Internal Revenue Service

Department of the Treasury

CERTIFIED

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

Date: OCT 2 2 2010

Number: **201102064**
Release Date: 1/14/2010

A
B

Taxpayer Identification Number:
[redacted]
Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:

In Re:

Tax Years:

UIL Index:
501.03-30

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. It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective your incorporation date, July 10, 2000.

Our adverse determination was made for the following reason(s): Based on our examination of your activities during 2002 and 2003, we have determined that you are not operating exclusively for an exempt purpose as required in order to be described in section 501(c)(3). Our determination is based on our findings that: (1) your net earnings inured to the benefit of private individuals or shareholders of your organization; (2) more than an insubstantial part of your activities were not in furtherance of an exempt purpose with the meaning of Treas. Reg. § 1.501(c)(3)-1(c); (3) you operated for the benefit of a private interest within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(ii); and (4) you operated for the primary purpose of carrying on an unrelated trade or business within the meaning of Treas. Reg. § 1.501(c)(3)-1(e)(1).

A substantial part of your activities consists of providing down payment assistance to home buyers. To finance this 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 to the home buyer in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated for a substantial nonexempt purpose. In addition, your operations further the private interest 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 § 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 Federal 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
Attention: Terri Anderson, Stop 4925STP
30 East 7th Street, Suite 1130B
St. Paul, MN 55101

January 27, 2006

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

LEGEND
ORG = Organization name ORG-1 = ORG-1 XX = Date Address = address
City = city State = state Country = country ATTN = ATTN
Commissioner = Commissioner President = president DIR-1 & DIR-2 = 1st & 2nd DIRECTORS RA-1, RA-2, RA-3 & RA-4 = 1ST, 2ND, 3RD & 4TH RA CO-1, CO-2, CO-3, CO-4, CO-5, CO6 & CO-7 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH & 7TH COMPANIES

ISSUE

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

FACTS

Overview

ORG (ORG) is an State not-for-profit corporation incorporated on July 10, 20XX. President (President) is ORG's registered agent, president and treasurer. ORG's address is Address, City, State. State Secretary of State's Office records state that ORG actively uses the assumed name "Futures Home Assistance Program."

On July 12, 20XX ORG applied for recognition as a tax-exempt organization under I.R.C. § 501(c)(3) on Form 1023. On November 9, 20XX, based on the information that ORG provided in its application for exemption and on the assumption that ORG would operate in the manner represented in its application, ORG was recognized, as of July 10, 20XX, as a tax-exempt organization as described in § 501(c)(3).

Since 20XX ORG has promoted and operated a down payment assistance (DPA) program for house buyers under which it provides funds to the buyers to use as their down payment or for closing costs and collects the same amount, plus an additional fee, from the house sellers. ORG also falsely and fraudulently advised house sellers and others that sellers may claim charitable deductions on their federal income tax returns for the amounts they pay to ORG. As more fully described below, under ORG's program down payment assistance is provided for all types of housing loan programs, including federally insured mortgages to buyers, whether first time or not, and without any income or asset limitations.

Application for Recognition of Tax-Exempt Status

Form 1023 was filed by ORG with the IRS to apply for recognition of tax-exempt status under penalties of perjury on July 12, 20XX. On Form 1023 ORG stated that its purpose was to

> provide down payment assistance program for low income individuals and families to allow individuals who could not otherwise do so to own their own home. CO-3 will also engage in other affordable housing efforts, using excess contributions to develop

low-income apartments for seniors and families, the acquisition and rehabilitation of single-family homes, and contributions to other housing related charitable organizations such as faith based charities, community based charities and national charities such as Habitat for Humanity. (emphasis supplied)

Regarding income limits and financial need, the application stated that

> [t]he down payment assistance will be provided only to individuals who have a financial need for such services, and who complete the educational requirements designed to increase the likelihood of permanent home ownership. (emphasis supplied)

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

> CO-3 will solicit gifts from corporations, foundations and individuals with whom the members, directors and officers have personal relationships.
>
> CO-3 will raise funds through the efforts of the Members, Board of Directors, and volunteers of the organization, none of whom are professional fundraisers. Fundraising efforts will be limited to individuals with whom these individuals already know, as long as corporations and foundations controlled by such individuals. No direct fundraising activities have been implemented to date, other than preliminary discussions with the individuals described above. Solicitations will be made through individual one on one personal contact, rather than through mass or even selective mailings. CO-3 does not intend to use any professional fundraisers.

Federal Returns

ORG filed Forms 990 for the calendar years ended December 31, 20XX and 20XX; it was not required to file and did not file Forms 990-T. ORG also filed Forms 941, W-2, and 1099-MISC.

In 20XX and 20XX ORG's only reported activity consisted of operating its DPA program as described in more detail below.

According to Part III of ORG's 20XX Form 990 "[ORG] assists individuals in obtaining down payments for home purchases through the CO-3 program." Part VIII of that return states that "[h]ome sellers in the down payment assistance program pay a fee to participate in the program."

In 20XX and 20XX ORG received $ and $$, respectively, in gross revenue from amounts paid to it by sellers participating in ORG's DPA program. ORG did not report the seller's

payments as contributions. Instead, ORG reported these payments as program service revenue. ORG reported the total amount of contributions and gifts it received, from all sources, as zero. ORG also reported that it distributed $$ and $$, respectively, in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs. ORG's Form 990, Part IV, line 73 shows that as of December 31, 20XX ORG had total unrestricted/net assets of $.

ORG states that its program allows home sellers to designate a portion of the fees they pay to ORG to be donated to other charitable organizations. ORG reported that it distributed $ for the year ended December 31, 20XX, and $ for the year ended December 31, 20XX, to other charities. However, ORG's general ledger showed that in 20XX $$ of these "designated amounts" was transferred to the investment accounts of ORG. Also in 20XX ORG transferred $$ to CO-1 (CO-1) as a "contribution" (see discussion below) and made additional payments of $$ and $$ to CO-1, which ORG reported on its 20XX Form 990 as "marketing fees" and "commissions," respectively.

