

Internal Revenue Service
TEGE Appeals Programs
300 N. Los Angeles Street
Los Angeles, CA 90012

Department of the Treasury
CERTIFIED

Release Number: **201023054**
Release Date: 6/11/10
Date March 16, 2010

Taxpayer Identification Number:

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

Tax Years:

UIL Index:

501.33-00

501.03-30

Last Day to File a Petition with the
United States Tax Court: **JUN 14 2010**

Dear

This is a final adverse determination as to your exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

From September of 1991 and continuing through at least 2004 a substantial part of your activities consisted of providing down payment assistance to home buyers. To finance this assistance, you relied on home sellers and other real estate related businesses that stood to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponded to the amount of the down payment assistance provided to the home buyer in substantially all of your down

payment assistance transactions. Your operations furthered the private interests of the persons that financed your down payment assistance program. In addition, the manner in which you operated demonstrated that you were operated primarily to further your insider's business interests. In this regard, the substantial fees you collected from operating your down payment assistance program inured to insiders of your organization. Accordingly, you were not operated exclusively for exempt purposes described in section 501(c)(3).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

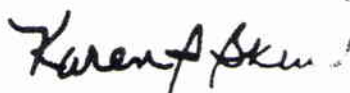
You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this final adverse determination of your exempt status, as required by Code section 6104(c).

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

Sincerely,



Karen A. Skinder
Appeals Team Manager



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
9350 Flair Dr., 2nd Floor
El Monte, CA 91731-2828

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,

Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit
Name of Organization/Taxpayer ORG	Tax Identification Number	Year/Period ended 12/31/19XX, 19XX, 20XX, 20XX, 20XX, 20XX and 20XX

LEGEND

ORG - Organization name XX - Date Address - address City - city State - state
 County - county CEO = CEO Agent - agent IND-1, IND-2, IND-3, IND-4, IND-5, IND-6 = 1ST, 2ND, 3RD, 4TH, 5TH, & 6TH IND EMP-1, EMP-2, EMP-3, EMP-4 & EMP-5 = 1ST, 2ND, 3RD, 4TH & 5TH EMPLOYEES website - website DIR-1 THRU DIR-52 = 1ST THRU 52ND DIRECTORS CO-1 THRU CO-78 = 1ST THRU 78TH COMPANIES

ISSUE

1. Whether the activities conducted by ORG ("ORG") throughout the years of its existence were in compliance with the rules and regulations under the Internal Revenue Code ("the Code") §5XX(c)(3).
2. Whether the officers received excessive Benefits within the meanings of the Code §4958 during the years and whether these excessive Benefits were significant enough to revoke the exempt status of ORG because the transactions inure to the Benefits of key individuals of ORG.

FACTS

Organizational Information:

ORG was incorporated on March 15, 19XX, in the State of State. The specific purpose of the organization, as stipulated by Article III of the Articles of Incorporation is "to lessen the burdens of governments and communities in the State of State, by assisting in the development of affordable housing, as defined by the State of State Community Redevelopment Law (Health and Safety Code Section 33000 et. Seq.), as it may be amended from time to time." The articles were amended to add the words "or by similar statutes of other states," in June of the year 20XX. Article V states that the "corporation is organized and operated exclusively for charitable purposes within the meaning of Section 5XX(c)(3) of the Internal Revenue Code."

The Internal Revenue Service ("The Service") received the Form 1023, *Application for Recognition of Exemption Under Section 5XX(c)(3) of the Internal Revenue code*, signed by CEO, the founder of ORG, on February 28, 19XX. Its intended purposes as described in the application were:

"This organization is newly incorporated. It plans to carry on a variety of activities related to provision of low and moderate income housing in State, beginning in County, County and the eastern portion of County County. The organization's activities will consist of:

- a. Construction of low and moderate income rental or owner-occupied housing, to help satisfy an unmet demand for such units. This will be initiated as rapidly as rapidly as appropriate sites are identified and project financing can be secured, within communities in State, through contractual arrangements with qualified builders.

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b. Rehabilitation of low and moderate income rental or owner-occupied housing to help satisfy an unmet demand for such units. This will be initiated as rapidly as appropriate sites are identified and project financing can be secured, within communities in State, through contractual arrangements with qualified builders and contractors.

c. Acquisition and operation of low and moderate income rental housing, to help maintain the supply of such needed housing. This will be initiated as rapidly as appropriate existing units are identified and financing can be secured, within communities in State, through contractual arrangements with qualified rental property managers.

All of the above-described activities are intended to assist low and moderate income households in obtaining decent, safe and sanitary living accommodations at affordable prices, and to assist communities in providing for the housing needs of the low and moderate income portion of their populations.”

ORG described its anticipated sources of financial support as follows:

- “a. Development fees, management fees and other forms of operating income derived from the activities described in II.1 above.
- b. Grants, loans and contracts, from state and local government agencies.
- c. Grants from private foundations, and from businesses and organizations associated with the real estate development industry.”

In response to its fundraising activities, ORG states:

“The organization will seek both grants and in-kind contributions, of the types described in II.2 above. Organization staff will perform these functions. All other funding will be derived in the form of income from activities related to the organization’s purposes, as described in II.1 above.”

In response to the determination agent’s inquiry, CEO, through his representative, elaborated ORG’s foundation for existence as follows:

“ORG initially will focus its efforts on the County of County. Within that area are numerous neighborhoods and communities with significant unmet housing needs for households in the low and moderate-income brackets. These typically are areas with older, deteriorated housing stock, inhabited by households whose income levels are insufficient to purchase or rent new, standard housing, or even to rehabilitate existing units. Historically, they have relied on public programs to financially subsidize housing costs and otherwise facilitate provision of additional housing supply.

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Even where public financial resources to address these conditions are available at least to some extent, there is a serious shortage of developers willing and able to undertake the kinds of projects which would alleviate the situation. This is largely a function of land and construction costs in State being so high that it is virtually impossible to deliver housing affordable to lower-income households without some form of substantial subsidy. Consequently, there has been little opportunity for the growth of a segment of the private development industry focused on production, rehabilitation and operation of below-market rate housing, particularly outside the urban centers. For that reason, the primary delivery channels here for lower-cost housing are local governments, and to some extent state agencies, acting through specialized programs and entities, such as:

- redevelopment agencies (which are required by state law to set aside 20% of their property tax revenues for low and moderate income housing programs, and also are able to write down property resale cost for such purposes);
- housing authorities;
- community development programs, typically acting as conduits for federal block grant funds; and
- other housing-related entities, e.g. city and county housing departments, and state housing agencies, which seek to stimulate lower-cost housing supply through various forms of financial subsidies.

Unfortunately, these public agencies have fallen woefully short of meeting the increasing demand for such housing, because of a combination of lack of knowledge and experience in carrying out that function, ineffective use of financial and other resources and discomfort in dealing with the development industry. That has left a void which increasingly is being filled by private non-profit entities such as ORG, which are able to assemble more experienced staff, make more effective use of the available resources and work comfortably in tandem with both public and private housing organizations. Because this effort essentially is a substitute for the public agencies charged with responsibility for it, ORG is incorporated to "lessen the burdens of government and communities in the State of State, by assisting in the development of affordable housing," as described above. ORG, like its counterparts in other localities, will produce, rehabilitate and operate housing affordable to lower-income households, making such housing affordable through the use of the financial and other resources available from local and state government agencies, and making use of the advanced expertise of private sector developers and contractors. ...

I have reviewed in detail the criteria set out in Revenue Procedure 96-32. ORG should meet the "safe harbor" standards in Sec. 3 in many but not all cases. The requirements associated with the public programs and agencies from which ORG anticipates obtaining financial and other assistance are not as strict as those of the safe harbor standards. Nonetheless, where it does not fit entirely within those standards, ORG still will fall within the alternative safe harbor criteria set forth in Sec. 4. Furthermore, ORG

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intends at all times to satisfy other recognized charitable purposes to qualify for exemption from federal income tax pursuant to 5XX(c)(3), as listed in Sec. 6, particularly lessening the burdens of government, as discussed above.”

After discussions between the representative of ORG and the determination specialist, ORG issued a letter dated October 21, 19XX, confirming the salient points of those discussions. In that letter CEO stipulated as follows:

“...I would like to clarify our organization’s intentions with regard to the eligibility criteria which we will utilize in carrying out programs and activities following receipt of our federal tax exemption.

We understand that, in order to satisfy the “safe harbor” provisions governing charitable low-income housing organizations, we must comply with the standards set forth in Section 3 of Revenue Procedure 96-32, as to eligibility criteria for households occupying housing units in any of our programs. We will be allowed to deviate from that standard only in the cases of housing units located within a geographic area which previously has been designated by a public agency as being blighted, or for which a legitimate finding of blight has been made by a public agency in connection with assistance being provided to our activities in such an area; in either case, our activities would combat community deterioration, in accordance with section 6 of Revenue Procedure 96-32. Alternatively, we may deviate from that standard in cases where we are engaged in a joint venture or similar relationship with a governmental agency to carry out activities which actually lessen the burdens of government, also in accordance with Section 6 of Revenue Procedure 96-32. We commit that all of our organizational activities will be carried out in compliance with the standards described in this paragraph.”

A determination letter was issued on November 13, 19XX granting exemption status under the Code §5XX(c)(3) as an organization described under the Code §§509(a)(1) and 170(b)(1)(A)(vi), with an advanced ruling period from May 15, 19XX through December 31, 19XX.

In a letter dated June 30, 19XX, ORG notified the Service of a change in the operations. A description of those expanded activities, in part, is as follows:

“The organization has not altered its original primary purposes of carrying on a variety of activities related to low and moderate income housing. However, it wished to expand the scope of activities under the purpose, to include the following:

- a. **Assisting low and moderate income households in purchasing homes, by facilitating down payments and affordable financing assistance from government agencies and private lending institutions. This activity was initiated in July, 19XX, through ORG’s down payment Assistance**

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Program, and operates in conjunction with approved lenders. Additional information on this program is attached. [Emphasis added.]

- b. Issuing non-profit corporate, tax-exempt bonds to finance acquisition and rehabilitation of multi-family residential structures for occupancy by low and moderate income households. This is intended to commence in the current calendar year, and will be carried out through state and/or local government jurisdictions.

In addition, the organization wishes to expand the scope of its activities to include the following, in none of which it currently is involved:

- a. Serving as an originator or facilitator of financing from the Small Business Administration and other public agencies, to assist businesses to become established in communities which historically are undersupplied with local service and retail businesses.
- b. Arranging and/or facilitating financing for acquisition and renovation of structures to house primarily locally serving businesses.

The foregoing activities are expected to commence in the current year, and will be conducted through state and federal economic assistance programs, with the participation of the organization's staff and any necessary consultants. These economic development activities are intended to assist low and moderate income households by expanding economic opportunities in the neighborhood and communities in which they are located."

The attachment to the above letter describes the DPAP as follows:

"... The organization was formed by for operating the existing affordable housing program as it expands statewide and nationwide which includes ORG's Down Payment Assistance Program.

ORG's charitable purposes are (1) to lessen the burdens of government agencies by increasing the affordability of housing; (2) combat community deterioration; and (3) to expand and maintain the supply of safe, decent and affordable housing for low and moderate income persons.

Homeownership and Down Payment Assistance are Government Burdens

The Federal Government has clearly recognized homeownership and the provision of down payment assistance as a government burden by initiating President Clinton's

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National Homeownership Strategy. Specifically the National Homeownership Strategy states that:

“Because homebuilding and homeownership contribute to national prosperity, the expansion of homeownership in this Nation has been supported for many years by public-private partnerships. From the Homestead Act of 18XX to the GI Bill of Rights in 19XX, key Federal Government innovations such as the Federal Housing Administration (FHA), Department of Veterans Affairs (VA) home loan guarantee program, Department of Agriculture’s Rural Housing and Community Development Service, Federal Home Loan Bank System, Fannie Mae, Ginnie Mae, Freddie Mac, and others have mobilized private capital to enable the average working family to buy a home with little or no down payment.” [Underlining added for emphasis.]

ORG works with other partners, including various National Association of HomeBuilders affiliates, Realtor Associations and **requires that every recipient of its down payment assistance complete an approved home ownership-counseling course.** [Emphasis added.]

Since July 19XX, the ORG Down Payment Assistance Program has provided approximately \$ in down payment assistance to over 1500 low to moderate-income families. This amount of support represents local, state and federal dollars that did not have to be expended to promote homeownership, thus reducing governmental burden (not to mention increasing property tax revenues). **The Department of Housing and Urban Development (HUD), The Veterans Administration, and the State Housing Finance Authority (CHFA) approved the program.** [Emphasis added.]

In a letter dated August 7, 19XX, the Service reaffirmed the exempt status of ORG and acknowledged the additional activities of the organization.

.....

Issue 1 – Operational Test

On March 13, 20XX, the Service initiated a review of the Forms 990 and activities of ORG for the years ending December 31, 19XX through 20XX. Agent observed 5 distinct and separate activities:

1. low-income-housing apartments,
2. down payment assistance program,
3. rehabilitation of old homes purchased from HUD,
4. property rental to other exempt organizations and
5. development of new houses.

Facts related to each activity are presented separately as follows:

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-----1.1-----1.1-----1.1-----1.1-----1.1-----1.1-----1.1-----1.1-----1.1-----1.1-----

Issue 1, Activity 1 – Low-Income-Housing Apartments:

Beginning in March 19XX, ORG entered into several contracts with CO-1 to acquire and operate low-income-housing apartments. The one agreement that was recorded in the general ledgers was the CO-2 (CO-2) for apartments in City, State. ORG's % ownership of CO-2 was donated by the other 2 partners of the CO-2: CO-3 and IND-1. In the response dated March 28, 20XX, ORG stated the following:

“CO-2 is in the business of developing and/or operating mixed-income residential developments. It was established for the initial purpose of acquiring and operating a 142-unit multi-family development known as CO-4, located in the City of City in County. By virtue of ORG’s participation as a member of the limited liability company, CO-2 was able to obtain financing through the County of County to assist its acquisition of the property, in the form of a low-interest loan under the HOME Program of the U.S. Department of Housing and Urban Development and bond financing under a County Multifamily Rental Housing Revenue Bond program. In return, the owner has been required to maintain rents on % of the units at a level affordable to very low income households, based on income standards for that locality, for the term of the loan. Although not required as a program condition, rents on the entire remainder of the property have been maintained at levels affordable to low and moderate income households. ORG’s involvement in this project was motivated by the opportunity to secure a significant number of affordable rental units in a locality where there is a severe shortage of such housing. As a component of its involvement with this development, ORG also provides tenants with homeownership counseling and other housing-related social services.”

There were no records indicating that ORG handled any of the day-to-day operation. The Forms 990 reported the financial information for this activity as follows:

Year	Description	Income	Balance Sheet
19XX	Direct Public Support		
	Donated Interest - CO-2		
19XX	Donated Interest - CO-2		
20XX	Donated Interest - CO-2		
20XX	Passthrough from CO-2 – CO-4		
	Donated Interest - CO-2		
20XX	Donated Interest - CO-2		
20XX	Donated Interest - CO-2		
20XX	Donated Interest - CO-2		

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Agent reviewed the agreement and observed that the 100% ownership was for book purpose only. For tax purposes, the other two partners would each be reporting 50% ownership instead of the 100%. ORG did not respond to the inquiry of the reasons/purposes for accepting such arrangement and request for documents indicating board's approval.

The initial donation of the partnership interest was recorded on the general ledgers. ORG provided page 4 of the Form 1065, *U. S. Return of Partnership Income*, the Form 8825, *Rental Real Estate Income and Expenses of a Partnership or an S Corporation*, and the accompanying statements for this property. The subsequent changes to the financial information were not recorded throughout the years under examination.

-----1.2-----1.2-----1.2-----1.2-----1.2-----1.2-----1.2-----1.2-----1.2-----

Issue 1, Activity 2 – Down Payment Assistance Program:

ORG began its down payment assistance program (DPAP) in July 19XX with a line of credit from a bank. ORG, under CEO' control, hired EMP-1 as the Executive Director and other individuals to handle the work related to DPAP.

