

Internal Revenue Service
Appeals Office
1000 South Pine Island Road
Suite 350
Plantation, FL 33324

Release Number: **201039049**
Release Date: 10/1/10
Date: April 22, 2008
UIL Code: 7428.00-00

A = Org. Name
B = Org. Address

UIL Code: 7428.00-00

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

EIN:

C = EIN

Form Required to be Filed:

Tax Period(s) Ended:

20XX, 20XX, 20XX

Last Day to File a Petition with the
United States Tax Court: JUL 21 2009

Certified Mail

Dear

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective March 12, 19XX.

Our adverse determination was made for the following reason(s): A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance, you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated primarily to further your insiders' business interests. Therefore, you are operated for a substantial nonexempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c)(3).

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

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment

of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

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 within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

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

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

Sincerely,

CHARLES FISHER
TEAM MANAGER



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
30 East 7th Street, #1130-B
St. Paul, MN 55101

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 Sirs:

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

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

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

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez,
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

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| Form 886A | Department of the Treasury - Internal Revenue Service Explanation of Items | Schedule No. or Exhibit |
| Name of Taxpayer ORG | | Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX |

LEGEND

ORG = Organization name XX = Date Address = address City = city
 XYZ = State President = president Director = director CO-1, Co-2,
 CO-3, CO-4, CO-5 & CO-6 = 1ST, 2ND, 3RD, 4TH, 5TH & 6TH COMPANIES

ISSUE

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

FACTS

Overview

ORG is an XYZ not-for-profit corporation incorporated on March 12, 19XX. ORG’s address is Address, City, XYZ.

In 19XX, ORG applied for recognition as a tax-exempt organization under I.R.C. § 501(c)(3) on Form 1023 (“application for exemption”). In July, 19XX, based on the information that ORG provided in its application for exemption and on the assumption that it would operate in the manner represented in its application, ORG was recognized as a tax-exempt organization as described in § 501(c)(3).

Application for Recognition of Tax-Exempt Status

ORG filed its application for recognition of tax-exempt status with the IRS under penalties of perjury in 19XX. In its application ORG stated that:

One of the major functions of ORG will be to make outright grants to families needing down payment assistance to purchase affordable housing. Affordable housing will be determined by the Federal Housing Administrations [sic] Maximum Mortgage Amount for the area. The acquisition cost can be no higher than % of the mortgage limit. The need for down payment assistance shall be determined by the corporation. The purpose of the down payment assistance is to allow families with limited assets to purchase affordable housing that they otherwise could not do because of the lender down payment requirement. Lack of down payment is the single major obstacle in stopping families from purchasing affordable housing.

The organization also stated that its planned activities included:

- Closing cost grants
- Interest Rate buydown grants
- Funding by the corporation to assist families that cannot obtain credit to purchase a home through conventional sources
- Provide affordable rental housing
- Contract with city, county, state or federal agencies to acquire sites to build affordable housing

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- Build “cooperative” and “assisted living” projects for the retired and elderly population

ORG’s Form 1023 included a proposed three year budget for 19XX, 19XX and 19XX. Gifts, grants and contributions were the only income shown on the proposed budgets.

Regarding funding the organization stated in its application that

Funding will be raised from actual face to face solitions [sic] with suppliers, subcontractors, developers, builders, landowners, professionals, utility companies, governmental agencies, financial institutions, insurance companies, abstractors and title companies.

At the end of the advance ruling period, the organization responded to questions on the percentage of support from the general public by saying:

In 19XX and 20XX, there were actually additional contributors. These contributors actually contributed to ORG so low-income families could purchase affordable housing. ORG would then grant qualifying recipients the required down payment. The contributions would be received and within a short period of time gifted back out.

Also, in response to questions at the end of the advance ruling period, the organization stated

We distribute brochures, advertise where we feel it is effective, and enlist specialists in affordable housing lending such as CO-1, CO-2, CO-3 to a mention a few, and Realtors.

Federal Returns

ORG filed Form 990 for the calendar years ended December 31, 20XX, December 31, 20XX and December 31, 20XX; it was not required to file and did not file Forms 990-T.

In these years ORG’s only reported activity consisted of operating its down payment assistance program (“DPA”) as described in more detail below.