Operation of ORG's Down Payment Assistance Program

ORG, through its website flyers, advertising, and other methods, promotes its DPA program to builders, lenders, loan officers, mortgage brokers, real estate agents, title insurers, buyers, and sellers. 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.

The ORG website explains how the down payment assistance program works as follows.

1. Once a buyer has begun to look for a house, the real estate agent informs the client about the ORG program;

2. After the buyer has found a house to purchase and begins negotiations with the seller, the seller is informed about the program and the tax benefits of the program. The seller completes "The ORG Program Seller Participating Agreement" (Seller Agreement);

3. Once an agreed-upon price is reached, the amount of the down payment is calculated and this amount is added to the previously agreed-upon sales price;

4. Escrow is instructed to withdraw proceeds form the seller's closing statement, in the amount of the down payment, and categorize it as a contribution to ORG;

5. The same down payment amount is added to the buyer's closing escrow statement as a gift from ORG and is used as the buyer's down payment.

In addition, ORG charges the seller a fee for each property sold. This fee is generally .75% of the total sales price for individual sellers or a flat fee of $$ for builders.

Through ORG's DPA program, buyers receive a "gift" of the funds that they use for the down payment. During the years under examination, the down payment "gifts" were generally between 1% and 10% of the property's stated sales price. 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 it 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 the amount of the "gift" provided to the house buyer, ORG required sellers to pay ORG an "administrative fee," typically equal to either .75% of the purchase price or a set amount (e.g., $$).

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.

Despite the representations in its application for exemption, ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The electronic records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened on such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. As a result, for example, on July 29, 20XX ORG's DPA program provided $$ in down payment assistance for a home that a buyer purchased for $$. On March 4, 20XX ORG's DPA program provided $$ in down payment assistance for a home a buyer purchased for $$. On April 29, 20XX ORG's DPA program provided down payment assistance of $$ for a home a buyer purchased for $$. And on April 25, 20XX ORG's DPA program provided down payment assistance of $$ for another buyer's purchase of a home for $$$.

ORG's promotional material and advertising make it clear that anyone who could qualify for some type of loan was eligible for ORG's down payment assistance program. For example, one piece of promotional literature states: "Your lender will help you determine how much you're qualified for during your mortgage consultation. If you can get the mortgage, we'll give you the downpayment." (emphasis supplied) Another states:

It's extremely easy to receive your FREE gift from ORG. In fact, there is only one requirement you must meet. You must qualify for any eligible loan program with your lender. Don't worry; they have many programs to meet your needs. Some lenders will also allow gifts to be used for mobile home, manufactured homes and modular homes as well. So start dreaming about your new home today. (emphasis supplied)

In addition, 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 other 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 service fee, in fact the actual source of the down payment assistance is the seller's "contribution."

In 20XX, CO-3 brokered 5,743 DPA transactions between buyers and sellers of which 339 were for homes over $$. From June 20XX through December 20XX, in 955 of those transactions the seller was CO-2. There were $ DPA amounts in excess of $$. There were eight homes with a purchase price in excess of $$; one home had a purchase price of nearly $ million. The seller information was not available for January 20XX through May 20XX.

In 20XX, CO-3 brokered 5,704 DPA transactions of which 269 were for homes costing more than $$, eight were for homes costing more than $$, and two were for homes costing more than $. The seller in 718 of those transactions was CO-2. There were 375 DPA amounts in excess of $$; nine were in excess of $$.

ORG also falsely and fraudulently promoted its DPA program by advising house sellers and others that sellers may claim charitable deductions on their federal income tax returns for amounts they pay to ORG. On its website, in advertisements, and in other promotional materials, ORG falsely and fraudulently characterized house sellers' payments to ORG as, inter alia, "gifts," "donations," "contributions," and "charitable contributions." Yet on its Forms 990, ORG listed no contributions received. Instead, it reported its revenue as program service revenue.

On its contract with each seller ORG also falsely and fraudulently 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 further understands that the seller is only obligated to make the contribution if a home buyer utilizing the CO-3 program purchases the participating home." In a recorded audio promotion on ORG's website directed at real estate agents, ORG acknowledged that sellers' payments to ORG were reimbursements for the DPA given to the buyer: "the seller agrees to

reimburse CO-3 for the amount of the down-payment and closing-cost assistance plus an administrative fee."

In a 20XX sales seminar in State, and in two separate 20XX television appearances on a City-City television news program (CO-4) that amounted to free infomercials (with ORG's phone number displayed on the screen), a ORG representative, in describing the ORG DPA program, falsely stated that the seller's payment to ORG is tax deductible for the seller as a charitable contribution.

As part of its contractual obligations to promote ORG's DPA program, CO-5, ORG's marketing and press representative, wrote in its October 20XX newsletter, " ," that ORG's DPA program allows a seller to "get full-appraised value on [his or her] home and a tax write off." The newsletter was distributed to real estate agents and mortgage lenders, who in turn distributed it to their own clients.

The parties to the down payment assisted real estate transactions, including the realtors, builders and lenders, benefited more than incidentally from ORG's operations. The references below, from some of ORG's promotional material, clearly demonstrate this benefit.

Sellers ORG advertised that its DPA program financially benefits sellers by providing them with ready buyers, enabling the sellers to sell for higher prices and allowing them to sell faster due to the larger pool of potential buyers, thereby reducing the costs associated with real estate remaining unsold for an extended period. For example, ORG advertised on its website: "Sell Your Home Faster and Easier With a ORG Approved Buyer!" and "Advertise your home as a ORG home. This will increase the potential buyers to your home by 30%, which means your home will sell faster."
ORG's promotional materials also told sellers that, if they participate in the ORG DPA program, the buyer "will most likely offer full value on [the] property ... [which] benefits [the seller] dramatically, netting the seller more even after the required "contribution." In an 18-minute CD-Rom produced by ORG, RA-1, the wife of ORG's founder and the sole shareholder and president of , emphasized that participating sellers will get "the tax advantages associated with contributing to CO-3 ... a win-win situation for the seller and the buyer."