ORG produced pamphlets regarding its DPAP, one in English and one in Spanish. The pamphlet in English summarized DPAP as follows:

“Buyers Regulations

- No Income Limit
- No Asset Limitations
- Available Nation Wide
- Gift Funds up to \$
- The homebuyer may select the home of their choice
- The home buyer may choose a lender of their choice
- No First Time Homebuyer requirement

It's as easy as...

1. Homebuyers must qualify for a primary mortgage loan
2. Homebuyers must occupy the property purchased with the ORG Program
3. **Builder/Seller participation is required with the ORG Program**

Home buyer may purchase a home with little or no money down with the help of the ORG Program.

ORG Gift Funds

The ORG gift funds may be used for the following:

- Down Payment

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- Closing Costs (recurring and non-recurring)
- Pre-paid
- Rate buy-downs

ORG Fee

ORG charges a flat fee which is lower when compared to other down payment assistance programs. Contact our National Marketing Directors for more information.

Compare the Difference!

On a typical real estate transaction, Sellers regularly receive offers below the list price. Builders usually offer incentives to homebuyers to help them qualify. With the ORG Down Payment Assistance Program, Builders and Sellers receive offers at full list price. Builders and Realtors agree that using the ORG Program increases prospective homebuyer traffic, resulting in increased sales of up to 50%. Builders benefit by quicker home sales, eliminating interest costs and inventory expenses. Here's an example how the ORG Program may help you.

Typical Transaction		ORG Transaction	
List Price		List Price	
Final Sales Price		Final Sales Price	
Less Commission (6%)		Less Commission (6%)	
Subtotal		Subtotal	
Less Closing Costs (2%)		Less Closing Costs (2%)	
		Less ORG Contribution	
Net		Net	

ORG Training

Mortgage Institutions (retail or wholesale) are not required to be approved to utilize the ORG Program, although we encourage them to register with ORG. Registration is free and only one form to complete. You will be added to our mailing list, which is distributed to prospective homebuyers and Realtors requesting Mortgage Companies/ Lenders currently utilizing our programs.

ORG training is available upon request. This informative seminar explains the program guidelines along with the application and closing process in "step by step" detail. Anyone involved in the transaction is encouraged to attend, such as, Loan Officers, Loan Processors, Underwriters, Settlement Agents, as well as Realtors.

Builders

Each main/branch office of the builder division is requested to submit a registration form. The registration must be completed and signed by an authorized officer of the company (i.e.: owner, president, legal counsel, branch manager, etc.)

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Real Estate Agents

The sellers/builders participation is necessary to help support ORG, a non-profit organization, in its efforts to assist future homebuyers in attaining the American dream of homeownership. By making a charitable contribution of the gifted amount & the ORG processing fee, (if paid by the seller) after closing, the seller/builder helps to replenish the "blind mixed pool of funds."

Settlement/Closing Agencies

Settlement/Closing Agencies or Attorneys who wish to participate in the ORG Program must complete the ORG "Settlement Application" (one application per individual office) and must be submitted directly to the ORG funding department at #. Closing Agents are not required to complete ORG training."

For a more detail description, ORG provided a 44-page document titled "ORG Down Payment Assistance Program" that was revised in January 20XX. In summary, the DPAP provides a home purchaser with assistance in meeting closing cost, reducing debt, down payment, rate buy-downs, and pre-pays. ORG applicants are usually referred by lenders and builders, participating in the down payment assistance program as affiliated concerns. ORG screens the applicants' financial condition by reviewing tax returns, W-2's, employment history, and bank records to verify need. The program is available for FHA and Conventional Loans. A 1% down payment is required from the buyer to qualify for the FHA program. The property must be owner occupied. If the applicant passes the screening process, which verifies the lack of liquid assets to meet home purchase expenses, they are eligible for ORG assistance. This eligibility criterion has been consistent from the inception of the program. The amount of funding provided is determined by calculating the amount of closing funds needed and subtracting the funds available from the buyer. ORG will provide additional funds up to the limit of \$.

For purposes of the DPAP, liquid assets cannot exceed the maximum gift amount of \$. If so, such cases are reviewed on a case by case basis by ORG. Final approval of assistance and the amount of assistance is a right held by ORG only. Initial screening is usually by ORG affiliates. Liquid assets are defined as cash, holdings in checking and savings accounts, Money Market accounts, and inheritance and lump sum insurance payments. Items not considered assets include household effects, automobiles used for personal use, depreciable business property gCO-19rating household income, and retirement type accounts.

The applicant must be able to qualify for primary financing from a lending institution. ORG's assistance is provided in the form of a "gift" which the recipient is not required to repay.

Property sellers are required to sign an agreement to reimburse ORG for funds advanced on behalf of the buyer. The reimbursement is normally collected at the closing of escrow. The turnaround time for the "gifts" to be wired out to escrow companies and back is 72 hours or less. Additional fees consist of wiring fees and ORG processing fees. The fees are \$ for sales under \$ and

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\$ for sales over \$, which can be paid by any party to the transaction. Due to the competition, the fees ORG charges were reduced to around \$ in 20XX.

Any builder or home seller willing to meet the requirements of the ORG lender/builder or seller criteria are eligible to participate in the program. If unable to participate for any reason, access to the program is allowed by working with an approved lender/builder or seller.

The training referred to in the pamphlet and elsewhere are trainings for the sellers/builders, realtors, mortgagers, etc. to inform these individuals/businesses how the DPAP works. There were no trainings to potential homeowners on how to be successful homeowners. ORG's contention was that educating prospective homeowners was eliminated because HUD stopped this requirement back in 19XX.

ORG publicized itself through the financial institutes, such as Countrywide and CO-37 Mortgage, and builders. It even offered incentive for builders to participate by donating \$ to its local Building Industry Association chapter. CEO spelled out this incentive in the *Nation's Building News* dated March 29, 19XX by stating "For every local association whose members use our down-payment assistance program, ORG will donate \$ to their chapter every time there is a closing in their area." ORG employees would attend builder's conventions through out the nations to publicize the DPAP. CEO even attended several builders conventions in foreign countries presenting the DPAP.

There were no records indicating that ORG tried to reach the general public or the intended charitable class through media or other direct means.

Initial funding for the organization was secured from builders, insurance concerns, banks, and other real estate related businesses. The June 19XX issue of CO-5 mentioned CO-6 donating \$ to support ORG's DPAP. The general ledger indicated a recording of this fund as "Contributions Income – Unrestricted".

The December 6, 19XX issue of CO-7 ran an article about ORG where by officers and employees described the DPAP during its first year of operation as follows:

"...He [CEO] hired EMP-1, a past CO-8 administrator once responsible for affordable housing projects in that city, including a first time home buyers program. Together, they began knocking on the doors of local banks residential developers, mortgage companies and insurance brokerages to get them to donate to the trust.

When CO-9 and former home builder CO-10 agreed to contribute a combined sum of about \$ to the trust, the program began to snowball, picking up other supporters like CO-11 and CO-12 CO-13 and CO-14.

Others joined from the financial community: CO-15, CO-16, CO-6, CO-17. and CO-18

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20XX, 20XX and 20XX

Today, ORG has dozens of financial backers.

Participating businesses not only get to write off the donations as business expense or charitable contribution, they also open the market to more middle-class buyers, CEO said.

ORG has a line of credit in case the well runs dry, CEO said. So far it hasn't. The trust consistently holds about \$.

To pay for operational expenses, ORG charges \$ for transactions valued more than \$ and \$ for deals less than \$. The fee is usually paid by the lender or builder.

Marketing the program has been a simple matter of word of mouth, said EMP-2, ORG program manager.

And Word is getting out. The trust has trained more than mortgage brokers and lenders nationwide on how to use the trust and which federal lenders, such as Fannie Mae, accept ORG's supplemental funding.

The trust now funds \$ deals a month, and has contributed to nearly \$ in home sales in less than a year. The organization employs 15 and is hiring a new employee almost weekly, CEO said."

The general ledger indicated that the contributions from CO-9 and CO-10 were recorded as "Other Current Liability, Contributions ..." There were five such liability accounts set up in 19XX. The liability accounts were decreased as "gifts" were made to the properties sold by these builders. In other words, the funds from these entities were not donations but rather advances to be applied to future "gifts." Only the \$ from CO-6 appeared to be a true donation to support the program.

The first DPAP gift was made on September 10, 19XX. The operation expanded beyond the state of State by November 19XX. The dollar value of down payment assistance provided is reflected in the following ORG, based on the information extracted from general ledgers and the Forms 990:

Year	# of Transactions	Total "Gift" Paid	Total Contribution Received
19XX			
19XX			
20XX			
20XX			
20XX			
20XX			
20XX			

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ORG provided five letters to substantiate the approval it received from government agencies. The first letter from U.S. Department of Housing and Urban Development in City, State dated 5/26/XX was addressed to CEO as the Chairman of ORG. The body of this letter states in part:

“Thank you for the documentation dated April 30, 19XX, and subsequent supporting addenda, requesting FHA non-profit status approval of ORG. **The documentation meets our requirements for non-profit status, and the ORG Down Payment Assistance Program may be used in conjunction with FHA Insured Mortgages,** provided the first lien guidelines are met by the lender.” [Emphasis added.]

The second letter from Fannie Mae dated 6/3/XX was addressed to CEO as the President of ORG. The body of this letter states in part:

“**Based on the information submitted, it appears that your program is a[n] unsecured grant program. Therefore, approval from Fannie Mae is not required.** Fannie Mae’s approved Seller/Servicers are responsible for documenting the source of funds under grant program pursuant to Fannie Mae’s Selling Guide, Part VI, Chapter 2, Section 2XX.3, *Sources of Borrower’s Funds*. I have attached a copy of the above guideline.” [Emphasis added.]

The third letter from U.S. Department of Housing and Urban Development in City, State dated 6/12/XX was addressed to CEO as the President of ORG. The body of this letter states in part:

“Based on your representations, **this office has no objection to the downpayment assistance proposed by the ORG (ORG) and found to be in compliance with FHA’s requirements.** Charitable organizations are permitted to provide gifts for downpayment assistance, and **your response indicates that you have complied with the gift-giving requirements described in our letter of May 27, 19XX.**” [Emphasis added.]

The fourth letter from U.S. Department of Housing and Urban Development in City State Office dated 7/21/XX was addressed to CEO as the President of ORG. The body of this letter states in part:

“Subject: ORG Down Payment Assistance Gift Program

Thank you for your request for approval of the above program. Based on your representations and documentation submitted, **we find that ORG is in compliance with our requirements for down payment assistance, as outline in HUD Handbook 4155.1m Rev. 1 and in Mortgagee Letter 94-2.**” [Emphasis added.]

The fifth letter from State Housing Finance Agency dated 8/13/XX was addressed to EMP-1 as Executive Director of ORG. The body of this letter states:

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20XX,
20XX, 20XX and 20XX

"I received your folder with information on the above referenced program and documents proving your status as a 5XX(c)(3) Nonprofit organization. I have reviewed the information submitted, and have determined that the

As the ORG Down Payment Assistance is a "gift" and no repayment is expected nor is a lien attached to Title, there are no documents that must be submitted with each CHFA loan. However, I would appreciate a copy of the approved "Request for Gift Funds" to be included to clarify from where the funds are coming for our reviewers." [Emphasis added.]

What information was provided to these agencies and offices was not know. These letters and the 44-page document about DPAP were **not** provided to the Cincinnati Campus of the Service with the letter dated June 30, 19XX.

CEO solicited supports from Members of Congress, and 4 of them collectively wrote a letter to the Secretary of Housing and Urban Development on 10/5/XX. The letter states:

"It has come to our attention that the Department of Housing and Urban Development has proposed a regulatory change that, if implemented, would eliminate down payment assistance programs operated by non-profit organizations.

The Housing Resource Trust (ORG) is a 5XX(c)(3) non-profit housing and community development organization established in 19XX in Southern State Districts. ORG's mission and goal is to provide affordable housing assistance to individuals and families across the country. So far, ORG has helped over 3000 individuals and families achieve home ownership, has gCO-19rated over \$ in down payment assistance gift money, and has facilitated more than \$ in first mortgages.

We believe it would be a shame to regulate ORG, and organizations like ORG, out of business. If necessary, please work with existing down payment assistance programs to develop reasonable and fair criteria by which these programs can continue to operate." [Emphasis added.]

A review of some funded case files indicated that ORG would issue gift letters with the following wordings:

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20XX,
20XX, 20XX and 20XX

“ORG (ORG) is pleased to inform you that you have been approved to receive a ORG Gift in the amount of ... which will be used toward the purchase of your home.

The ORG Gift which has been provided to you is a bonafide “gift” and there is no obligation of repayment of the funds. The ORG gift is made to you with the condition that you complete the home buyer education course and the purchase of your home as set forth in the real estate agreement signed and date by you.

Congratulations in your endeavor toward the purchase of your home. Our office will be in contact with you and your Lender to complete the necessary closing of escrow.”

ORG employees placed a lot of emphasis on getting the wordings related to gifts on the HUD-1 Settlement Statement correct. They would go back and ford several times with escrow companies to get the correct dollar amount and the following wordings on the settlement statements:

“ORG Gift” for the money funded by ORG

“ORG Contribution” for the money to be paid back to ORG

ORG required sellers to sign off on the application form under the statement “Seller hereby agrees to provide a contribution to ORG in the amount of up to \$_____ to support the mission of the organization in developing affordable housing throughout selected communities in the United States.” The amount entered in the blank space would be the “gift” amount plus any fees seller would be paying.

We agree to comply with the regulations and procedures of the Program. We further understand that the Lender listed above utilizes FHA guaranteed mortgages.”

The DPAP operation continued with substantial net profits that were used to fund Activity 3, 4 and 5. The following is a summary of the financial information for the 7 years under examination:

Account Description	19XX12	19XX12	20XX12	20XX12	20XX12	20XX12	20XX12
DPAP Income							
DPAP Expenses							
Net DPAP Income							
HUD Properties Income							
Interest income							
Net sale of non-inventory assets							
Net rental income							
Rental - Low Income							
Income from other activities							

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20XX,
20XX, 20XX and 20XX

Cost of HUD Properties Sold							
Consulting - prop dvlpmnts & others							
Expenses for other activities							
Net income from other activities							
Overall net income							

-----1.3-----1.3-----1.3-----1.3-----1.3-----1.3-----1.3-----1.3-----1.3-----

Issue 1, Activity 3 – Rehabilitation of old homes purchased from HUD:

The rehabilitation of old houses was handled by ORG employees under the supervision of EMP-1. In a letter dated November 16, 20XX, ORG described its rehabilitation program as follows:

“... ORG has participated in the REO Program of the U.S. Department of Housing and Urban Development, by acquiring, rehabilitating and reselling a total of 23 homes foreclosed on by HUD. Following rehabilitation, we understand that all the homes were sold by ORG to low-income and/or moderate income households.

Finally, ORG recently qualified as a dealer of mobile homes, and has initiated a program to sell those units at below-market cost to low-income and very-low income households.”

HUD discovered this arrangement and in a letter dated 5/10/XX denied ORG's participation in this program. Based on this letter, CEO fired EMP-1.

-----1.4-----1.4-----1.4-----1.4-----1.4-----1.4-----1.4-----1.4-----1.4-----

Issue 1, Activity 4 – Property Rental to Other Exempt Organizations:

One of HUD's Supportive Housing Program was called transitional housing. HUD defines the transitional housing as to facilitate “the movement of homeless individuals and families to permanent housing within 24 months. This temporary housing is combined with supportive services to enable

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homeless individuals and families to live as independently as possible. Supportive services – which help promote residential stability, increased skill level and/or income, and greater self-determination – may be provided by the organization managing the housing or coordinated by that organization and provided by other public or private agencies. Transitional housing can be provided in one structure or several structures at one site or in multiple structures at scattered sites.”