According to Part III of ORG’s Forms 990 for 20XX, 20XX and 20XX, the primary activity of the organization was providing financing grants to low-income home buyers. Part VIII of those returns states that “[d]onor contributions pay for direct financing assist [sic]& operating costs.”

In 20XX ORG received \$ in gross revenue from amounts paid to it by sellers participating in ORG’s DPA program. These payments were reported as contributions. ORG also reported that it distributed \$ in financing for low income homebuyers. ORG’s Form 990, Part IV, line 59 shows that as of December 31, 20XX ORG has assets of \$.

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Operation of ORG's Down Payment Assistance Program

Many of the participants in ORG's DPA program utilize Federal Housing Administration ("FHA") financing for their home purchase. To qualify for a federally insured mortgage, a buyer must make a down payment in a specified minimum amount, generally equal to 3% of the purchase price. To qualify under applicable Department of Housing and Urban Development ("HUD") rules, such a buyer may only receive gifts to use for the down payment from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The seller cannot loan money to the buyer for the down payment.

A pamphlet produced by ORG, describing the process to be used by the buyer, says that, "First, you must apply through your mortgage lender for a mortgage 'pre-approval' Commitment. The lender will complete the necessary forms on your behalf. Any qualified lender may send in an application for assistance."

Through ORG's DPA program, buyers receive a "gift" of the funds that they use for the down payment. A house buyer was eligible to participate in ORG's DPA program only if the buyer purchased a house from a seller that agreed to ORG's contractual terms. ORG and sellers entered into agreements that required sellers to pay ORG an amount equal to the down payment "gift" that the buyer received under ORG's DPA program. ORG claimed that the seller's payment was not provided directly to the buyer, but instead was used to "replenish" the pool of funds that was used to provide "gifts" to subsequent buyers. In addition to requiring the seller to pay an amount equal to the amount of the "gift" provided to the house buyer, ORG required sellers to pay ORG an "administrative fee" equal to 15% of the "gift."

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. ORG provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller's home, thereby returning the funds to the seller.

As noted above, ORG documents explicitly state that the down payment "gift" to a buyer comes from preexisting ORG funds rather than from the seller's "contribution" in the transaction. However, ORG does not solicit outside public contributions or have any source of funds other than "contributions" from sellers and related fees. Because the amount of the "contribution" is always equal to the amount of the down payment assistance provided to the buyer plus the administrative service fee, the actual source of the down payment assistance is, in fact, the seller's "contribution."

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ORG also falsely and fraudulently promoted its DPA program by leading house sellers and others to believe that sellers may claim charitable deductions on their federal income tax returns for amounts they pay to ORG.

In its contract with each seller, entitled "Participating Home Agreement", ORG also labeled the seller's payment to ORG as both a "gift" and a "contribution." These contracts obligate the seller, in consideration for participating in ORG's program, to pay ORG an amount equal to the amount of the DPA received by the buyer. The contract, which was required to be signed by each participating seller, stated:

Seller understands that the contribution will not be used to provide assistance to the Buyer of the Participating Home, and that the gift funds provided to the Buyer toward the purchase of the Seller's home are derived from pre-existing ORG funds. Seller further understands that the Seller is only obligated to make the contribution if a homebuyer utilizing the ORG Program purchases the participating home.

This agreement also provides that "any gift funds deposited by ORG with escrow or closing agent shall be returned without recourse within three (3) days to ORG in the event Buyer's loan closing is terminated. Seller shall not be obligated to make a contribution upon termination of loan closing of participating home."

A sample acknowledgement letter was provided by the organization. It states

Thank you for your contribution to ORG, a 501(c)(3) non-profit corporation. Our records indicate you made the following contribution:
Your generous contribution was appreciated. Please retain this information for your tax records.

The ORG gifts and administrative fees are shown as reductions in the amount due seller on the real estate transaction settlement sheets and the down payment assistance gifts are shown as amounts paid by or on behalf of borrower on the same settlement sheets.

Other entities

During 20XX President was the President of ORG; Director was a director. The organization has the same address as CO-4, which is owned by the three sons of Director and President. The organization reports that CO-4 had a small office in the larger ORG office which CO-4 used in exchange for cleaning and maintaining the premises. There is no written agreement. This is office space for which ORG pays rent.

In 20XX, the CO-4 used the services of ORG three times and paid the usual 1% fee.

Director is also the owner of CO-5, a home building company, which had one transaction with ORG

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in 20XX.