Realtors ORG's promotional materials tell realtors that they will "sell [their] listings 30% faster and turn [their] cash poor borrowers into homeowners with ORG." The materials further state, for example

> Realtors across the country are discovering the benefits of using the ORG program with their prospective buyers and sellers. How many times have you had a buyer who was willing to purchase a home, had a good payment history on their rental, but didn't have the down payment or closing costs necessary to secure financing on a property? If you're

like many Realtors, you've faced this problem more times than you'd like to count. Add up all of those lost commissions and you'll see how ORG can help you, your buyers and your sellers. In addition, ORG makes a contribution on behalf of the real estate team to a local charity every time you use their program.

Builders ORG's promotional materials tell builders that their new construction homes will sell 30% faster with ORG, adding

> We recognized that the opportunity to sell to a larger pool of qualified buyers, the ability to sell a home faster, and the knowledge that the buyer is credit-approved and ready at the time of contract, is all of substantial benefit to builders.
>
> In many markets, downpayment assistance programs have helped builders sell their homes VERY quickly, saving them thousands of dollars in marketing, advertising and personnel costs, not to mention the savings on bank fees to carry the properties until closing.
>
> In more competitive markets, downpayment assistance programs have resulted in buyers choosing one builder over another. This greatly alleviated any competition they may have had in their market. When your homes sell faster, you're happier.

Lenders ORG's promotional materials tell lenders that using ORG will "[i]ncrease your business, help your realtors and builders sell more homes, and turn your cash poor borrowers into homeowners." The materials urge them to introduce the ORG program to buyers and realtors, thereby "develop[ing} a great referral base," telling them

> We've made it easy for lenders to help their buyers and Realtors by designing sales and marketing materials to help you finance more homes. Simply click on the spaces below to download the necessary documents and sales and marketing materials. In addition, we'll add you to our approved ORG lender list when you've closed your first transaction. This list is used by ORG for referrals and used by consumers browsing through our site.

Other Parties Benefited by ORG's DPA Program

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

President. On August 9, 20XX ORG borrowed $$ from President. Stated interest on the loan was 10.5%. Notes to the audited financials indicate that, as of December 31, 20XX, ORG owed a remaining balance of $$ and that the loan was repaid in May of 20XX.

CO-5 RA-1 (aka RA-1), President's wife, owns 100% of the stock of CO-5 (CO-5), a for profit entity incorporated in State. ORG entered into an exclusive six-year "marketing agreement," dated January 1, 20XX, with CO-5. ORG is the source of substantially all of CO-5's gross revenues in 20XX-20XX.

CO-5 and RA-1 committed to perform the duties set forth in Exhibit B to the Agreement in such a way as to "foster and close the highest possible number of Transactions ..." Those duties included, inter alia, creation of the ORG logo and corporate identity, development of a website in English and Spanish, development of all marketing materials, development of a video presentation of the down payment assistance program, and assistance to ORG field representatives in setting up training sessions in the market.

For the agreed upon services ORG agreed to pay CO-5 30% of the fees generated for each transaction closed, plus any invoiced services. Under the Agreement every grant made by ORG is deemed attributable to marketing services performed by CO-5. Therefore, CO-5 received a "marketing fee" from every grant transaction engaged in by ORG. Compensation is subject to an annually agreed limit, set forth in Exhibit C to the Agreement. The compensation limit for 20XX was $$; for 20XX, $$.

In 20XX ORG transferred a total of $$ to CO-5, as follows:

Wire transfers	$$
Other marketing expense	$
ORG paying CO-5 expenses	$
ORG reimb. to CO-5 for ORG exp.	$

The balance sheet shows a total of $$ in loans from ORG to CO-5 outstanding at year end 20XX. In addition, during the year ORG made an adjusting journal entry to reclassify $$ from amounts due to CO-5 as marketing fees to "prepayment of 20XX marketing expense" and listed it as "security bond."

In 20XX ORG transferred a total of $$ to CO-5, as follows:

Wire transfers	$$
Other marketing expense	$
Loans to CO-5	$

The general ledger shows a total of $$ in loans to CO-5 outstanding at year end 20XX.

The Agreement between ORG and CO-5 is exclusive. ORG agrees not to enter into any other representation agreement; CO-5 agrees not to market down payment assistance program products

or similar services that actually or potentially would compete with ORG's down payment program, unless ORG consents in writing.

Performance criteria under the Agreement include "speed and effectiveness in market penetration," which are "critical and material covenants" of the Agreement. The Agreement specifically provides that the express purpose of the Agreement is that "ORG shall quickly obtain market share and a national presence in the delivery of the ORG Program services pursuant to this and similar agreements."

The Agreement provides that ORG must pay liquidated damages in the event of any breach of the agreement by ORG, including a breach caused by changes in the regulatory environment. The liquidated damages are fixed at eight times the compensation earned by representative during the 60 day period immediately prior to the occurrence of the breach committed by ORG. There is no provision for the payment of liquidated damages by CO-5 or RA-1.

RA-1. In December 20XX, ORG loaned RA-1 $$ to purchase the property located at Address, City, State (Address). The stated purchase price for Address was $$. Stated interest pursuant to the written loan agreement was six percent. The loan was not secured by the property. As of December 31, 20XX the balance due on this mortgage was $$.

Effective January 1, 20XX ORG entered into a three-year lease with RA-1 for Address. This lease calls for monthly payments of $$, plus real estate taxes, maintenance and insurance. ORG has the option to renew the lease for three additional three-year periods on similar terms and conditions. Minimum future rental payments for 20XX and 20XX are $$ per year. In addition, CO-5, a for profit corporation wholly-owned by RA-1, also rented space at Address from RA-1, for which it paid $$ and $$ in 20XX and 20XX, respectively.