CO-20, a non-profit organization exempt under the Code §5XX(c)(3), operated the transactional housing and received funding from HUD. In July 20XX, ORG purchased a property and leased it out to CO-20. ORG’s involvement in this activity was limited to what a landlord would do for the rental properties on hand. This operation continued to the present time, with ORG maintaining the property. There were no records as to how much staff times were spent on this activity.

-----1.5-----1.5-----1.5-----1.5-----1.5-----1.5-----1.5-----1.5-----1.5-----

Issue 1, Activity 5 – Development of New Houses:

The general ledgers indicated the establishments of two bank accounts in late 20XX for housing developments, under the names “CO – 21” and “CO – 22”. The operation expanded 20XX and four more accounts were open under the names “CO – 23,” “CO – 24,” “CO – 25” and “CO-26.”

ORG listed these entities on the statements titled “Information Regarding Taxable Subsidiaries” attached to the Forms 990 for 20XX through 20XX. The statements disclosed the following information:

Year	Name	% own	Nature of Business	Total Income	End-of-year Assets
20XX	CO-27	100%	Real estate activities providing		
	CO-28	100%	Real estate activities providing		
	Total 20XX				
20XX	CO-27	100%	low income housing		
	CO-28	100%	low income housing		
	Total 20XX				
20XX	CO-27	100%	low income housing		
	CO-28	100%	low income housing		
	CO-29	100%	low income housing		
	Total 20XX				

ORG employees handled the bookkeeping of these entities and hired contractors to develop these properties. The financial information of these entities were reported on Forms 990 in consolidated format.

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A research of the property records, state corporate records and the Service records indicated the following:

CO-27: Incorporated in the State of State as a non-profit housing on 12/14/20XX by EMP-1 using ORG's Address address. The real property records indicated that CO-27 sold a vacant land for \$ in July 20XX.

CO-28: Incorporated in the State of State with "housing" as the business type on 10/31/20XX by EMP-1 using ORG's Address address. The real property records indicated that ORG 24 sold 12 new properties in the first 4 months of 20XX with prices ranging from \$ to \$ in the city of 24, State. Records indicated that property taxes were assessed on ORG 24 on vacant land back in 20XX.

CO-29: Incorporated in the State of State with "housing" as the business type on 8/6/20XX by CEO using ORG's Address address. The Federal tax identification number was obtained in November 20XX with "CEO Sole Member" as secondary name.

CO-30: Incorporated in the State of State on 8/5/20XX by EMP-3, ORG's employee, using ORG's Address address. The agent for service of process was EMP-4, another ORG's employee.

In a response to Agent's inquiry, ORG stated that there were 4 projects: CO-31, CO-21, CO-22, and CO-27. They were all for the charitable purpose of "affording housing" in partnership with CO beginning back in 20XX and 20XX. The partnership dissolved in 20XX with CO-31 and CO-27 interests going to ORG. The land under CO-27 was sold in June 20XX, while the CO-31 development was completed and with last phase going on sale in late 20XX. There were no records as to how much of the staff times were spent on which project.

.....

Issue 2: Inurement and Private Benefits

ORG's general ledgers indicated many questionable transactions. The supporting records indicated there was no internal control, the accountable plan was not followed, and a number of the expenses were non-business or personal. The following table summarizes the transactions and serves as an index to the facts for each items below the table:

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	Description	19XX12	20XX12	20XX12	20XX12	20XX12	20XX12	20XX12	Total
Category A: Transactions Directly Benefiting Disqualified Individuals									
1	Credit card charges without substantiation								
2	Ford Excursion								
3	19XX Volvo								
4	Payments to CO-32								
5	Reimbursements without substantiation								
6	Personal expenses paid to 3rd Parties								
	Total Category A								
Category B: Transactions Indirectly Benefiting Disqualified Individuals									
1	Payments to IND-4 which CEO had full access to								
2	Fair mkt values of HUD properties Cost of HUD properties Net Gain								
3	CO-33								
4	CO-34								
5	CO-35								
6	CO-36								
7	CO-37								
8	CO-38								
	Total Category B								
	Total								

-----2.A.1-----2.A.1-----2.A.1-----2.A.1-----2.A.1-----2.A.1-----2.A.1-----2.A.1-----2.A.1-----

Issue 2, Category A, #1: Credit cards charges

Through out the years there were several corporate credit cards with CEO and EMP-1 as authorized card holders. The charges for the 7 years exceeded \$. Both CEO and EMP-1 did not follow the accountable plan. With CEO' electronic calendars and other available records, Agent allowed the charges that were sufficiently supported by these records. The balance of \$ represents non-substantiated business and personal expenses.

-----2.A.2-----2.A.2-----2.A.2-----2.A.2-----2.A.2-----2.A.2-----2.A.2-----2.A.2-----

Issue 2, Category A, #2: 20XX Ford Excursion

A 20XX Ford Excursion was purchased under EMP-1's name on 7/9/XX for \$, with \$ down payment. She took out a loan with her credit information on the balance. A total of \$ of ORG funds were used to payoff this loan in 20XX through 20XX. The registration fees were also paid with ORG funds. When she was fired in 20XX, she kept this vehicle.

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-----2.A.3-----2.A.3-----2.A.3-----2.A.3-----2.A.3-----2.A.3-----2.A.3-----2.A.3-----

Issue 2, Category A, #3: 19XX Volvo sedan

A 19XX Volvo sedan was purchased on 7/23/XX for \$. The vehicle was registered to EMP-1. ORG paid the registration fees in 20XX, 20XX and 20XX. No one knew what happCO-19d to the vehicle since 20XX. There were no records to substantiate the business use of this and the above vehicles. Meanwhile, other ORG employees were reimbursed based on the number of miles driven with their personal vehicles.

-----2.A.4-----2.A.4-----2.A.4-----2.A.4-----2.A.4-----2.A.4-----2.A.4-----2.A.4-----

Issue 2, Category A, #4: CO-32

EMP-1 joined CO-32 from April 20XX through December 20XX and incurred \$ expenses for meals, salon services, nail services, nanny services, etc. EMP-1 used ORG's address for mailing purpose and used ORG funds to pay the bills.

-----2.A.5-----2.A.5-----2.A.5-----2.A.5-----2.A.5-----2.A.5-----2.A.5-----2.A.5-----

Issue 2, Category A, #5: Reimbursements without Substantiations

The general ledger of ORG indicated CEO and EMP-1 received reimbursements throughout the years under examination. No supporting records were available for reimbursements to EMP-1. Agent reviewed the descriptions within the general ledger and removed the items that appeared to be reasonable for reimbursements to EMP-1. CEO was able to provide some receipts and printouts of his electronic calendars. Agent removed the items that were sufficiently documented. The remaining amounts are summarized in the following table:

Year	Amount reimbursed		Amount deemed reasonably supported		Need Substantiation
	CEO	EMP-1	CEO	EMP-1	Combined
19XX					
20XX					
20XX					
20XX					
20XX					
20XX					
Total all years					

-----2.A.6-----2.A.6-----2.A.6-----2.A.6-----2.A.6-----2.A.6-----2.A.6-----2.A.6-----

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Issue 2, Category A, #6: Personal Expenses Paid to 3rd Parties

Supporting documents for the following payees indicated the payments were for the personal expenses of CEO and EMP-1:

Payee	Purpose	Amount
CO-39	Payments for specific team	\$
CO-40	Installing carpet in EMP-1's resident	
CO-41/CO-42	Repair services at properties owned by EMP-1	
CO-43	CEO' oversea trip charged to credit card	
	Total	

-----2.B.1-----2.B.1-----2.B.1-----2.B.1-----2.B.1-----2.B.1-----2.B.1-----2.B.1-----

Issue 2, Category B, #1: IND-4 Contract

ORG entered into a general contract for services with IND-4 effective 9/1/XX for "develop a database program for ORG. Also provide technical assistance and training to ORG staff on an as needed basis." EMP-1 signed as Executive Director of ORG. The payments to IND-4 began on 12/16/XX, 3 and ½ months after the effective date, and ended on 9/2/XX. The payments including reimbursement of expenses were \$. The Form 1099 issued to IND-4 was \$.

In addition, the checks issued to IND-4 were deposited into a bank account co-owned with CEO, the President. Some of the reimbursements to CEO were also deposited to the same account. CEO did not respond to the question of why these payments were deposited into the joint account.

Agent requested supporting documents for IND-4's services and received a set of invoices. Agent questioned why the invoices and the payments within the general ledgers did not match. In response to this question, another set of invoices that matched the payments were provided but they were different from the first set. ORG didn't respond to the question why the two sets were different.

Using the 3rd party contact procedure, Agent inquired about the service arrangement IND-4 had with ORG. IND-4 responded as follows:

Contracts – provided a copy same as ORG.

Statements, bills, invoices – provided a copy of the set of invoices that matched with the ORG payments.

Services – "I provide contractual services to ORG from September 19XX to august 19XX. I provided computer services and equipment, developed database programs for ORG. I also provided technical assistance and training to ORG staff. I provided real estate and marketing consultation."

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-----2.B.2-----2.B.2-----2.B.2-----2.B.2-----2.B.2-----2.B.2-----2.B.2-----2.B.2-----

Issue 2, Category B, #2: HUD Properties Purchased by EMP-1

EMP-1 had the primary responsibility of managing the activity 3 – Rehabilitation of old homes purchased from HUD. Agent searched and studied the property records available on-line and noticed that 7 properties were sold to one individual, IND-2 in 19XX and 20XX. Selling 7 properties to one individual wasn't in compliance with HUD's rules and regulations. Hence, ORG was denied participation in the program.

ORG's supporting documents and Agent's further research indicated 4 of the 7 properties were subsequently sold at cost to EMP-1 or CO-19 ("CO-19"), wholly owned by IND-3 & EMP-1. The following table list out when the title of each property changed hands from HUD through a party unrelated to ORG:

Property Address	Sale/Transfer of record	Date	Price	Market Value per	Market Value over cost
Address, City, State	HUD sold to ORG	09/22/xx			
	ORG sold to IND-2	10/27/xx			
	IND-2 transferred to CO-44	11/11/xx			
	CO-44 sold to CO-19	XX/16/xx			
	CO-19 sold to 3rd party	12/13/xx			
Address, City, State	HUD sold to ORG	12/29/xx			
	ORG sold to IND-2	06/27/xx			
	IND-2 sold to CO-19	04/15/xx			
	CO-19 sold to 3rd party	05/02/xx			
Address, City, State	HUD sold to ORG	XX/XX/xx			
	ORG sold to IND-2	XX/25/xx			
	IND-2 sold to EMP-1	06/28/xx			
	EMP-1 transferred to CO-19	04/09/xx			
	CO-19 sold to EMP-3 (EMP-1's primary assistant at ORG)	06/15/xx			
	EMP-3 sold to 3 rd party (she was fired in late 20XX)	08/31/xx			
Address, City, State	HUD sold to ORG	XX/14/xx			
	ORG sold to IND-2	07/28/xx			
	IND-2 sold to EMP-1	06/28/xx			
	EMP-1 transferred to CO-19	04/09/xx			
	CO-19 sold to 3rd party	07/16/xx			

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Total Market Value over cost at the time ORG sold to IND-2	
Total Market Value over cost at the time IND-2 sold to EMP-1/CO-19	
Total Gain earned when CO-19 sold the properties	

Agent searched the market price at website which provide the market price of specific neighborhood for the last 10 years and compared it to the initial sale price of each property and incorporated in the table above.

In words, the above table tells the following story: In an attempt to disguise her purchases, EMP-1 enlisted the assistance of IND-2, a business associate. In 19XX and 20XX, she caused ORG to sale 7 properties to IND-2 at cost or a little over cost, but below market price. IND-2 held on to these properties and in 20XX sold 4 of them at his cost to EMP-1 or CO-19, even though the property prices were going up indicating that he was doing a favor. EMP-1 transferred the 2 properties under his name to CO-19 without exchange of money. The 4 properties were then sold at market price in 20XX and 20XX with a total net gain of \$.

Using the 3rd party contact procedure, Agent inquired IND-2 about his involvement in these properties. IND-2 stated that he purchased the seven properties for long term investments. He resold 3 properties back to the EMP-1s. The one he did not mention was Address. He also stated:

“EMP-1 requested that I sell these homes back to IND-3 and her.

The homes were sold to them for the same price that I had purchased them for plus closing costs.

EMP-1 stated that she had Board Approval to purchase these homes and that they were passed the HUD Timeline for directors and officers for a non profit to make these purchases...

At that point in time the homes had not had any rapid rise in appreciation and the market value of the homes was approximately what I resold them for.”

-----2.B.3-----2.B.3-----2.B.3-----2.B.3-----2.B.3-----2.B.3-----2.B.3-----

Issue 2, Category B, #3: CO-33

In 20XX, over 2-month period, 3 checks were written out to CO-33 (“CO-19”) for “employee training/education” totaling \$ \$. CO-19 was the d.b.a. of CO-19, an entity 50/50 owned by IND-3 & EMP-1s. ORG provided 4 invoices from CO-19 covering the period from January thru mid-June of 20XX. The invoices indicated the services were what she would normally do as the executive director of ORG.

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While EMP-1 held a fulltime key-employee position at ORG, and EMP-1 was working as a construction contractor as the sole-owner of CO-45, the invoices indicated one or both of them provided up to 15 hours of services a day, seven days a week. Her job contract with ORG was \$ per year or \$ per hour. The service rate charged by CO-19 was \$ per hour regardless of the type of services provided: training employees, meeting with clients, upgrading computer programs, working with computer crash, etc.

A study of the credit card charges indicated the following charges were made from 1/4/XX through 6/13/XX:

Type of charges	Store name	# of charges & amount from 1/4 th to 6/13 ^h	# of charges & amount from 4/24 th to 6/13 th
Food & Beverages	Various	41	11
Gas	Various	16	5
Supplies	Best Buy, Costco Wholesale, OfficeMax, Office Depot, etc.	28	7
Department stores	BBB #1XX and Homelife w/ \$ purchased and then returned 3 ½ months later	3	1
Landscape, etc.	Inland Wholesale Nursery & Lowes	2	
Furniture store	American Furniture Store	1	1
Travel & Misc.	Various	18	15
Salon services	CO-32 (starting on 4/11 th)	5	3
Days on the road		17	11

Every charge represents some times spent by the individual making the charge. For example, a charge for gas may be 5 to 10 minutes while a charge for meal can be anywhere from 1 to 3 hours.

From 4/24th through 6/13th, while performing her full-time duties at ORG and providing 8 to 15 hours of additional work under CO-19, EMP-1 entertained others over a meal 11 times, purchased gas 5 times, purchased supplies and other items over 10 times, purchased and returned some items at department stores twice, purchased landscape materials and supplies twice, purchased furniture once, and traveled out of town for 11 days. She also visited CO-32 3 times for salon services. These charges indicated it was impossible for her to provide 8 to 15 hours of additional services per day while performing her full-time job in accordance with her contract agreement.

It was unusual that the services were not provided before or after the six months. There were no records of board oversight or approval for hiring or paying CO-19.

On 10/17/XX, EMP-1 made a \$ transfer from one of ORG's bank account to CO-19 for services rendered from November 20XX through September 20XX. Billings were for digital design of homes, scanning, supervision & coordination, general services, etc. It was unusual that services for

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eleven months presumably billed monthly were not paid as the bills were received but rather requested a wire transfer after the 11th month. It was also unusual that there were no payments for such services before or after the 11 months of billing.

On 6/6/XX, a \$ check was issued to CO-19 for "Employee – Training/Education." ORG was unable to provide invoice for this payment.

-----2.B.4-----2.B.4-----2.B.4-----2.B.4-----2.B.4-----2.B.4-----2.B.4-----2.B.4-----

Issue 2, Category B, #4: CO-34

ORG contracted CO-46 CO-2 to do most of its construction works. One of them was to develop the housing project know as Co-30. As the key-employee of ORG, EMP-1 was involved with the negotiation process for ORG. She entered a separate agreement just below the original contract with CO-46 on 3/20/XX, which states:

"Agreement Between EMP-1 & IND-5 Per This Contract.

