepting contributions contingent on the sale of any particular properties, ensured that the organization was 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. The organization's grantmaking procedure combined with its efforts to educate home buyers ensured that the organization was operated primarily to benefit the low-income beneficiaries of its down payment assistance. The revenue ruling held that since the low-income beneficiaries constituted a charitable class and that any benefit to other parties (such as home sellers, real estate agents, or developers) who participated in the transactions did not detract from the charitable purpose of relieving the poor and distress, the organization qualified for exemption under section 501(c)(3).

Situation 2 described an organization that is like the organization in Situation 1 except that to finance its down payment assistance activities, the organization relied on sellers and other real estate businesses that stood to benefit from the transactions that the organization facilitated. Further, in deciding whether to provide assistance to a low-income applicant, the organization's grantmaking staff knew the identity of the home seller and may also have known the identifies of other interested parties and was able to take into account whether the home seller or another interested party was willing to make a payment to the organization. The organization'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 the organization's reliance on these payments for most of its funding indicated that the benefit to home seller is a critical aspect of the organization's operations. In this respect, the organization was determined to be 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

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*American Campaign Academy*, the organization was 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*, the organization also served an exempt purpose, but because the organization was not operated exclusively for exempt purposes, the ruling held that the organization in Situation 2 did not qualify for exemption under section 501(c)(3).

Situation 3 described an organization formed to combat community deterioration in an economically depressed area that had suffered a major loss of population and jobs. Although the organization did not limit its down payment assistance program to low-income recipients, the organization's downpayment assistance program still served a charitable purpose described in section 501(c)(3) because it combated community deterioration in a specific, economically depressed area that had suffered a major loss of population and jobs. Through a combination of counseling and financial assistance, the organization helped low and moderate-income families in that area to acquire decent, safe and sanitary housing and to prepare for the responsibilities of home ownership. The revenue ruling held that because the organization was operated exclusively for charitable purposes, it qualified for exemption under section 501(c)(3).

### **GOVERNMENT'S POSITION:**

ORG is not operated exclusively for exempt purposes under *section 501(c)(3) of the Code*. An organization cannot be recognized as exempt under *section 501(c)(3)* unless it shows that it is both organized and operated exclusively for charitable, educational, or other exempt purposes. 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.

The gathered information indicates that ORG's primary activity has been the operation of a down payment assistance program that does not serve a purpose described in *section 501(c)(3)* and that furthers a substantial private benefit.

Charitable purposes include relief of the poor and distressed. See *section 1.501(c)(3)-1(d)(2) of the regulations*. ORG does not screen or limits its assistance to low-income individuals or those who are distressed or underprivileged within the meaning of law on charity.

Instead, ORG's program is open to anyone, without any income limitations who otherwise qualified for a mortgage. This is evidenced by ORG's website printed on July 6, 20XX, and in a letter dated January 12, 20XX, in which ORG stated that it must restrict its gift funds to individuals who otherwise meet the guidelines for an affordable mortgage loan program, but who do not have the necessary down payment and/or closing costs required, and cannot otherwise afford to purchase a home without such assistance.



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In addition, CO-1, the for-profit online internet company that performs clerical services for ORG's down payment assistance program, stated on its website printed on July 6, 20XX, that there are no educational course requirements, no income restrictions, no purchase price restrictions, no percentage down limitations, and no geographic limitations. Accordingly, ORG's activities do not serve the purpose of relieving the poor and distressed or underprivileged within the meaning of section 501(c)(3).

ORG has not demonstrated that its down payment assistance program exclusively serves any other exempt purpose within the meaning of section 501(c)(3). ORG does not require participants in its down payment assistance program to undergo training in order to participate in the program. ORG's educational activities were at best incidental to its primary activity of providing down payment assistance and served primarily marketing function rather than educating the public about house purchasing process or financial responsibility of home ownership. The "frequently asked questions" section of ORG's website merely provides "a general overview of how ORG can work for you and your clients." The "homebuyer's guide" section of ORG's website provides a "Budget Worksheet" link and an "important links" link, which provide little educational information and primarily discuss that the prospective homebuyer should first pre-qualify for ORG's program, find a real estate, professional, and find a home. ORG's "glossary" website page provides only a list of terms dealing with real estate transactions and the "important links" page provides nothing more than links to independent websites with information about house purchasing that is otherwise freely available to the public. Also, ORG's involvement in the real estate transactions occurred well after any education instruction to a homebuyer could prove helpful or useful. ORG did not work with potential homebuyers on improving their understanding of real estate transactions or the responsibilities of homeownership; rather it simply facilitated real estate transactions that were already in process for a fee.