CO-3/CO-6

During 20XX ORG loaned amounts totaling $$ to CO-3 (ORG). According to the audited financial statement for 20XX, interest on the advances accrued at 5% and was paid through December 31, 20XX. During 20XX ORG repaid $$. However, ORG advanced additional amounts totaling $$ to ORG/CO-6 America during 20XX. According to the audited financial statement for 20XX, interest on these advances accrued at 4.5% and was been accrued through December 31, 20XX.

ORG was originally named "ORG-1" (ORG-1). In February 20XX President, President of CO-3, purchased 3 in 1 from for $$ because ORG-1 had a letter from HUD that enabled it to do HUD rehab/resale. HUD had verbally informed President that the letter could be transferred. However, after the purchase, HUD informed President in writing that the letter could not be transferred. President renamed ORG-1 to CO-3.

President later changed ORG's name to "CO-6" (CO-6), because lenders informed him that

they did not like the name ORG. Because it does not have a HUD letter, ORG/RAI rehabilitates non-HUD homes. The rehabilitation work is done for ORG/CO-6 by independent contractors, RA-2 and RA-3. This particular endeavor by President is not going well. He is having difficulty with the contractors. There are notes/loans between ORG and ORG. It is questionable whose activity the rehabilitation work is, ORG's or ORG's.

CO-7 CO-7 (CO-7) is an State not-for-profit corporation incorporated on December 14, 20XX. According to State Secretary of State records, President is the registered agent, at Address, City, State. President started this entity to receive CO-7s from other people or businesses so that the property can be donated to charities and the donors could receive a charitable contribution deduction per Section 170 of the IRC. There is very limited activity in this entity, but again money is being transferred from ORG into CO-7.

CO-1 CO-1 (CO-1) is a State not-for-profit corporation incorporated on October 2, 20XX. RA-1 is the president and one of the directors, together with two friends of hers who are also directors of ORG. CO-1's Form 990 indicates that the books are in the custody of President at Address. This organization was established to provide DPA for a lower fee than other DPA organizations, including ORG. ORG claims that this is to allow those who can not afford the fee to do business with them at less cost.

In 20XX ORG transferred a total of $$ to CO-1, as follows:

Wire transfer & checks ("donation")	$$
Transfer ("marketing fees")	_____$
Transfer ("commissions")	$

At the end of 20XX there was a balance outstanding on a loan from ORG to CO-1 in the amount of $$.

CO-1's 20XX Form 990, lines 1 and 1a, shows $$ as "contributions, gifts, grants and similar amounts received" from "direct public support." On line 13 it shows $$ in expenses paid for "program services," shown on line 43b as "marketing fees." RA-1 confirmed that CO-1 paid this amount to CO-5, RA-1's wholly-owned corporation. With the exception of $$ in program management expenses, this was the only "activity" in CO-1 in 20XX. This was CO-1's initial return.

CO-3 Country. ORG's year end 20XX general ledger indicates that ORG invested $$ to start a down payment entity in Country. According to the taxpayer this entity had not started operations as of the time of the examination.

RA-2. RA-2 is one of two rehabbers used by ORG. ORG lent him $$ in 20XX. There are no indications that the loan was repaid. The note receivable was written off on ORG's books and shown as a loan to CO-6 .

ORG has no internal controls. President, President, controls all bank accounts and is the only signatory on the checks. The board is made up of President and two friends of RA-1, his wife. The board meets once a year where they conduct the following business:

> **RESOLVED**, that any and all acts of the Board of Directors undertaken or performed for or on behalf of this Corporation since the date of the last annual meeting of the shareholders be and are herby ratified, affirmed and approved, and such acts shall have the same force and effect as if originally authorized, directed, and empowered by the shareholders; and
>
> **FURTHER RESOLVED**, that the following named persons be and are hereby elected as directors of this Corporation to serve in the capacity until the next annual meeting of the shareholders until their successors shall be elected and qualified;
>
> President
> DIR-1
> DIR-2
>
> The undersigned ratify and confirm the action taken by the Corporation as set forth in the foregoing resolutions.

LAW & ARGUMENT

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

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of City, STATE 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.

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.

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.

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.

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.STATE, 20XX), 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.

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 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.

Benefiting Private Interests

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

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

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

Excessive compensation for services is a form of inurement. For example, in Mabee Petroleum Corp. v. U.S., 203 F. 2d 872, 875 (5th Cir. 1953), the Fifth Circuit held that the organization's payment of a full-time salary for part-time work was inurement.

The use by insiders of the organization's property for which the organization does not receive adequate consideration is a form of inurement. See, e.g., The Founding Church of Scientology v. U.S., 412 F.2d 1197, 1201 (Ct. Cl. 1969) (holding that the insiders' use of organization-owned automobiles and housing constituted inurement); Spokane Motorcycle Club v. U.S., 222 F.Supp. 151 (E.D. Wash. 1963) (holding that the organization's provision of goods, services and refreshments to its members constituted inurement).

Loans that are financially advantageous to insiders from the organization's funds (particularly unexplained, undocumented loans) are a form of inurement. For example, in The Founding Church of Scientology, 412 F.2d at 1200-01, the Claims Court listed unexplained loans to and from insiders among the examples of inurement. In Church of Scientology v. Commissioner, 823 F.2d 1310, 1314-15, 1318 (9th Cir., 1987), the Ninth Circuit held that "debt repayments" in the form of 10 percent of the organization's income made to the organization's founder, allegedly to compensate the founder for the organization's past use of his personal income and capital, constituted inurement. In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.STATE, 20XX), the court held that forgiveness of interest was a form of inurement.

Leasing arrangements that favor disqualified persons to the detriment of the organization are a form of inurement. In The Founding Church of Scientology, 412 F.2d at 1201-02, the Claims Court treated the organization's payment of rent to the founder's wife as inurement in the absence of any showing that the rental was reasonable or that the arrangement was beneficial to the organization. See also State Trade School v. Commissioner, 272 F.2d 168 (5th Cir. 1959) (holding that inflated rental prices constitute inurement).