The address of ORG is also the address of CO-6, which is also an organization that operates a down payment assistance program. The president of CO-6 is Director. CO-6 was recognized as a 501(c)(3) organization by the Internal Revenue Service. CO-6 is currently appealing the proposed revocation of its exempt status.

Minutes

The organization had no minutes of meetings for the period under examination.

Payments to President

President was paid for work performed as president and/or executive director in 20XX, 20XX, 20XX and 20XX. The organization filed no information documents reporting this and did not withhold any tax. The organization paid President more than she reported on her personal income tax return. None of the payments to President meet the requirements of an accountable plan.

Loan

The books of the organization record that some of the amounts paid to President in 20XX were a loan. There is a promissory note dated July 31, 20XX (although the balance sheet for 20XX shows this loan) stating that the undersigned, President, promises to pay ORG \$ with interest from July 31, 20XX, payable on August 1, 20XX at the rate of % interest. This is filed with the 20XX material.

There is \$ on the balance sheet for 20XX and a statement attached to the return giving borrower's name and title, President, President. There is no security. The term is 3 years.

The books of 20XX record a reduction in the principal of the loan. This is a journal entry explained "to record out of pocket expenses by SKA per SKA."

Reimbursements for business expenses

During the examination, the organization provided ledger sheets that were noted that they were prepared in April, 20XX. They were supported only with credit card bills and other invoices. Documentation of business purpose was not present.

LAW & ARGUMENT

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

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Treasury Regulations Section 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). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279, 283 (1945), the Supreme Court held that the “presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes.”

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

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

Treasury Regulations Section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term “educational” for § 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Treasury Regulations Section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization’s primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff’d, 846 F. 2d 78 (Fed. Cir.), the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under § 501(c)(3). The court concluded that the organization did not qualify for exemption under § 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization’s argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization’s operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization’s sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman’s child sponsored the care financially. Accordingly, the court found that the “business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff’s adoption service is its primary goal” and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

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In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization’s graduates worked in campaigns for the party’s candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party’s candidates and entities. Although the candidates and entities benefited were not organization “insiders,” the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of § 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party’s candidates and entities did “comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner.” American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of § 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the organization’s activity was to benefit disadvantaged communities. The organization’s commercial activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in § 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

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See also, Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Rev. Rul. 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. In Rev. Rul. 67-138, the organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of § 501(c)(3).

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate income families with a preference given to residents of the area. The revenue ruling held that the organization was described in § 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption

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under § 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of § 501(c)(3) and the regulations.

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

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

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

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

Because the organization described in Situation 2 provides down payment assistance amounts that directly correlate to the amounts provided by home sellers and relies primarily on payments from home sellers and real estate related businesses that stand to benefit from the transactions to finance its program, the Service held that the organization described in Situation 2 is not operated exclusively for exempt purposes and does not qualify for exemption from Federal income tax as an organization described in § 501(c)(3).

Benefiting Private Interests

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of § 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Reg. § 1.501(c)(3)-1(d)(1).

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

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

An organization does not serve a public rather than a private interest within the meaning of Reg. 1.501(c)(3)-1(d)(1) if any of its assets or earnings inure to the benefit of any insiders (or disqualified persons). Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Inurement is any transfer of charitable assets to the organization's insiders for which the organization does not receive adequate consideration. Inurement can take many forms.

The provision of inurement can be direct or indirect. In Church of Scientology, 823 F.2d at 1315, the organization transferred in excess of \$3.5 million to a for-profit corporation incorporated by the organization's founder and his wife. The directors of the corporation were high-ranking members of the Church of Scientology. The directors approved the founder's decision to transfer \$2 million from the corporation's account to the ship *Apollo* aboard which the founder and his family lived. The Ninth Circuit held that the funds funneled through the for-profit corporation constituted inurement to the founder and his family. Church of Scientology, 823 F.2d at 1318.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), the Ninth Circuit held that a church that conducted its activities by mail did not qualify for exemption under § 501(c)(3) because a

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substantial purpose of its activities was to benefit a for-profit corporation controlled by the church's insiders. The church employed an advertising agency controlled by its insiders to provide all of the printing and mailing services for the church's mass mailings. The advertising agency devoted approximately two-thirds of its time to the work for the church. The majority of the church's income was paid to the advertising agency. Although the advertising agency claimed to have clients unrelated to the church, it did not advertise its services and refused to identify its other clients. The Ninth Circuit held that the church was operated for the substantial non-exempt purpose of "providing a market for [the advertising agency's] services" and, thus, primarily served the private interests of the advertising agency and its owners rather than a public purpose. In so holding the Ninth Circuit rejected the church's argument that the income paid by the advertising agency should not be included in the determination of reasonableness and treated this income as indirect inurement of the church's earnings to the church's insiders.