ORG's activities do not combat community deterioration or serve the purpose of lessening neighborhood tensions or eliminating prejudice and discrimination within the meaning of section 501(c)(3). Arranging the purchase of homes in a broadly defined geographic area does not combat community deterioration within the meaning of *section 501(c)(3) of the Code*.

Even if ORG directed its program exclusively to low-income individuals or disadvantaged communities, its total reliance on sellers for financing its down payment assistance program would establish that ORG has been operating for the substantial purpose of benefiting private interests of the sellers that have benefited from the transactions, as well as CO-1, a for profit organization which derived all of its business from ORG.

ORG indicates in the Taxpayer's Position section below that it is different than *Rev. Rul. 20XX-27, Sit. 2* since it: a. has no foreknowledge of the seller until after the fact and, therefore, any benefit to the seller is incidental to the transaction ; b. has broad based fundraising for which it received IRS approval to fund its downpayment assistance program through gross receipts from exempt function activities (fees collected from sellers for services); c. does not compete with for-profit businesses since it has carefully avoided competing with for-profit businesses by having the for-profit function of ORG's transactions being handled by for-profit entities/individuals and that ORG

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has not accumulated substantial profits; d. since ORG deals with transactions across the country, it is not affiliated with funders and typically is unfamiliar with the real estate professionals involved; and e. since ORG is not generally familiar with the sellers or the real estate professionals, and carefully avoids competing with for-profit businesses, the benefits derived by the sellers (the sale of their homes) is incidental rather than central (i.e. intended) to ORG's activities and that in each transaction the seller provides the means by which ORG is able to raise funds for continued downpayment assistance to future buyers.

Although ORG states that it does not know the identities of the sellers until after the fact, the identities of the sellers would be known by ORG through CO-1, the for-profit online down payment assistance processing tool utilized by ORG. Knowledge of the seller's identity is secondary to the fact that ORG provides down payment or closing costs grants only if it is assured, through contractual arrangements, that it will receive a fee from the house seller and the fee is always equivalent the homebuyer's grant plus the administrative fees.

ORG does not receive funding from disinterest sources such as the general public. All of the funds used to operate its program are derived from home sellers that have an interest in the transactions. All of the funds come from the receipt of payments from home sellers corresponding to the down payment assistance in substantially all of its transactions. ORG is merely acting as a conduit to facilitate transfers of cash to homebuyers. HUD's guidelines prohibit contributions of cash towards down payment or closing costs from house sellers. Essentially, here ORG served the role of a conduit, circumventing the HUD rule prohibiting contributions from sellers for down payment or closing costs.

ORG states that the for-profit portion of its down payment assistance program is handled by for-profit businesses it, therefore, does not compete with for-profit businesses and it has not accumulated substantial profits. ORG working together with CO-1 and CO-2, compete with for profit companies that are in the business of facilitating real estate transactions. The manner in which ORG operates its program assures profit making and accumulation by CO-1 and CO-2, rather than ORG. In addition, ORG is at a competitive advantage in that its purported tax-exempt status allows the organization to circumvent the HUD rules prohibiting contributions of cash from house sellers for down payment or closing costs. ORG is able to lend its tax-exempt status to increase the number of transactions CO-1 and CO-2 are able to close, thus maximizing their fees and profits. By engaging in down payment assistance transactions in concert with the for-profit entities, ORG furthers the business interests of CO-1 and CO-2. CO-1 and CO-2 benefit from the administration fees received from the transactions which are usually \$ when the seller was an individual and \$ when the seller was a builder.