Payment to one person for services performed by another (or for services presumed to be performed, without any proof of performance) is a form of inurement. In Church of Scientology, 823 F.2d at 1314, 1317-18, the court listed royalties received by the organization's founder on the sale of publications written by others among the improper benefits received by the founder from the organization. In The Founding Church of Scientology, 412 F.2d at 1202, the court held

that the payment of salary to the founder's daughter without any proof that she actually performed any services for the organization constituted inurement.

A number of courts have held that unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement. Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966); Kenner v. Commissioner, 318 F.2d 632 (7th Cir. 1963); Church of Scientology, 823 F.2d at 1316-17, 1319.

The provision of inurement can be direct or indirect. In Church of Scientology, 823 F.2d at 1315, the organization transferred in excess of $ 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 $ 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 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.

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. 20XX-4, §14.01 (cross-referencing §13.01 et seq.), 20XX-1 C.B. 123. An organization may not rely on a favorable

determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, §13.02, 1990-1 C.B. 514.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 20XX-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 (including the organization's founder and his wife); (3) results in inurement of a substantial portion of ORG's net earnings to the benefit of the organization's officers and other insiders; and (4) 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. The down payment assistance program did not serve exclusively low-income persons. Despite the representations in its application for exemption, ORG does not have any income limitations for participation in its DPA program. ORG did not screen applicants for down payment assistance based on income. ORG's electronic records do not even include data on the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. Our analysis showed that, in fact, for the years at issue ORG's DPA program provided down payment assistance on hundreds of expensive homes. The program is not even limited to first-time homebuyers.

ORG's DPA program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of City STATE, 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. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. About 15% of all ORG-assisted transactions in 20XX and 20XX involved one particular seller, a national home builder. 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 instructions to title and escrow companies provide that at the close of escrow the seller's contribution, along with any ORG fees, must be sent to ORG within 72 hours. Escrow companies that do not appropriately disburse funds in a timely manner are

prohibited from utilizing the ORG DPA program. 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.

ORG's promotional material and its marketing activities show that ORG operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in § 501(c)(3). The manner in which ORG operated its 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 ORG's operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.STATE, 20XX).

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 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 substantial private benefit to ORG's insiders. Facts establish that ORG and Royale Dynamics ("CO-5"), a for-profit corporation wholly-owned by RA-1, entered into an exclusive six-year marketing agreement, dated January 1, 20XX. Under the terms of the agreement, ORG carried out most of its DPA activities through CO-5. For the years at issue, ORG was the source of substantially all of CO-5's gross revenues. Like the organization in KJ's Fund Raisers, supra, ORG existed for a substantial nonexempt purpose of creating business for CO-5. Thus, like the organization in KJ's Fund Raisers, ORG's operations resulted in a substantial private benefit to ORG's insiders.

ORG's operations also resulted in inurement of its charitable assets to ORG's insiders, including ORG's founder, President, and his wife, RA-1. On August 9, 20XX, ORG borrowed $$ from President at an inflated rate of interest. In the absence of any proof that this loan was fair and beneficial to the organization, the loan will be treated as inurement of ORG's net earnings to President. See The Founding Church of Scientology, 412 F.2d at 1200-01.

On January 1, 20XX ORG entered into an exclusive marketing agreement with CO-5, a for-profit entity owned by RA-1. For the agreed upon services, ORG agreed to pay CO-5 30% of the fees generated for each transaction closed. Excessive compensation for services constitutes inurement. See, e.g., Mabee Petroleum Corp., 203 F.2d at 875. To the extent the fees paid by ORG to CO-5 were excessive, a portion of ORG's net earnings inured to CO-5 and, indirectly, to President and RA-1. In addition, under the agreement with CO-5, ORG agreed that every grant made by ORG would be attributable to marketing services performed by CO-5. As a result, ORG paid CO-5 a percentage of fees from every DPA transaction without regard to whether there was any proof of actual services by CO-5. Payment to one person for services performed by another (or for services presumed to be performed, without any proof of performance) constitutes inurement. See, e.g., Church of Scientology, 823 F.2d at 1314, 1317-18. In the absence of proof that every DPA transaction engaged in by ORG was actually attributable to CO-5's services, ORG's marketing arrangement with CO-5 will be treated as resulting in inurement of ORG's net earnings to CO-5 and, indirectly, to President and RA-1.

In December 20XX, ORG loaned $$ to RA-1 for the purchase of the property located at Address, City, State. Upon purchasing the property with the organization's funds, RA-1 leased the property to the organization. In the absence of any showing that this lease was fair and beneficial to ORG, the lease will be treated as inurement of ORG's net earnings to RA-1. See Founding Church of Scientology, 412 F.2d at 1201-02.

In 20XX, ORG made payments totalling $$ to CO-1, a not-for-profit entity controlled by RA-1. These payments were CO-1's sole source of funds in 20XX. In the same year, CO-1 paid $$, allegedly for marketing services, to CO-5, RA-1's wholly-owned corporation. With the exception of $$ in program management expenses, this was the only activity of CO-1 in 20XX. In the absence of any proof that CO-1 engaged in any legitimate exempt activities, CO-1's payment of $$ to CO-5 will be treated as indirect inurement of ORG's charitable assets to CO-5 and RA-1. See, Church of Scientology, 823 F.2d at 1315, 1318.

During the years under examination, ORG's principals had unfettered control over the organization and ready access to the organization's assets, including cash, at any time. President had sole authority over bank accounts and was the only signatory on all ORG accounts. Internal controls were lacking. The board, consisting of President and two friends of RA-1, had no involvement in the organization. The directors merely approved, retroactively, all transactions that occurred during the year and elected voted themselves for another term. This is demonstrated by the one page minutes for the annual meeting, the only documentary evidence that the board took any action during the years under examination. This lack of oversight by the board allowed inurement to occur. The facts show numerous transfers of ORG charitable assets for the benefit of ORG's insiders. Unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control, in the absence of any acceptable justification, constitute inurement. Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966);

Kenner v. Commissioner, 318 F.2d 632 (7th Cir. 1963); Church of Scientology, 823 F.2d at 1316-17, 1319. Because ORG has failed to provide acceptable justification for the transfers of its charitable assets to insiders, the transfers will be treated as inurement of ORG's charitable assets to the benefit of private interests in violation of the § 501(c)(3) prohibition on inurement.