Total Due to IND-5: \$\$ site supervision
 \$ \$ bonus
 \$\$ Due upon completion of proj

Total Due to EMP-1: \$\$ due upon completion of project"

This agreement indicated the abuse of her power and the disregard for her fiduciary duty to ORG. The entire payment she would have received from CO-46 would be a form of excess benefit to her.

-----2.B.5-----2.B.5-----2.B.5-----2.B.5-----2.B.5-----2.B.5-----2.B.5-----

Issue 2, Category B, #5: CO-35

ORG contracted with CO-35 ("CO-35") for consulting services with compensations based on the number of closed down payment assistance program ("DPAP") cases. Based on all available records, Agent summarized the following findings:

1. Effective 9/1/XX, ORG entered into a consulting agreement with CO-35. CEO signed as President of ORG and IND-6 signed as Director of CO-35.
2. The services to be provided were "marketing and promoting the ORG Down Payment Assistance Program to lending institutions, builders and real estate professionals throughout

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the United States. In addition, provide recommendation on other housing projects and programs.”

3. The commission was at \$ per closed DPAP case. ORG made payments from 9/30/XX through 8/9/XX totaling \$. ORG was unable to provide records to substantiate the services received.
4. Most of the cancelled checks were endorsed by IND-4.
5. The Service’s records indicated that the EIN for “CO-35 International Company care of IND-4” was established in September 19XX, the month the contract was signed.
6. The Service records indicated CO-35 filed Forms 1120 for the years ending August 31, 20XX and 20XX with no taxes paid. It also filed Forms 941 and paid taxes in the first 3 quarters of 20XX, also the period CO-35 was receiving payments from ORG. This indicates CO-35 was formed because of the contract with ORG.
7. The State corporate records indicated CO-35 was incorporated on 9/16/19XX with IND-4 as the president. The status of the corporation was “inactive – suspended” and the last complete statement file date was 9/13/20XX. It appeared that CO-35 was created solely for the contract agreement with ORG.
8. There was no formal termination record by either party.
9. Using the 3rd party contact procedure, Agent inquired about the service arrangement it had with ORG. On behalf of CO-35, IND-4 made the following statements:

Services – “... provided marketing service for the ORG Down Payment Assistance Program and did real estate consulting. The marketing was based on the contacts and presentations to the Real Estate professionals, Such as:

- a) Realty Offices
- b) Members of State/ National Association of Realtors, CAR, NARM
- c) Members of Association of Realtors, NAR
- d) Members of Mortgage Lenders Associatioions [spelling error]
- e) Members of Mortgage Banker Associations
- f) Members of Builder Industry Associations”

Contracts – CO-35 provided the same copy as ORG.

Statements, bills, invoices – “There are no statements, bills or invoices as ORG did the accounting and remitted on the number of applications/cases that were received and closed per contract.”

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Termination – “I cannot recover the written termination notice. To my recollection, the written notice was very brief. It only contained the statement of “Intent to terminate the contract” and “effective date”. I was informed also beside the written notice in person at the time by ORG Executive Officer.”

-----2.B.6-----2.B.6-----2.B.6-----2.B.6-----2.B.6-----2.B.6-----2.B.6-----2.B.6-----

Issue 2, Category B, #6: CO-36 Inc

ORG contracted with CO-36 (“CO-36”) for consulting services with compensations appeared to have been based on the number of closed DPAP cases. Based on all available records, Agent summarized the following findings:

1. The service contract was not available.
2. There were no records for board members discussing, negotiating, evaluating, or approving the contract or payments.
3. The payments appeared to have been based on \$ per DPAP closing in 20XX and 20XX. The rate dropped down to \$ per DPAP closing in early 20XX and \$ in the remainder of 20XX.
4. The corporation was set-up on 2/28/XX, 2 months before the first payment was made.
5. The Service records indicated the corporation was established in April 20XX, only days before the first payment was made.
6. The corporate records did not indicate the president name. However, during a discussion about these entities, ORG stated that CO-36 was also under IND-2’s control.
7. The payments were from May 20XX through March 20XX and totaled \$. Yet, there were no bills or invoices available.
8. All checks made out to CO-36 were signed by EMP-1.
9. The cancelled checks indicated all were endorsed with hand written “for deposit only” except for one check which was endorsed with a deposit stamp.
10. The Service records indicated 3 corporate returns were filed for the years ending May 31, 20XX, 20XX and 20XX, and \$, \$ and \$ taxes were paid respectively. No payroll returns were filed, implying that there were no paid employees providing the contracted services. The revenues for 5/31/XX were \$ below, 5/31/XX were \$ above and 5/31/XX were \$ above the payments from ORG. Expenses categorized as other deductions were at % or higher.

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These records implied that the entity was formed to receive the payments from ORG primary and the deductions were inconsistent with a consulting business.

-----2.B.7-----2.B.7-----2.B.7-----2.B.7-----2.B.7-----2.B.7-----2.B.7-----2.B.7-----

Issue 2, Category B, #7: CO-37

ORG contracted with CO-37 ("CO-37") for consulting services with compensations based on the number of closed down payment assistance program (DPAP) cases. Based on all available records, Agent summarized the following findings:

1. The contract was signed by CEO as President/Chairman of the Board of ORG and IND-2 as President of CO-37.
2. The services to be provided were "marketing and promoting the ORG Down Payment Assistance Program to lending institutions, builders and real estate community. In addition, Consultant will work with ORG on a variety of housing programs and projects that will fit the ORG's goals and will be the basis of business diversification for ORG."
3. The commission was at \$ per closed DPAP case and increased to \$ with one line statement "That effective August 1, 20XX, the CO-37 Development contract shall be increased from \$ per closed transaction to \$ per closed transaction on the ORG Down Payment Assistance Program." in the corporate minutes of 9/26/XX.
4. The effective date of the contract was 7/1/XX, and yet, the first payment was on 5/10/XX with no apparent catch-up payments for the first 10 months.
5. There were no records for board members discussing, negotiating, evaluating, or approving this contract.
6. The corporation was set-up by IND-2 3 days before the first payment was made. In other words, the contract was signed before the corporation existed, and the corporation was formed for the purpose of collecting funds.
7. The Service records indicated the corporation was established in May 19XX, also 10 months after the contract was signed.
8. The payments covered 2 year period from May 19XX through April 20XX and totaled \$. Yet, there were only 3 monthly statements of accomplishments available. ORG's general ledgers indicated little or no DPAP business came from the names of entities IND-2 mentioned as under negotiation for increase/future referral for DPAP.
9. All checks made out to CO-37 Investments were signed by EMP-1.

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10. The cancelled checks indicated IND-2 endorsed many of the checks and the remaining checks were endorsed with a hand written phrase "for deposit only" or "CO-37, Acct# ..." signifying that there was no formal deposit stamp.
11. The Service records indicated only 2 corporate returns were filed for the years ending May 31, 20XX and 20XX, and no payroll returns were filed. This implied that there were no paid employees and supported the theory that it was formed for the contract with ORG only.
12. ORG provided 3 letters from IND-2 as the President of CO-37. The letter dated 9/1/XX, 10/4/XX and 11/4/XX were addressed to EMP-1 and the letterhead simply stated "CO-37" without any address or phone numbers. The letters began with number of DPAP transactions, summarized as follows:

	Aug. 20XX	Sep. 20XX	Oct. 20XX
Total number of applications			
Total number of grants funded			
Payment due (at \$ per case)			
Letter date	09/XX/XX	10/04/XX	11/04/XX
GL/payment date	09/27/XX	10/02/XX	11/02/XX

The payment for August was made 26 days after the letter while the payments for September and October were actually 2 days before the letter date. The delay indicates that EMP-1 or someone who normally issuing the check sought approval before making the 50% increase in payment. The other 2 payments indicate these payments were made automatically, without consideration of whether reasonable services were received in return.

13. The letter dated 9/1/00 explained the increase with the statement that the payment due "represents an increase of \$ per file based on our agreement to increase to compensation after CO-37 exceeded \$ funded ORG Grants." Based on the general ledgers the funded cases were around 9,300 as of 8/31/XX. The contract effective 7/1/XX did not have a statement for increase in commission. Agent requested amendments to all the contracts and received an annual board of directors meeting dated 9/16/20XX, that was not signed which simply stated that CO-35 and CO-38 contracts were terminated and the payments to CO-37 would be increased by \$ per DPAP closing.

The 3 letters mentioned about discussing, negotiating and obtaining contracts for ORG with about 12 realtors and financial institutes. Agent searched the general ledgers and found 3 of them with following transactions:

		19XX	19XX	20XX	20XX	20XX	20XX	20XX	Total
CO-9	Prgm Fees Inc								
	# of trans								

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	# of gifts funded								
CO-47	Prgm Fees Inc								
	# of trans								
	# of gifts funded								
CO-48	Prgm Fees Inc								
	# of trans								
	# of gifts funded								
Total	Prgm Fees Inc								
	# of trans								
	# of gifts funded								

One unusual matter in the table above was that there were \$ program fees earned through CO-9 with a possible 178 transactions but no records of "ORG gifts" for these transactions.

The Service records indicated IND-2 earned W-2 wages from CO-9 in calendar years 19XX and 20XX.

The letters also mentioned other services as follows:

"CO-37 is developing several affordable housing projects for ORG. The first tow projects are in County and will be for first time homebuyers. The prelim[in]ary information has been provided to ORG under a different cover." [Within 10/4/XX letter.]

"The affordable housing projects that CO-37 is developing with ORG are moving forward. The first two projects are in County,

homes. Both projects are for first time homebuyers. The communities will provide housing for families between 80% to 100% of the medium income. The sales prices for both projects are approximately \$ below the completion in the area. The scheduled start dates for these projects are January 20XX, with the first units being completed in March of 20XX.

CO-37 has had preliminary

(The

apartment community. The project will be a quality of live development. **target groups for this development will be handicapped adults and senior citizens.** The population that we are aiming at providing affordable housing for it between 50 to 70% of the medium income and is a high-risk population. **We have located two sites for this development and are currently negotiating with the owners on purchasing the sites.** The project will focus on a quality of life community. **The ARC will provide all the support services and ORG will**

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ORG			

own and operate the project. As we progress with this development I will provide you with additional information on this development.

CO-37 is currently working on several multi-family projects for ORG. **The projects are located in City and consist of a forty-unit apartment building and an 84-unit mobile home park.** Both projects provide housing for very low-to-low income families. As we progress with our due diligence I will provide ORG with the project information.” [Within the 11/4/XX letter, emphasis added.]

- 14. IND-2 indicated paying EMP-1s in his letter dated 11/24/XX to the lawyers for the lawsuit between ORG and EMP-1s that was later dismissed with prejudice.
- 15. There was no formal termination record by either party.
- 16. Using the 3rd party contact procedure, Agent inquired about the service arrangement it had with ORG. On behalf of CO-37, IND-2 made the following statements in a letter without signing the letter:

Services – “The primary services ... from 19XX to 20XX was the development of their down payment assistance program documents and the marketing concept. This included the down payment assistance marketing materials, the development of a marketing program aimed at builders, lenders and realtors.”

Contracts – “I do not have a copy ... It is my understanding that ORG’s legal staff has provided your office with the original document.”

Statements, bills, invoices – “... The statements, bills, invoices and receipts for CO-37 Investments were the checks paid by ORG to CO-37 Investments thru their accounting department. It is my understanding that you have these checks.”

Termination – “The contract was terminated by mutual consent. The services under that structure were no longer required for the development of the marketing program guidelines.”

-----2.B.8-----2.B.8-----2.B.8-----2.B.8-----2.B.8-----2.B.8-----2.B.8-----2.B.8-----

Issue 2, Category B, #8: CO-38

ORG contracted with CO-38 for consulting services with compensations based on the number of closed DPAP cases. Based on all available records, Agent summarized the following findings:

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ORG			

1. The effective date of the contract was 2/1/00, signed by EMP-1 as Executive Director of ORG and EMP-5 as Director of CO-38.
2. The services to be provided were "marketing and promoting the ORG Down Payment Assistance Program to lending institutions, builders and real estate professionals throughout the United States. This also includes, but not limited to, assisting in the development and planning of acquisition of other housing projects and programs."
3. There were no records for board members discussing, negotiating, evaluating, or approving this contract.
4. The commission was at \$ per closed DPAP case.
5. The corporation was set-up by IND-2 on 1/24/XX, one month before the first payment was made and one week before the contract was signed.
6. The Service's records indicated that EIN for "CO-38 a State Corp." was established in January 20XX, the month before the contract was signed.
7. The State corporate records indicated CO-38 Inc. was incorporated on 1/27/XX with IND-2 as the registered agent. The status of the corporation was "inactive – forfeited" and the Franchise Tax Board forfeiture took place on 11/1/XX.
8. The Service records indicated 3 corporate returns were filed for the years ending January 31, 20XX, 20XX and 20XX, and taxes paid were \$, \$, and \$ respectively. No payroll returns were filed, implying that there were no paid employees providing the contracted services.
9. ORG made payments from 2/23/XX through 6/21/XX totaling \$, covering 5-month period from January through May 20XX. ORG was unable to provide records to substantiate the services received.
10. All checks made out to CO-38 were signed by EMP-1.
11. The cancelled checks indicated IND-2 endorsed all the checks.
12. The minutes of the board meeting dated 9/26/XX indicated the contract was terminated with no documented discussions for the reasons of termination. There was no formal termination record by either party.
13. IND-2 indicated paying EMP-1 in his letter dated 11/24/XX to the lawyers for the lawsuit between ORG and EMP-1s that was later dismissed with prejudice.

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14. Using the 3rd party contact procedure, Agent inquired about the service arrangement it had with ORG. On behalf of CO-38, IND-2 made the following statements in a letter without signing the letter:

Services – “The primary services ... from 19XX to 20XX was the development of their down payment assistance program documents, structure of the internal document flow procedures and the marketing concept. This included the down payment assistance format, document, internal forms, and internal procedures.”

Contracts – “I do not have a copy ... It is my understanding that ORG’s legal staff has provided your office with the original document.”

Statements, bills, invoices – “... The statements, bills, invoices and receipts for CO-38 were the checks paid by ORG to CO-38s thru their accounting department. It is my understanding that you have these checks.”

Termination – “The contract was terminated by mutual consent. The services under that structure were no longer required for the development of the program documents, procedures or policies for the program.”

-----2.B.5 to 8-----2.B.5 to 8-----2.B.5 to 8-----2.B.5 to 8-----2.B.5 to 8-----

Issue 2, Category B, #5, 6, 7 & 8: Overall

Agent made a side-by-side analysis of the consulting fees paid to the 4 entities and observed additional facts. The following table list out the payments made to these entities within the months indicated:

Month	CO-35	CO-37	CO-38	CO-36	Total by month	Total by year
May-xx						
Jun-xx		skipped				
Jul-xx						
Aug-xx						
Sep-xx						
Oct-xx	skipped					
Nov-xx						
Dec-xx						
Jan-xx						
Feb-xx		skipped				
Mar-xx						
Apr-xx		skipped				
May-xx						
Jun-xx		skipped				

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Jul-xx					
Aug-xx					
Sep-xx					
Oct-xx					
Nov-xx					
Dec-xx					
Jan-XX					
Feb-XX					
Mar-XX					
Apr-XX					
May-XX		-			
Jun-XX		-			
Jul-XX		-	in above month		
Aug-XX		-			
Sep-XX		-	in below month		
Oct-XX		-			
Nov-XX		-			
Dec-XX		-			
Jan-xx					
Feb-xx					
Mar-xx					
Apr-xx			in above month	-	
May-xx					
Jun-xx					
Jul-xx			skipped	-	
Aug-xx					
Sep-xx			skipped	-	
Oct-xx			skipped	-	
Nov-xx			skipped	-	
Dec-xx			skipped		
Jan-XX			skipped		
Feb-XX					
Mar-XX					
Apr-XX			skipped		
May-xx					
Jun-XX			in below month		
Jul-XX					
Aug-XX			skipped		
Sep-XX			skipped		
Oct-XX			skipped		
Nov-XX			skipped	-	
Dec-XX			skipped	-	
Jan-xx			skipped	-	
Feb-xx					

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Mar-xx						
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1. The payments to CO-38 overlapped with payments to CO-37. There were no payments to CO-37 in February, April and June. The payment in March 20XX appeared to include a catch-up payment for February. It appeared that during these few months either CO-38 or CO-37 would be paid per DPAP closing but not both.
2. The rate of payment to CO-35 was at \$ per DPAP closing while CO-37 and CO-38 were at \$ per DPAP closing. When the decision was made to increase the rate of payment to CO-37 to \$, the contracts to CO-35 and CO-38 were terminated and payments stopped simultaneously. It is understandable for CO-38 to accept this arrangement because its owner is the same as CO-37. However, it is inconceivable that CO-35 would go for this arrangement without any complain, since the owner was IND-4 not IND-2.
3. The payment to CO-36 began the month after the last payment to CO-37, and at the same rate of \$ per DPAP closing.
4. Payments for DPAP closing in August thru December 20XX, March 20XX, May 20XX, and from July 20XX on were not paid to CO-36, and there were no catch-up payments. This implied that it did not matter to CO-36 that ORG did not comply with the signed agreement.
5. The 2 payments in 20XX appeared to have no relation with the DPAP closings.
6. Using the 3rd party contact procedure, Agent inquired about the business and personal relations IND-2 had/has with ORG and its key-individuals. For the projects he was involved in, IND-2 made the following statements:

DPAP – “The development of the down payment assistance program. This included developing the documents, policies, procedures and marketing program... from my understanding still being used and marketed by ORG.” [CEO publicly claimed that he came up with this program.]