The prohibition on inurement in § 501(c)(3) is absolute. The Service has the authority to revoke an organization's exempt status for inurement regardless of the amount of inurement. See, Spokane Motorcycle Club, supra; The Founding Church of Scientology, 412 F.2d at 1202.

Promoting improper charitable contribution deductions

Section 170(a)(1) allows as a deduction, subject to certain limitations and restrictions, any charitable contribution (as defined in § 170(c)), payment of which is made within the taxable year.

Section 170(c) defines a charitable contribution as a contribution or gift to or for the use of an entity described in one of the paragraphs of § 170(c). Section 170(c)(2) describes certain entities organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Generally, to be deductible as a charitable contribution under § 170, a transfer to a charitable organization must be a contribution or gift. A charitable contribution is a transfer of money or property without receipt of adequate consideration, made with charitable intent. United States v. American Bar Endowment, 477 U.S. 105, 117-18 (1986). A payment generally cannot be a charitable contribution if the payor expects a substantial benefit in return. American Bar Endowment at 116-117; see also Singer Co. v. U.S., 449 F. 2d 413, 423 (Ct. Cl. 1971). Substantial benefits are those that are greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely incidental to the transfer). Singer at 423.

Section 102 provides that the value of property acquired by gift is excluded from gross income. A gift "proceeds from a 'detached and disinterested generosity,' ... 'out of affection, respect, admiration, charity or like impulses.'" Commissioner v. Duberstein, 363 U.S. 278, 285 (1960). Payments that proceed from "the constraining force of any moral or legal duty," or from "... 'the incentive of anticipated benefit' of an economic nature," are not gifts. Duberstein, 363 U.S. at 285. Thus, payments attendant to ordinary business or commercial transactions, or that proceed primarily from the moral or legal obligations attendant to such transactions, are not gifts.

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Organizations that promote tax avoidance schemes do not qualify for exemption under section 501(a) as organizations described in section 501(c)(3). See Church of World Peace, Inc. v. Commissioner, T.C. Memo 1994-87 (1994), aff'd, 1995 U.S. App. LEXIS 8775 (10th Cir. 1995). In Church of World Peace the church used its tax-exempt status to create a circular tax-avoidance scheme. Individuals made tax-deductible charitable donations to the church. The church then returned the money to the individuals in the form of tax-free "housing allowances" and also reimbursed the individuals for "church expenses" that were in fact unrelated to church operations. The Church emphasized tax advice in connection with this tax-avoidance scheme. The Tax Court held, and the Tenth Circuit affirmed, that the church did not comply with the requirements of § 501(c)(3) because, by promoting a circular flow of funds from donors to the church and back to the donors and facilitating improper charitable contribution deductions, the church did not operate exclusively for exempt purposes enumerated in § 501(c)(3).

Effective date of revocation

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. § 1.501(a)-1(a)(2); Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, § 13.02, 1990-1 C.B. 514.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 et seq.).

ANALYSIS

ORG does not qualify as an organization described in I.R.C. § 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), (2) provides substantial private benefit to persons who do not belong to a charitable class ; and (3) ORG has violated the requirements of § 501(c)(3) by promoting improper charitable contribution deductions.

Charitable purposes include relief of the poor and distressed. See section 1.501(c)(3)-1(d)(2) of the regulations. ORG's down payment assistance program does not operate in a manner that establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1.

ORG's DPA program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. It is not limited to first time home buyers. See Rev. Rul. 70-585, Situation 4. Arranging or facilitating the purchase of homes in a broadly defined

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geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if ORG's DPA program were directed to exclusively low-income individuals or disadvantaged communities, ORG's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in ORG's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. Buyers who participate in ORG's DPA program benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in ORG's DPA program, from real estate brokers to escrow companies, benefit from increased sales volume and the attendant increase in their compensation. It is evident from the foregoing that ORG's DPA program provides ample private benefit to the various parties in each home sale.