ORG states that since it deals with transactions across the country, it is not affiliated with funders (lenders) and is typically unfamiliar with real estate professionals involved. Irrespective of ORG's familiarity with any of the parties to a real estate transaction, ORG's primary activity substantially benefits private interests of individuals connected to the real estate transactions it facilitates and these individuals are not members of a charitable class. The sellers benefit by having their homes sell faster and for a higher price. The lenders and real estate professionals and companies benefit

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by selling more homes and with shorter time on the market, thus maximizing their fees and commissions. The homebuyers are able to purchase a home without committing any of their own funds. As shown in the Marketing Materials (removed from CO-1 website after July 6, 20XX) of CO-1's website page, printed on July 6, 20XX, "Create New Buyers!" states that utilizing down payment assistance "creates new qualified buyers"; "increases the marketability of property" and "sells more homes faster", thereby benefiting the sellers, loan officers, processors, and escrow officers.

Also, it should be noted that CO-1 (CO-1) and CO-2 (CO-2) stood to benefit by being affiliated with ORG since DIR, officer and owner of CO-2, provided a private line of credit to ORG. Also, DIR benefited through a transaction with ORG since one of the downpayment assistance transactions involved DIR as a buyer who received a downpayment assistance gift from ORG.

Finally, ORG states that because it is not generally familiar with sellers or real estate professionals that the benefits derived by sellers are incidental to ORG's activities. As the record shows, the benefits derived by sellers and other parties related to real estate transactions facilitated by ORG in concert with its for-profit counterparts are the central or intended to consequence of the ORG's down payment program.

Similar to the organization in *American Campaign Academy*, *supra*, and the organization described in *Rev. Rul. 20XX-27, Sit. 2*, ORG is structured and operated to assist the private parties who pay for its services and give it business. The manner in which ORG operated its down payment assistance program shows that the private benefit to the various participants in ORG's down payment assistance activities was the intended outcome of ORG's down payment assistance activities and not a mere incident of such activities. ORG's down payment assistance transactions are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of proceeds from the sale of their homes that may have been sold at artificially inflated prices. As indicated by the November 20XX GAO report entitled Mortgage Financing – Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance, GAO-06-24, FHA-insured homes bought with seller-funded nonprofit assistance were appraised at and sold for about 2 to 3 percent more than comparable homes bought without such assistance.

ORG's grant making procedures indicate that gift funds are only provided if a seller has paid a service fee to ORG and an administration fee to CO-2. The Service has not found any instance in which a seller was able to sell its home in a ORG transaction without having made an administration fee payment to CO-2 and a service fee payment to ORG in the amount equal to the amount of the down payment assistance on the seller's home plus and additional amount to cover ORG's administration fee. In addition ORG's transactional documents, through CO-1, such as the "Irrevocable Agreement to Issue Funds", "Addendum to Real Estate Purchase Contract", and "Cooperating Home Registration", indicate that ORG's grant making staff, through CO-1, is able to take into account whether there is a home seller willing to make a payment to cover the down payment assistance an applicant has requested. In essence, the sellers agree to assist buyers in

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purchasing their homes with little or no down payment, through inflated sales prices, with ORG facilitating the transaction for a fee.

The fact that ORG receives a payment from the home seller corresponding to the amount of the down payment assistance in every transaction indicates that the benefit to the home seller is not a mere accident but rather an intended outcome of ORG's operations. In this respect, ORG operates in a substantially similar manner as the organization described in situation 2 of *Rev. Rul. 20XX-27*. Also, ORG is similar to *Easter House, supra*, 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 operates in a manner that is 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 a charitable class or the public at large. ORG, by utilizing CO-1 and CO-2, facilitated the sales of homes in a manner that is indistinguishable from an ordinary trade or business.

Facilitating home sales is not an inherently charitable activity. Unlike the trade or business considered in *Aid to Artisans, supra*, ORG's trade or business is not a mere instrument of furthering charitable purposes but is an end in itself. ORG facilitates real estate transactions allowing the designated entities, CO-1 and CO-2, to charge a market rate fees and make profits. The fees structure and the transactions have been designed in such a way as to make a profit for CO-1 and CO-2. Thus, ORG has been operating in furtherance of a non-exempt business purpose. Virtually all of ORG's revenue comes from the sellers. ORG, through CO-1, markets and provides its services to a wide variety of individuals and entities. Most of these individuals and entities are not within a charitable class. ORG, through CO-1, does not solicit funds from any parties that do not have interest in its down payment transactions. ORG's reliance on seller financing and a lack of public support are indicative of a commercial purpose. Like *Rev. Rul. 20XX-27, Sit. 2*, and like the organizations in *Easter House* and *Airlie Foundation*, the manner in which ORG operated is inconsistent with the requirements of section 501(c)(3).