City of City DPAP – “The development of governmental relationship between ORG and the City of City in managing the down payment assistance program for the City. The project time line was approximately three months to develop the procedures and policies. The program from what I understand is still being managed by ORG.” [ORG did not mention that it has this program, and there were no financial records with the city of City.]

ORG Offices – “The purchase of the ORG corporate office in City. I was the broker of record for the purchase of the facility. The commission was credited back to ORG, at the request of ORG.”

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CO Homes – “Development of a builder/non-profit partnership between ORG and CO Homes. The relationship was terminated by ORG. ORG and CO reached an agreement. The termination letter and agreement is on record with ORG, at their corporate office.” [IND-2 was 1/3 owner of CO. When he was doing all these works, which hat was he wearing: owner of CO, owner of CO-37, owner of CO-38, owner of CO-36 or a volunteer of ORG?]

Foreclosure Prevention Program – “The development of a prevention program for families ready to lose their homes in foreclosure. This program from what I understand is currently being used by ORG.” [ORG never mentioned it had this program and the financial records did not indicate that it existed.]

Home Buyer Education Program – “The development of a homebuyer education program for home buyers. This program consisted of the home buying process, finding a sales agent, builder and lender then going thru the process. The purpose of the program was to develop home owners who would understand the process. This program from what I understand is still being used by ORG.” [Well, ORG did not educate home buyers since the beginning because HUD did not require it to do so.]

IND-2 added the following note to this section of his response “Note: I started as a consultant for ORG in 19XX and continued to do various projects for them. I do not remember all the projects or the specific date timelines.” This appeared to be the most accurate statement of all. He did not remember what he did for \$ he earned from May 19XX through March 20XX. He did not even remember that the first contract he signed under CO-37 was on 7/1/xx and supposedly providing his services since then.

In regards to his relation with CEO, IND-2 stated “My relationship with CEO has been as a consultant for ORG as well as a member of the CO-43. I have know CEO since he was the executive director for the CO-43. I think this is approximately 15 years.”

In regards to his relation with EMP-1, IND-2 stated “I have personally and professionally know[n] EMP-1 through my association and work with the City of 24s redevelopment department as well as thru ORG... became both a personal and professional friend... I ended the professional and personal relationship in May 20XX when I learned of EMP-1’s alleged improprieties involving activities related to ORG.”

7. Using the 3rd party contact procedure, Agent inquired about the business and personal relations IND-4 had/has with ORG and its key-individuals. IND-4 stated:

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20XX,
20XX, 20XX and 20XX

“Besides ORG contracts, I have/had no business relationship with ORG officers. I have known ORG founder, CEO since early ‘90s. He sought consultation regarding “trans-portable emission fees” issue at the time I worked for CO-49, CO-49. Air Resource Board, ARB, had raised the issue to charge fees for construction vehicle travel from CO-20 to County County. I acted as his Real Estate Broker when he purchased his current residence. We are neighbors and family friends for each other.”

In response to the 80-acre land in City, IND-4 stated “In July 20XX, I loaned \$ to ORG to close the escrow. This loan has been paid off. There is no contract for this between ORG and me.”

What IND-4 failed to mention in his letter was that starting in July 20XX, he held 2 corporate business credit cards of ORG and began making charges in August 20XX for meals, office supplies, electronic goods, etc. From August through December 20XX his charges totaled to about \$.

In addition, he is the president of CO-50 and this entity is providing consulting services to ORG at \$ per month. From July through December 20XX, All-in-one received \$ in fees and reimbursements.

All the facts collectively imply that the payments to there 4 entities were for the primary purpose of funneling funds out of ORG for someone’s personal gain. CEO and/or EMP-1 were aware of the purpose of the transfers, and the bevergreenfactors, including him/herself.

Overall Operational Control:

Under Part V of Form 990 for “List of Officers, Directors, Trustees, and Key Employees” ORG listed the following individuals:

Name	Title	19XX	19XX	20XX	20XX	20XX	20XX	20XX
CEO	Pres/Chair.	yes	yes	as needed	10 hrs/wk	10 hrs/wk	10 hrs/wk	\$40,385 20 hrs/wk
EMP-1	Exec. Dir.							
DIR-1	Board of Dir.		yes					
DIR-2	Board of Dir.		yes	as needed	10 hrs/wk			
DIR-3	Board of Dir.			as needed	10 hrs/wk			
DIR-4	Board of Dir.			as needed	10 hrs/wk			

Under Part I of Schedule A for “Compensation of the Five Highest Paid Employees Other Than Officers, Directors, and Trustees” ORG listed the following individuals:

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20XX, 20XX and 20XX

Name	Title	19XX	19XX	20XX	20XX	20XX	20XX	20XX
EMP-1	Controller							
EMP-3	Office Manager							

As part of its letterhead, ORG listed its board members and advisory board members. The letterheads used in 19XX through 20XX are summarized below:

Individual Name	Title/Co. in Sep. 19XX	Title/Co. in Sep. 20XX	Title/Co. in Feb. 20XX	Title/Co. in Aug. 20XX
Board of Directors				
CEO	Chairman of ORG Exec. Off. CO-43	same	same	same
EMP-1	not listed	not listed	Vice Chairman/Sec.	not listed
EMP-2	Public Mbr of ORG	not listed	not listed	not listed
DIR-2	Public Mbr of ORG	same	same	same
DIR-1	Public Mbr of ORG	same	same	not listed
DIR-4	not listed	not listed	Public Mbr of ORG	not listed
DIR-5	not listed	not listed	not listed	Pub. Mbr-ORG
Advisory Board				
DIR-6	not listed	Mbr of Congress, 28th District	same	same
DIR-7	Assemblyman	Mbr of Congress, 41st District	same	same
DIR-8	not listed	not listed	Mbr of Congress, 42nd District	same
DIR-9	Mbr; State Assy.	same	Former Mbr; State Assy.	same
DIR-10	not listed	not listed	Past Pres., CO-51 ("CO-51")	same
DIR-11	not listed	not listed	Past Pres., CO-51	same
DIR-12	not listed	not listed	Past Pres., CO-51	same
DIR-13	Exec. Dir, CA State Allocation Board	Exec. VP	CO-52	same
DIR-14	CO-10		same	same
DIR-15	CO-14	same	CO-53	same
DIR-16	CO-2.	same	same	same
DIR-17	Prof. of Gov't, State & Local Gov't	same	same	same
DIR-18	CO-54, Pres., CO-43	same	Past Pres., CO-43 of City State CO-54	same
DIR-19	CEO CO-43 of Orange County, former State Housing Director, former Board Mbr	same	same	same
DIR-20	Exec. Off., CO-43	same	same	same

EXPLANATION OF ITEMS

Name of Organization/Taxpayer

Tax Identification Number

Year/Period ended

ORG

12/31/19XX, 19XX, 20XX,
20XX,
20XX, 20XX and 20XX

DIR-21	City of City	same	same	same
DIR-52	City Manager, City	same	same	same
DIR-22	City of City, Pres., CO-55	same	City of City, Past Pres. CO-55	same
DIR-23	CO-56.	same	same	same
DIR-24	CO-57	same	same	CO-57. CO-43
DIR-25	CO-58	CO-59	same	same
DIR-26	County, Treasurer-Tax Collector	same	same	same
DIR-27	not listed	County, Auditor/Collector	same	same
DIR-28	CO-60	same	same	same
DIR-29	CO-61	same	same	same
DIR-30	CO-62	same	same	same
DIR-31	CO-63 of CO-43	CO-63	same	same
DIR-32	City of City, Chairperson, CO-64	same	same	same
DIR-34	CEO, CO-43 of CO-65	same	same	same
DIR-35	Former Councilmbr City of City	same	same	same
DIR-36	CO-60	same	same	same
DIR-37	CO-67	same	same	same
DIR-38	not listed	CO-66	CO-70	same
DIR-39	not listed	CO-68	same	same
DIR-40	not listed	CO-69	same	same
DIR-41	not listed	not listed	Strategic Policy Analyst	same
DIR-42	not listed	not listed	Med. Dir.,	same
DIR-43	not listed	not listed	CO-71	same
DIR-44	not listed	not listed	Attorney at Law	same
DIR-45	not listed	not listed	Deputy Ass't – Sec.	same
DIR-46	not listed	not listed	Exec Off,	same
DIR-47	not listed	not listed	CO-72	same
DIR-48	not listed	not listed	CO-73	same
Dan Davis	not listed	not listed	CO-74	same
DIR-50	not listed	not listed	CO-75 (Ret.)	same
DIR-51	not listed	not listed	CO-76	same

The letterheads indicated that CEO was the Chairman/President throughout the years. EMP-1 was listed as Vice Chairman/Secretary in 20XX.

EMP-2 appeared in the 19XX letterhead as a “public member”. In 19XX ORG only issued Forms 1099 and EMP-2 was the 3rd highest paid individual in 19XX with \$ earning. IND-4 was the 2nd

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highest paid individual with \$ earning and EMP-1 was the highest paid individual with \$ in earning. The Forms 1099 and W-2 for 19XX indicated their earnings as \$ for EMP-1, \$ for EMP-2 and \$ for IND-4.

There were other board members. However, the listing of these board members was inconsistent with the ones listed on Forms 990. There were 26 to 46 advisory board members throughout the years, but none of them were listed on the Forms 990.

Agent requested minutes of board of director's meetings within the calendar years 20XX through August 20XX, but was told that none of the minutes were available. EMP-1 was fired by CEO in mid-20XX. ORG claimed that EMP-1 destroyed records, failed to keep proper records or took records with her. Agent mentioned that CEO was all along the president of ORG and he would have copies. There was no response. In addition, CEO took over the management since he fired EMP-1. More than one year passed and yet, ORG was not able to produce a single minutes of board meetings.

In response to substantial payments to some consultants, ORG provided minutes of Annual Board of Directors Meeting dated September 26, 20XX without approval signature. The entire body of the minutes read as follows:

The annual meeting of the Board of Directors of ORG was held at the corporate offices at Address, City, State. The Meeting was held on Tuesday, September 26, 20XX at 1:00 p.m.

The meeting was called to order by CEO, Chairman. Directors present were CEO and DIR-2. The Chairman announced that a quorum of the directors was present, and that the meeting, having been duly convened was ready to proceed with its business.

Motion were made, seconded and unanimously approved as follows:

1. *That the Board of directors shall be expanded to 5 members.*
2. *That CEO shall be elected to the Board of Directors.*
3. *That EMP-1 shall be elected to the Board of Directors.*
4. *That DIR-2 shall be elected to the Board of Directors.*
5. *That DIR-1 shall be elected to the Board of Directors.*
6. *That DIR-4 shall be elected to the Board of Directors.*

EXPLANATION OF ITEMS

Name of Organization/Taxpayer
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20XX,
20XX, 20XX and 20XX

A Motion was made, seconded and unanimously approved to elect officers of the Board as follows:

- A. *Chairman:* CEO
- B. *Vice-Chairman/Secretary:* EMP-1
- C. *Member-at-Large:* DIR-2
- D. *Member-at-Large:* DIR-4
- E. *Member-at-Large:* DIR-1

Additional motions were made, seconded and unanimously approved as follows:

1. *That the minutes of the previous Meeting of Directors be approved. [no date was provided]*
2. *That ORG employees shall be offered the option of participating in a 4XXK program with no employer contribution.*
3. *That the Executive Director of ORG shall be authorized to sign on behalf of ORG for a line of credit at CO-15. [The general ledgers indicated a \$ loan was taken out in 19XX which was then converted into line of credit with CO-15 by the end of the year. No new line of credit was recorded in 20XX.]*
4. *That ORG shall approve the purchase of the new ORG building located Address, which includes the vacant land adjacent to this address for additional parking. [According to the property records, the purchase date was on 4/19/20XX. Even with the shortest escrow days (30 days), the decision to purchase a \$ property was made in early March 20XX. This indicated that even a major expenditure did not require a formal review and approval by the board.]*
5. *That the Executive Director shall be authorized to sign the construction contract with CO-46 for Address. [The first payment to CO-46 was on 11/16/20XX.]*
6. *That ORG shall approve the lease agreement for CO-43 to lease 4,000 square feet of office space at Address. [In a follow-up letter dated 9/3/20XX, CO-43 indicated mailing the final lease agreement to ORG on 7/2/XX, but had not received a "fully executed original" from ORG. In*

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other words, there was no lease for the board members to approve during this meeting. The lease was signed by CEO as President and EMP-1 as the Executive Director on 9/17/XX. The general ledgers indicated ORG rented the old location through November 20XX.]

7. *That ORG shall purchase one property to be made available for rental purposes with CO-20's clients. [The property was purchased in September 20XX. The lease with CO-20 was executed on 12/16/20XX by EMP-1 as the Executive Director. See Activity 4 above for matters related to this property.]*
8. *That ORG shall continue participation with the County Housing Authority on the Homeownership Program.*
9. *That ORG shall proceed with negotiations with CO-26 Estates to enter into a property management agreement to manage the homeowners associations.*
10. *That ORG shall submit the Recertification application to HUD.*
11. *That ORG shall participate with CO-77 (Developer) on the projects know as CO-78 (City) and Classic Valley View (City). [See Activity 5 above for matters related to these properties.]*
12. *That ORG shall proceed in locating an alternative site for the ORG/ARC Project in the City of City.*
13. *That ORG shall terminate the contracts with CO-35 and CO-38. [See issue 2 – Inurement and Private Benefits for information related to these 2 entities.]*
14. *That effective August 1, 20XX, the CO-37 Development contract shall be increased from \$ per closed transaction to \$ per closed transaction on the ORG Down Payment Assistance Program. [See issue 2 – Inurement and Private Benefits for information related to this entity.]*
15. *That ORG Board of Directors approves a bonus compensation for the Executive Director in the amount of \$\$\$. [She was earning around \$\$\$ per year in accordance with her service contract, except for 20XX. Her Form W-2 for 20XX indicated \$ in total compensation.]*

There being no further business to come before the Board of Directors, a motion was made, seconded and unanimously approved to adjourn the meeting at 2:30 p.m.