The manner in which ORG operated its DPA program shows that the private benefit to the various participants in ORG's activities was the intended outcome of ORG's operations rather than a mere incident of such operations. ORG's down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, ORG relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. ORG neither solicits nor receives funds from other sources. Before providing down payment assistance, ORG's grantmaking staff takes into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. ORG requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of several hundred dollars per home sale. ORG secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless ORG is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. ORG's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of ORG's operations. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

The manner in which ORG operated its DPA program shows that ORG was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect

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ORG's operations are similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003).

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. ORG provided services to home sellers for which it charged a market rate fee. ORG did not market its services primarily to persons within a charitable class. ORG's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. ORG did not solicit or receive any funds from parties that did not have an interest in the down payment transactions. Like the organizations considered in American Campaign Academy, supra, and Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.) a substantial part of ORG's activities furthered commercial rather than exempt purposes.

Furthermore, ORG's activities were structured to provide private benefit to ORG's insiders. President and Director allowed their sons and the business operated by their sons, CO-3 to use the space leased by ORG without making any attempt to determine the fair market value of the rent and without any oversight by ORG's board of directors. ORG made loans to Director without adequate consideration, or made reimbursements to Director without verifying the business purpose of the expenses. The fact that the organization cannot show any meetings of the board makes it apparent that the board provided no oversight.

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

ORG is also not entitled to exemption under § 501(c)(3) because it promoted improper charitable contribution deductions. A payment of money generally cannot be deducted as a charitable contribution if the payor expects to receive a substantial benefit in return. A seller's payment to ORG is not tax deductible as a charitable contribution under § 170 because the seller receives valuable consideration in return for the payment. In addition, the seller's payment to ORG is not tax deductible to the seller as a charitable contribution because the payment is compulsory. Furthermore, the payments from the home sellers to ORG also do not qualify as gifts under § 102. The payments from the home sellers do not proceed from detached and disinterested generosity but, rather, in response to an anticipated economic benefit, namely facilitating the sale of the seller's home. Under Commissioner v. Duberstein, 363 U.S. 278 (1960), such payments are not gifts for purposes of § 102.

An organization that promotes an abusive tax avoidance scheme is not entitled to exemption as an organization described in § 501(c)(3). See Church of World Peace, Inc. v. Commissioner, T.C. Memo 1994-87 (1994). In its acknowledgements to sellers, ORG led sellers to believe that sellers who participate in its DPA program would be able to claim a charitable contribution deduction for their payments to ORG. ORG used the prospect of a charitable contribution deduction as an inducement for sellers to participate in its DPA program. In implying that the seller-participants in its DPA program would be entitled to a charitable contribution deduction, ORG falsely and fraudulently misrepresented

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the quid pro quo nature of these payments. Because ORG has promoted improper charitable contribution deductions in connection with its DPA program, ORG does not operate exclusively for exempt purposes enumerated in section 501(c)(3) and does not qualify for exemption as an organization described in § 501(c)(3).

The government proposes revoking ORG's exemption back to the organization's inception because the organization operated in a manner materially different from that represented in its application for exemption. In its application for exemption, signed under penalties of perjury on May 9, 1996, ORG did not disclose that the only source of funds for the organization would be from persons who wished to sell their homes. Form 1023 listed the following as sources of financial support: Suppliers and subcontractors, developers/builders, landowners, professional group, utility companies, government agencies, financial institutions, insurance companies, abstractors and title companies, church affiliated groups and economic development commission.

Conclusion:

In order to qualify for exemption under I.R.C. § 501(c)(3) an organization must be both organized and operated to achieve a purpose that is described under that Code section. ORG's DPA program is not operated in accordance with § 501(c)(3) and the regulations thereunder governing qualification for tax exemption under Code. ORG provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. ORG's DPA activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

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

Furthermore, ORG has promoted an abusive tax avoidance scheme in connection with its DPA program by advising sellers that they may take a charitable contribution deduction for their payments to ORG even though such payments were quid-pro-quo payments for services rather than payments motivated by detached and disinterested generosity. ORG's promoter activities are inconsistent with § 501(c)(3) exemption.

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that in 20XX, 20XX and 20XX ORG operated in a manner materially different from that represented in its Form 1023 application the government proposes that the revocation be effective retroactively to the date of the organization's inception.

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Taxpayer's Position

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