Based on the foregoing, ORG does not operate exclusively for exempt purposes enumerated in section 501(c)(3) and does not qualify for exemption as an organization described in § 501(c)(3).

### **TAXPAYER'S POSITION:**

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

In a letter dated May 31, 20XX, Power of Attorney (POA), ATTN, attorney, stated the following, in part:

"...In that [Form 1023] correspondence, the [ORG (the "Company")] Company clearly described the manner in which it would conduct its affairs and further its charitable purposes. The Company has operated in conformity with that description.

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Specifically, in its final attestation, dated August 6, 20XX, the Company unambiguously advised the IRS it would undertake the following activities:

- The Company would operate a down payment assistance program that was designed to create home ownership opportunities for persons who qualify for mortgage loans under the standards prescribed by the Federal Housing Administration, but otherwise do not have the necessary down payment and/or closing costs required to obtain such financing. The Company has done this.
- Under the terms of the Company's program, a prospective homebuyer/donee would locate affordable housing, obtain pre-qualification for mortgage financing, and execute a real estate sales contract with the seller. At that point, the Company would enter into the transaction process to make a grant to the qualified prospective homebuyer in the amount of the funds required to provide the homebuyer with the necessary down payment. Unlike many down payment assistance groups (who are actively involved with a buyer before he/she even makes an offer on a home), the Company does not engage in the real estate transaction until after the homebuyer has completed all steps leading up to and including the full execution of the real estate sales contract.
- The Company applied for and was awarded foundation classification status as a public charity under Section 509(a)(2) of the Code. Pursuant to this classification, the Company would finance its operations through service fees charged to the seller (although the seller engaged in a particular transaction would not provide the funds used to make the down payment assistance grant to the person buying that seller's real property). Indeed, the Company expressly advised the IRS in the correspondence relating to its Form 1023 that on average, the Company expected to charge sellers fees between 4 and 6 percent of a home's sales price and that the Company expected grants to buyers to be between 3 and 5 percent of the home's sales price. It thus was anticipated and disclosed to the IRS that the seller fees would finance, in full, the Company's down payment assistance grants. While the Company retained the option to engage in broad-based fundraising, it chose to operate under the business model described above in full compliance with its recognized classification as a public charity under Section 509(a)(2) of the Code.

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- Unlike many other down payment assistance organizations, the Company does not (and has not) actively market its services to realtors or home builders, and service fees charged are not collected until after the closing and recording of the underlying transaction. Instead, the Company has focused its efforts on educating loan officers and mortgage brokers about the Company's program."

"...Since the date of the initial determination [August 8, 20XX], the Company has operated according to the terms and conditions of its business model, as initially disclosed to the IRS in the Company's Form 1023 and corresponding filings."

### How ORG is Not an Organization Described in Situation 2 of Revenue Ruling 20XX-27

ORG was asked to explain how ORG is not an organization described in situation 2 of Revenue Ruling 20XX-27.

ORG's response included in a letter dated January 12, 20XX, is as follows:

"ORG is different from the organization described in situation 2 of Revenue Ruling 20XX-27" as set forth below.

- Foreknowledge of Seller.** Per ORG's final summation of its charitable activities dated August 6, 20XX found in its Form 1023 Recognition of Exemption application previously provided in IRD (sic) #1, and to which it adheres, please note:

"The role of ORG is to enter the transaction process after a potential buyer/donee has found a loan officer, pre-qualified for an affordable mortgage loan program, found an affordable home, negotiated an affordable purchase price, and secured a fully executed purchase contract with the seller, independent of ORG."