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EMP-1, Secretary

Date”

The following inconsistencies are observed with the minutes and other actions described above:

- The minutes discusses about matters that took place over several years, as indicated by Agent's inserts within '[' brackets.
- Article II, Section 2 of the Bylaws states “The authorized number of directors shall be no fewer than five and no more than fifteen...” The minutes indicates it was less than before this meeting, and Forms 990 indicate the number of directors were below minimum requirement for most of the years under examination.
- Article II, Section 7 of the Bylaws states “the Board shall hold a regular meeting each year, at a location and time previously designated by the Board, to elect directors, choose officers, consider matters of organization, and transact other business as desired.” The Bylaws was silent on when the annual meeting was to be held. The silence itself was unusual because the bylaws Agent reviewed, during her years as an Exempt Organization Specialist, always specify when the annual meetings would be held. The minutes above did not mention when the previous annual meeting was or when the next annual meeting would take place.
- Article III, Section 4 of the Bylaws states “Any officer chosen by the Board may be removed at any time, with or without cause or notice, by the Board.” EMP-1 was hired and fired by CEO, not the Board. This action would have been in compliance with Article III, Section 4 of the Bylaws if CEO was the only director, but would be out of compliance with Article II, Section 2.
- Article V, Section 4 of the Bylaws states “The Chief Financial Officer shall cause the accounting books and records of the corporation to be audited annually by an independent accountant selected by the Board, and shall cause an annual report to be sent to the directors within one hundred twenty days after the end of the corporation's fiscal year.” The annual meeting did not discuss ORG's financial status. Other records indicated that the financial records were not formally audited throughout the years.

CEO' calendars

CEO' calendars for the years 19XX through 20XX indicated CEO had meetings with EMP-1 in the month period. The names of the other board members were not observed in the calendars, indicating that CEO never had any meeting with these individuals who should have been overseeing his and ORG's actions and activities.

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The only reference to the board was the phrase "ORG Lunch for Board" entered on 2/10/xx. The \$ bill was recorded under "Tradeshows/Conferences" account with the memo "Heart of ORG luncheon 02/10/xx." Assuming it cost about \$ per person, there would have been 22 individuals at the luncheon. ORG issued 24 Forms W-2 in 19XX with one as little as \$ and there were 9 individuals earning less than \$. ORG records indicated it only had 4 board members, implying that the luncheon was for employees of ORG rather than a board meeting.

The calendar for 9/26/xx was blank, even though CEO supposedly had an annual meeting with ORG's board members. Throughout the 60 months, there was no entry for ORG's annual board meeting.

All facts indicated that CEO had the overall control of ORG, while EMP-1 had the day-to-day operational control. Other directors or advisory board members did not appear to be involved in any of ORG's activities.

LAW

Laws primary applicable to Issue 1

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

The Income Tax Regulations ("the Regulations") §1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3) of the Code. An organization must not engage in substantial activities that fail to further an exempt purpose.

The Regulations §1.501(c)(3)-1(d)(1)(ii) of 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.

The Regulations §1.501(c)(3)-1(d)(2) provides that the term "charitable" includes relief of the poor and distressed or underprivileged, lessening of the burdens of government, and promotion of social welfare by conducting programs to combat community deterioration and juvenile delinquency.

The Regulations §1.501(c)(3)-1(d)(3) defines the term "educational" for the purposes of §501(c)(3) of the Code as including the instruction of the public on subjects useful to the individual and beneficial to the community.

The Regulations §1.501(c)(3)-1(d)(1) provides that an organization may be exempt as an organization described in §501(c)(3) of the Code if it is organized and operated exclusively for one or

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more of the following purposes: (a) religious, (b) charitable, (c) scientific, (d) testing for public safety, (e) literary, (f) educational, or (g) prevention of cruelty to children or animals.

The Regulations §1.501(c)(3)-1(d)(2) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (1) of this subparagraph unless it serves a public rather than a private interest.

The Regulations §1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of §501(c)(3) 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 *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single...(nonexempt) purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly...(exempt) purposes."

In *Easter House v. U.S.*, 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F.2d 78 (Fed.Cir.) cert. denied, 488 U.S. 907 (1988), the court found an organization that operated an adoption agency was not exempt under § 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 § 501(c)(3) of the Code because the primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in §501(c)(3) of the Code. *Easter House*, 12 Cl. Ct. at 485-486.

In *American Campaign Academy v Commissioner*, 92T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) 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 Republican Party entities and that most of the organization's graduates worked in campaigns for Republican candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting Republican candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve

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a private interest within the meaning of §1.501(c)(3)-1(d)(ii) of the Regulations. The court concluded by stating that even if the Republican 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 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 §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 given by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from a community of craftsmen. It did not market the kinds of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the activity was to benefit disadvantaged communities. The method it used to achieve its purpose did not cause it to serve primarily private interest 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.

Revenue Ruling 2006-27 discusses three examples of organizations providing downpayment assistance and whether each qualified as an organization described in § 501(c)(3) of the Code.

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

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

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

In Situation 2, Y is a nonprofit corporation that is like X in all respects as set forth in Situation 1, except as follows. Under Y's grantmaking procedures, Y's staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which Y provides down payment assistance to a home buyer, Y receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by Y in connection with each of these transactions and the amount of the home seller's payment to Y. Finally, Y does not conduct a broad based fundraising campaign to attract financial support. Rather, most of Y's support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive Y's down payment assistance.

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

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

In Situation 3, the revenue ruling held that although Z does not limit its down payment assistance program to low-income recipients, Z's down payment assistance program still serves a charitable purpose described in § 501(c)(3) because it combats community deterioration in a specific, economically depressed area that has suffered a major loss of population and jobs. Through a combination of counseling and financial assistance, Z helps low and moderate-income families in that area to acquire decent, safe and sanitary housing and to prepare for the responsibilities of home ownership. In this respect, Z is like the organization described in Situation 3 of Rev. Rul. 70-585. Because Z is operated exclusively for charitable purposes, Z qualifies for exemption from federal taxation as an organization described in § 501(c)(3).

The revenue ruling concluded that down payment assistance payments for home buyers in Situations 1 and 3 are made by those organizations out of a detached and disinterested generosity and from charitable or like impulse, rather than to fulfill any moral or legal duty, and thus qualify for exclusion from such home buyers' gross incomes as "gifts" under § 102. The benefits provided to the home buyers in these circumstances are sufficiently removed from the interests of any home sellers or sales agents that they proceed from a detached and disinterested generosity on the part of the donor organization, and such grants lack the indicia of a rebate, price adjustment, or *quid pro quo* incident to a sale. In Situation 2, the organization is not operated exclusively for charitable purposes, and consequently, does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

In issuing Revenue Ruling 2006-27, the Service issued Information Release 2006-74. Among other things, this information release advised of reports of other government agencies with regard to seller-financed downpayment assistance programs, as follows:

A March 2005 report entitled, "An Examination of Downpayment Gift Programs Administered By Non-Profit Organizations," commissioned by the U.S. Department of Housing and Urban Development (HUD), found that seller-funded down-payment assistance has led to underwriting problems and resulted in an increase in the effective

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cost of homeownership. A report from November 2005 entitled, "Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance," conducted by the U.S. Government Accountability Office (GAO) found similar results.

Revenue Ruling 67-138, 1967-1 C.B. 129, holds that a nonprofit organization created to help low income persons obtain adequate and affordable housing may be exempt from Federal income tax under §501(c)(3) of the Code because it relieves the poor and distressed or underprivileged. It describes the organization's activities, which are directed toward assisting low-income families obtain improved housing, as "(1) conducting a training course relative to various aspects of housebuilding and homeownership, (2) coordinating and supervising joint construction endeavors, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans. No charge is made for any of these services."

Revenue Ruling 70-585, 1970-2 C.B. 115, provides that nonprofit housing organizations created to aid low and moderate income families by lessening neighborhood tensions, eliminating prejudice and discrimination, and combating community deterioration may qualify for exemption under §501(c)(3) of the Code.

Revenue Ruling 85-1, 1985-1 C.B. 177, and Revenue Ruling 85-2, 1985-1 C.B. 178, provide that the criteria to be used to determine whether or not an activity is lessening the burdens of government are "first, whether the governmental unit considers the organization's activities to be its burden; and second, whether these activities actually lessen the burden of the governmental unit."

Revenue Ruling 68-17, 1968-1 C.B. 247 provides that a nonprofit organization formed to aid low-income families living in deteriorating neighborhoods in improving their homes may qualify for exemption from Federal income tax under §501(c)(3) of the Code. The organization's "membership consists of other nonprofit institutions, neighborhood groups, and individuals. To accomplish its purposes, a model demonstration housing program is conducted by the organization. It is financed in part by a grant from the Department of Housing and Urban Development under Section 207 of the Housing Act of 1961 (42 U.S.C.A. 1436). The objects of the demonstration program are to test the feasibility, cost, and procedural and financial aspects of providing housing for low-income families through the acquisition, rehabilitation, and resale or lease of residential structures in a deteriorating neighborhood."

"Homes rehabilitated by the organization in the model demonstration program are sold or leased to low-income or displaced families on a nonprofit basis. The organization does no new construction."

Revenue Procedure 96-32, 1996-1 C.B. 717 sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable because they relieve the poor and distressed as described in the Regulation §1.501(c)(3)-1(d)(2). The procedure also describes the facts-and-circumstances test that will apply to determine when organizations that fall

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outside the safe harbor will still be considered charitable organizations that offer relief to the poor and distressed. It also, clarifies that housing organizations may rely on other charitable purposes to qualify for recognition of exemption from income tax as the Code §501(c)(3) organizations.

Section 2 of the revenue procedure provides the background of safe harbor. The pertinent subsections are summarized as follows:

- Section 2.01 of the Revenue Procedure provides that poor and distressed beneficiaries must be needy in the sense that they cannot afford the necessities of life, and demonstrate an inability to secure adequate housing under all the facts and circumstances to determine whether they are poor and distressed within the meaning of Regs. 1.501(c)(3)-1(d)(2).
- Section 2.02 acknowledges the existence of a national housing policy to maintain a commitment to provide decent, safe, and sanitary housing for every American family as reflected in federal housing acts. Not all beneficiaries of these housing acts however are necessarily poor and distressed within the meaning of Regs. 1.501(c)(3)-1(d)(2).
- Section 2.03 of the Safe Harbor provides that a limited number of housing units may have residents with above the low-income limits in order to assist in the social and economic integration of the poorer residents, and thereby, further the organization's charitable purposes. To avoid giving undue assistance to those who can otherwise afford safe, decent, and sanitary housing, the safe harbor requires occupancy by significant levels of both very low-income and low-income families.
- Section 2.06 of the Safe Harbor provides that to be recognized as exempt from income tax under §501(c)(3), a low-income housing organization must not only serve a charitable purpose but also meet the other requirements of that section, including the prohibitions against inurement and private benefit.

Section 3 of the revenue procedure describes the safe harbor for relieving the poor and distressed. The pertinent subsections are summarized as follows:

- Section 3.01 of the Safe Harbor provides that an organization will be considered as described in 501(c)(3) if it satisfies the following requirements:
 - (1) The organization establishes for each project that (a) at least percent of the units are occupied by residents that qualify as low-income; and (b) either at least percent of the units are occupied by residents that also meet the very low-income limit for the area or percent of the units are occupied by residents that also do not exceed percent of the area's low-income limit. Up to percent of the units may be provided at market rates to persons who have incomes in excess of the low-income limit.
 - (2) The project is actually occupied by poor and distressed residents.

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(3) The housing is affordable to the charitable beneficiaries. In the case of homeownership programs, this requirement will ordinarily be satisfied by the adoption of a mortgage policy that complies with government-imposed mortgage limitations or otherwise makes the initial and continuing costs of purchasing a home affordable to low and very low-income residents.

- Section 3.02 provides that the Service will follow the provisions listed below:

(1) Low-income families and very low-income families will be identified in accordance with the income limits computed and published by the Department of Housing and Urban Development (“HUD”) in “Income limits for Low and Very Low-Income Families Under the Housing Act of 1937.” The term “very low-income” is defined by the relevant housing statute as 50 percent of an area’s median income. The term “low-income” is defined by the same statute as 80 percent of an area’s median income. However, these income limits may be adjusted by HUD to reflect economic differences, such as high housing costs, in each area.

Section 4 of the revenue procedure provides the facts and circumstances test for relieving the poor and distressed. The pertinent subsections are summarized as follows:

- Section 4.01 allows an organization, which does not satisfy the requirement of Section 3 to demonstrate that it relieves the poor, and distressed by reference to all of the surrounding facts and circumstances.
- Section 4.02 provides that facts and circumstances, which demonstrate relief of the poor, may include, but is not limited to, the following:
 - (1) A substantially greater percentage of residents than required by the safe harbor with income up to 120 percent of the area’s very low-income limit.
 - (2) Limited degree of deviation from the safe harbor percentages.
 - (3) Limitation of a resident’s portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very-low income residents.
 - (4) Participation in a government-housing program designed to provide affordable housing.
 - (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization’s operations.
 - (6) The provision of additional social services affordable to the poor residents.

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(7) Relationship with an existing 501(c)(3) organization active in low-income housing for a least five years if the existing organization demonstrates control.

(8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.

(9) **Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.** [Emphasis added.]

(10) Existence of affordability covenants or restrictions running with the property.

Section 5 of the revenue procedure provides examples of the safe harbor would be applied. The pertinent subsections are summarized as follows:

- Section 5.01(3) of the Safe Harbor provides an example of an organization *R* providing affordable homeownership opportunities to purchasers determined to be low-income under a federal housing program. The homes are scattered throughout a section of *R*'s community. Beneficiaries under the program cannot afford to purchase housing without assistance. *R*'s program makes the initial and continuing costs of mortgages affordable to the home buyers by providing assistance with down payments and closing costs. Homeowners assisted by *R* will have the following composition: 40 percent will not exceed 140 percent of the very low-income limit for the area, 25 percent will not exceed the low-income limit, and 35 percent will exceed the low-income limit but will not exceed 115 percent of the area's median income. *R* does not satisfy the safe harbor. However, the facts and circumstances demonstrate that *R* relieves the poor and distressed.
- Section 5.01(6) of the Safe Harbor provides an example of an organization, which provides homeownership opportunities to purchasers with incomes up to 115 percent of the area's median income. The organization does not meet the income levels required under the safe harbor. Its board of directors is representative of community interests, and it provides classes and counseling for its residents. The facts and circumstances do not demonstrate that the organization relieves the poor and distressed.
- Section 6.01 of the Safe Harbor provides that an organization may meet the qualification for exemption without having to satisfy the standards for relief of the poor and distressed by providing housing in a way that accomplishes any of the purposes set forth in IRC 501(c)(3) or Regs. 1.501(c)(3)-1(d)(2).
- Section 6.01 (1) provides that an organization can meet the requirements by combating community deterioration. This can be demonstrated by (1) operating in an area with actual or

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potential deterioration, and (2) directly preventing or relieving that deterioration. Constructing or rehabilitating housing has the potential to combat community deterioration.

- Section 6.01 (2) provides that an organization can meet the safe harbor by lessening the burdens of government by showing that (a) there is an objective manifestation by the governmental unit that it considers the activities of the organization to be the government's burden, and (b) the organization actually lessens the government burden.
- Section 6.01 (3) provides that an organization can meet the safe harbor by eliminating discrimination and prejudice for the purpose of stabilizing neighborhoods or reducing racial imbalances.
- Section 6.01 (4) states that an organization can meet the safe harbor by lessening neighborhood tensions. This is generally identified as an additional charitable purpose by organizations that fight poverty and community deterioration associated with overcrowding in lower income areas in which ethnic and racial tensions are high.
- Section 6.01 (5) states that an organization can meet the safe harbor by relieving the distress of the elderly and physically handicapped by meeting the special needs of these groups.

Section 7 of the revenue procedure states that if an organization furthers a charitable purpose, it may still not qualify if private interests of individuals with a financial stake in the project are being furthered.

In *Carrie A. Maxwell Trust, Pasadena Methodist Foundation V. Commissioner*, 2 TCM 905 (1943) the court found a trust which benefit a specified individual to be a private trust, rather than a charitable trust, despite the fact that the individual was in need.