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 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 promotional materials and public appearances, ORG advertised 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 claiming that the seller-participants in its DPA program would be entitled to a charitable contribution deduction, ORG falsely and fraudulently misrepresented 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 July 12, 20XX, ORG represented that its purpose was to "provide down payment assistance program for low income individuals and families ... ." and that its "down payment assistance will be provided only to individuals who have a financial need for such services, and who complete the educational requirements designed to increase the likelihood of permanent home ownership." Despite these representations in its application for exemption, ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The electronic records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened on such data.

Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. Furthermore, although ORG has an educational module on its website, ORG did not obtain verification from buyers that they had reviewed or completed the module. Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 20XX-4, § 14.01. ORG's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of ORG's determination letter.

Conclusion:

In order to qualify for exemption under IRC § 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 Internal Revenue Code § 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 offers its down payment assistance to interested buyers regardless of the buyers' income levels or need. 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 assure future business for the mutual benefit of the participants. Although ORG has an educational module on its website, ORG did not obtain verification from buyers that they had reviewed or completed the module. 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).

In addition, ORG's activities have resulted in inurement of charitable assets to ORG's insiders. ORG's principals have unfettered control over the organization and ready access to the organization's assets, including cash, at any time. Loans to insiders and related entities are readily available and, based on the books and records, are readily given. The organization has been paying unjustified amounts of compensation to a related for-profit entity for marketing services. All of this constitutes evidence that assets and/or earnings of ORG inured to ORG's insiders in violation of the requirements 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 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.

Taxpayer's Position

1. The taxpayer contends they did nothing falsely or fraudulently referring to the following paragraph in the facts:

ORG also falsely and fraudulently promoted its DPA program by advising house sellers and others that sellers may claim charitable deductions on their federal income tax returns for amounts they pay to ORG. On its website, in advertisements, and in other promotional materials, ORG falsely and fraudulently characterized house sellers' payments to ORG as, inter alia, "gifts," "donations," "contributions," and "charitable contributions." Yet on its Forms 990, ORG listed no contributions received. Instead, it reported its revenue as program service revenue.

However, per a news release cited below, they consented to the DOJ injunction order which stated that ORG falsely and fraudulently promoted its DPA program.

FOR IMMEDIATE RELEASE TAX

, APRIL 19, 20XX

TDD

FEDERAL COURT BARS DOWN-PAYMENT ASSISTANCE ORGANIZATION

FROM MAKING FALSE TAX BENEFIT CLAIMS

ORG Agrees to Court Order Prohibiting it from Falsely Advising Sellers They Can Claim Charitable Tax Deductions

CITY, STATE - The Justice Department announced today that ORG (ORG) based in City, State-a down payment assistance organization- and its president-President of City, State-**have been permanently barred from making false and misleading statements in promoting their down payment assistance program to house sellers. ORG and President agreed to the civil injunction order, which also requires them to post a copy of the injunction on ORG's website and to give the Justice Department relevant information about participants in ORG's program.**

According to the government's amended complaint, ORG enters into "down-payment assistance" contracts with house sellers. Under these contracts, ORG agrees to provide the down payment to people who buy the sellers' houses, and the sellers agree to

reimburse ORG for the down payment and to pay ORG an administrative fee. The suit alleges that in marketing and operating this scheme, ORG and President falsely advised house sellers and others that the sellers may claim charitable deductions on their federal income tax returns for the amounts they pay ORG under these contracts. Sellers' payments are not deductible charitable contributions; the injunction requires the defendants to refrain from falsely stating that they are. The government's court filings had stated that the payments did not proceed from "detached and disinterested generosity," but rather were made in order to "facilitat[e] the sale of the seller's house." The amended complaint also stated that a significant portion of house sellers participating in the ORG program improperly claimed a charitable deduction on their federal income tax returns.

"The Tax Division of the Department of Justice has made it a high priority to put an end to the business of providing false tax advice," said ATTN, Assistant Attorney General for the Tax Division. "Anyone receiving tax advice should verify the motives and qualifications of those giving it, even those claiming to be charitable organizations."

"We're starting to see instances where charities facilitate and encourage inappropriate deductions," said IRS Commissioner Commissioner.

"Maintaining the integrity of charities and ensuring they operate for the public good is an enforcement priority for the IRS."

This case is part of the IRS's and Justice Department's initiative to stop abusive tax schemes. More information about this case can be found at. More information about the initiative is available at. For more information about the Justice Department's Tax Division, go to.

2. The taxpayer contends that the Internal Revenue Service, specifically the tax exempt organization division did not fulfill its responsibility by issuing guidelines on how a down payment assistance charity should and could operate.

Organizations do not have the option of receiving guidance over being audit. In some cases the only way the Service can issue guidance is to determine the problem by examining exempt organizations.

3. "Over 40% of these individuals have indicated they are minority group members, and an additional group of recipients are single mothers without the ability to purchase suitable housing," . . .

The taxpayer provided **no** such documentation to support this statement. All the records provided by ORG were reviewed. The spreadsheets which were provided for the downpayment

assistance transactions contained no demographic information such as age, race, gender, marital status, or income.

Furthermore, the reason for revocation is a circular flow of funds. 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. This downpayment assistance is evidenced by the seller signing an agreement that they will pay the downpayment plus ORG's fee. What do you think of this statement RA-4?

4. "The IRS argues that it is not charitable to help low income, moderate income, minorities and single mothers [to] obtain housing."