Under ORG's customary gifting procedures, to which it consistently adheres, ORG does not enter the transaction process until a fully executed purchase contract has been secured, and the seller and transaction fees have already been established, independent of ORG. Any knowledge ORG has of the seller is limited and "after the fact". As a result, any benefit to the seller is incidental to the transaction. Buyers qualify for ORG assistance by meeting ORG's funding criteria, which include fulfilling HUD loan requirements (other than having downpayment funds), demonstrating that they are unable to make the downpayment without assistance, and entering into a contract with their seller by which the seller agrees to pay ORG's service fee if ORG provides the buyer's downpayment, The identity of the seller is immaterial, and

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ORG does not negotiate with the seller. The focus is on the buyer, who either meets the funding criteria or not.

- b. **Broad based fundraising.** Per ORG's Form 1023 application, to which it adheres, ORG elected to generate its financial support from contributions, membership fees, and gross receipts from activities related to its exempt functions, rather than from contributions from publicly supported organizations, from a governmental unit, or from the general public, and received IRS approval to do so. Therefore, ORG is allowed to limit its fundraising efforts to service fees collected from activities related to its exempt functions. Unlike many downpayment assistance entities, which typically applied for exempt status on the basis of obtaining public support for their funding needs (and which the entity in Situation 2 of the Revenue Ruling is presumably intended to represent), ORG obtained express approval from the IRS to fund its downpayment assistance program through gross receipts from exempt-function activities. Thus, ORG is operating consistent with its "charter" and it would be unfair for the IRS to now prohibit ORG from conducting its operations as previously approved.
- c. **Competing with For-Profit Business.** Revenue Ruling 20XX-27 cites the case of Easter House v. U.S., 12 Cl. Ct. 476 (1987) in analyzing Situation 2 of the Revenue Ruling. In Easter House, the exempt organization provided adoption and related health services to pregnant women who agreed to place their newborns for adoption through the organization. The court determined 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 found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. The court concluded that the organization's primary goal was to engage in business, not fulfill its charitable purposes. The revenue ruling then compares this case to Situation 2, concluding that in Situation 2 the organization's reliance on seller fees to fund its downpayment assistance program indicates that, like the organization in Easter House, its business purpose predominates. ORG is clearly distinguishable from this scenario because, unlike the organization in Easter House, ORG has carefully avoided competing with for-profit businesses. It has not actively engaged in advertising. It has avoided engaging in activities that would tend to compete with existing for-profit businesses (such as providing loan broker services, escrow services, and related services associated with the purchase of a home.) In every ORG transaction, for-profit functions are handled by for-profit entities/individuals, precisely to avoid the problem of competing with for-profit businesses. As a result (and in further contrast with Easter House), ORG has not accumulated substantial profits. ORG restricts its activities to providing downpayment assistance, consistent with its Form 1023 application. All others involved in its transactions are presumed to be taxable entities that are subject to full taxability.

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on any income they may earn. ORG believes that this approach represents a good-faith effort to narrowly restrict its activities to its charitable purpose of assisting homebuyers needing downpayment assistance, while leaving the inherently for-profit activities in the transaction to be conducted by for-profit entities, so that no for-profit activity will escape taxation. This represents a fundamental distinction between ORG and the organization in Situation 2 of the Revenue Ruling.