HUD Directive 4155.1 REV- 5, issued in October 2003, describes the type of nonprofit organizations eligible for participation in various HUD programs under Chapter 1, Section 5 as follows:

“1-5 NONPROFIT ORGANIZATIONS AND STATE AND LOCAL GOVERNMENT

AGENCIES. Nonprofit organizations and state and local government agencies are permitted to purchase properties with FHA-insured mortgages, subject to the conditions listed below. These government and nonprofit organizations are eligible for the same percentage of financing available on owner-occupied principal residences. Nonprofit agencies may only obtain FHA-insured fixed rate mortgages, and only an existing FHA-insured mortgage is eligible for refinancing and may never result in equity withdrawal.

A. Nonprofit Organizations. Nonprofit organizations that intend to sell or lease the property to low- or moderate-income individuals (generally defined as income not

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exceeding 115 percent of the applicable median income) may obtain FHA-insured financing on rental property. ...

B. Nonprofit Approval. In order to qualify to purchase properties with FHA-insured mortgages and to obtain the same percentage of financing available to owner-occupants, HUD must approve the nonprofit agency. The nonprofit must:

1. Be of the type described in Section 501(c)(3) as exempt from taxation under Section 501(a) of the Internal Revenue Code of 1986; and
2. **Have a voluntary board, and no part of the net earnings of the organization or funds from the transaction may benefit any board member, founder, contributor, or individual. [Emphasis added.]**
3. Have two years' experience as a provider of housing for low- and moderate-income persons.

A nonprofit agency not meeting the above requirements, including religious and charitable organizations, may only purchase properties backed by FHA mortgage insurance under the conditions described for other investors in paragraph 1-4A.

Detailed instructions on qualifying nonprofit organizations as mortgagors, including documentation requirements, are contained in Mortgagee Letter 2002-01. Questions concerning a nonprofit agency's approval should be directed to the appropriate HOC."

HUD Directive 4155.1 REV-5, issued in October 2003, describes about "Gift Funds" in Chapter 2, Section 3 C as follows:

"C. Gift Funds. An outright gift of the cash investment is acceptable if the donor is the borrower's relative, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. The gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. No repayment of the gift may be expected or implied. ... [Emphasis added.]

FHA deems the payment of consumer debt by third parties to be an inducement to purchase. ... **When someone other than a family member has paid off debts, the funds used to pay off the debt must be treated as an inducement to**

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purchase and the sales price must be reduced by a dollar-for-dollar amount in calculating the maximum insurable mortgage. [Emphasis added.]

Documentation Requirements. The lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift, states that no repayment is required, shows the donor's name, address, telephone number and states the nature of the donor's relationship to the borrower...

Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

NOTE: FHA does not "approve" down payment assistance programs in the form of gifts administered by charitable organizations (i.e., nonprofits). Mortgage lenders are responsible for assuring that the gift to the homebuyer from the charitable organization meets the appropriate FHA requirements and the transfer of funds is properly documented. In addition, FHA does not allow nonprofit entities to provide gifts to homebuyers for the purpose of paying off installment loans, credit cards, collections, judgments, and similar debts." [Emphasis added.]

The Directive 4155.1 Rev.4, issued in September 1995 has similar wordings for the "Gift Funds" description and nonprofit organization requirements.

On March 3, 2000, HUD issued Mortgagee Letter 00-8 for "Nonprofit Agency Participation in Single Family FHA Activities" stating:

"Monitoring and Reporting Process: Periodically, FHA will perform field reviews of nonprofit agencies that participate in FHA activities. ... These reviews may include, without limitation, a review of projects under development, **the agency's internal control procedures, adherence to the goals of the approved affordable housing program, and verification that HUD Homes purchased at the 30 percent discount level are sold to persons at or below the applicable median income.** [Emphasis added.] ...

Approval of Downpayment Assistance Programs in the Form of Gifts: There has been widespread confusion regarding the Department's role in approving downpayment assistance programs in the form of gifts. **FHA does not "approve" down payment assistance programs in the form of gifts administered by charitable organizations.** Mortgage lenders are responsible for assuring that the gift to the

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homebuyer from the charitable organization meets the instructions described in HUD Handbook 4155.1, REV-4, Change 1 (e.g., no repayment implied, etc.). Thus, **while FHA will issue approval letters to nonprofit agencies for their participation as mortgagors, providers of secondary financing, and as purchasers of HUD homes at a discount, such letters are not to be construed as approval of the nonprofit agency's down payment assistance gift programs. FHA will not issue approval letters for down payment assistance gift programs.** [Emphasis added.]

On August 7, 2000, HUD issued Mortgagee Letter 00-28 for "Gift Documentation, Mortgage Forms and other Credit Policy and Appraisal Issues" revising HUD procedures for verifying the transfer of gift funds from private individual donors to homebuyers, as well as the required contents of the gift letter itself. The letter states:

"... These reforms are intended to ensure to the greatest extent possible that the gift funds were in fact the donor's own and are not derived from an unacceptable source. The donor must be able to furnish conclusive evidence that the funds given to the homebuyer came from the donor's own funds and thus, were not provided directly or indirectly by the seller, real estate agent, builder, or any other entity with an interest in the sales transaction.

The gift letter, ... now must also contain language asserting that the **funds given to the homebuyer were not made available to the donor from any person or entity with an interest in the sale of the property including seller, real estate agent or broker, builder, loan officer or any entity associated with them.** ...

Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification the closing agent received funds from the donor for the amount of the purported gift." [Emphasis added.]

On January 9, 2002, HUD issued Mortgagee Letter 2002-01 for "Nonprofit Participation in Single Family FHA Activities - New Requirements and Restrictions" clarifying the requirements that new and renewing nonprofit applicants must meet to participate in FHA's Single Family activities, including purchasing discounted HUD Homes, serving as mortgagors, and offering secondary financing assistance. The letter states:

"Conflict of Interest Issues

... It is a conflict of interest for a nonprofit to employ staff who also work for and receive financial benefits from a for-profit entity that is providing the nonprofit with services related to the nonprofit's affordable housing plan. Board members must serve

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on a voluntary basis, and may not be paid nor receive any compensation for any services they provide in the implementation of the nonprofit's affordable housing program. FHA will collect information on the job responsibilities of all Board members to ensure that their occupational activities and obligations do not conflict with the work of the nonprofit. **HUD strictly prohibits the sale or lease of properties with FHA financing and/or discounted HUD Homes to any of the nonprofit's officers, directors, elected or appointed officials, employees, or business associates, either during their tenure or for one year thereafter, or to any individual who is related by blood, marriage, or law to any of the above. ... [Emphasis added.]**

Ineligible Participants

To be approved and to maintain approval, neither the nonprofit, nor any officer, partner, director, principal or employee shall:

- Be suspended, debarred, or otherwise restricted under the Department's regulations in 24 or 25 CFR, or similar procedures of any other Federal agency.
- Be indicted for, or convicted of, an offense which reflects upon the responsibility, integrity, or ability of the nonprofit to participate in FHA activities.
- Be subject to unresolved findings as a result of HUD or other government audits or investigations.
- **Be engaged in activities that do not conform to generally accepted practices of prudent nonprofits or that demonstrate irresponsibility. [Emphasis added.]**

These requirements are applicable at the time that the nonprofit applies for approval and at all times while it is an approved nonprofit.

Consultant Services

Nonprofit agencies must have the administrative capacity to develop and carry out their FHA approved homeownership plans in a timely and successful manner. Nonprofits that obtain consultant services to help implement their homeownership programs are not relieved from this requirement. The nonprofit's operations must be independent of the influence, control, or direction of the consultant or any other outside party, particularly those seeking to derive profit or gain from a proposed project (such as, but not limited to, landowners, real estate brokers, bankers, contractors, builders, or consultants). Therefore, **to assure that the consultant services are provided on an 'arms length' basis, the nonprofit must disclose any written and/or side agreements with parties that may derive financial gain through the homeownership program. [Emphasis added.]** Disclosure should identify the name of the business entity, and the individuals from the company who will be working with the nonprofit, the terms of the relationship and how the party will be compensated. Failure to adequately disclose may result in a conflict-of-interest determination.

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In addition, consultant services - administrative, management, financial, or otherwise - provided under an independent contractor relationship (as opposed to employer-employee relationship) shall not constitute more than half of the nonprofit's activities. This measurement will be calculated by evaluating: the ratio of nonprofit staff to contracted or consultant staff; the ratio of hours devoted to the implementation of the Affordable Housing Plan by nonprofit staff versus contracted or consultant staff; and the funds devoted to paying nonprofit staff compared to those paying contracted or consultant staff. In other words, the nonprofit must have the in-house resources and capacity to run its own programs, and contract for services on a temporary and supplementary basis."

Laws primary applicable to Issue 2

the Regulations §1.62-2 defines reimbursements and other expense allowance arrangements as establishing an accountable plan which requires sufficient documentation for business connection, substantiation for business expenditures and returning any excess back to the employer.

The Code §4958(c), in part, defines "excess benefit transaction" as any transaction in which an economic benefit is provided by an "applicable tax-exempt organization" directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

The Code §4958(e) defines "applicable tax-exempt organization" as an organization described in either The Code §501(c)(3) or §501(c)(4) or an organization which was so described at any time during the five-year period ending on the date of the excess benefit transaction.

The Code §4958(f)(1) defines "disqualified person" as (A) any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of a disqualified person, and (C) a 35% controlled entity.

§53.4958-3(a)(1) of the Regulations defines a disqualified person, with respect to any transaction, as any person who was in a position to exercise substantial influence over the affairs of an applicable tax-exempt organization at any time during the five-year period ending on the date of the transaction.

§53.4958-3(b)(2) of the Regulations defines a disqualified person, with respect to any transaction with an applicable tax-exempt organization if the person is a 35-percent controlled entity.

§53.4958-3(b)(2)(A) of the Regulations defines a 35% controlled entity as a corporation in which the disqualified person(s) own(s) more than 35% of the combined voting power.

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§53.4958-3(c) of the Regulations provides that voting members of the governing body, presidents, chief executive officers, or chief operating officers are persons who are in a position to exercise substantial influence over the affairs of the organization.

§53.4958-3(e) of the Regulations describes the use of facts and circumstances to determine whether a person will be considered as a disqualified person if the person doesn't hold a key position. Two of the factors to be considered are (1) whether the person has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation for employees and (2) whether the person manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole.

§53.4958-4(a)(1) of the Regulations provides that to determine whether an excess benefit transaction has occurred, all consideration and benefits exchanged between a disqualified person and the applicable tax-exempt organization and all entities it controls are taken into account.

§53.4958-4(a)(2) of the Regulations provides rules on how an excess benefit transaction can occur in an indirect manner, i.e. through entities controlled by the applicable tax exempt organization or through an intermediary. For purposes of The Code §4958, economic benefits provided by a controlled entity or an intermediary will be treated as provided by the applicable tax-exempt organization.

§53.4958-4(a)(2)(iii) of the Regulations defines an intermediary as any person (including an individual or a taxable or tax-exempt entity) who participates in a transaction with one or more disqualified persons of an applicable tax-exempt organization. It further states that:

“For purposes of section 4958, economic benefits provided by an intermediary will be treated as provided by the applicable tax-exempt organization when —

(A) An applicable tax-exempt organization provides an economic benefit to an intermediary;
and

(B) In connection with the receipt of the benefit by the intermediary —

(1) There is evidence of an oral or written agreement or understanding that the intermediary will provide economic benefits to or for the use of a disqualified person; or

(2) The intermediary provides economic benefits to or for the use of a disqualified person without a significant business purpose or exempt purpose of its own.”

§53.4958-4(a)(3)(ii) of the Regulations defines a fix payment as an amount of cash or other property specified in the contract, or determined by a fixed formula specified in the contract, which is

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to be paid or transferred in exchange for the provision of specified services or property. A fixed payment does not include any amount paid to a person under a reimbursement (or similar) arrangement where discretion is exercised by any person with respect to the amount of expenses incurred or reimbursed.

§53.4958-4(a)(4) of the Regulations allows for the exclusion of certain payments, including reimbursement arrangements that meet the requirements of §1.62-2(c) of the Regulations known as accountable plan.

§53.4958-4(b)(1)(i) of the Regulations provides that the fair market value of property will be used to value a property, including the right to use property.

§53.4958-4(b)(1)(ii)(A) of the Regulations provides that the value of services is the amount that would ordinarily be paid for like services by like enterprises under like circumstances (i.e., reasonable compensation). The standards under The Code §162 apply in determining the reasonableness of compensation, taking into account the aggregate benefits provided to a person and the rate at which any deferred compensation accrues.

§53.4958-4(b)(1)(ii)(B) of the Regulations provides that the compensation for purposes of determining reasonableness under §4958 includes all economic benefits provided by the organization in exchange for the performance of services, except for economic benefits that are disregarded for purposes of §4958 under §53.4958-4(a)(4).

§53.4958-4(b)(2) of the Regulations provides that the “facts and circumstances to be taken into consideration in determining reasonableness of a fixed payment (within the meaning of paragraph (a)(3)(ii) of this section) are those existing on the date the parties enter into the contract pursuant to which the payment is made. However, in the event of substantial non-performance, reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment. In the case of any payment that is not a fixed payment under a contract, reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment.”

§53.4958-4(c) of the Regulations provides rules regarding intent to treat economic benefits from an applicable tax exempt organization to a disqualified person as in exchange for services. In general, the parties must contemporaneously identify in writing that such economic benefits are intended to be compensation for services.

§53.4958-6(a) of the Regulations provides that payments under a compensation arrangement are presumed to be reasonable if all of the requirements in §53.4958-6(c) are satisfied, as follows:

1. The compensation arrangement is approved in advance by an authorized body of the organization or an entity it controls, composed entirely of individuals who do not have a conflict of interest as to the compensation arrangement or property transfer;

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2. Prior to making its determination, the authorized body obtained and relied upon appropriate data as to comparability; and
3. The authorized body adequately documented the basis for its determination concurrently with making that determination.

§53.4958-6(e) of the Regulations provides that the fact that a transaction between an organization and a disqualified person is not subject to the rebuttable presumption of reasonableness does not create any inference that the transaction is an excess benefit transaction.

§53.4958-8(a) of the Regulations states that §4958 does not affect the substantive standards for tax exemption under §501(c)(3) or (4), including the requirements that the organization be organized and operated exclusively for exempt purposes, and that no part of its net earnings inure to the benefit of any private shareholder or individual. Thus, regardless of whether a particular transaction is subject to excise taxes under §4958, existing principles and rules may be implicated, such as the limitation on private benefit.

In the *Caracci v. Commissioner*, 118 TC 379 (2002) the United States Tax Court has upheld determinations made pursuant to the Code §4958.

In the *Housing Pioneers, Inc. v. Commissioner*, 58 F.3d 401 (9th Cir. 1995), taking advantage of an exempt organization's funds or its exempt status to benefit the insiders is prohibited event if the benefit was indirect and there were advantages to the exempt organization also.

GOVERNMENT POSITION

Issue 1 – Operational Test

Throughout the years of its existence ORG was involved in 5 distinct activities. ORG was unable to quantify how much of its staff times were spent on which activity. Based on the information provided, Agent quantified the utilization of staff time as follows:

Activity	Estimated staff time applied
(1) low-income-housing apartments	none or 0%
(2) down payment assistance program	substantial or 85%
(3) rehabilitation of old homes purchased from HUD	insubstantial or 5%
(4) property rental to other exempt organizations	de minimis 1%
(5) development of new houses	insubstantial or 9%

Based on the estimated staff time applied Agent allocated the expenditures, by first eliminating expenses that were not consumed: ORG Gifts and Purchase Cost of HUD properties. The remaining

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expenses were separated into compensation, direct (if known) and other operating expenses. The result of the allocation is as follows:

	19XX	19XX	20XX	20XX	20XX	20XX	20XX
HUD Homes Rehabilitation							
5% of compensation exp.							
Exp. in % of Total Op. Exp.		1%	1%	1%			
Property Rental to Other EO's							
1% of compensation expenses							
Exp. in % of Total Op. Exp.						0%	0%
Construction of New Houses							
Consulting fees							
9% of compensation expenses							
Total Construction Exp.							
Exp. in % of Total Op. Exp.							
DPAP							
Total other operating expenses							
Net of compensation expenses							
Total DPAP expenses							
Exp. in % of Total Op. Exp.							