Despite the representations in its application for exemption, ORG does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The electronic records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened on such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. As a result, for example, on July 29, 20XX ORG's DPA program provided $$ in down payment assistance for a home that a buyer purchased for $$. On March 4, 20XX ORG's DPA program provided $$ in down payment assistance for a home a buyer purchased for $$. On April 29, 20XX ORG's DPA program provided down payment assistance of $$ for a home a buyer purchased for $$. And on April 25, 20XX ORG's DPA program provided down payment assistance of $$ for another buyer's purchase of a home for $$$.

5. "The IRS also alleges that ORG made a misclassification of a $$ entry in its 20XX books and records. . . . Yet, the IRS labels this as an example of why ORG should not be an exempt entity." . . .

ORG is not being revoked because they misclassified $$. However, ORG overstated their charitable contributions on the 990 by $$ which is material.

6. "All Down payment assistance programs have a pool of funds that is replenished when a payment is made into the pool. The pool is decreased when a gift is made. No payment from a seller is directly made to any buyer, it is paid into the down payment assistance pool. This is allowed and allowable by the federal government pursuant to HUD standards for down payment assistance. Yet the IRS lack of guidance on how an entity should treat these payments is now in questions, due to the IRS lack of diligence and not doing their own job. Now all DPA's are "bad" according to the current IRS initiative to drive all DPA's put on their charitable endeavors."

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 instructions to title and escrow companies provide that at the close of escrow the seller's contribution, along with any ORG fees, must be sent to ORG within 72 hours. Escrow companies that do not appropriately disburse funds in a timely manner are prohibited from utilizing the ORG DPA program. 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.

7. "Did the IRS try looking through even ONE client file. The information is contained in each and every client file, yet the IRS did not look through even one file, as they already had the conclusion they wanted to reach before they started the audit. The buyers income was not in electronic format, as it was not needed for database purposes. Is there some where in the IRC that a taxpayer must put any records, let alone all records in electronic format or they will lose their charitable exemption?"

We reviewed individual downpayment assistance files for the month of September 20XX and found they were in agreement with the electronic spreadsheet for the same month. Therefore, we reviewed the spreadsheets for the remainder of the months. These spreadsheets did not include the buyer's income. ORG did not screen applicants based on their income. If the applicant was able to secure a loan of any kind they would get a downpayment from the seller via ORG. The organization provided copies of five downpayment assistance files to include in the case file.

8. "Another blatant falsehood is that "ORG's material and advertising mike [sic] it clear that anyone who could qualify for some type of loan was eligible for ORG's down payment assistance program." The IRS appears to discount that the loan programs are qualifying loan programs. The qualifying loan programs provide moderate and low income housing. That is benefiting the public, that is charitable."

The Internal Revenue Service does not base exemption on other department/agency rules. However, downpayment assistance organizations such as ORG are circumventing the HUD requirement which prohibits the seller from funding the downpayment of the buyer. HUD allows the downpayment gift to come from 1. family and friends, 2. employer and labor union, or 3. a 501(c)(3) organization. In fact, ORG is a conduit on behalf of the seller to fund downpayments for the buyer which is further supported with the contract ORG requires of the seller. No downpayment assistance transactions were noted that were not funded by the seller.

The Internal Revenue Service has not indicated that the low and moderate income levels set by FHA are the same for exemption requirements for a IRC 501(c)(3) organization.

9. "In fact the IRS takes great efforts to attack ORG for their fund raising efforts, without inquiring as to what they are and what they have been doing," . . .
In fact, the first day of fieldwork, September 26, 20XX, the taxpayer was asked: 1. Tell me about your organization/activities. Why did you start it? How much time is spent on the various activities? 2. What are your sources of income?

In addition, the revenues per the 990 return were reconciled to the books and records and 99% of the revenue came from the sellers.

10. "CO-5 helped create what ORG now is."

There were no records to show the work CO-5 performed.

11. "RA-1 is married to President. RA-1 did receive an arms length loan, and repay it with interest."

The fact that this is an arms length transaction is questionable when it is between husband and wife with **no** oversight.

12. . . . "President, . . . is being accused of doing too much for free and attempting to reduce the charities costs to provide more funds for its charitable purpose."

There is no prohibition for working for free. However, there is a requirement to safeguard the assets from private inurement. How can this be done if the sole officer controls the money? In ORG's application they stated they would have a community based board.

There is no evidence that the board members currently on the board are active. It appears from the one page of minutes provided that they merely approve retroactively transactions performed by President for the year. Again, President, President, controls the money.

13. "Not indicated but known by the IRS auditors, were that the other directors had expertise in specific areas. . . . yet their competency and independence appears to be attacked for no apparent reason other than the auditor would like more detailed minutes, even though no statute, rule, regulation or other guideline requires, directs or mandates this."

There is no evidence to show that the directors exercised such expertise.

14. "The issue in this matter is whether ORG conformed to their application that granted them exemption within IRC 501(c)(3)?"

Form 1023 was filed by ORG with the IRS to apply for recognition of tax-exempt status under penalties of perjury on July 12, 20XX. On Form 1023 ORG stated that its purpose was to

> provide down payment assistance program for low income individuals and families to allow individuals who could not otherwise do so to own their own home. CO-3 will also engage in other affordable housing efforts, using excess contributions to develop low-income apartments for seniors and families, the acquisition and rehabilitation of single-family homes, and contributions to other housing related charitable organizations such as faith based charities, community based charities and national charities such as Habitat for Humanity. (emphasis supplied)

Regarding income limits and financial need, the application stated that

> [t]he down payment assistance will be provided only to individuals who have a financial need for such services, and who complete the educational requirements designed to increase the likelihood of permanent home ownership. (emphasis supplied)

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

> CO-3 will solicit gifts from corporations, foundations and individuals with whom the members, directors and officers have personal relationships.
>
> CO-3 will raise funds through the efforts of the Members, Board of Directors, and volunteers of the organization, none of whom are professional fundraisers. Fundraising efforts will be limited to individuals with whom these individuals already know, as long as corporations and foundations controlled by such individuals. No direct fundraising activities have been implemented to date, other than preliminary discussions with the individuals described above. Solicitations will be made through individual one on one personal contact, rather than through mass or even selective mailings. CO-3 does not intend to use any professional fundraisers.