- d. **Affiliation with funders.** The Revenue ruling also cites American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989) in connection with its analysis of Situation 2. In American Campaign, the court held that the organization, which operated a school to train individuals for careers as political campaign professionals, served private interests more than incidentally because its organizers were affiliated with a particular political party and most of the organization's graduates worked in campaigns for the same party. The revenue ruling then compares this case to Situation 2, concluding that the Situation 2 organization is structured to assist private parties (sellers) who are affiliated with the organization's funders. Because the Situation 2 organization operates exclusively in its local metropolitan area and knows the identity of the sellers, and because of its presumably close connection with the real estate professionals that handle the transactions, it is plausible to conclude that the parties involved are "affiliated" with each other. However, this is simply not the case with ORG. ORG deals with transactions across the entire country, rather than only in its local area, and typically is unfamiliar with the real estate professionals involved. Also, ORG does not get involved until the purchase contract has been finalized and the transaction fees have already been established. By preserving its independence in the transaction, it cannot be said that ORG is "affiliated" or closely aligned with other participants in each transaction. And since ORG does not get involved in the transaction early, there is little or no risk of favoritism based on the identity or characteristics of the seller. Thus, the problem of favoritism that is at the heart of the court's ruling in American Campaign is not a factor here.
- e. **Benefit to Sellers as Critical Rather than Incidental to Organization's Activities.** Based on the Situation 2 organization's familiarity with the sellers, its close connection with the real estate professionals servicing each transaction, and its operating in competition with for-profit businesses, it is understandable why the revenue ruling could reach the conclusion that the benefit derived by the sellers (being able to sell their homes) was central (i.e. intended) rather than incidental to the organization's activities. However, since ORG is generally not familiar with the sellers, does not have familiarity with the real estate professionals involved in each transaction, and carefully avoids competing with for-profit businesses, it would be unfair to conclude that the benefit to the sellers is intended and central to ORG's program. Indeed, the sellers in Situation 1 of



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the revenue ruling obtain the identical benefit as the sellers in Situation 2, but the revenue ruling concludes that the benefit to the sellers in Situation 1 “does not detract” from the organization’s charitable purpose, presumably because such benefit is not the focus nor intent of the organization. Similarly, the revenue ruling cites an earlier ruling (Rev. Ruling 72559 (sic) 1972-2 C.B. 247) for the proposition that a subsidy to law graduates who agreed to provide legal services in economically depressed communities was not a improper benefit. Again, the defining distinction seemed to be that the benefit was not the focus of the organization’s efforts, but merely the means by which it accomplished its charitable purposes, and was undertaken in a way that did not play favorites or intentionally confer undue benefits on private interests. Although ORG’s funding methodology certainly resembles the funding approach in Situation 2, the different circumstances indicate that ORG is not playing favorites with related parties or other private interests, and is not focusing on conferring benefits to sellers. Rather, in each transaction the seller provides the means by which ORG is able to raise funds for continued downpayment assistance to future buyers, without preference to any particular seller and without conducting its activities in a way that demonstrates a business profit motive. Instead, seller funding is an efficient funding source, approved for ORG in advance by the IRS, and confers no greater benefit to the seller than he would obtain in Situation 1. The defining indicator, then, of whether the benefit to sellers is central or incidental, is the demonstrated focus or intent of whom ORG is seeking to benefit, as evidenced by the way it conducts business.

**CONCLUDING OBSERVATION.** ORG readily acknowledges that there have been many abuses by downpayment providers which justify close scrutiny by the IRS. However, it would be unfair to disallow exempt status to all organizations that use seller fees as their primary source of funding for downpayment assistance, regardless of the other circumstances involved and regardless of how each organization conducts its activities. Such an across-the board approach would run counter to the important public policy interest of facilitating home ownership for families that need downpayment assistance, since it is apparent that without seller funding, most if not all downpayment assistance organizations would be economically unable to provide downpayment assistance. In essence, the across-the-board approach suggested by the revenue ruling would result in most if not all downpayment assistance organizations being “punished” regardless of whether they were involved in the abuses that triggered IRS scrutiny in the first place. In the final analysis, such an approach would hurt families who cannot achieve home ownership without downpayment assistance. Such a draconian result can be avoided by applying a case-by-case approach that (i) takes into account the unique circumstances, intent, and compliance efforts of each organization, and (ii) seeks to realistically work with organizations that have not been involved in abusive practices and are seeking to meet an important public need in an economically feasible manner. “

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**CONCLUSION:**

ORG (ORG) does not qualify for exemption under IRC section 501(a) as described in IRC section 501(c)(3) because it is not operated exclusively for exempt purposes under *section 501(c)(3) of the Code*.

Revocation of exempt status is proposed effective January 1, 20XX. The proposed date of revocation is based on the fact that ORG followed its Form 1023 Application by generally charging a service fee to the seller of 4% to 6% of the final sales price and by generally providing a downpayment assistance grant of 3% to 5% of the sales price. If sustained, ORG is required to file Form 1120 for the year ending December 31, 20XX, and all subsequent years.