The above analysis indicates that ORG's primary activity was DPAP and secondary activity was construction of homes. Let us proceed and analyze the activities to determine whether the operational test was met.

ORG applied for exemption status as an organization whose purposes are meant to provide affordable housing opportunities in a manner which will allow for tax exempt treatment under the Code §5XX(c)(3). During the application process ORG was asked to adhere to Revenue Procedure 96-32, 19XX-1 CB 717, which sets forth guidelines whereby organizations that provide low-income housing will be considered charitable, because they relieve the poor and distressed as described in the Regulations §1.5XX(c)(3)-1(d)(2). The procedure also describes the facts and circumstances test that will apply to determine when organizations that fall outside the safe harbor will be considered charitable organizations that offer relief to the poor and distressed. Further, it clarifies that housing organizations may rely on other charitable purposes to qualify for recognition of exemption from income tax as the Code §5XX(c)(3) organizations.

The Regulations provide that the term "charitable" includes relief of the poor and distressed or underprivileged, lessening the burdens of government, and the promotion of social welfare by conducting programs to combat community deterioration and juvenile delinquency.

Let us first apply the test of section XX of the safe harbor to ORG. ORG contends that its meets the provisions of section XX of the safe harbor by citing their involvement with the apartment development known as "CO-4 (CO-4)" (Activity 1) and their participation in the HUD REO program (Activity 3). ORG's involvement in the development of CO-4 was basically to be the recipient of a donated interest in the property. This interest appears to be limited to the receipt of a portion and

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profits, if any, from the operation of CO-4. CO-4 is operated as a separate partnership entity and is managed by a party having a separate interest in the development. The development is not controlled by ORG under the auspices of its tax exemption and cannot be used to justify its continued tax-exempt status, even if operated in accordance with HUD rules. At most, ORG has a donated investment interest in CO-4 only.

The REO program allows non-profit organizations to purchase HUD owned properties at a discount from 10%-15% for non-revitalization properties and 30% for properties in designated revitalization areas. The properties rehabilitated if necessary and sold to the public. With the exception of the revitalization properties, no significant charitable benefit is derived from this program. There are no requirements within the program itself limiting the sale of the revitalized properties to individuals in charitable need. The REO program under HUD serves its intended purpose, but it is not a program, which primarily benefit a charitable class of individuals. ORG has not shown that they sell the revitalized properties in a charitable manner, by limiting the sale of the properties to individuals who meet the definition of needy. In fact, ORG sold 7 properties to one individual who was clearly not in charitable need. This activity ceased in 20XX because HUD stopped ORG's participation due to lack of compliance with requirements set ford by HUD. Section 3.02 of the safe harbor provides that the Service will follow the income guidelines for low and very low-income bCO-19ficiaries as defined by the Department of Housing and Urban Development ("HUD") in "Income limits for Low and Very Low-Income Families Under the Housing Act of 1937." In Revenue Ruling 67-138, Revenue Ruling 76-408, and Revenue Ruling 68-17 the Service granted exemption to organizations, which adhered to the standard of benefiting low and very-low income individuals and families. To operate in a manner, which provides charitable benefit to individuals, the income limits provided by HUD is a basic starting point. ORG has no such limitations and does not adhere to the HUD guidelines mentioned in Revenue Procedure 96-32. Accordingly, this activity failed to meet the operational test.

ORG states that their involvement with the Department of Housing and Urban Development (HUD), the Veterans Administration (VA), and the State Housing Finance Authority (CHFA) allow it to meet Section 4.02 (4) of the Revenue Procedure 96-32, by participation in government programs designed to provide affordable housing. ORG claims to operate with the explicit approval of the government agencies mentioned above. As proof they have presented copies of letters secured at their request from various government agencies. Based on a set of facts provided by ORG, they acknowledge that the DPAP (Activity 2) provided would not violate their various agency requirements. It is not known what that set of facts contained. Exemption under the Code §5XX(c)(3) was and is a prerequisite for ORG to offer down payment assistance. In fact, on 3/3/00, FHA issued the Mortgagee Letter 00-8 providing clarification for its position on DPAP by stating "while FHA will issue approval letters to nonprofit agencies for their participation as mortgagors, providers of secondary financing, and as purchasers of HUD homes at a discount, such letters are not to be construed as approval of the nonprofit agency's down payment assistance gift programs. FHA will not issue approval letters for down payment assistance gift programs."

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Based on HUD rules and regulations, ORG's down payment program fails to comply with the requirement that down payment funds be derived from a party or parties that are not involved in the transaction. In most if not all cases, funds expended by ORG are reimbursed at the time of closing or soon thereafter, from the seller of the property. HUD rules do not allow the seller in any direct or indirect manner to be the source of Down Payment or closing cost funds for the buyer. To function as a source of down payment assistance ORG had to first secure exemption as a §5XX(c)(3) organization. Other government agencies are not approving ORG's DPAP, but acknowledging the fact that a tax-exempt §5XX(c)(3) organization can be a source of down payment funds. HUD's Directive # 4155.1 specifically states that the gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase. In reality, ORG requires reimbursement of any funds expended in addition to an administrative fee from the seller upon closing of escrow. ORG's DPAP does not operate for the benefit of a charitable group of individuals or for social welfare purposes. The program does not limit Benefits to individuals or families with incomes within the HUD guidelines mentioned in Revenue Procedure 96-32. Accordingly, it is not operated in a manner which warrants the Code §5XX(c)(3) exempt status.

It is ORG's contention that the DPAP falls within the provisions of Section 4.02 (9) of the Revenue Procedure, by providing homeownership assistance to low and moderate income families that otherwise could not afford to purchase safe and decent housing. ORG's policy is to provide assistance to anyone regardless of income guidelines. The organization does not screen recipients to assure that its program Benefits only qualified individuals and families, which are classified as low and very low-income recipients. ORG'S program requires the beneficiary to be able to qualify for FHA or conventional financing. The applicants must be able to make the necessary mortgage payment. Individuals and families classified as needy will generally not have the necessary income to qualify for a mortgage. ORG's fund recipients simply do not have funds available to meet the down payment requirements or to pay closing costs. ORG'S screening process is to verify the amount of liquid funds, which are available from the buyer, in order to determine the amount to be provided by ORG. ORG does not follow the HUD income guidelines of Revenue Procedure 96-32 for low and very-low income recipients. Since the operation of the DPAP is its primary program, the organization is not entitled to exemption. Section 5.06 of the safe harbor provides an example of an organization, which provides homeownership opportunities to purchasers with incomes up to 115% of the area's median income. The example describes an organization whose program does not adhere to the income levels required under the safe harbor. Its board is representative of the community and it provides classes and counseling for its residents. Based on the facts and circumstances as indicated, the organization does not provide relief to the poor and distressed and therefore, could not qualify for exemption. This situation is similar to the fact pattern evident in ORG.

Finally, ORG states that its activities fall squarely within paragraph (2) of Section 06 of the Revenue Procedure, by the operation of programs which lessen the burdens of government. ORG bases this on the fact that government agencies, state, federal and local, have for decades operated programs to provide safe and decent housing for needy individuals or to alleviate social ills within communities. ORG states that their activities supplement those of other government agencies

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dealing in affordable housing. Section 6.XX (2) of the Revenue Procedure, allows for exemption to an organization which demonstrates that its activities lessen the burdens of government. This can be shown by showing that there is (a) an objective manifestation by the governmental unit that it considers the activities performed by the organization to be government burdens, and (b) the organization actually lessens the government burden. Section 2.02 of the Revenue Procedure, acknowledges the existence of a national housing policy to maintain a commitment to provide decent, safe, and sanitary housing for every American family as reflected in various federal housing acts. This is the acknowledgement of a government goal not a burden. This goal is weighed toward providing some minimal form of housing to those who cannot afford decent, safe, and sanitary housing. Benefits are generally not available for those whose income should allow them to afford such housing. This is a broad and ongoing goal of government policy, but it is not an acknowledged specific burden of the government. It is an act of compassion for those in need. In order to demonstrate that ORG relieves some government burden, it must first show that the burden is that of a governmental unit. It then must demonstrate how its programs lessen that burden. ORG has provided no evidence to indicate that it can meet either criterion.

In addition, the DPAP poses other problems with continued qualification. ORG's core funds are derived from banks, builders, insurance, mortgage, title, and other similar organizations. All are industries that benefit substantially from the home selling business and from their affiliation with the ORG program. ORG uses this fund pool to provide down payment assistance to bCO-19ficiaries. ORG requires the home seller to reimburse it for the amount of funds expended, plus an administrative fee of \$ to \$ per home sale. ORG secures an agreement from the seller stipulating to this arrangement. ORG's instructions to Title and Escrow companies provide that at the close of escrow the sellers contribution along with the HUD-1 and any ORG fees must be sent to ORG within 72 hours. Escrow companies that do not appropriately disburse funds in a timely manner will be prohibited from utilizing the ORG Down Payment Assistance Program. ORG will impose a 10% interest fee of the total amount due to ORG for funds not received within 72 hours of the recording date. In fact, HUD disapproves such inducement to sales.

In addition to the absence of an acceptable charitable beneficiary or social welfare objective, the program creates several private benefit situations. The seller Benefits in the completion of a sale, which without the facilitation of ORG may not be possible. Funds utilized by ORG to assist in the completion of a sale are a private benefit to the home seller. In addition funds received by non-charitable bCO-19ficiaries are also private benefit to the buyer. Relief of the poor and distressed generally does not include median or high-income households. Finally, it can be said that all parties to the transaction, from the real estate brokers to the escrow company, receive some benefit from receipt of compensation as a result of ORG's facilitation of home sales. Many of ORG's funding donors also utilize the program to assist their prospective homebuyers with the necessary funds to complete the sale. §1.5XX(c)(3)-1(d)(2) of the Regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (1) of this subparagraph unless it serves a **public rather than a private interest**. ORG's DPAP provides ample private Benefits to the various parties in each home sale.

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Under the Activity 4, ORG purchased a property and rented it out to another §5XX(c)(3) organization that manages transition homes for homeless individuals. ORG's involvement in this activity was limited to landlord related matters. This rental activity that began in 20XX is an investment activity. Investment activities are generally not considered as exempt activities within the meanings of the Code and the Regulations. In fact, ORG filed Forms 990-T, *Exempt organization Business Income Tax Return*, for the rental income it received from another organization. Accordingly, ORG can't rely on this small investment activity to maintain its exempt status under the Code §5XX(c)(3).

Since 20XX, ORG was involved in developing new houses, Activity 5. ORG hired IND-2 as a "consultant" to handle the majority of the operations. ORG partnered with CO CO-2 which IND-2 was a part-owner. Property records indicated ORG purchased an 80-acre land parcel in mid-20XX and sold 12 houses in early 20XX. As of the beginning of 20XX, several more houses are ready to be sold. ORG contends that it lessens the burden of government by gCO-19rating more affordable housing. ORG provided no support that it was the government's burden to construct houses for low income people. In fact, allowing exempt organizations to construct houses for sale in this manner will give them unfair advantage over for-profit construction companies, especially when for-profit construction companies will often sell the houses below market price for quick turn-around of their investments. Therefore, this activity of developing new houses fails to meet the operational test under the Regulations §1.5XX(c)(3)-1(c)(1).

Issue 2 – Excess Benefit Transactions

Prior to the enactment of the Code §4958, any excess benefit transaction to an insider, no matter how small, meant that the Service would revoke the exempt status of the organization. Since this approach was very harsh to the exempt organization in question and did not punish the wrongdoer, the Congress passed the Code §4958. With this Code section, the Service is permitted to evaluate the excess benefit transactions individually and collectively to determine whether the exempt status of the participating exempt organization should be revoked.

Throughout the years under examination, ORG was under the control of two individuals: CEO, and EMP-1. EMP-1 handled the day-to-day operation, had access to all funds, supervised and controlled all employees, etc. On the other hand, records indicated she would consult CEO for major decisions.

CEO kept the appearance that he had no financial interest by not taking any compensation directly from ORG until 20XX. After he fired EMP-1, he became a paid key-employee of ORG. He held the president position throughout the years. Even though there were 3 to 5 board members throughout the years, there were no other officers until EMP-1 was appointed to Vice Chairperson/Secretary position on September 26, 20XX. Apparently, EMP-1 wasn't sure what her position was, as indicated by her letter dated 3/1/20XX. In accordance with the royalty agreement with CO-43 Chapter, EMP-1 notified CO-43 to terminate the agreement effective 4/1/20XX, and signed the letter as the Executive Director of ORG.

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There were no regular meetings by the board members to discuss and decide ORG's matters. ORG only produced one minute that appeared to cover matters over a 3-year period. No records indicated the other board members were involved in any of the decision making. The operational control resembled a private business of CEO.

The facts and circumstances described above indicated that disqualified persons are:

1. CEO, as President of ORG
2. EMP-1, as Secretary and key-employee of ORG
3. CO-19, as an entity owned by a disqualified person, EMP-1

The intermediaries of these disqualified persons are:

- IND-4
- CO-35
- CO-46
- IND-2
- CO-37
- CO-38
- CO-36

These disqualified persons individually or cooperatively misused the funds of ORG in the following transactions:

	Description	Total
Category A: Transactions Directly Benefiting Disqualified Individuals		
1	Credit card charges without substantiation	
2	Ford Excursion	
3	19XX Volvo	
4	Payments to CO-32	
5	Reimbursements without substantiation	
6	Personal expenses paid to 3rd Parties	
	Total Category A	
Category B: Transactions Indirectly Benefiting Disqualified Individuals		
9	Payments to IND-4 which CEO had full access to	
	Fair market values of HUD properties	
	<u>Cost of HUD properties</u>	
8	Net Gain	
7	CO-33	
1	CO-34	
2	CO-35	

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3	CO-36	
4	CO-37	
5	CO-38	
	Total Category B	
	Total	

The excess benefit transactions began soon after ORG's operation was up and running. The amount of outflow was only limited by the net revenues. The outflow was large and frequent when the net revenue was high, and small and sporadic when the net revenue was low.

When CEO found out about EMP-1 purchasing HUD properties, he fired her and proceeded to sue her for the "stolen" funds. In her answer to the complaint EMP-1 stated that ORG was "estopped from asserting the claims set forth in the Complaint by virtue of the conduct of the Plaintiff [ORG]" and "claims are barred by virtue of Plaintiff's unclean hands." A few months later ORG dismissed the case with **prejudice**. In other words, no serious attempt was made to recover the "stolen" funds.

After the elimination of EMP-1, ORG operations remained the same. However, the control and oversight changed for the worse. CEO, who had primary authority, now has sole authority. He is the only officer, and the key-employee of ORG. There were no board meetings since he took over the operation. In addition, the two primary intermediaries, IND-4 and IND-2, are still around. In fact, IND-4 is holding ORG's corporate credit cards and earning compensations through CO-50.

The transactions listed above were significant and excessive. There were no corrective actions taken. There were no oversights by disinterested board before, during or after these transactions. Such inurement are strictly prohibited under the Code §5XX(c)(3) and the exempt status of ORG should be revoked.

TAXPAYER POSITION

Taxpayer's position has not been provided.

CONCLUSION

Based on the information secured during the examination, we conclude that ORG is not operated for exempt purposes under §5XX(c)(3) of the Code. An organization can not be recognized as exempt under §5XX(c)(3) unless it shows that it is operated exclusively for charitable, education, or other exempt purposes. Among other things, ORG activities must demonstrate conclusively that it meets the operational test of §1.5XX(c)(3)-1(c) of the Regulations. The activities show that the primary purpose is to operate a down payment assistance program that does not exclusively serve a purpose described in §5XX(c)(3) of the Code.

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The information secured also indicated substantial excess benefit transactions that inure to the two officers who control the activities of ORG, CEO and EMP-1. Inurement to insiders are strictly prohibited for an organization exempt under the Code §5XX(c)(3).

Therefore, the exempt status granted to ORG should be revoked effective from January 1, 19XX, the year in which the down payment assistance program began.

If the revocation is sustained, ORG is required to file Forms 1120 for the years 19XX through 20XX.