ORG did not operate in the manner they indicated in their application as discussed above.

15. Law & Argument section.

No rulings, case law, or any other guidance issued by the Internal Revenue Service condones the circular flow of funds nor has the organization cited law that supports the circular flow of funds.

16. "Normally an analysis of the organizational and operational test would be paramount, but in this case the major issue appears to be an issue as to inurement."

The basis of revocation is that ORG does not meet the operational test. The organizational test is merely a form test.

17. "One of the charitable endeavors was to provide down payment assistance. This was and is an approved purpose from the Internal Revenue Service, in spite of the IRS not providing any guidelines, rules or instructions on how to accomplish this purpose."

They misrepresented what was in the application as indicated above.

18. "Of course, lets not overlook that ORG offered and continues to offer, fee educational seminars to the public, both in person, which two of the IRS auditors at issue attended one such session, and available on the internet, all free of charge, on the ORG website as flows:" .

The seminar which the Internal Revenue Service revenue agents attended was a marketing seminar to secure business. A lender was present to offer his services of securing a loan. A representative of ORG, President, then further assisted the lender in selling the free downpayment to purchase a home, duplex, condominium, investment property, and so forth. If you have used the downpayment assistance program before you can use it again there is no limit. The only requirement is to secure a loan to get the "free" gift of the downpayment.

There was an educational course on the Internet that was available free of charge to the public. Although this activity is educational and acceptable for a 501(c)(3) it did not represent ORG's primary purpose.

ORG did not obtain verification from buyers that they had reviewed or completed the module. ORG does not engage in any counseling or other activities that further charitable purposes.

19. "The apparently strongest attack is the allegation of inurement or the benefiting of private versus public interests. Case law indicates that an arms length, fair market value payment is not and does not constitute inurement."

20. "Even the argument that control equals inurement does not have support in the case law in the instant case. For example, the IRS asserts that ORG does not have adequate internal controls. It does not allege, nor could it allege, that any funds have been misappropriated."

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 City STATE, 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.

On January 1, 20XX ORG entered into an exclusive marketing agreement with CO-5, a for-profit entity owned by RA-1. For the agreed upon services, ORG agreed to pay CO-5 30% of the fees generated for each transaction closed. Excessive compensation for services constitutes inurement. See, e.g., Mabee Petroleum Corp., 203 F.2d at 875. To the extent the fees paid by ORG to CO-5 were excessive, a portion of ORG's net earnings inured to CO-5 and, indirectly, to President and RA-1. In addition, under the agreement with CO-5, ORG agreed that every grant made by ORG would be attributable to marketing services performed by CO-5. As a result, ORG paid CO-5 a percentage of fees from every DPA transaction without regard to whether there was any proof of actual services by CO-5. Payment to one person for services performed by another (or for services presumed to be performed, without any proof of performance) constitutes inurement. See, e.g., Church of Scientology, 823 F.2d at 1314, 1317-18. In the absence of proof that every DPA transaction engaged in by ORG was actually attributable to CO-5's services, ORG's marketing arrangement with CO-5 will be treated as resulting in inurement of ORG's net earnings to CO-5 and, indirectly, to President and RA-1.

In December 20XX, ORG loaned $$ to RA-1 for the purchase of the property located at Address, City, State. Upon purchasing the property with the organization's funds, RA-1 leased the property to the organization. In the absence of any showing that this lease was fair and beneficial to ORG, the lease will be treated as inurement of ORG's net earnings to RA-1. See Founding Church of Scientology, 412 F.2d at 1201-02.

In 20XX, ORG made payments totalling $$ to CO-1, a not-for-profit entity controlled by RA-1. These payments were CO-1's sole source of funds in 20XX. In the same year, CO-1 paid $$, allegedly for marketing services, to CO-5, RA-1's wholly-owned corporation. With the exception of $$ in program management expenses, this was the only activity of CO-1 in 20XX. In the absence of any proof that CO-1 engaged in any legitimate exempt activities, CO-1's

payment of $$ to CO-5 will be treated as indirect inurement of ORG's charitable assets to CO-5 and RA-1. See, Church of Scientology, 823 F.2d at 1315, 1318.

During the years under examination, ORG's principals had unfettered control over the organization and ready access to the organization's assets, including cash, at any time. President had sole authority over bank accounts and was the only signatory on all ORG accounts. Internal controls were lacking. The board, consisting of President and two friends of RA-1, had no involvement in the organization. The directors merely approved, retroactively, all transactions that occurred during the year and elected voted themselves for another term. This is demonstrated by the one page minutes for the annual meeting, the only documentary evidence that the board took any action during the years under examination. This lack of oversight by the board allowed inurement to occur. The facts show numerous transfers of ORG charitable assets for the benefit of ORG's insiders. Unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control, in the absence of any acceptable justification, constitute inurement. Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966); Kenner v. Commissioner, 318 F.2d 632 (7th Cir. 1963); Church of Scientology, 823 F.2d at 1316-17, 1319. Because ORG has failed to provide acceptable justification for the transfers of its charitable assets to insiders, the transfers will be treated as inurement of ORG's charitable assets to the benefit of private interests in violation of the § 501(c)(3) prohibition on inurement.

21. "As the payments at issue are at arms length price, or less than an arms length price, for actual services rendered, they are reasonable and competitive in the market place for outside third party services. Therefore, the payments to CO-5 do not constitute an [sic] inurement."

Upon request, no documentation was provided to substantiate the services were performed. In absence of such documentation the amounts paid to CO-5 are excessive.

22. "What are the tax benefits to my seller? . . . The deduction does not qualify as a charitable income tax deduction."

This statement was not present at the time of the examination. If this statement was present for the years under examination 20XX and 20XX then DOJ would not have had an issue.

The facts, law, and argument presented in this RAR stand unchanged based on the organization's rebuttal.